FUND FACT SHEET
OCTOBER 2018

Cadiz Passive Bond Fund

cadiz ASSET MANAGEMENT

KEY INFORMATION

Portfolio Manager	Alastair Sellick
Inception	1 November 2003
Benchmark	BESA ALBI

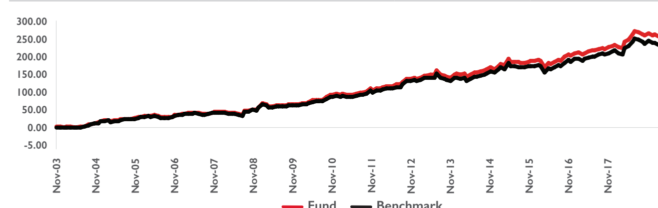
FUND OBJECTIVE

The Cadiz Asset Management Passive Bond product encompasses both segregated and pooled portfolios. These moderate risk South African bond mandates focus on delivering strong consistent returns over the medium to longer term, benchmarked against the BESA All Bond Index. Passive bond mandates are managed on a full-discretionary best house view basis and are appropriate for institutional clients, such as pension and provident funds, seeking moderate risk specialist fixed interest investment strategies. This product is managed to have an average modified duration of ± 0.2 relative to the BESA ALL Bond Index. The Passive Bond product has consistently outperformed the BESA All Bond Index since inception.

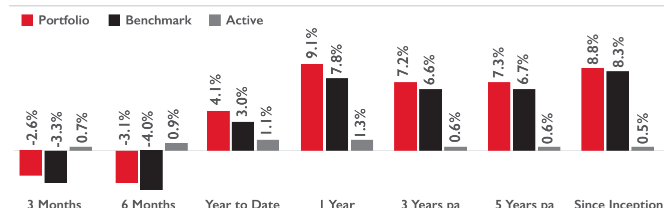
RISK STATISTICS (3 YEARS)

	Fund	Benchmark	Active
Standard Deviation	8.0%	8.1%	-0.2%
Tracking error	0.9%		
Information Ratio	0.6		

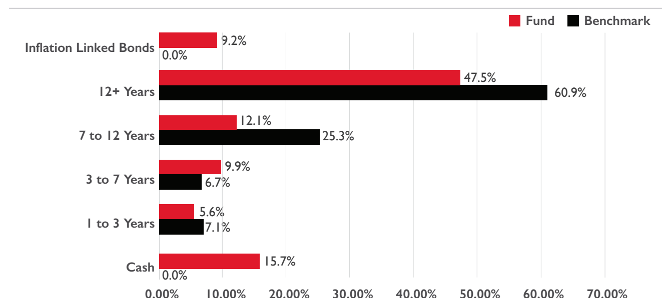
CUMULATIVE PERFORMANCE SINCE INCEPTION



PERIOD RETURN ENDING – 31 OCTOBER 2018



SECTOR ALLOCATION



FUND CHARACTERICTICS

Modified Duration	6.9
Average number of holdings	63
Turnover per annum	144.7%
Maximum exposure to one stock	15.0%
Credit limit applied	40.0%
Maximum exposure to single counterpart (excluding government and government guaranteed debt)	15.0%
Maximum duration deviation around benchmark	1

Quarterly Fund Commentary-Third Quarter 2018

ECONOMIC AND MARKET COMMENT

The 3rd quarter of 2018 was an interesting quarter, for all the wrong reasons. Unlike the first half of the year, where domestic factors seemed to dominate, the main forces influencing South African yields in Q3 were international developments. A combination of ongoing rate hikes from the Fed and ever more hawkish rhetoric from the FOMC (and Fed Governor Jay Powell in particular) put upward pressure on US treasuries and global bond yields. Then a toxic cocktail of extremely negative risk events occurring in Italy, and several emerging markets, notably Argentina and Turkey, sent global bond investors fleeing from the carry trade and EM risk, back to the safety of US Treasuries & German Bunds. Ongoing uncertainty in the UK around how hard BREXIT will actually be (the likelihood of a no-deal BREXIT is now high and rising), and finally, the ratcheting upwards of Trade War tensions, courtesy of President Trump combined with all the other factors I have listed, driving South African yields higher and the USDZAR exchange rate weaker. Foreign outflows from the South African bond market continued, albeit at a reduced pace, and this caused the USDZAR exchange rate to briefly touch R15.70, although it has subsequently staged a strong recovery to the low R14s.

Global bond yields generally rose over the quarter – US 10yr treasury yields sold off from 2.85% to a quarter-ending level of 3.05%. The 10yr German Bund yield rose from 0.30% to end the quarter at 0.47%. The market is now fixated on the first European rate hike in the ECB's rate normalisation cycle, and this is currently expected to be at the end of the European summer in late 2019. The ECB is still expected to cease Quantitative Easing (or buying of European government and agency bonds) at the end of December 2018, but one complication could be European contagion caused by an Italian debt crisis related to the contentious budget proposals of the new Italian coalition government – which caused the Italian 10yr BTP yield to rise dramatically from 2.65% at the start of the quarter to close at 3.15%.

South African bond yields sold off quite dramatically over the quarter, due primarily to ongoing foreign selling of SA fixed interest securities due to a spike in risk aversion from the contagion listed above. The R186 sold off from 8.82% to an intra-quarter high of 9.33%, but recovered to finish the quarter at 8.99%.

The -0.7% Quarter on Quarter (Annualised) Q2 SA GDP release combined with a revision down to -2.6% of the Q1 SA GDP number confirmed that South Africa did indeed enter a technical recession in H2 2018. Coupled with the negative global backdrop, this added fuel to the negative sentiment driving bond yields higher. The much weaker Rand, coupled with the elevated oil price, caused large petrol price hikes, which the SARB was quick to cite as one of the main reasons for their hawkish outlook and a large contributor to the upside risk in the CPI trajectory. However, this is at odds with the observed CPI prints, and August CPI surprised to the downside, printing at 4.9%. September CPI is expected to fall even further to 4.8%. This low growth and well-behaved inflation environment would ordinarily require rate cuts, not hikes, but the risk of a rapid Rand depreciation, ongoing US rate hikes and further foreign capital flows away from emerging markets into US Dollar denominated assets is what the SARB is worried about, hence their cautious stance.

The bond market (All Bond Index) returned +0.78% for Q3 2018, leaving the 2018 year to date return at +4.81%. Equity markets (represented by the JSE ALSI) were down -2.17% over the quarter and Inflation Linked Bonds (ILBs) returned +0.46% for the quarter, with a flat -0.09% return year to date. Cash returned +1.74% for the quarter – again, outperforming bonds and equities. Rolling 12 month returns for bonds fell to +7.11%, equities have returned +3.32%, and ILBs only +0.92% with cash returning 7.25% over the last 12 months.

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