Size & Style Investing In South Africa

Guidance For Capital Allocation In A Low Return World

ACTUARIAL SOCIETY OF SOUTH AFRICA

cannon asset managers
DELIVERING VALUE

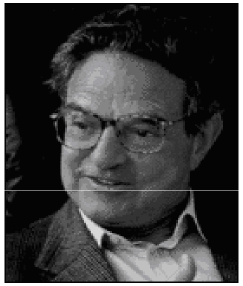
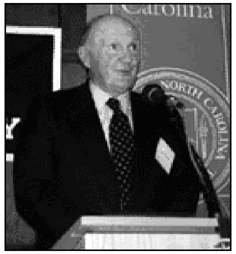
October 2014

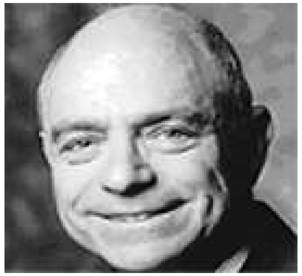
No Style Has A Performance Monopoly

cannon asset managers
DELIVERING VALUE

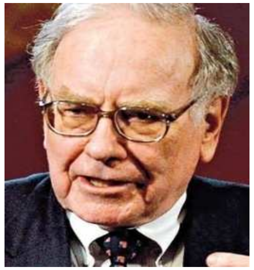
Various Approaches To Investing

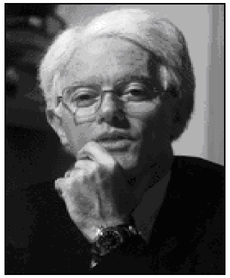
Growth	GARP	Value
Thomas Rowe Price, Jr, Bill O'Neill, Julian Robertson, George Soros, Michael Steinhardt, Ralph Wagner	Warren Buffett, Charlie Munger, Jim Slater, Peter Lynch	Benjamin Graham, David Dodd, Charles Brandes, Mario Gabelli, Seth Klarman, Joel Greenblatt, Sir John Templeton, John Neff, Bill Miller, David Dreman

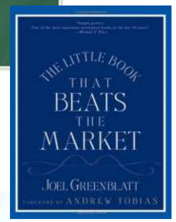


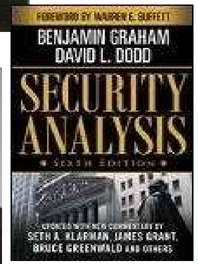




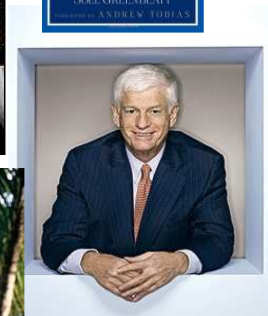




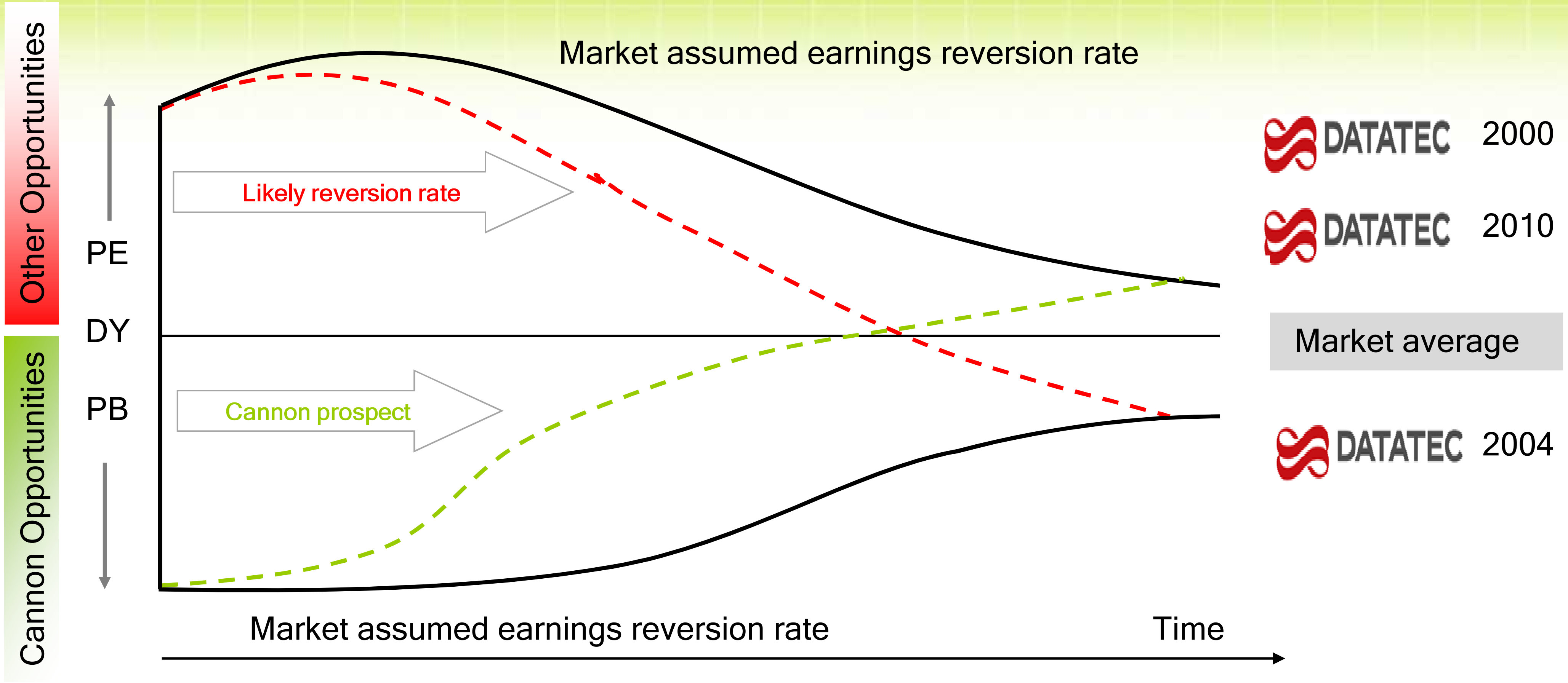




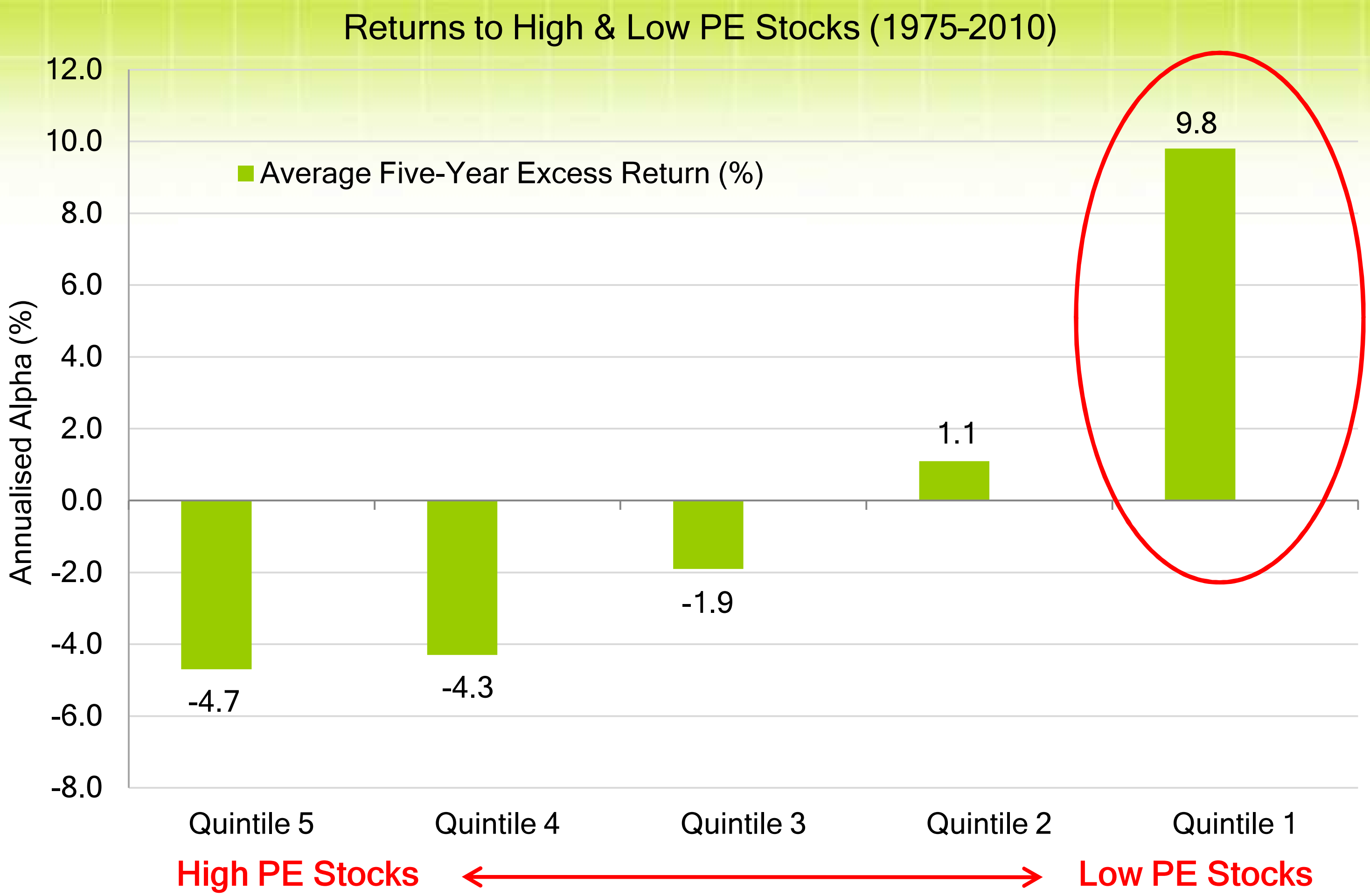




Investment Philosophy Caricatures



Adapted from Marathon Asset Management, BCG, Holt, Gannon & Cannon Asset Managers



