

## Cadiz Asset Management Market View: Month ended 28 February 2010

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### **International**

Equity markets have seen more flip-flops in the past few months than a top-class tumbler experiences in a life time. Thus the more fearful view of January – during which Health Care and Consumer Staples blossomed – was replaced in the following month by those stocks with a greater cyclical flavour. Retailers, Diversified Financials and Materials headed the tables and Utilities and Telecomms dragged at the rear. The more positive mood was further reflected in the portfolio strategies reflected below. High Beta stocks in the US experienced the best performance, followed by those counters which have seen the highest, positive adjustment to forecast earnings.

INDICES (US\$)	February	Quarter	12 Months
MSCI World	1.4%	-0.9%	55.2%
MSCI Emerging	0.4%	-1.5%	92.1%
MSCI China	2.2%	-6.2%	71.0%
MSCI India	1.4%	-0.7%	121.6%
SA FTSE/JSE	-0.6%	-4.0%	94.2%
S&P 500	3.1%	1.3%	53.1%
FTSE 100	-1.4%	-3.7%	55.4%

A couple of the fiscally-constrained PIGS (Portugal, Ireland, Greece and Spain) continued to appear on the list of underperforming regions and by all accounts, the acronym has now been expanded to PIIGS, with the inclusion of Italy.

Best country	Month	Worst country	Month
Peru	7.3%	Turkey	-12.4%
Philippines	5.4%	Greece	-9.8%
Colombia	4.5%	Spain	-7.5%

Best country	Year	Worst country	Year
Hungary	165.2%	Ireland	23.1%
Indonesia	159.9%	Portugal	31.8%
Russia	121.9%	Greece	32.3%

Best sectors	Month	Worst sectors	Month
Retailing	3.1%	Utilities	-2.2%
Div. Financials	2.6%	Durables	-0.3%
Materials	2.4%	Telecomm.	-0.3%

Best sectors	Year	Worst sectors	Year
Banks	91.5%	Utilities	21.2%
Materials	86.4%	Telecomm.	21.7%
Div. Financials	82.4%	Health Care	37.0%

Top strategy*	Month	Worst strategy*	Month
Hi Beta	7.0%	Lo price/cflow	0.4%
EPS revision	6.7%	Trailing PE	1.6%
Small cap	4.9%	ROCE	1.6%

Top strategy*	Year	Worst strategy*	Year
Small cap	214.7%	EPS revision	53.2%
Lo price	211.0%	ROCE	54.0%
Hi Beta	210.0%	ROE	53.2%

(\* US only)

After much debate, finger pointing, street demonstrations, general sulking and a strong testing of the resolve of the EU about the way forward for Greece, it does appear as though there is begrudging consensus that the home of the Ionic, Doric and Corinthian columns will not be allowed to become the next Atlantis. Aid will be extended to the Greeks as long as they agree to help themselves via a range of fiscally prudent measures, which include higher taxes and a reduction in the bonuses paid to government employees at Christmas and Easter. And of course, they mustn't lie about the true state of their finances.

We believe that equities will still benefit from certain of the tail-winds that provided much of the upside in 2009. The composition of these tailwinds is changing though. Common to last year and this, is the fact that interest rates will stay low. Different will be the withdrawal in 2010 of the massive liquidity injection provided by governments – in essence, a mopping up of the excesses

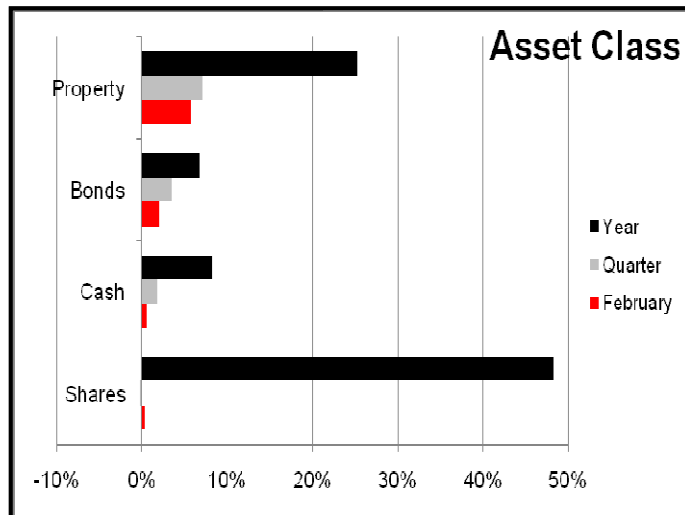
rather than a tightening. Also different in 2010 will be the appearance of the earnings abundance that was anxiously anticipated last year. This will provide the growth driver for equities this year: the better earnings, the better the performance of the share market.

