cadiz
ASSET MANAGEMENT

Cadiz Worldwide Flexible Fund

Quarterly Fund Manager Commentary – Second Quarter 2018

PORTFOLIO COMMENTARY

The Cadiz Worldwide Flexible Fund gained 13% over the second quarter a good reversal of the first quarter decline of 7.3%. Metair, MTN and Impala Platinum detracted from performance, while Naspers, Diamond Offshore Drilling, Transocean, Sasol and Macys were good performers during the quarter. The offshore investments also benefited from Rand weakness over the second quarter which was a reversal of the Rand gains of the first quarter.

Over a 1 year rolling period, the Cadiz Worldwide Flexible Fund has delivered a return of 12.4% versus a target of 10.5%. Over a rolling 3 year period, the fund has provided a total annualised return of 6.3%, which is less than the target of 11.4%. The main reason for this poor long term result is a change in the fund strategy from a protected equity investment strategy with large and costly put options to the Worldwide Flexible Fund strategy. This change happened one year ago.

The Cadiz Worldwide Flexible Fund is now able to apply the same investment philosophy and process as the Cadiz Equity fund, which has a good 3 year track record, but is not limited to a maximum of 30% in offshore investments. The more flexible nature of the Cadiz Worldwide Flexible fund with less restrictions enables us to invest in our best worldwide ideas across asset classes with greater conviction.

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 Cadiz Worldwide Flexible Fund has moved the offshore investment positioning from 34% to 48% over the quarter. The fund ended the quarter with 95% invested in equities, 2% preference shares and 3% cash. Local SA equity is evenly split with direct offshore equity.

Internationally, 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 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.

Anheuser Busch was also added which is included in the local equity portion of the fund holdings even though it is a global business. 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.

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. Alphabet was added at a fair price as we view the company as having a phenomenal business model which is hard to compete against with lots of optionality in their moon shot divisions. Alphabet has also got surplus cash on the balance sheet with owner operator management who have done a tremendous job in creating this business.

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

We funded these investments by selling out of Netcare, trimming Howden, Sasol and Mediclinic. Netcare rerated strongly off the back of the announcement to exit the UK operations. Howden, Sasol and Mediclinic were trimmed in order to move assets offshore to take advantage of the attractive high quality opportunities in the US telecom and media space.

Macys and Bed Bath & Beyond have been good performers during the quarter and hence have entered into the list of Top 10 holdings. Both of these businesses are still significantly undervalued and hence the investment case for both is still intact.

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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