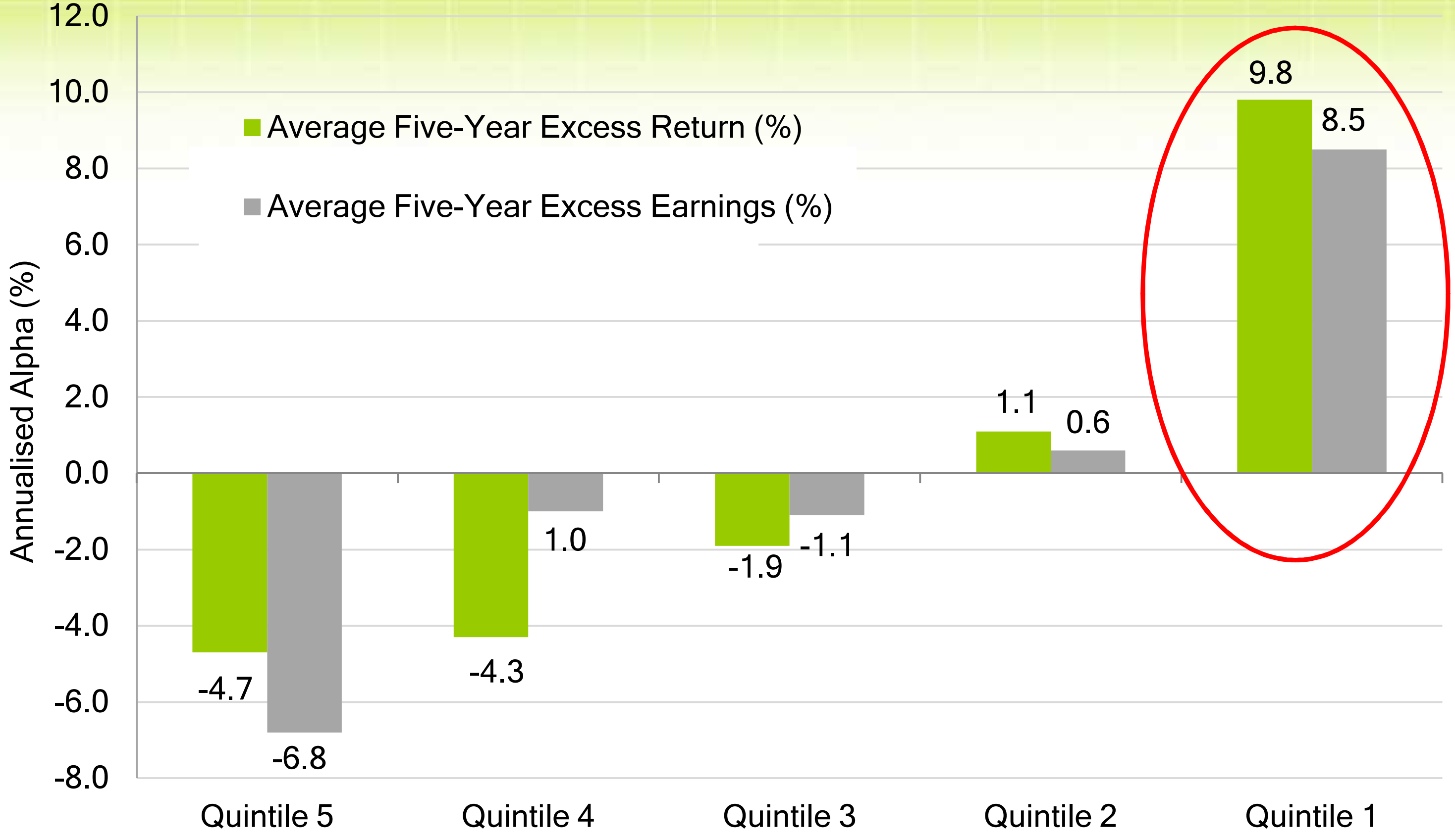
- Returns come from *the most* unloved stocks

McGregor BFA; DRKW Macro Research (2007); updated by Cannon Asset Managers (2014)

Easy to own

Hard to own

Returns to High & Low PE Stocks (1975-2010)



High PE Stocks ⟵⟶ Low PE Stocks

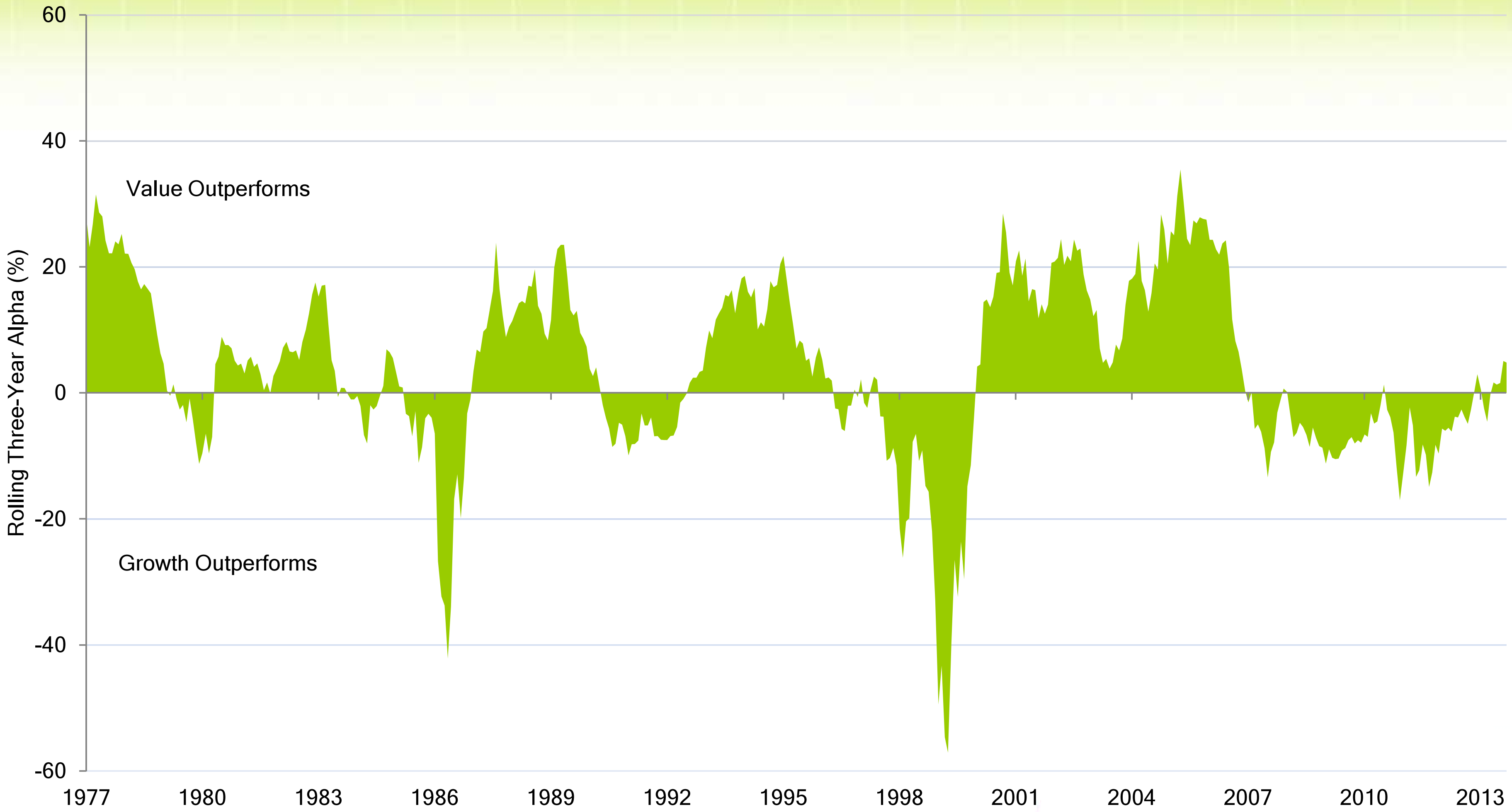
PE 34

PE 9

- Cannon PE 10.8x versus market PE 18.4x
- Implied alpha ~6.1% per annum over three years

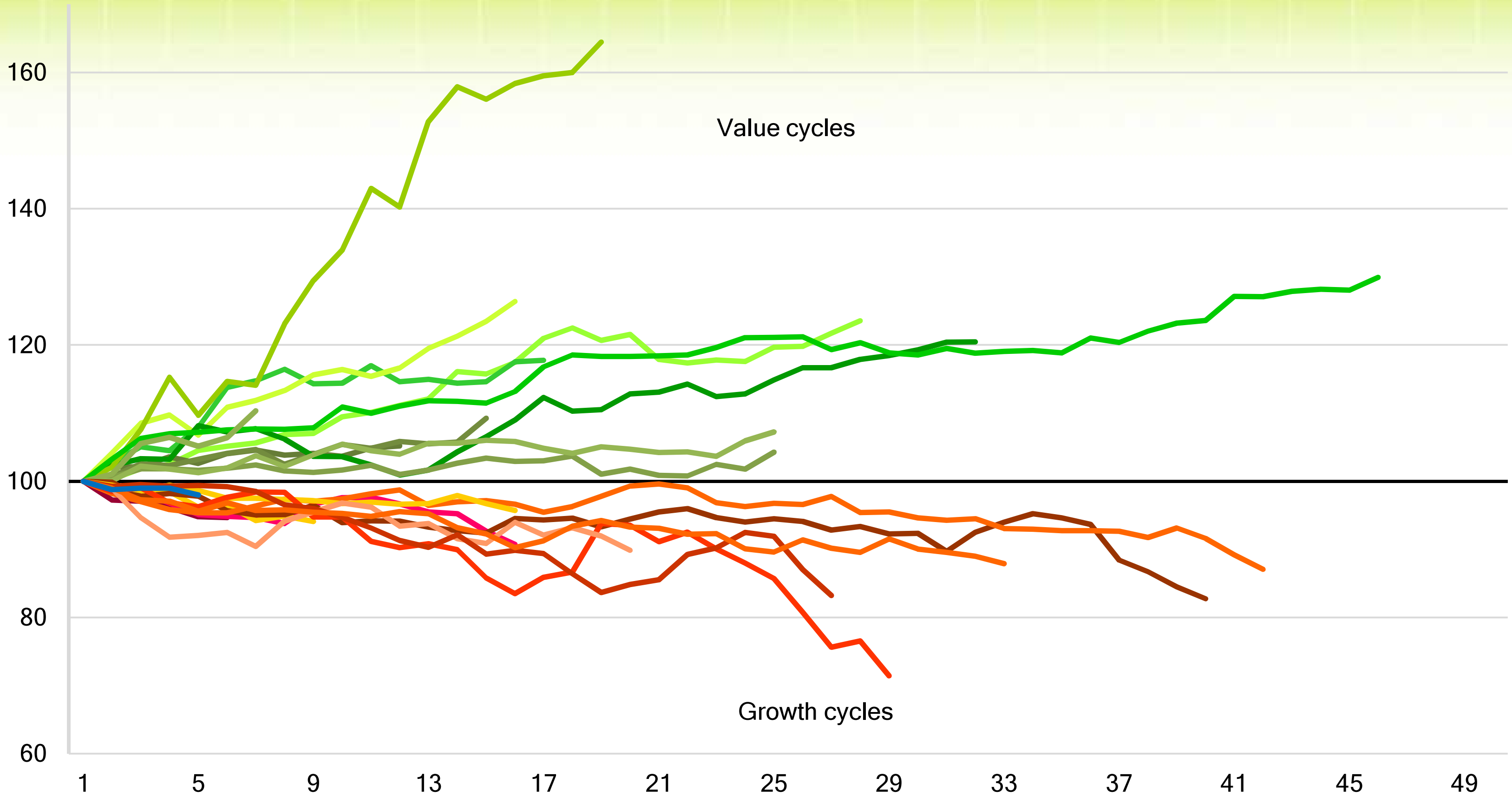
McGregor BFA; DRKW Macro Research (2007); updated by Cannon Asset Managers (2014)

Styles Are Cyclical: Global



MSCI & Bloomberg (2014); Cannon Asset Managers (2014)