### Local

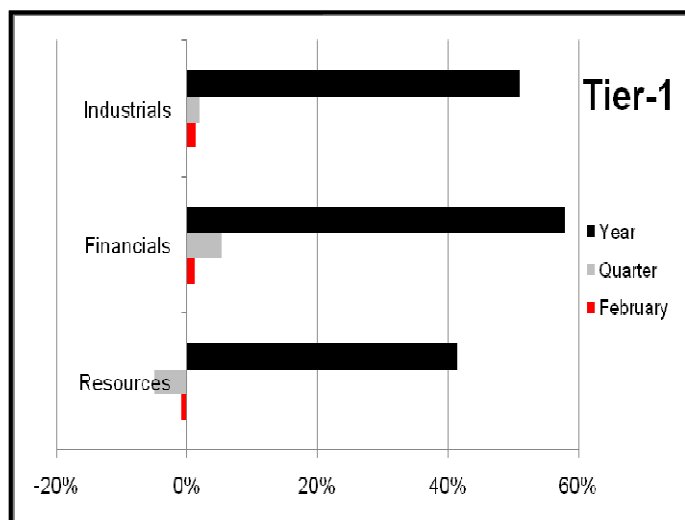
(Ranking of the following 6 graphs is based on performance for the month of February)

The SA share market was on the ropes versus its peer international group and the other local asset classes in February. Investor interest might have been negatively impacted by a busy month, which contained Minister Gordhan's first budget and much angst around what price increases the energy regulator would grant Eskom.

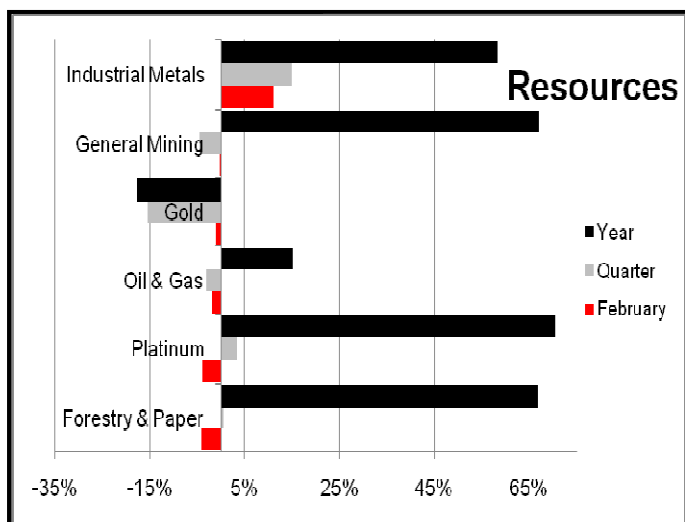
After underperforming *Shares* by some 13% in 2009, *Property* counters have grabbed the initiative in 2010 and have performed well in the short-term, helped by the bond market.



Returns were muted in the month, ranging from -1% for *Resources* to +1.1% for *Financials* and +1.4% in the case of *Industrials*. Resource counters didn't want to come out to play in February, despite generally higher commodity prices. The weaker Rand didn't help either.

