

Why invest in the Cadiz Managed Flexible Fund: an update November 2009

While financial studies show that investing in equities is the best way to beat inflation over the long term, determining what will be the top performing asset class over the shorter term is extremely difficult.

Consider the following table, which ranks the relative annual performance of the four major asset classes – equities (as represented by the All Share Index), property (as represented by the Listed Property Index), bonds (as represented by the All Bond Index) and cash (as represented by 3-month Treasury Bills), as well as inflation (as represented by the CPI) for the period 1993 - 2008. The relative ranking of the annual performance of the four asset classes appears random – during the 16 year period all of the four asset classes have been the top performing asset class at least once, and only cash has never been the worst performing asset class. It is also worth noting the magnitude of the movement in asset class returns from one year to the next – consider, for example, that the return for equities was 70.92% in 1999 (making it the top performing asset class), 0.35% in 2000 (making it the worst performing asset class), 32.61% in 2001 (once again making it the best performing asset class) and -8.31% in 2002 (once again making it the worst performing asset class).

The table clearly demonstrates how difficult it is for the average investor to select the best performing asset class one year out. Note though that when considering the returns of the four asset classes for the full 16 year period normality returns, with property and equity outperforming bonds and cash.

KEY	RANK	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	16 Year Annualised
Cash	1	54.77%	22.70%	30.18%	16.17%	29.18%	17.96%	70.82%	27.59%	32.61%	20.09%	41.00%	41.26%	50.04%	41.23%	26.52%	16.97%	20.21%
Bonds	2	32.03%	11.69%	14.50%	9.51%	16.86%	9.08%	59.49%	19.44%	17.84%	15.96%	18.07%	25.44%	47.25%	28.37%	19.19%	11.38%	17.62%
Equities	3	14.74%	9.83%	9.96%	9.31%	16.29%	5.04%	28.73%	10.60%	14.04%	12.41%	16.08%	15.25%	10.80%	7.67%	9.60%	9.50%	15.95%
Property	4	11.81%	-0.02%	8.42%	6.57%	6.05%	-0.87%	13.41%	6.99%	10.10%	11.90%	10.96%	7.78%	7.10%	5.79%	8.98%	-4.47%	12.60%
Inflation	5	9.55%	-9.05%	6.93%	-16.19%	-6.91%	-5.91%	2.24%	0.35%	4.59%	-8.31%	0.33%	3.39%	3.60%	5.48%	4.21%	-23.23%	7.20%

In recognition of the above, professional investors, including Cadiz Asset Management offer what are termed managed or balanced portfolios, where the complex asset allocation decision is made by the portfolio manager and not the investor.

The Cadiz Managed Flexible Fund – your asset allocation companion

The Cadiz Managed Flexible Fund is a prudentially managed (ie complies with Regulation 28 of the Pension Funds Act) domestic balanced unit trust fund, which aims to provide investors with a balance between capital growth and income over the medium to long term. The fund offers medium-risk, diversified exposure to equities, property and fixed interest instruments, and places an emphasis on active stock selection, as well as sector and asset allocation.

This multi-asset class investment strategy is grounded in our investment philosophy that markets are driven by interest rates, earnings growth and investor sentiment; and in order to be successful you need to:

- understand investment environments and the likely behaviour of markets;
- have skill in asset allocation and fund structuring – Cadiz Asset Management (CAM) has incredibly strong building blocks across all the asset classes, largely due to the fact that CAM has one of the most stable and experienced investment teams in South Africa;
- have stock picking capability – specifically the stock picking skill of the CAM Specialist Equity Team has, over the past ten years, delivered returns of approximately 2.6% per annum more than FTSE/JSE All Share Index; and
- understand how to mitigate risks and ensure downside portfolio protection – given that Cadiz has been the top rated derivatives house for the past thirteen consecutive years (source: annual Financial Mail surveys: 1997 – 2009), Cadiz is uniquely placed to protect balanced portfolios through the efficient and effective use of derivatives.