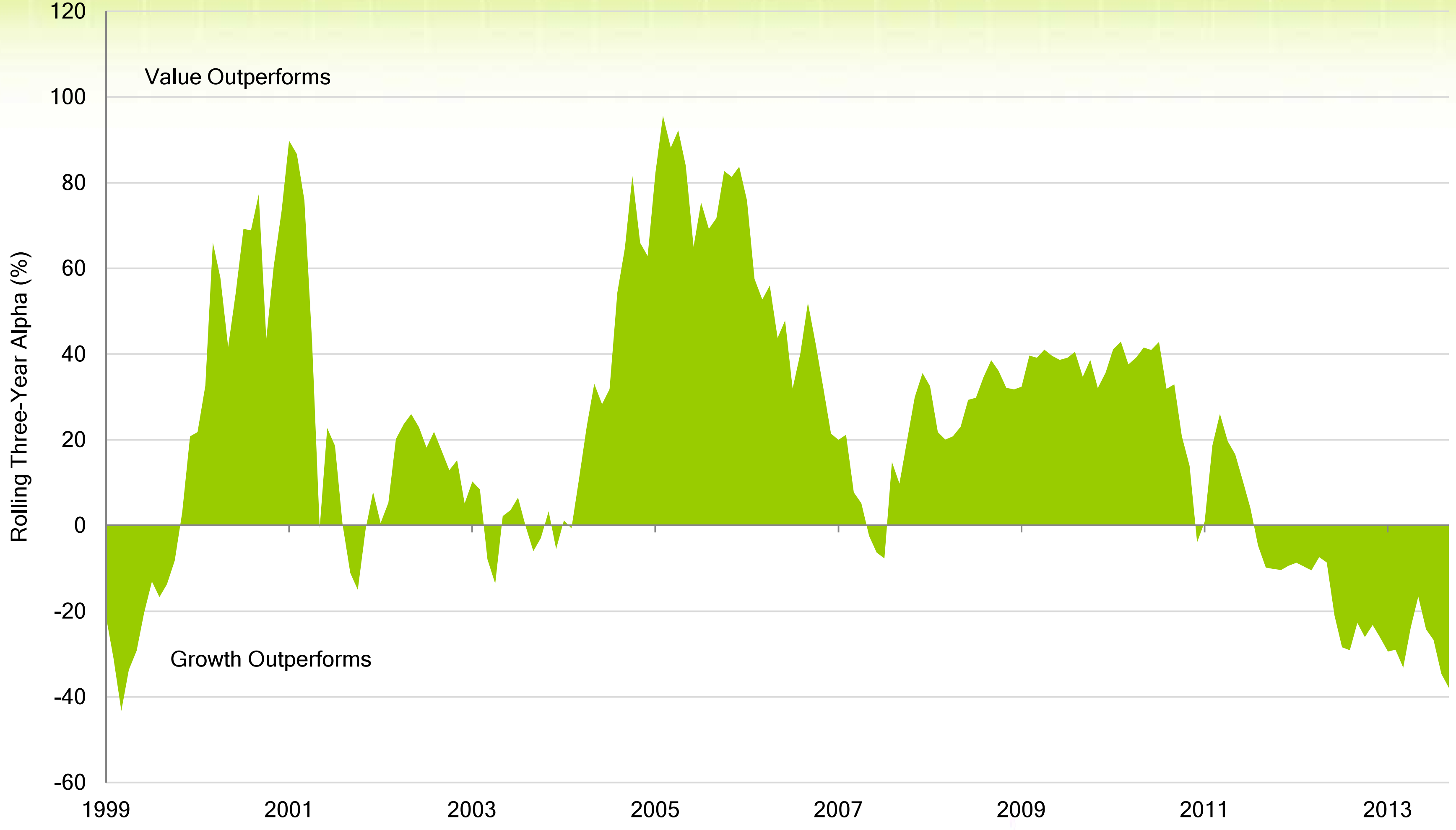
Value & Growth Cycles: Global



	Value	Growth	Value Alpha
Cumulative Return (%)	4,522	2,592	1,929
Annualised (%)	10.1	8.6	1.5

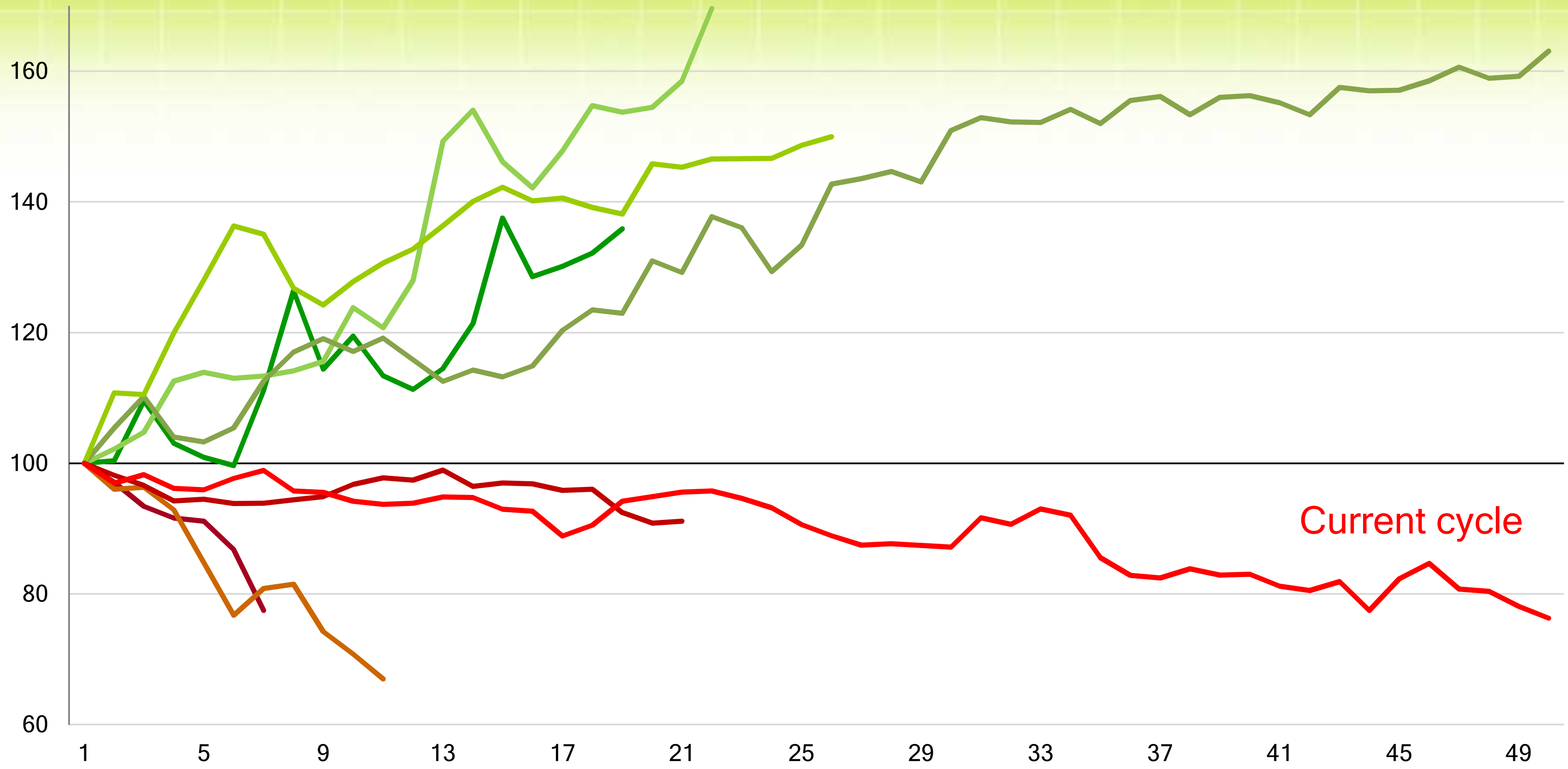
Cannon Asset Managers, MSCI World Value and Growth Indices (Majority of countries included = developed)

Styles Are Cyclical: South Africa



MSCI & Bloomberg (2014); Cannon Asset Managers (2014)

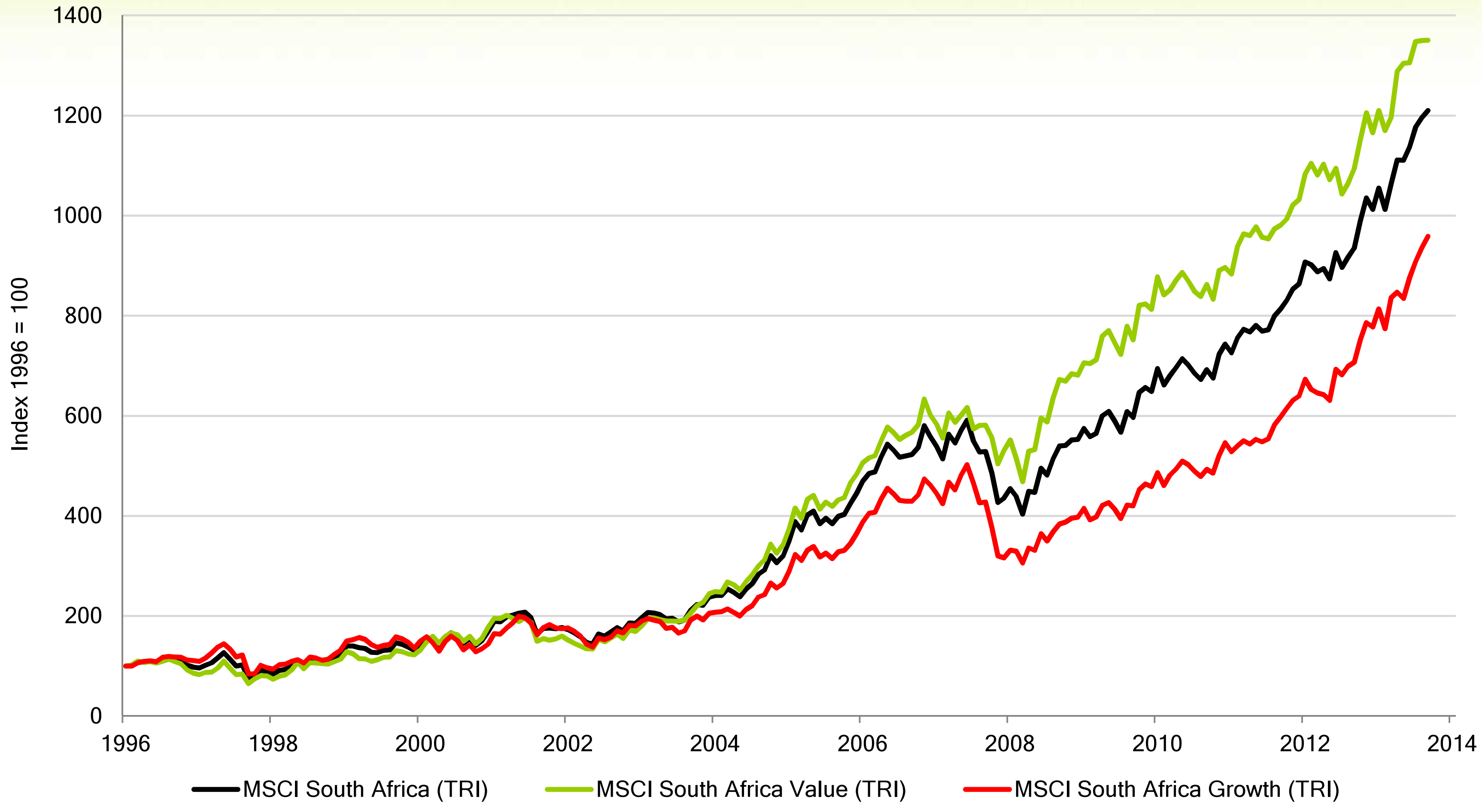
Value & Growth Cycle: South Africa



	Value	Growth	Value Alpha
Cumulative Return (%)	1,250	858	392
Annualised (%)	15.8	13.6	2.2

