

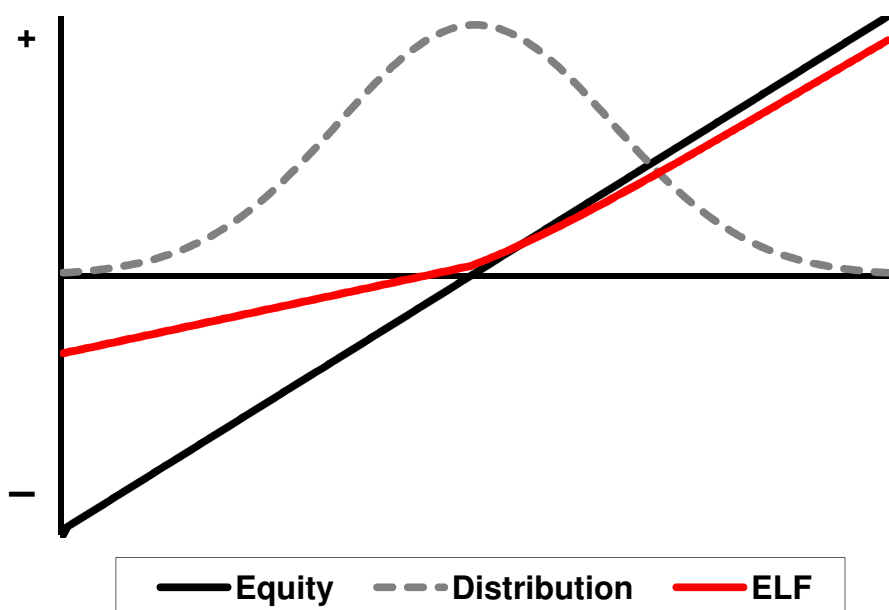
## WHY INVEST IN THE CADIZ EQUITY LADDER FUND: AN UPDATE

08 April 2011

The Cadiz Equity Ladder Fund (ELF) has been developed for investors who require exposure to positive equity market growth, but with an element of downside protection. Specifically the fund aims to achieve equity like returns at lower than market risk, while targeting capital preservation over the medium term. Effectively the fund is a long equity portfolio with active stock picking, which targets medium term capital preservation through equity portfolio protection.

### Background

The following slide is key to understanding the value proposition of the ELF.



- Effectively the slide illustrates that ELF is expected to participate in upward trending equity markets with an element of downside protection ie it demonstrates equity like characteristics and will deliver negative returns in negative markets
  - We expect ELF to slightly underperform the market's return in positive equity markets because of the cost of protection. Furthermore we would expect to pay more for protection when we are bearish and managing the fund's net effective equity exposure closer to 50% and less when we are bullish and managing the fund's net effective equity exposure closer to 90%. Thus the impact of the cost of protection on performance is greater when we are bearish
- As a result we view the fund as a conservative aggressive fund (because of the protection strategies, which reduce equity market exposure in down markets) or as an aggressive conservative fund (because of its equity like characteristics)

When evaluating ELF's performance it is also important to consider the following:

- The equity holdings are actively managed – we back the stock picking skills of the Cadiz Asset Management equity team
  - While the equity team has delivered 2.5% alpha per annum over the long term it is important to note that this alpha tends to be 'lumpy' ie it does not come through every month like clockwork and as such there will be periods of outperformance and underperformance relative to the FTSE/JSE Top40
    - This is perhaps best evidenced by the fund significantly outperforming the FTSE/JSE Top40 for the period March to December 2009 and slightly underperforming the market during 2010