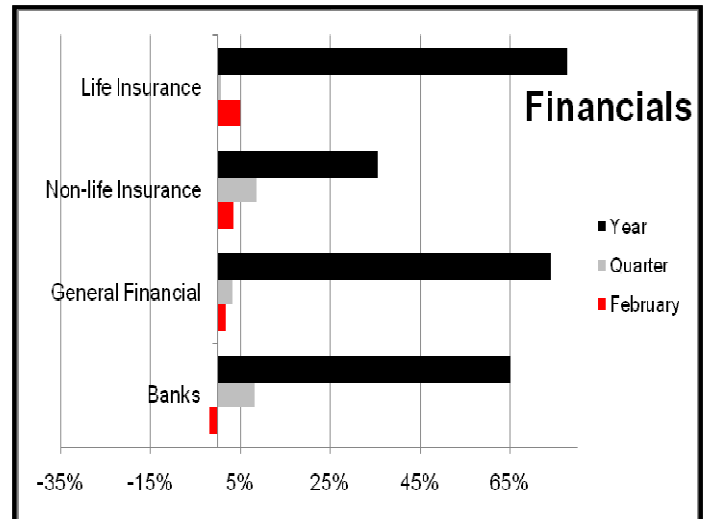


There is no doubt that the mood within the Resource counters would have been even gloomier, were it not for the fact that the best performer (*Industrial Metals*: Arcelor Mittal (+11%)) was saved by a suspension. In what some would view as a Machiavellian move, Kumba Iron Ore (+13%) declared the preferential iron ore agreement with Arcelor to be null-and-void

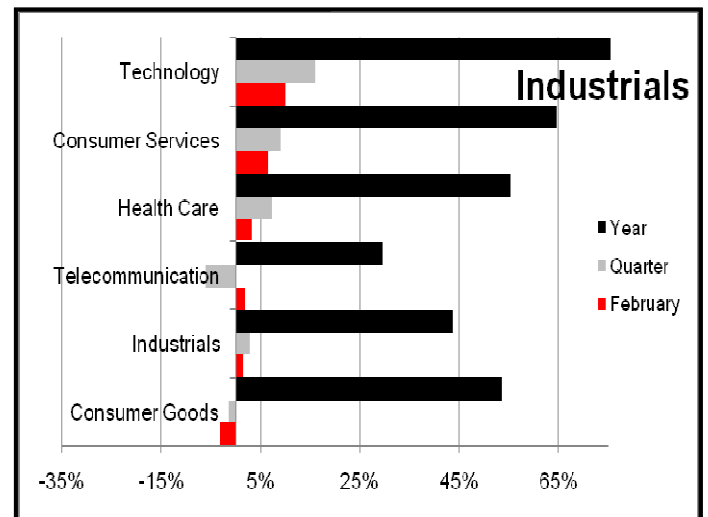


as the latter had not applied for conversion of its Sishen entitlement into new order mining rights. Exxaro (+9%) was dragged up by virtue of its stake in the Sishen project. For the rest, it was a dull day at the office.

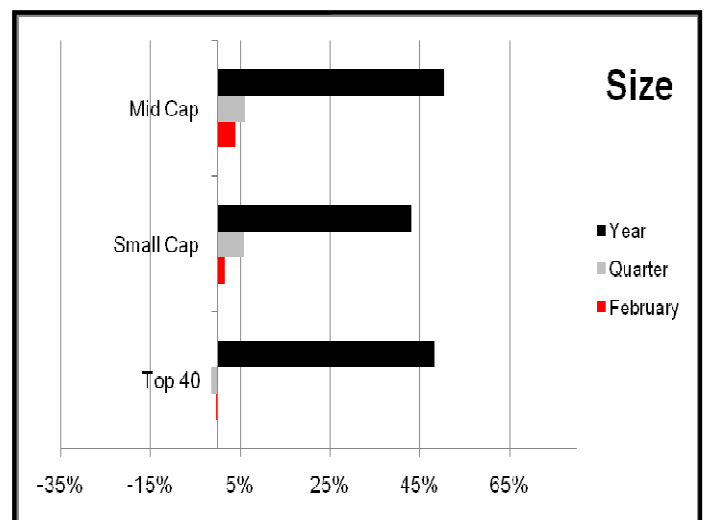
Stand out returns were delivered by Discovery (+8%), Sanlam (+7%) and Liberty Life (+5%). *Banks* (FirstRand -3%, ABSA and Standard Bank -1%, each) lagged as the reporting season delivered generally poor results.



As was the case with the international markets, local tech and discretionary consumer stocks were the winners. The US Nasdaq Index has outperformed the broader S&P Index by 16% over the past year as the expectation of increased corporate capex spend has been a driving factor. Similarly, Didata (+11%) and Datatec (+8%) have led to the local tech sector occupying no.1 spot over all reported periods. Within *Consumer Services*, retailers such as Truworths (+17%), Woolworths +13% and Foschini +8%) stood out. Although *Industrials* might not have delivered much as an index, it did hold some good performers in the shape of Imperial (+17%) and Trenchor (+14%). By comparison, SAB Miller fell by 5%.

