WARWICK Financial Maturity

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ASSET MANAGEMENT House View

This Month's Focus

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WARWICK Financial Maturity
WARWICK Funds
cadiz Funds

TWO GREAT BRANDS
ONE ASSET MANAGEMENT TEAM

Warwick announced the purchase of the asset management business of Cadiz from JSE-listed Stellar Capital Partners last month and we have spent the past month integrating the Cadiz asset management professionals into a strengthened Warwick Asset Management.

It is important at this point to reaffirm the investment objectives and philosophy of Warwick Asset Management.

Our objective is to protect and grow our client's capital over the long-term.

We predominantly invest in good quality businesses, run by a capable management team, with low financial risk, and that trade at an attractive price below what we believe the business is worth.

Good quality businesses are more resilient to industry and economic downturns and tend to compound their profits (earnings) over the long term, hence they are a safer way to gain exposure to equities. In the short term, however, asset prices can differ materially from the underlying value of the investment. This is because prices tend to be driven by investor sentiment, industry or stock specific concerns and the effect interest rates have on the supply of money.

Market-beating outcomes are achieved when we can buy these businesses while they trade at a discount due to short term issues which are easily rectifiable. All investments carry some degree of risk, but we only invest if there is an adequate margin of safety built into our valuations, which ensures that we are not overpaying for these businesses.

By establishing what we believe the fair market value of the business is worth, this creates a margin of safety, even if the current problems are persistent.

We build our portfolios from a bottom up, stock-by-stock selection process, without regard to the benchmark weightings. We take high conviction positions when we are investing in a good quality business with capable management that is trading close to our worst-case valuation together with significant upside to our normal scenario valuation. We perform a high-level review to ensure that our bottom-up selection process does not lead to a portfolio which is too concentrated in any industry, or too reliant on a specific macroeconomic outcome to deliver on our objective to protect and grow our clients' capital.

We believe that our investment process is sound, as it is predicated on a bottom-up fundamental company research which is performed by highly-qualified and experienced investment analysts.

With this background outlining our investment philosophy and disciplines, over the coming months, I will be introducing our team members within Warwick Asset Management. Next month we will focus on Alastair Sellick who is the Joint Head of Fixed Income.

In This Issue

International Market Overview

Following a positive April, world markets were placed on the back-foot as geopolitical anxiety in the Eurozone and the US reared its head once again. Concerns were largely focused on Italy, with the Eurozone's third largest economy potentially requiring fresh elections, as populist parties failed to come to an agreement. This political impasse could lead to a referendum regarding Italy's continued membership of the European Union (EU). Furthermore, renewed trade war fears were ignited when President Trump slapped tariffs on the importation of steel and aluminium from the EU, Canada and Mexico.

United States of America

American markets had a decent month in the main, with all indices ending in the black. The Dow Jones ended the month firmer by 1.05%, the S&P 500 by 2.16%, and the Nasdaq jumped 5.32%. Forthcoming economic data from the US continued to boost sentiment, with consumer confidence increasing to 128 in the May reading, after a dip to 125.6 in April and the first quarter GDP coming in at 2.2% annual rate, slightly below the previously reported 2.3%. Private Consumer Expenditure rose to 1.8% year-on-year, with consumer spending growing the most in five months and inflation remaining steady. All signs continue to point toward solid and steady US economic growth, which is supportive of the Federal Reserve's planned action of gradual interest rate hikes. This sentiment needs to be tempered to a degree, however, as a potential trade fallout could impact the world markets, with both China and the EU responding to the newly-imposed steel and aluminium tariffs by threatening to impose duties of their own. This has raised the fear again of a global trade war and leaving world markets on edge.

Europe

European markets did not escape the fallout from the Italian crisis with that country's bonds entering a tailspin and impacting not only the Euro, but also other risk on assets. The general atmosphere in the Eurozone is that the anti-European Union sentiment being expressed could have a broader impact and hit the zone harder than both Brexit, and the Greek Financial Crisis.

The UK market saw the FTSE 100 up by 2.25% for the month, but hitting a wall with the US tariff imposition on steel and aluminium imports from the EU on the last day of May. Retail spending in May also showed good growth as the warmest month on record drove consumers to the stores. Year-on-year spending increased by 5.1%, the most since April 2017, with total sales jumping 4.1%, the biggest gain since January 2014. It is expected that this spending spree will strengthen the case of the Bank of England policy makers, who anticipate the first quarter slowdown to be temporary and may bolster calls for another interest rate hike, possibly as soon as August. Investors are assigning a 40% probability to such an event, which was higher than the less than 30% ascribed to the previous period.