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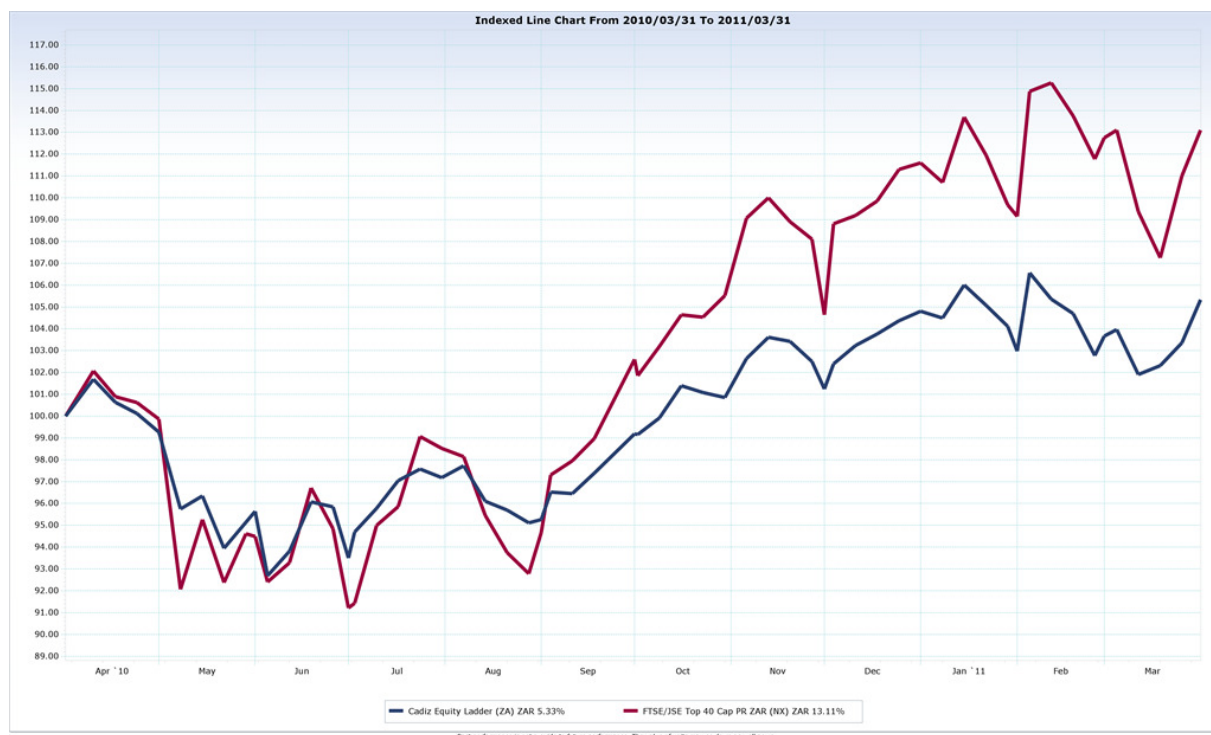
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- The fund manager, Francois Finlay then implements the Cadiz house view against the FTSE/JSE Top40. This is because the primary method of providing protection is using ALSI40 futures and we want to ensure a low tracking error between the equity holdings in the portfolio and the protection strategies
  - The majority of equity funds are either benchmarked to the Shareholder Weighted Index (SWIX), which significantly downweights Resources or the respective fund managers actively reduce their Resource exposure
  - There are periods when the Top40 outperforms the SWIX (ie when Resources outperform Financials and Industrials) and vice versa – over the past year though the SWIX has outperformed the Top40 and hence ELF has relatively underperformed versus general equity funds
- In general Francois buys protection in the band 95% - 80% of the current market level (spot) at the time he buys the protection ie if the market is currently at 100 ELF's protection is from 95 down to 80. This means that ELF participates in the first 5% of the market's fall. The reason that we do not as a rule buy protection from spot is that it is significantly more expensive and changes the return profile of the fund from an 'equity like / protected equity' fund to a 'cash like / cash plus' fund. Importantly, Francois is positioning ELF for more meaningfully negative markets, and because equity markets don't fall 20% in a day the 15% band of protection also allows Francois breathing room to determine whether he expects the downward move to continue, in which case he can buy more protection or, in the event that he expects the equity market to recover, to take the protection off and bank his profits. However, when the cost of protection is low (due to low volatility), and depending on his view, Francois may buy protection in the band 100% – 85%

### One year performance of ELF versus the FTSE/JSE Top40 Index



- The above graph illustrates the performance of ELF versus the Top40 for the one year to 31 March 2011. The fund manager has been very cautious over this period and still maintains that the risk is to the downside. That is why he didn't take any protection options off in June and September 2010. He was hedged for a 20% down move
- As stated in previous communications it is clear that ELF falls behind when the market runs up (due largely to the cost of protection), but each time the market falls back ELF catches up again, demonstrating the benefits of ELF's protection strategies. The fund thus continues to behave as expected