A brief summary of the CAM view on the various asset classes

Equities

The long term or structural market drivers (currently low interest rates and inflation), as well as long term fundamental valuation tools indicate that equities are undervalued relative to other asset classes and point to a strategic overweight position in our balanced mandates. Short term indicators, however, suggest that the market has to a large extent discounted the positive turnaround in economic fundamentals and that, in the absence of positive earnings growth, it

might be vulnerable to short term pull backs. This dynamic is of concern not only locally, but is being grappled with by strategists around the world.

We are, therefore, bullish on equities over the longer term. In the short term however, the market is probably somewhat overextended. As such, we have avoided the temptation to be aggressively overweight equities.

Fixed interest

Cash and Inflation Linked Bonds are our preferred asset classes within the fixed income spectrum. Our allocation is largely determined by looking at risk adjusted returns relative to bonds.

More recently, **bonds** have retraced from their levels of extreme overvaluation. The move has not been large enough though to warrant any material change in asset allocation. The potential for structural oversupply emanating from aggressive bond issuance is also of concern to us.

We have recently increased our exposure to **property** largely because of its value relative to bonds. Overall, our position remains neutral though – the valuations are not sufficiently compelling to warrant an aggressive view either way.

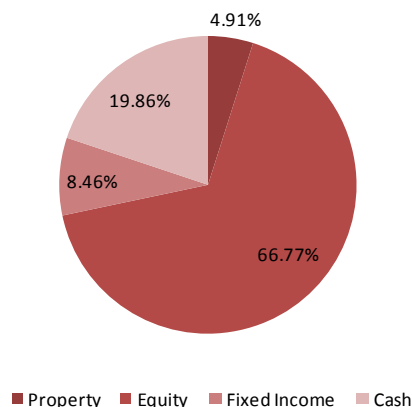
Current positioning of the Cadiz Managed Flexible Fund

The following table further summarises the work done by CAM on the risk adjusted returns expected from the various asset classes one year out. Inflation is expected to average 6.5%, with the risk free rate equal to 7.75%.

One Year Risk Adjusted Expected Returns

	EQUITIES	BONDS	ILB	PUT	CASH
EXPECTED RETURN	12-18%	6.1%	9.25%	10%	7.75%
EXCESS RETURN	7.25%	-1.65%	1.5%	2.25%	
HISTORIC SD	21.6	10	5	14.9	0.95
SHARPE RATIO	0.34	-0.17	0.30	0.15	
RANK	1	5	2	3	4