Cannon Asset Managers, MSCI South Africa Value and Growth Indices

South African Cumulative Result: Value & Growth

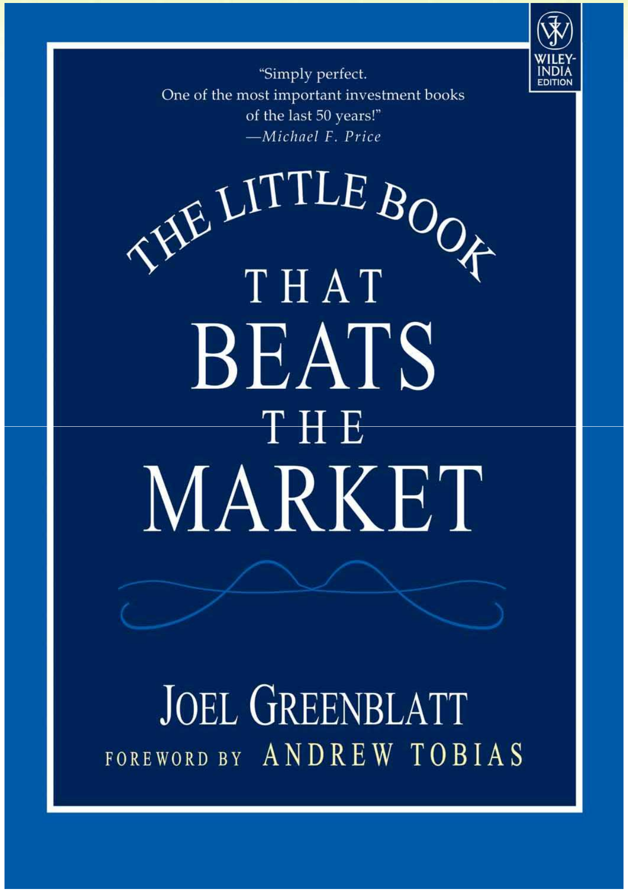


Cannon Asset Managers, MSCI South Africa Value and Growth Indices (2014)

Capital Allocation In A Low Return World

cannon asset managers
DELIVERING VALUE

Price Is The Most Important Determinant Of Your Investment Result

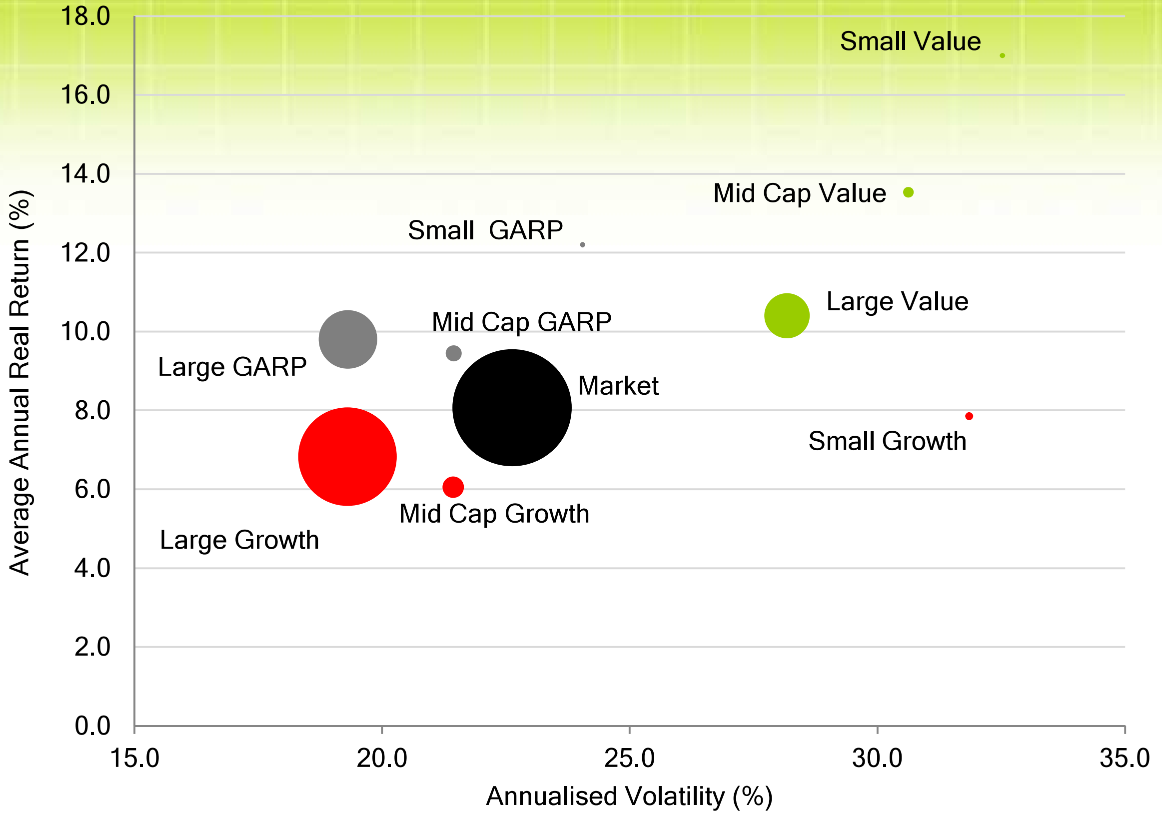


"I know a place where they sell companies at half price every day. It's called the market."

Joel Greenblatt
The Little Book That Beats The Market, 2010

The Little Book That Beats The Market (Wiley), Joel Greenblatt, 2010

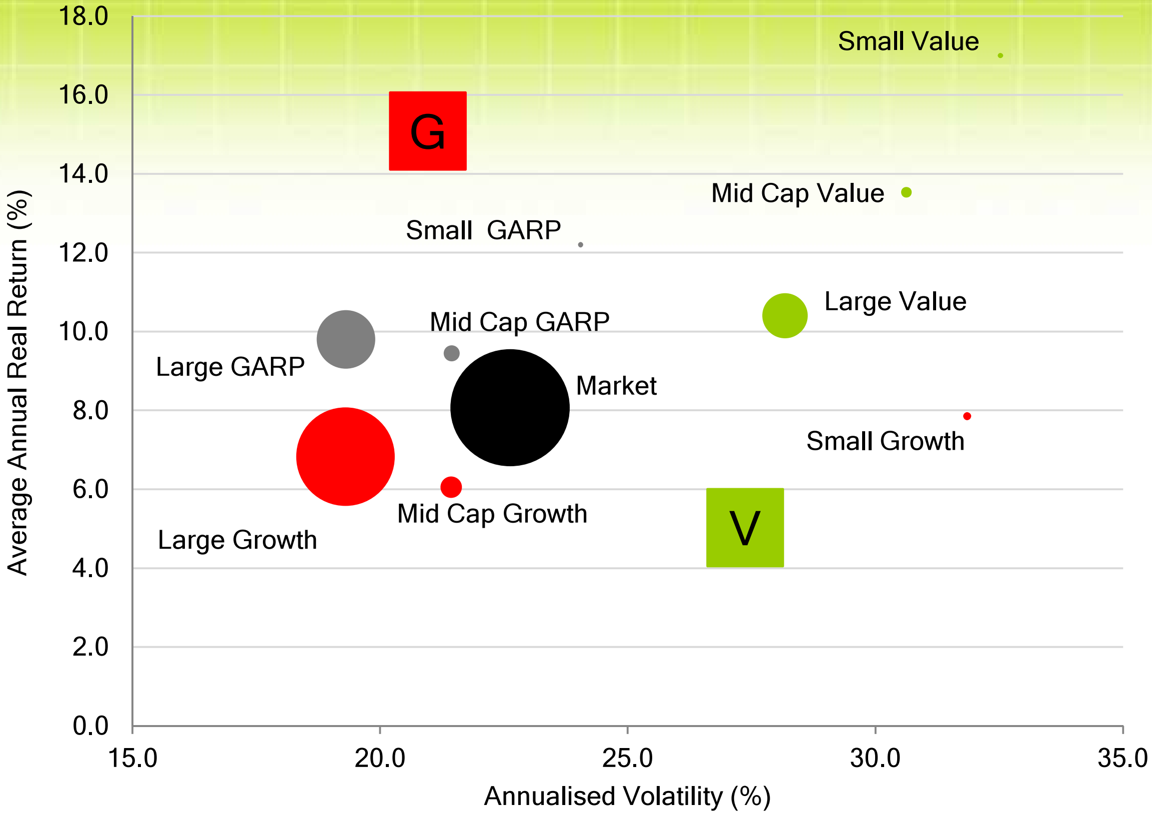
Where Should Long-Term Investors Be?



Attribute	Average Annual Volatility (Real) (%)	Average Annual Total Return (Real) (%)	Total Cumulative Return (Real) (%)	Long-Term Market Weight (%)
Large Growth	19.3	6.8	374.9	36.8
Large GARP	21.4	9.5	608.6	21.9
Large Value	28.2	10.4	723.4	16.9
Mid Growth	21.4	6.1	323.8	8.1
Mid GARP	19.3	9.8	648.7	5.9
Mid Value	30.6	13.5	1265.4	4.1
Small Growth	31.9	7.9	453.3	3.3
Small GARP	24.0	12.2	999.7	2.4
Small Value	32.5	17.0	2310.6	0.6

Cannon Asset Managers (2014) proprietary data archive; analysis from Fama and French (1992 & 1993); Index Fund Advisors (2010)

Where Should Long-Term Investors Be?