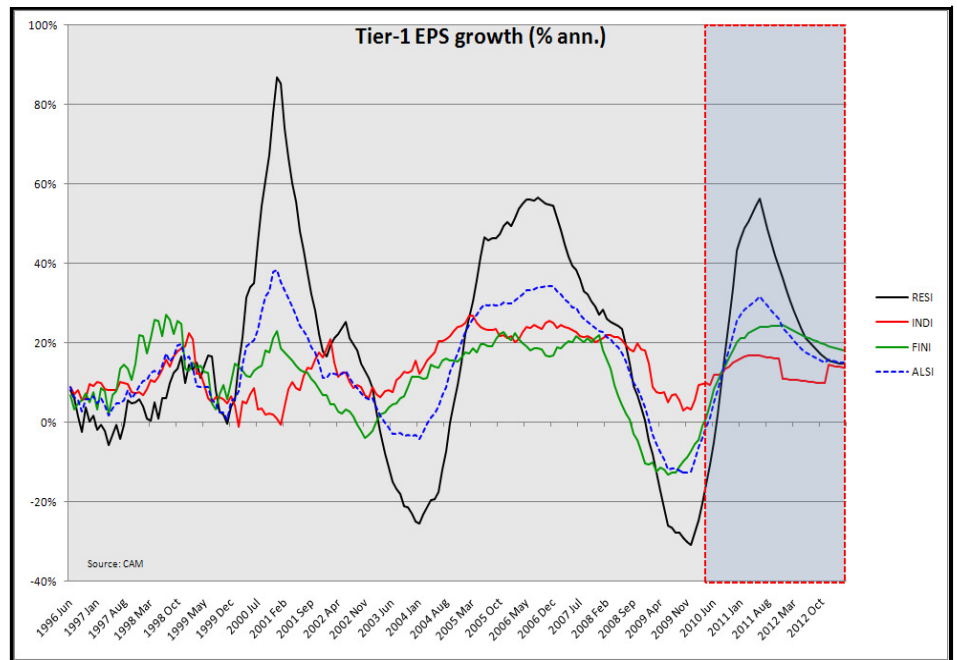


Resource counters dragged the Top 40 into negative territory. With most of the strongly performing counters mentioned in the previous paragraph falling into the Mid Caps' classification, it's no wonder that it outperformed in February.



## General Commentary

In an earlier section, we mentioned that markets were moving into a period of earnings abundance and the graph below best illustrates this point. In it, we plot the historic actual and prospective earnings growth of the major subsets of the All Share Index. Our data extends back to the mid-'90s using actual figures. For the period ahead, we use consensus sell-side earnings forecasts through to the first quarter of 2013. The shaded area covers the forecast period, starting 1<sup>st</sup> March 2010. In the process, we have decalendarised the earnings covering the gap between the most recent reporting period and the one lying ahead, so as to smooth the data, thereby eliminating the distortionary step-down (or step-up) jump in the growth profile that would occur if we did not do so. A similar argument can be applied to the resultant PE ratings.



This exercise shows a number of interesting observations:

- Firstly, the volatility of the earnings profile of the Resource sector, which underscores the higher risk when investing in these counters: very much a case of boom-to-bust-to-boom;
- By comparison, Industrials and Financials are far tamer. Note the resilience of the Industrial earnings, which experienced hardly a glimmer of a slowdown in this last "Great Recession". With the exception of early 2000 and 2001, earnings for this sector have not moved into negative territory, irrespective of the state of the economy. This speaks volumes for the ability of these companies to generally pass on price increases to the consumer and to manage their way effectively through the tough times;
- The sectors are through the worst of the most recent collapse in earnings;
- What is not evident from the above graph is how the forecast profiles have changed over the past year. For example, a year ago, the All Share earnings growth was projected at plus 19%. The actual reading has clocked in at minus 4% (talk about forecast error!). Similarly, the two year forecast earnings to February 2011 was positive and in the mid-teens, a year ago. By comparison, the 1 year forecast from today expects earnings to be up nearly 30% by February 2011. So forecasts have nearly doubled in the past 12 months. This upwardly moving trend is generally supportive of equities and the feeling lasts until some negative event bowls the market or investors doubt forecasters more than usual.

In a recent, interesting study by Bank of America, Merrill Lynch, the sectors that typically outperform during these phases of earnings abundance are Retailing, Media and Energy. The laggards are typically Telecomms, Health Care and Industrials. Have you noticed some of the similarities with what has happened in the current month? Keep the faith.

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