In Germany, the Dax 30 ended the month weaker by 0.06%, as German unemployment continued to fall to a fresh record low, as companies in Europe's largest economy continue to step up their hiring in order to work through backlogs, despite signs of slowing growth. The jobless rate declined to 5.2% in May, with the number of people out of work falling by a seasonally-adjusted 11 000, to 2.358 million, exceeding the consensus predicted decline of 10 000. Although Germany's export-oriented economy has benefited from a global recovery and is forecast to see the strongest annual expansion in seven years, recent euro data has hinted at a loss of momentum, with indications of cooling underlying demand. This notwithstanding, demand for new workers continues to remain high with almost 800 000 vacancies being registered by the company's labour agency.

The French markets followed suit, ending May weaker by 2.21%, even as the economy grew less than anticipated in the first quarter of 2018. The expansion of 0.2%, was down from the 0.7% of the previous three months (quarter four 2017) and was the weakest since the third quarter of 2016. In addition, exports and imports fell by 0.3%, while household spending rose by just 0.1%.

Asia

Asian markets ended mixed for the month as the Shanghai Index ended firmer by 0.43%, but the Hang Seng was down by 1.10%. From an economic perspective, the Chinese factory gauge rose more than expected with export orders accelerating, indicating that trade continues to drive as expansion with the global economy continuing to power through risks. Manufacturing PMI came in at an eight-month high of 51.9 in May, exceeding all consensus forecasts that had expected an unchanged number of 51.4. Non-manufacturing PMI, (which covers services and construction), rose for the third straight month to 54.9, from 54.8 in April. Recall that levels above 50 indicate an improvement. In addition, the PMI for new export orders also increased to 51.2 from 50.07, with readings of output pricing, inventories and work backlogs declining.

Japanese markets also ended the month on the backfoot, ending down 1.18%, with the stronger Yen having an impact. Japanese economic data also showed a slowdown, with the economy shrinking by 0.60% for the first quarter of 2018, breaking an eight-quarter growth streak. Japanese factory output also grew less than forecast in April, raising concerns regarding the strength of the Japanese economy following a growth contraction in the first quarter of 2018, with a notable sharp drop in the production of electronic components and devices as key factors. There is an expectation among economists that the expansion of the Japan's economy will resume this quarter, but they remain cognisant of the risks ascribed to heightened trade frictions and US protectionism, including threatened US auto tariffs, which could impact the Japanese auto manufacturing industry.

Local Market Overview

Local Equities

The volatile trading environment experienced in 2018 continued in May, as the JSE All Share Index (ALSI) reversed most of the gains from the previous month, with the index finishing the month 3.50% in the red. Most of the major indices ended the month significantly lower, yet the RESI20 bucked the trend, recording strong gains. The SACCI business confidence figure released during the month declined slightly from the previous month as the "Ramaphoria" effect began to wane. Toward the end of the month, the SARB kept rates unchanged as expected and we believe the probability of a second rate cut in 2018 has reduced, given the inflation outlook.

RESOURCES - Resources continued their upward trend in May, adding 4.75% over the period, outperforming the FTSE/JSE All Share Index by a convincing 8.22%. Dollar strength helped drive returns, along with a general surge in commodity prices, with the Bloomberg Commodity Index rising 1.25% in USD over the period. Precious metals were mixed for the month, with platinum rising a marginal 0.27%, compared to gold's decrease of 1.28%. This decrease in the gold price helped push the FTSE/JSE Gold Mining Index down 9.02%. The biggest losers for the month were Sibanye Gold (-28.14%), Lonmin PLC (-26.66%), and finally, ArcelorMittal (-23.99%) after its CFO resigned and the company announced its sale of its indirect 50% interest in Macsteel International holdings BV. On the up was Montauk Holdings (+23.03%), outperforming the likes of Exxaro Resources (+12.62%) and BHP Billiton (+8.63%). Despite the price of iron ore dropping by 2.76% in Dollar terms, Kumba Iron Ore managed to add 8.05% to its share price.

INDUSTRIALS - The INDI25 came under serious pressure in May, as SA Inc. shares took a battering. Several companies reported results during the month, which played a role in some of the large movements seen in the share prices. Foreigners exiting/reducing their weight in emerging markets also contributed to the 5.11% decline in the INDI25 for the month. Retailers Massmart, Dischem and The Foschini group all released results/updates that disappointed the market relative to where the shares were trading, resulting in the share prices falling 28.95%, 23.59% and 14.31% respectively. Other notable SA Inc. companies that saw their share prices decline by double digits included Barloworld, Truworths, Bidvest and Tiger Brands. The Rand hedges held up a bit better, although some sharp sell-offs were experienced by Mediclinic, Bidcorp and Aspen. We continue to favour the larger Rand hedge industrial companies that have exposure to faster-growing economies and diversified revenue streams, while actively looking for attractively priced SA Inc. opportunities that may benefit from a resurgent South African economy.