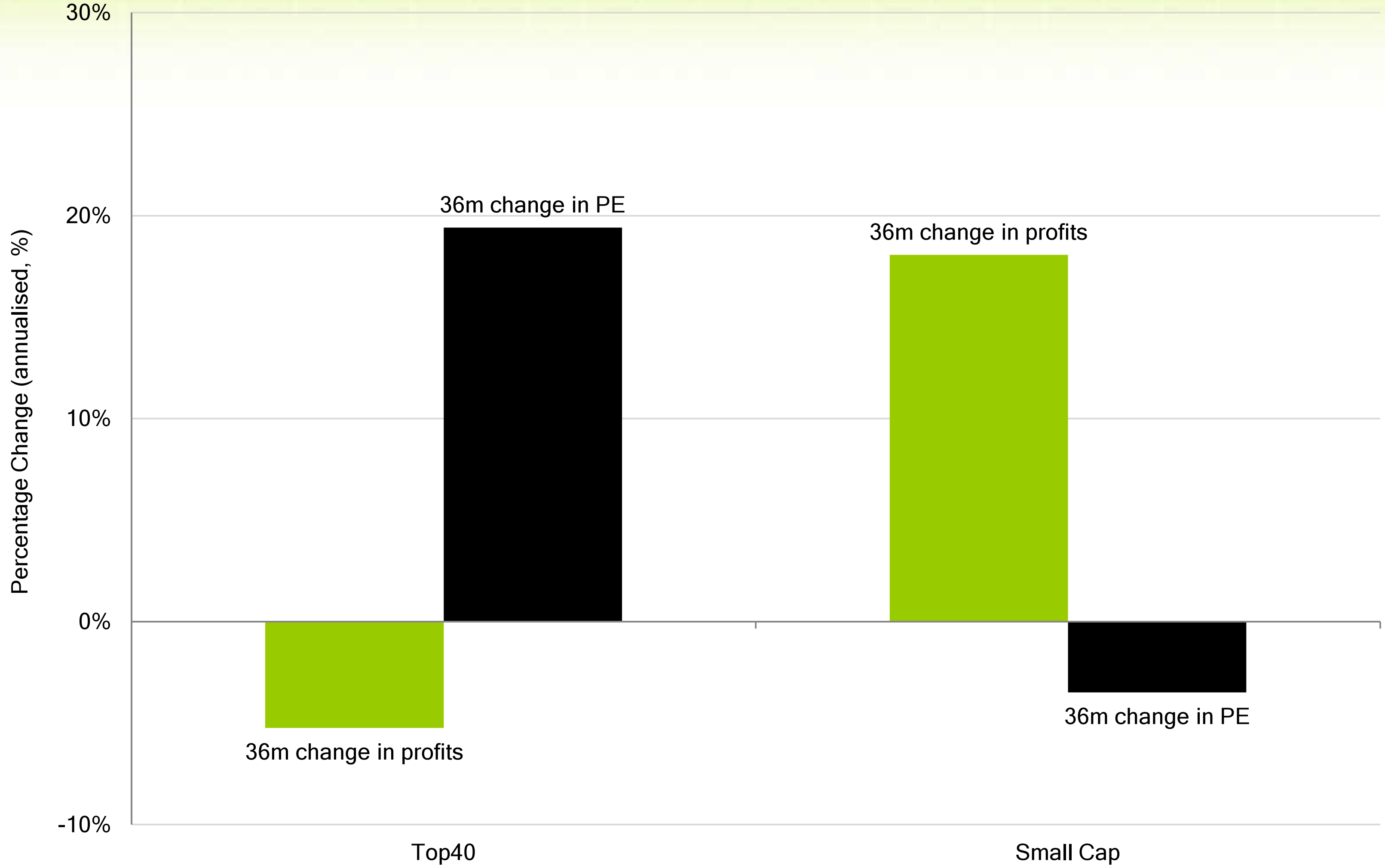
Attribute	Average Annual Volatility (Real) (%)	Average Annual Total Return (Real) (%)	Total Cumulative Return (Real) (%)	Long-Term Market Weight (%)
Large Growth	19.3	6.8	374.9	36.8
Large GARP	21.4	9.5	608.6	21.9
Large Value	28.2	10.4	723.4	16.9
Mid Growth	21.4	6.1	323.8	8.1
Mid GARP	19.3	9.8	648.7	5.9
Mid Value	30.6	13.5	1265.4	4.1
Small Growth	31.9	7.9	453.3	3.3
Small GARP	24.0	12.2	999.7	2.4
Small Value	32.5	17.0	2310.6	0.6

Cannon Asset Managers (2014) proprietary data archive; analysis from Fama and French (1992 & 1993); Index Fund Advisors (2010)

The Recent Past

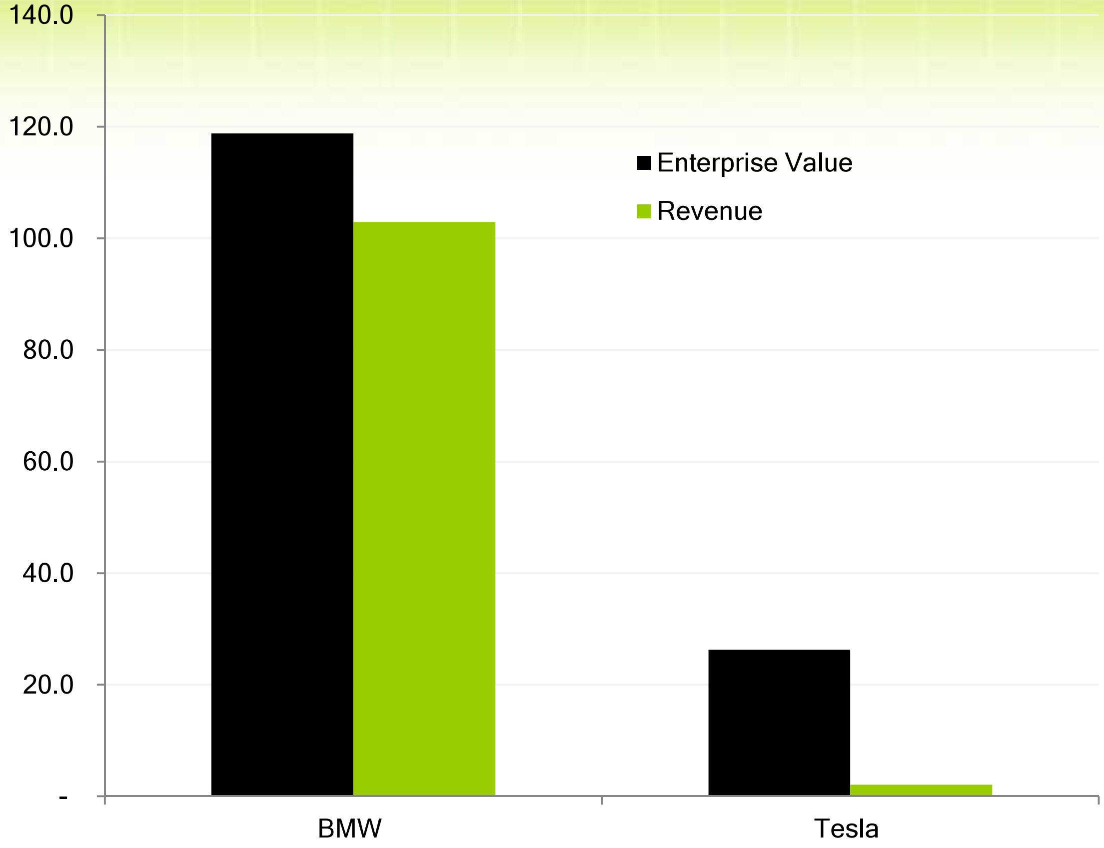
cannon asset managers
DELIVERING VALUE

South Africa: Sentiment In The Wrong Place



Keith McLachlan, smallcaps.co.za, 2013

Investment Versus Speculation



BMW	Tesla
1.964mn vehicles (2014 i3 sales >10k)	22,477 vehicles
$19.1bn EBITDA	EBITDA $32.0mn
Net income $7.3bn	Loss $105.5mn
EV/EBITDA 11x	EV/EBITDA 775x
P/Earnings 11.0x	P/Earnings Not meaningful
P/Book 1.6x	P/Book 7.4x

Bloomberg (2014); analysis by Cannon Asset Managers (2014)

Has The Cycle Turned?

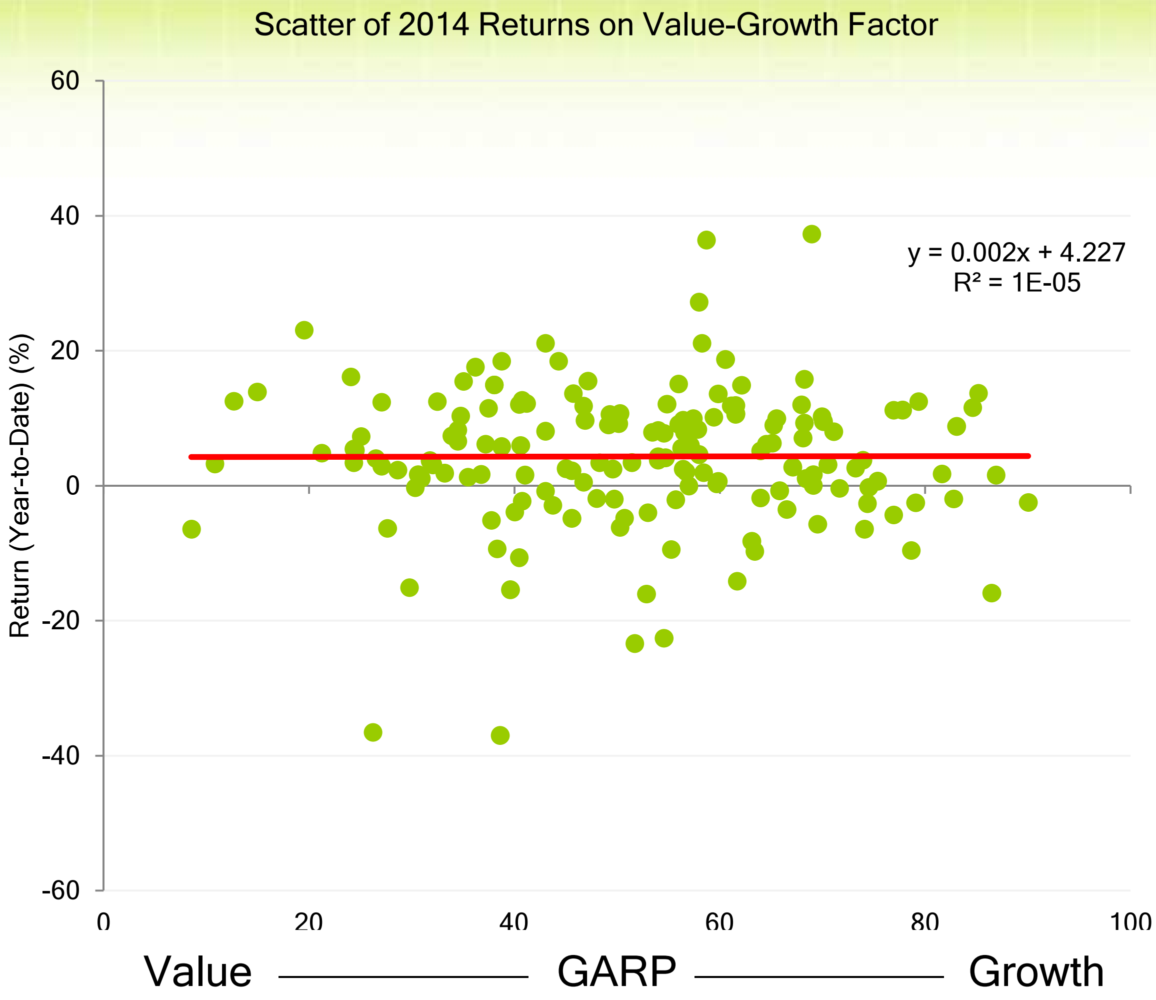
cannon asset managers
DELIVERING VALUE

2014 Style & Size Performance

Performance by Style & Size	Large Growth	Large GARP	Large Value
Median Stock (%)	5.70	8.84	8.02
	Mid Growth	Mid GARP	Mid Value
Median Stock (%)	5.71	1.12	9.43
	Small Growth	Small GARP	Small Value
Median Stock (%)	7.54	14.39	4.51

Performance by Style	Growth
Average Stock (%)	10.27
	GARP
Average Stock (%)	9.87
	Value
Average Stock (%)	9.87