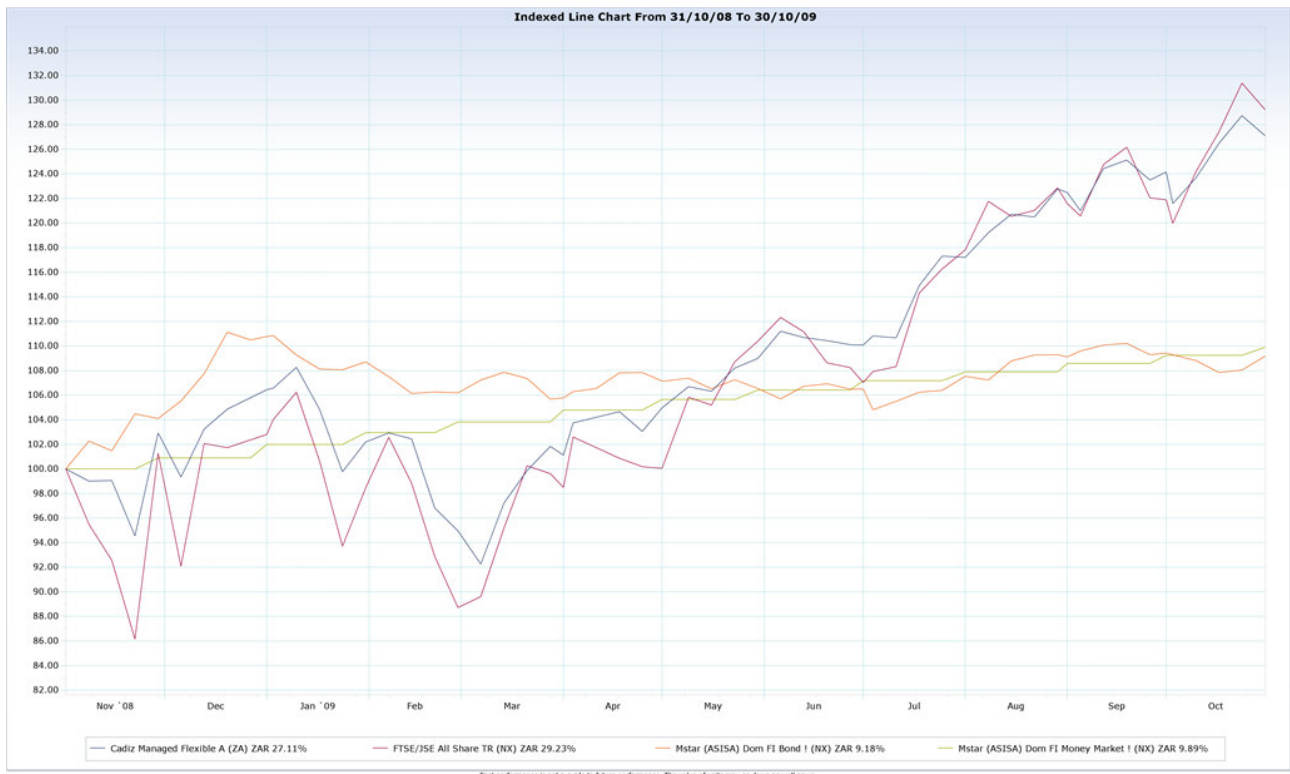
Our risk adjusted return expectations in respect of these asset classes are evident in our portfolio construction (see pie chart below; source: CAM, 31 October 2009), where we are currently below maximum (75%) equity weighting, and a low property and bond holding, with the remainder in cash.



Francois van Wyk, Chief Investor Officer of CAM and manager of the Cadiz Managed Flexible Fund explains; 'We are fully cognisant of the fact that forward-looking indicators for the global economy are still rising – implying that the cyclical bull market is still intact. However, nothing happens in a straight line and the markets are clearly overbought in the short-term. We plan to reduce our exposure to both equities and bonds in exchange for increased weightings in cash and inflation-linked bonds. The equity reduction is purely tactical but the bond reduction is based on disturbing fundamental trends and a lack of sufficient risk compensation. We would reconsider this strategy once we have seen the equity market consolidate year-to-date gains.'

Performance

The benefits of Francois' experience and skill is evident in the fact that the Cadiz Managed Flexible Fund has outperformed all domestic – asset allocation – prudential unit trust funds (low, medium, high and variable equity) with a return of 27.22% for the one year to 31 October 2009 (source: Morningstar). The benefits of a multi-asset fund and the Cadiz Managed Flexible Fund are further illustrated in the following graph, which shows the one year performance of the Cadiz Managed Flexible Fund as compared to the FTSE/JSE All Share Index, the mean return of all bond unit trust funds and the mean return of all money market unit trust funds.



Who should invest and how

The Cadiz Managed Flexible Fund is ideally suited for investors who do not want to make the complex asset allocation decision themselves, as it provides a one-stop investment solution that effectively reflects CAM's house view. As the fund complies with Regulation 28 of the Pension Funds Act, it is also suitable as the underlying investment option in respect of Pension or Provident Funds, Preservation Funds or Retirement Annuities.

Investors can access the Cadiz Managed Flexible Fund directly or via the following linked investments service providers: AIMS, Equinox, Galaxy, Glacier, Investec, Momentum, Odyssey, Old Mutual Max Investments / Income and Ovation.

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November 2009

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