FUND FACT SHEET AUGUST 2018

cadiz
ASSET MANAGEMENT

Cadiz Equity Fund

Quarterly Fund Manager Commentary – Second Quarter 2018

PORTFOLIO COMMENTARY

The Cadiz Equity Fund gained 10.6% over the second quarter compared to the FTSE/JSE SWIX which gained 2.1%. Over a rolling 3 year period, the Cadiz Equity Fund has provided a total annualised return of 9.4% while the FTSE/JSE SWIX has gained 5.3%, which is significant outperformance. Investments in MTN, Impala Platinum and Woolworths underperformed during the second quarter, while good gains were made from investments in Sasol, Naspers, Transocean, Diamond Offshore Drilling, National Oilwell Varco and Bed Bath & Beyond.

Short term results in equity investments can be volatile as highlighted by the first quarter 2018 loss of -7.4% versus the second quarter 2018 gain of 10.6% for the Cadiz Equity Fund, but over longer time frames such as 3 year and 5 year periods the volatility is more muted. Another example is the wild swings in the month of June with the ALSI up 4% mid-month, only to give back all the gains (and more) going into month end. The final trading day of June saw the ALSI add 3.25%, helping it end the month in positive territory, up by 2.8%.

The Credit Suisse Stock market study of Global Investment Returns 2018 by Dimson, Staunton and Marsh reinforces that the ability to stay in equity investments for a long time produces the best return versus other asset classes. There are not many periods of stock market history where one would suffer a capital loss with a diversified portfolio of equity investments that is held for 10 years or more.

As an example, the Total return of the JSE peaked on 30 May 2008 and fell 60% to the bottom on 28 February 2009, after which the market recovered strongly and by 30 September 2010 gained back all of the losses. 10 years later the market has more than doubled from the peak pre global financial crisis and has delivered a compound annual return of 9.3%. So even if you invested right at the peak before the global financial crisis, holding your nerve and staying invested in equity for the long term would have delivered a good investment result. The ability to act in a contrarian manner and investing when things are priced for the worse case outcome results in even better returns as investing at the bottom in February 2009 would have generated a compound annual return of 17%.

FUND POSITIONING

The fund received a large inflow which is in the process of being deployed. This has resulted in a significant change in the individual investment weights, but the counters are consistent with the prior quarter. New entrants to the Top 10 holdings are FirstRand and Anheuser Busch.

Anheuser Busch has underperformed the market since the acquisition of SAB Miller. Anheuser Busch is the largest beer brewer in the world with strong brands and dominant market share in the countries where they operate. They are well on the way to achieving and surpassing the synergies from the SAB Miller acquisition and have a high quality management team. The debt levels are elevated but will come down as the underlying business generates strong free cash flow.

We were able to invest in FirstRand at an attractive price due to the emerging market sell-off. FNB together with Wesbank is the premier banking business in South Africa. FirstRand has a well-capitalised and provisioned balance sheet with good management and hence is a good fit for our investment criteria.

We sold Capital and Counties properties and switched this into Intu properties where the risk/reward trade-off is more favourable. We also exited Netcare at a decent profit as it reached our fair value estimate on the back of the announcement to exit the UK operations.

On the international holdings, we used the market volatility during the quarter to invest in high quality businesses at attractive prices. We invested in Discovery Communications, which owns and distributes the Discovery suite of TV channels. We also invested in US cable and media companies, Comcast and Charter Communications. These businesses have all been sold off due to the threat of over the top (OTT) video content distribution (mainly driven by Netflix). We believe that the current share prices don't factor in the power of these businesses video content libraries and that the recent changes to net neutrality rules together with increasingly data hungry video applications will result in good earnings per share growth over the long term.

We also invested in Philip Morris and Starbucks which are both high quality businesses with fantastic track records. Philip Morris is leading the tobacco industry in the roll out of reduced risk products and is available at an attractive price due to potentially more stringent FDA rules with respect to nicotine content in cigarettes.

Starbucks is a long term dividend compounder. Its share price has been under pressure due to negative public image news flow as well as low same store sales growth in the USA. We agree that Starbucks USA is a mature business but see enough levers for management to pull to continue growing that business at a moderate pace. Growth prospects in China however, are appealing.

L Brands owns the Victoria Secret business and Bath and Body Works business. Victoria Secret has been struggling due to over-promotions and fashion missteps, while the Bath and Body Works business continues to produce good results. The market had marked down the share price too severely making this an attractive investment opportunity that meets our investment criteria.

We invested in Macy's, at a very attractive price as brick and mortar retail was severely punished by the stock market during the quarter. The real estate portfolio alone is worth $21 billion, while the enterprise value is only $13 billion and we were able to buy this business at 8 times free cash flow, a very good price.

We funded these investments by selling Capital One Financial Corporation, Softbank and Inpex. Capital One and Softbank was sold at a profit slightly below their intrinsic values. This capital was recycled into better quality more attractively priced investments. We sold Inpex off the back of their financial results as the latest results indicated that the Ichthys LNG project economics where not going to be as good as initially estimated.

We continue to steadfastly stick to our investment philosophy and process and focus intently on protecting and growing your capital by investing in predominantly good businesses at attractive prices with capable management and low financial risk. Thank you for your continued support.

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