Bloomberg (2014); Cannon Asset Managers (Q3 2014)

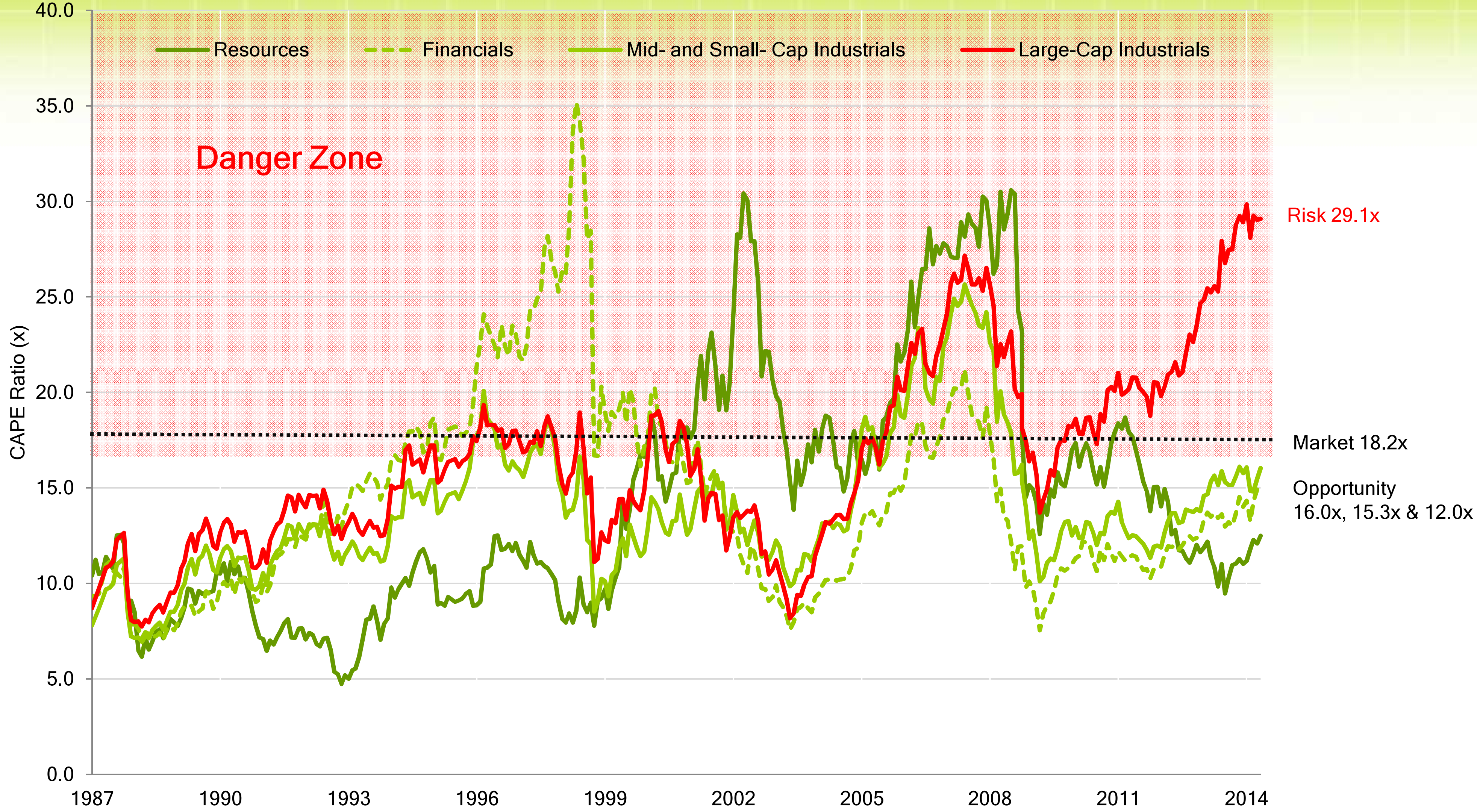


Bloomberg (2014); Cannon Asset Managers (2014)

Current Market Valuations

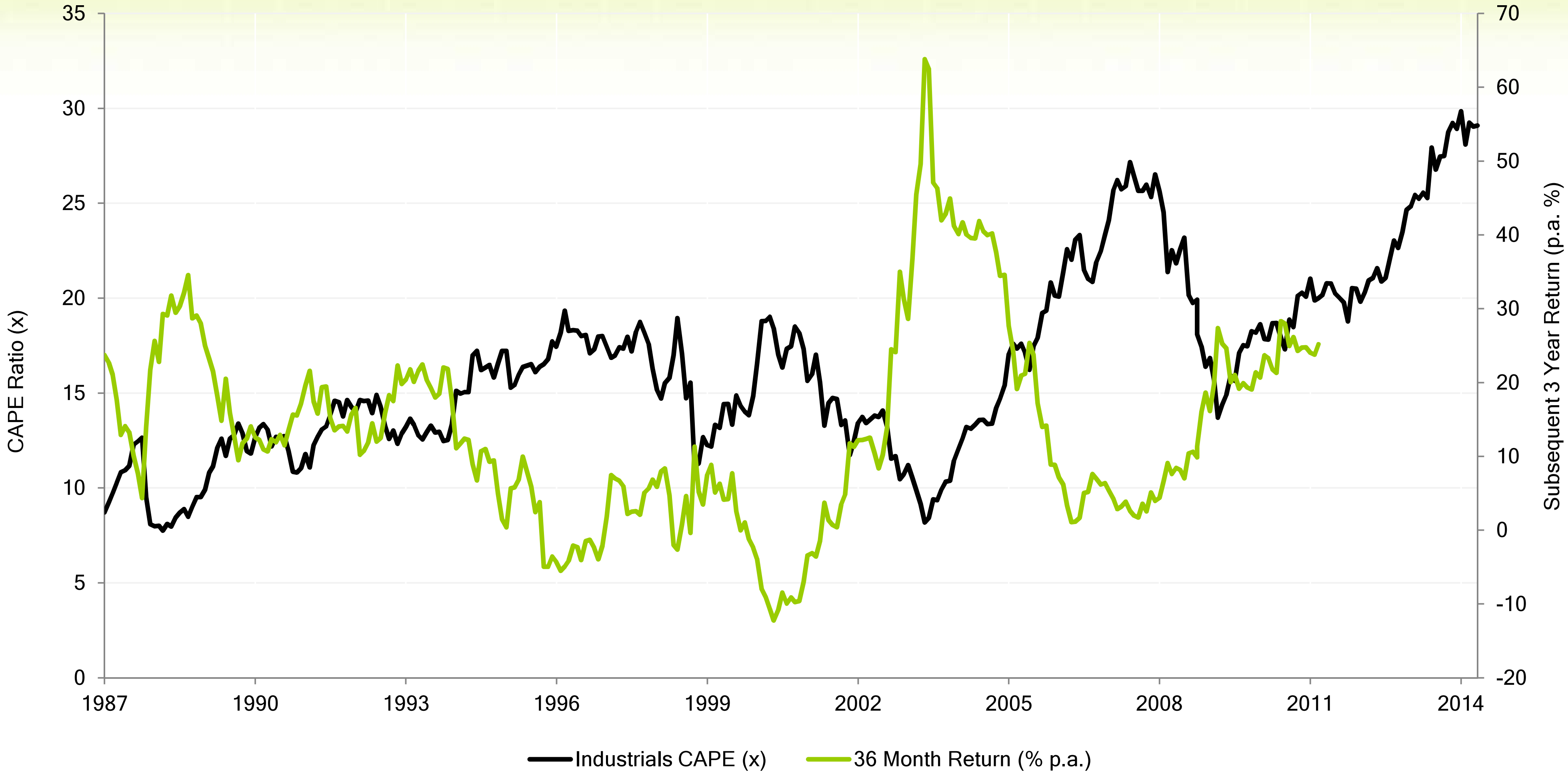
cannon asset managers
DELIVERING VALUE

Be Careful Of What You Own



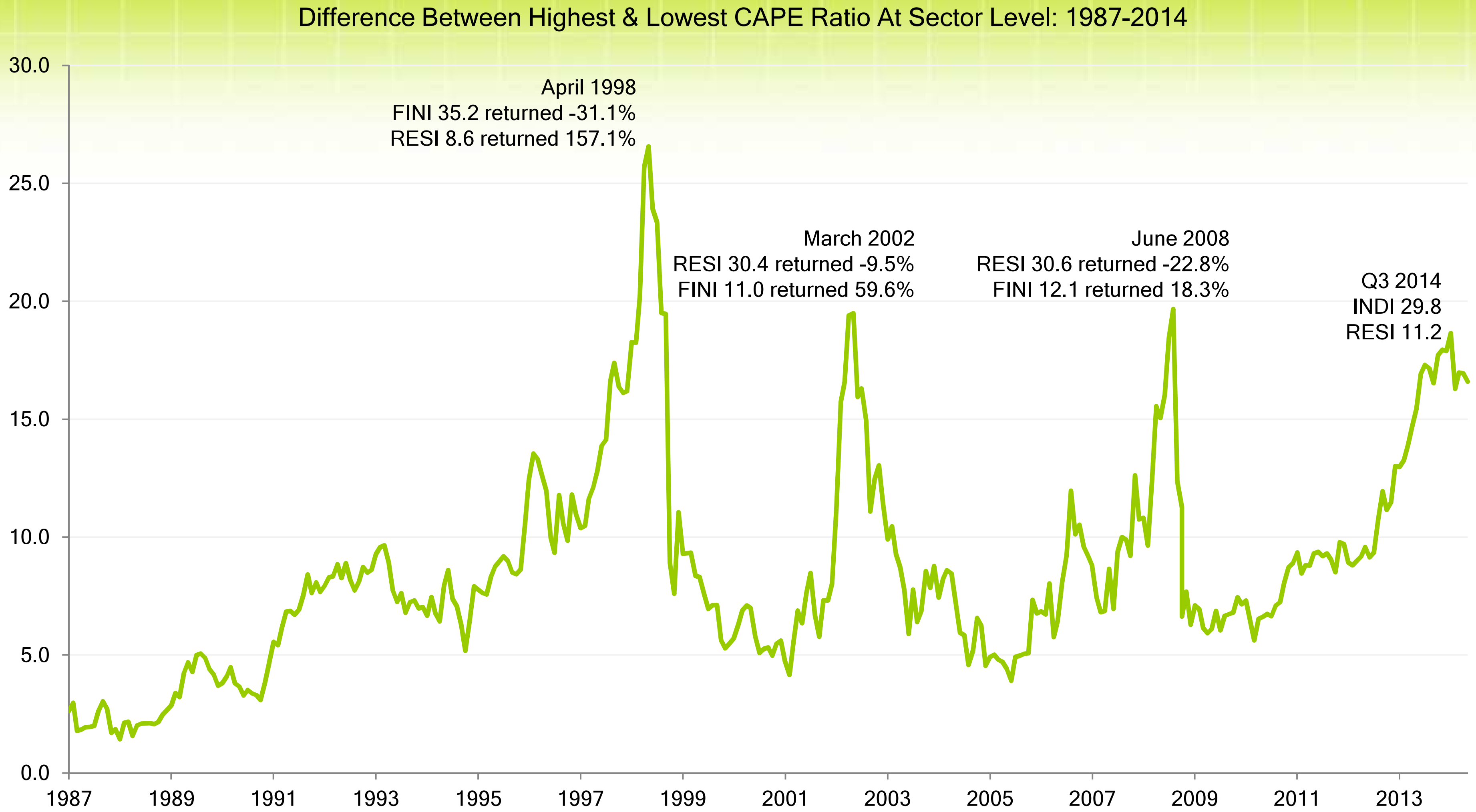
Analysis Cannon Asset Managers (2014)

