cadiz ASSET MANAGEMENT

Cadiz Absolute Yield Fund

KEY INFORMATION

Portfolio manager	Alastair Sellick
Inception	01 April 2006
Benchmark	STeFI + 2% from 01/08/2017 (SA CPIX + 3% to 31/07/2017)

FUND OBJECTIVE

The fund aims to provide investors with a return of 2% in excess of the STeFI Composite Index over rolling three years and a positive return over any rolling 12 month period. The fund is expected to deliver more consistent returns than an income fund and reduce the volatility normally inherent in the bond market.

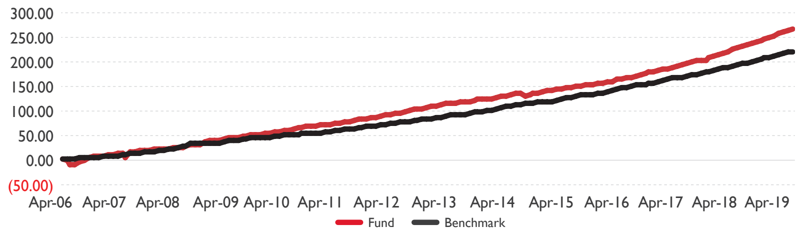
RISK STATISTICS (3 YEARS)

	Fund	Benchmark	Active
Standard Deviation	1,2%	0.6%	0.6%
Tracking error	1,4%		
Information Ratio	1,4		

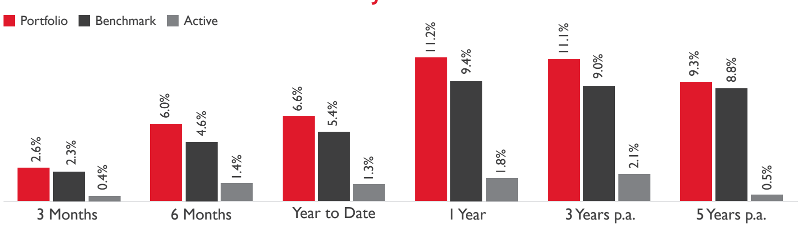
FUND CHARACTERISTICS

Modified Duration	1,8
Average number of holdings	77
Turnover per annum	134,1%
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	3

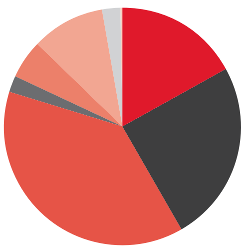
CUMULATIVE PERFORMANCE SINCE INCEPTION



PERIOD RETURN ENDING – 31 JULY 2019



SECTOR ALLOCATION



- Cash (18.0%)
- 1 to 3 Years (26.5%)
- 3 to 7 Years (40.3%)
- 7 to 12 Years (2.3%)
- 12+ Years (5.6%)
- Inflation Linked Bonds (10.6%)
- Foreign Bonds (2.6%)
- Foreign Cash (0.2%)

Quarterly Fund Commentary Second Quarter 2019

ECONOMIC AND MARKET COMMENT

The 2nd quarter of 2019 was consumed by a focus on the South African General Election and all things political. Bond markets were characterized by a great deal of uncertainty, and then ultimately staged a rally and an aggressive curve steepening. The Rand was relatively stable early in the quarter, weakened quite abruptly, and then recovered strongly. The Trade Weighted Nominal Effective Exchange Rate of the Rand closed the end of the quarter stronger. USDZAR weakened from 14.33 at the start of April to briefly touch 15.17 in early June, but finished the month at 14.09. South African yields followed the currency, but shorter dated bonds like the R186 outperformed the long end bonds significantly. Concerns about the debt burden at ESKOM continue to weigh on bond investors. There was also talk of fast-tracking the government's support of the struggling parastatal. In addition to the committed R67bn in support to ESKOM over the next 3 years, some of the total R230bn of support over the next decade could occur sooner. This is one of the main reasons behind the expected significant deterioration in the fiscal deficit (as a percentage of GDP) – one of the key metrics Moody's (and all other rating agencies) monitors. The yield curve steepened as initial fears were that this would be funded by National Treasury in the domestic market.

Once the ANC's election victory was assured, SA government bonds rallied, due to a perception that President Ramaphosa had won a significant enough majority to embolden him in tackling corruption. His new cabinet was well received, and several non-performing ministers were axed. However, initial hopes that he has gained the upper hand against the pro-Zuma faction within the ANC have been dashed. The most recent concern is around Ace Magashule deploying ANC MPs tainted by corruption allegations to head parliamentary oversight committees. The New Dawn appears to be at risk.

Global bond and money markets rallied aggressively over the quarter. They appear to be implying that the next move in the Fed Funds rate will be a cut. The US 10yr treasury yield reached a low of 1.97% in June, having started the quarter around 2.43%, as the Fed rate cuts were priced in. The 10yr German Bund yield continued to plunge even further from –0.07% to a low of -0.33% There is now no chance of an ECB rate hike in the near term. South African bond yields rallied, with the R186 yield falling from 8.54% to end the quarter at 8.08%. However, to illustrate the curve steepening, the R2048 bond opened the quarter at 9.65%, touched 10.04% intra-quarter and closed at 9.66%.

The SARB kept rates unchanged at the May MPC meeting. However, the most notable new development was that two of the voting MPC members were in favour of rate cuts. This came as a surprise, especially given that as

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recently as November 2018 the SARB had implemented an insurance rate hike. However, inflation outcomes have surprised to the downside and the most recent CPI reading for May 2019 printed at 4.5%, right in line with the mid-point of the 3% to 6% target range. The SARB revised its CPI average forecasts downwards to 4.5% for 2019, 5.1% for 2020 and back down to 4.6% for 2021. This would ordinarily suggest that rate cuts could be on the cards, but we are concerned about the implications of the ESKOM developments on the Sovereign Rating – and the implications for higher cost of capital in the South African economy.

The bond market (All Bond Index) returned +3.70% for Q2 2019. Equity markets (represented by the JSE ALSI) were up 3.92% over the quarter and Inflation Linked Bonds (ILBs) returned +2.76% for the quarter. Cash returned +1.80% for the quarter. Rolling 12 month returns for bonds rose to +11.48%, equities have returned +4.42%, and ILBs a paltry +4.19% with cash returning 7.29% over the last 12 months.

PORTFOLIO REVIEW AND OUTLOOK

We reduced the modified duration positioning of the Fund as yields fell towards the end of the quarter, and have tried to increase the liquid high quality assets in the Fund. The diversified holdings of Floating Rate Notes (FRNs) protected the fund in the rising short rate environment, and now that yields have fallen, we intend to increase holdings of FRNs. We intend to retain the strategy of reducing modified duration into strength as and when bond yields rally, especially since close to two local rate cuts are now being priced. We will continue to increase our exposure to Floating Rate Notes (FRNs) if attractive opportunities present themselves, in terms of credit spreads, even though investors continue to over-pay for credit of late. We will continue to exercise caution with our credit assessments before investing in credit assets.

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