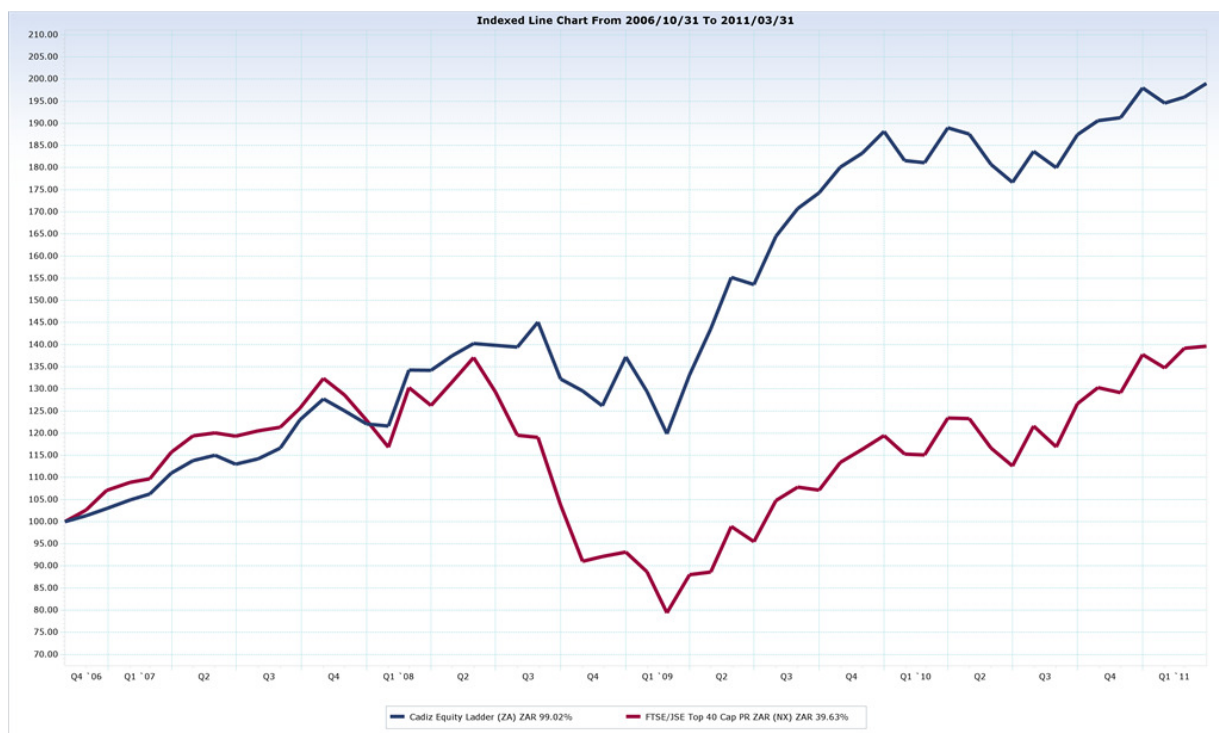


- Over this one year period ELF returned 5.34%, whereas the Top40 returned 13.11%. This relative underperformance is as a result of Francois' cautious fund positioning and the resultant cost of protection
- From the graph you will note that both the June and September 2010 put options expired out of the money (having been in the money mere weeks prior to the respective close-outs)
  - If either the June or September 2010 put options had expired in the money ELF would have outperformed the Top40 for this period
- However, the March 2011 put options expired in the money. With the result that from the peak in February 2011 to the trough in March 2011, ELF fell by less than half the market's fall, and as a result outperformed the Top40 over the one and three months ended 31 March 2011

### Longer term performance of ELF versus the FTSE/JSE Top40 Index (1 November 2006 to 31 March 2011)

While the graph above demonstrates the behaviour we expect from ELF it is perhaps fairer to consider ELF's longer term track record as illustrated in the following graph

- This graph clearly demonstrates the long term benefits of an element of protection in down markets. Because ELF fell by less than the market's fall to March of 2009 the fund has been able to open up a performance gap on the market of approximately 59%
- We would expect this pattern of ELF outperforming following market corrections to continue and therefore would expect ELF to outperform through the full market cycle because of its ability to capture subsequent positive market performance from a higher base



In summary ELF is a protected equity investment that aims to provide equity like returns in positive markets, with an element of downside protection in negative markets.

Paul Hutchinson  
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