Large-Cap Industrial CAPEs & Subsequent Three-Year Returns



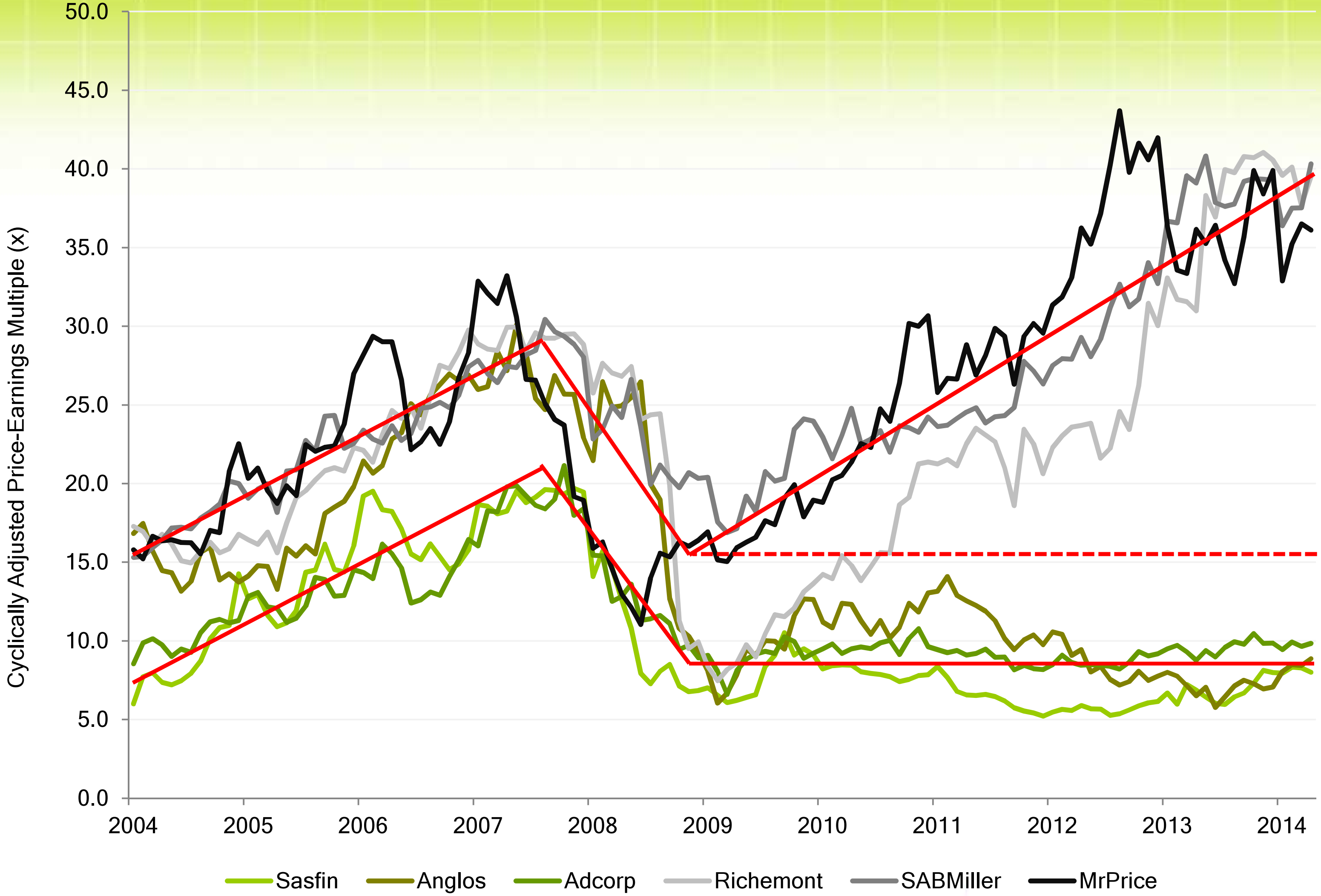
Analysis Cannon Asset Managers (2014)

Bi-Polarity Comes In Fours



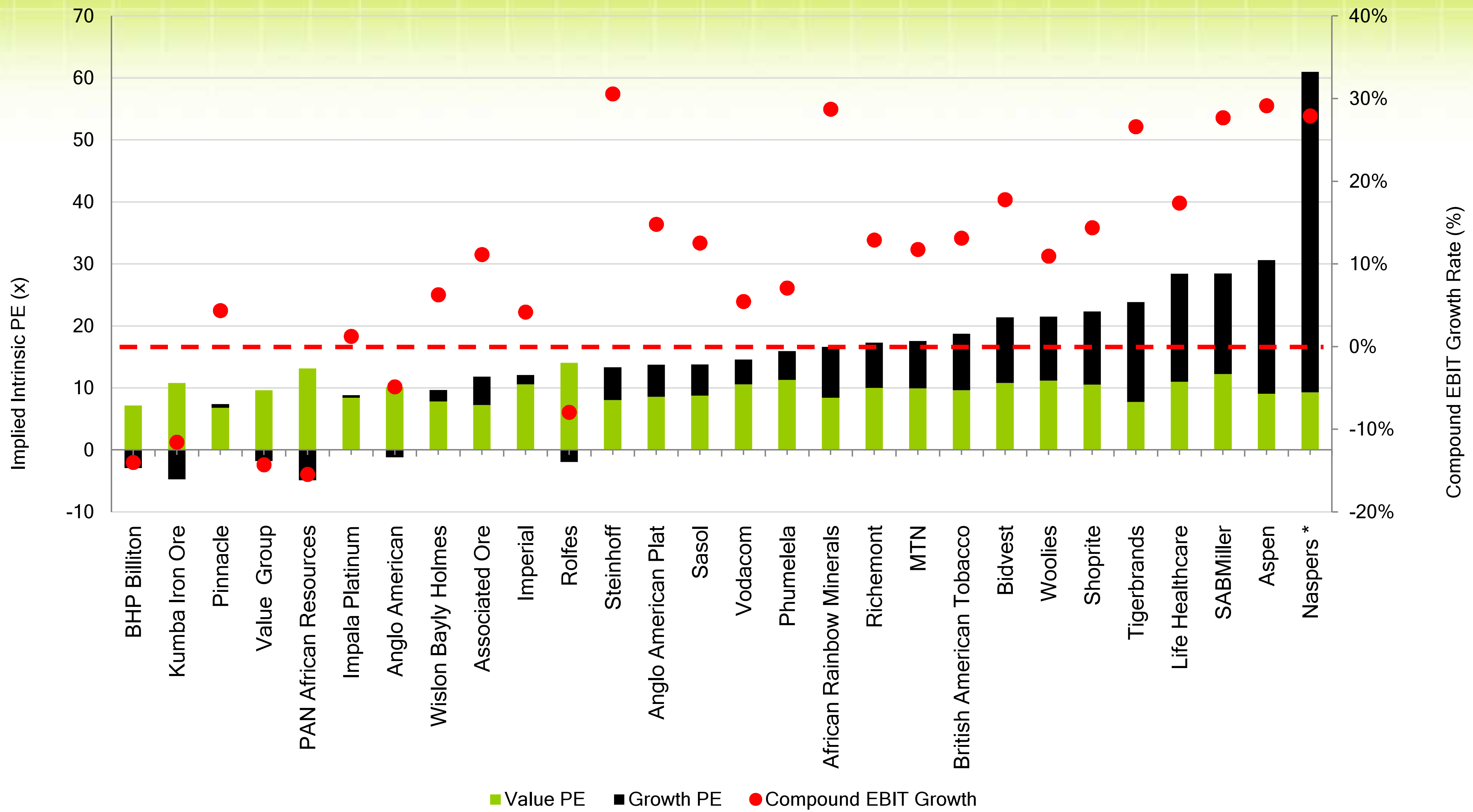
Bloomberg (2014); Cannon Asset Managers (2014)

Yes … This Time Is Different



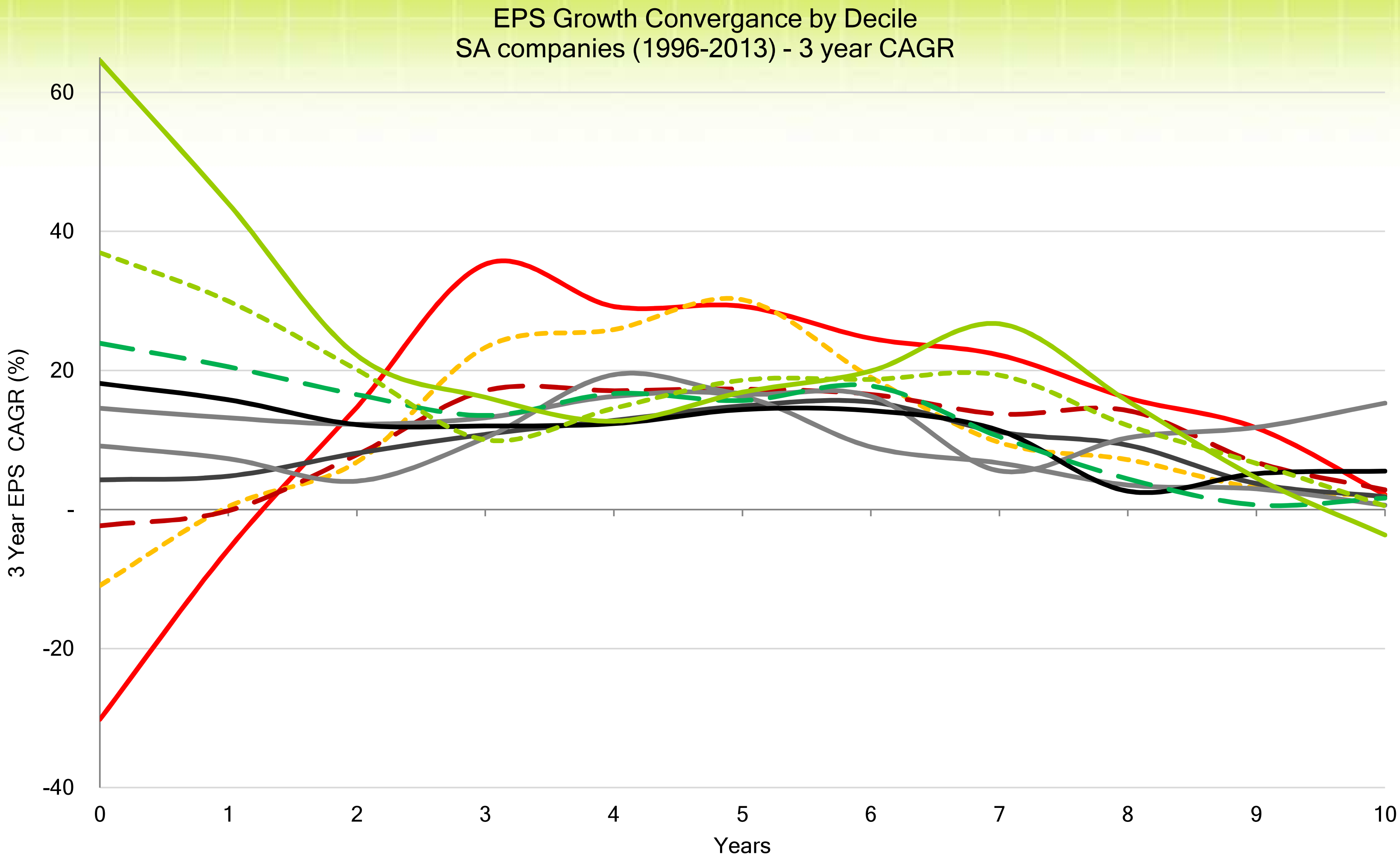
Bloomberg (2014); Cannon Asset Managers (2014)

Are Inferred Earnings Attainable?