FINANCIALS - Financials were hit the hardest in the May sell-off as the FINI15 dropped 6.71% for the month. After the strong rally from November to March, the banking sector has de-rated over the last few months and valuations are now starting to look more attractive. After falling 11.65% and 10.39% in May, Barclays Africa Group and FirstRand are down approximately 20% since the highs reached in March. On the insurance side, MMI Holdings steadily declined throughout the month, to end 15.96% lower from where it started. Discovery was also under pressure and the 11% drop in May now sees the innovative financial services company 19% off the highs reached in March. We continue to hold a slightly overweight position with regard to the banking sector and have recently increased our weight to the insurance sector with the addition of Old Mutual.

LISTED PROPERTY - The local listed property sector lost most of the gains made during the month of April as negative sentiment surrounding the Resilient group of companies, coupled with emerging market weakness that plagued the local market. Counters across the board traded weaker regardless of their geographic focus. Stalwart, Growthpoint, was down more than 6.0% for the month, while Redefine traded more than 8% weaker.

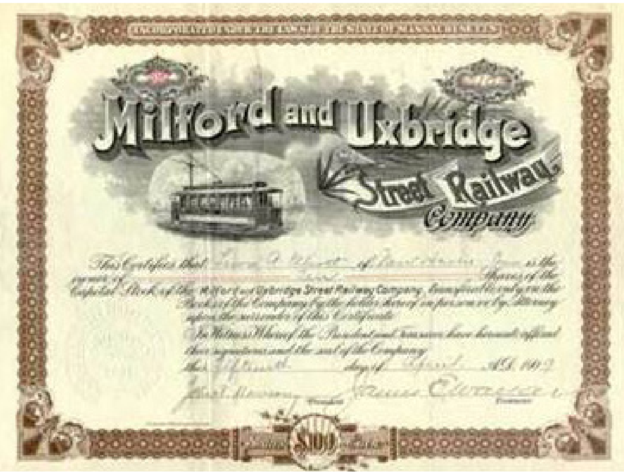
Property fundamentals remain under pressure despite some positive signs starting to emerge from potential economic growth activity. The office sector remains a laggard, however, as oversupply continues to increase. The industrial and logistics sector is showing decent activity, but occupiers are demanding higher specifications at cheaper rentals.

Overall, the listed property market was down 5.92% for the month. The near-term outlook still remains volatile, but distribution yields are expected to stabilize somewhat for the remainder of the year.

We maintain a diversified mix of property counters in our portfolios. The investment strategy remains one that focusses on consensus and index holdings, while ensuring that we invest in shares that fall within defined quality and liquidity parameters.

LOCAL CURRENCY - The Rand backslid over the period, ending the month at ZAR 12.70 against the US Dollar. This was mainly on the back of renewed Dollar strength, with the Bloomberg Dollar Spot Index rising approximately 2.1% (this is the value of a Dollar weighted against a basket of international currencies). Developed markets took centre stage yet again, with uncertainty surrounding President Trump's decision to meet with North Korea's Kim Jong-un, and the US imposing steel and aluminium tariffs on the European Union. During the month, the South African Reserve Bank left the repo rate unchanged at 6.50%, citing mounting inflationary pressure (April's inflation figure reached 0.8% month-on-month) and that rate cuts would not be supportive of the economy currently. This did little to move the currency, which traded in a tight range after the announcement was made. The Rand regained its footing against the Euro and Pound, appreciating by 1.20% and 1.54% respectively. The Japanese Yen managed to shore up against the Rand, appreciating by 2.28%.

Local Fixed Income



Market Review

Global bonds had a strong month in contrast with the declines seen in global equities. The US 10-year generic bond yield fell 9 basis points to end the period, below the psychological 3.0% level. German and French yields were also down 22 basis points and 12 basis points respectively.

Foreigners sold-off local bonds more aggressively during the month of May. In total R30.9bn was sold over the period, compared to the R0.4bn sold the previous month. Local bonds lost ground across the curve with most of the losses experienced in the longer end. The All Bond Index was down 1.95% for the month.

Minor demand for Inflation-Linked Bonds caused this asset class to end the month up 0.12% on average.