Bloomberg (2014); Cannon Asset Managers (2014)

Over Time All Earnings Mean Revert

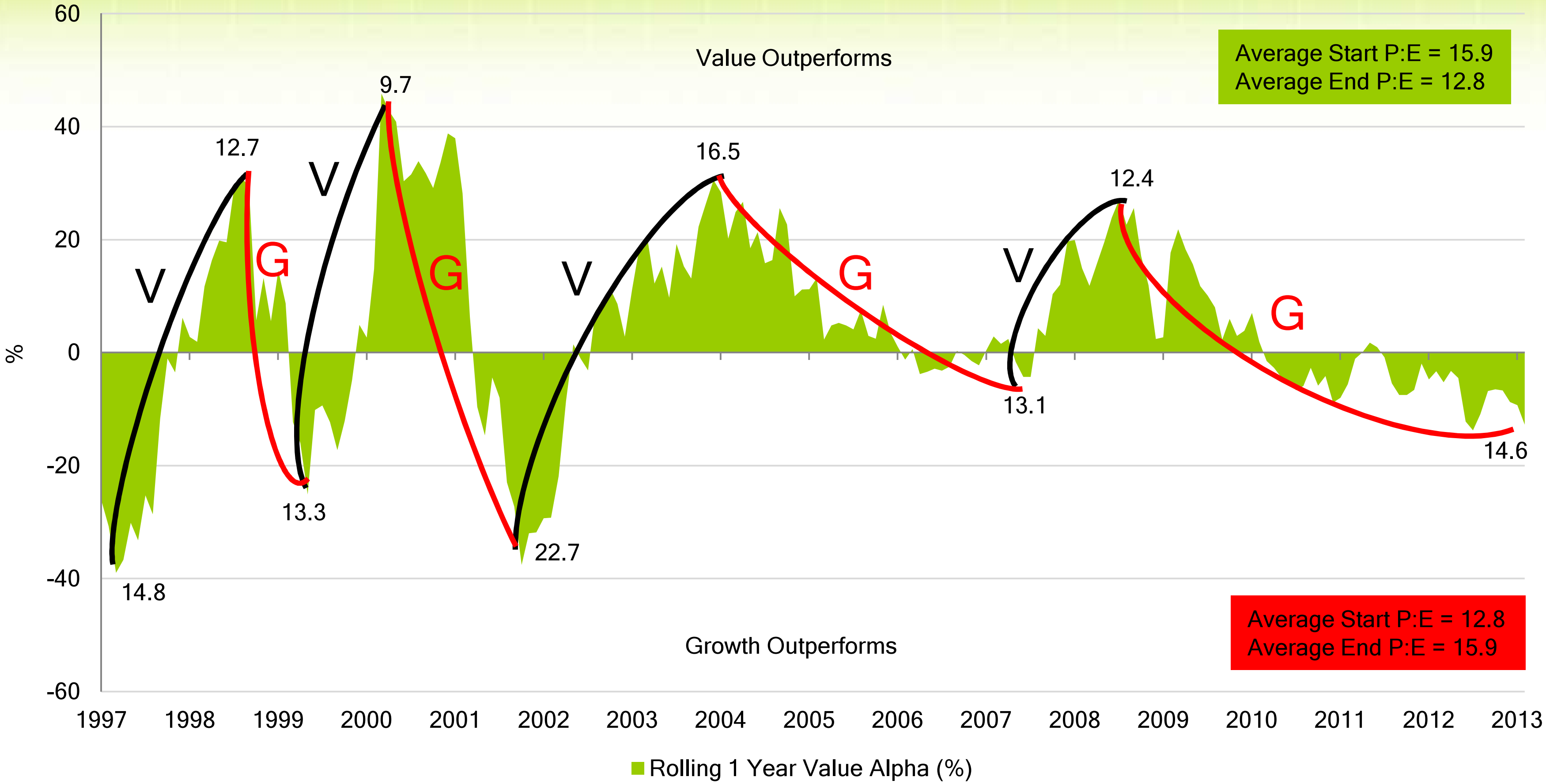


Bloomberg (2014); Cannon Asset Managers (2014)

Where To From Here?

cannon asset managers
DELIVERING VALUE

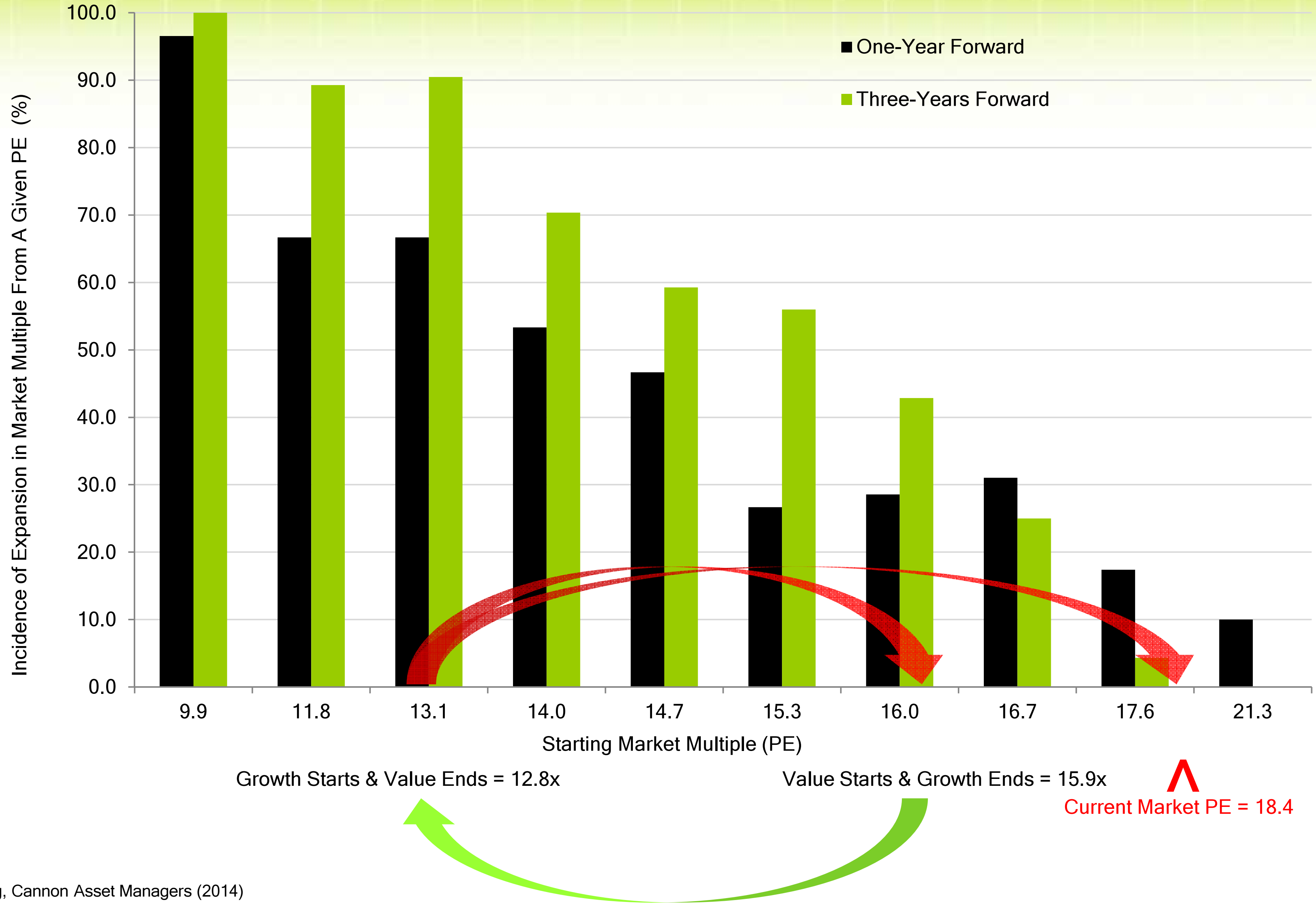
The Pendulum Of Style



A change in multiple has a powerful explanatory factor for value and growth cycles

Cannon Asset Managers, MSCI South Africa Value and Growth Indices (2014)

Where Does The Pendulum Swing From Here



Bloomberg, Cannon Asset Managers (2014)

Where Does The Pendulum Swing From Here

Bloomberg, Cannon Asset Managers (2014)

Thank You

@CannonAssets

andrew@cannonassets.co.za

cannon asset managers

DELIVERING VALUE

Disclaimer

This presentation has been approved by a member of Cannon Asset Managers (Pty) Ltd ("Cannon Asset Managers ") and should not be considered as an offer or solicitation of an offer to sell, buy or subscribe to any investment products, securities or any derivative instrument or any other rights pertaining thereto (“financial instruments"). This presentation is intended for use by professional and business investors only. This presentation may not be reproduced without the consent of Cannon Asset Managers.

The information and opinions expressed in this presentation have been compiled from sources believed to be reliable, but, neither Cannon Asset Managers, nor any of its directors, officers or employees accepts liability from any loss arising from the use hereof or makes any representations as to its accuracy and completeness. Any opinions, forecasts or estimates herein constitute a judgment as at the date of this presentation. There can be no assurance that future results or events will be consistent with any such opinions, forecasts or estimates. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied is made regarding future performance. This information is subject to change without notice, its accuracy is not guaranteed, it may be incomplete or condensed and it may not contain all material information concerning the company and its subsidiaries. Cannon Asset Managers is not agreeing to nor is it required to update the opinions, forecasts or estimates contained herein.

The value of any securities or financial instruments mentioned in this presentation can fall as well as rise. Foreign currency denominated securities and financial instruments are subject to fluctuations in exchange rates that may have a positive or adverse effect on the value, price or income of such securities or financial instruments. Certain transactions, including those involving futures, options and other derivative instruments, can give rise to substantial risk and are not suitable for all investors. This presentation does not have regard to the specific instrument objectives, financial situation and the particular needs of any specific person who may receive this presentation. Investors should seek financial advice regarding the appropriateness of investing in any securities, financial instrument or investment strategies discussed in this presentation.

Cannon Asset Managers (or its directors, officers or employees) may, to the extent permitted by law, own or have a position in the securities or financial instruments (including derivative instruments or any other rights pertaining thereto) of any company or related company referred to herein, and may add to or dispose of any such position or may make a market or act as a principal in any transaction in such securities or financial instruments. Directors of Cannon Asset Managers may also be directors of any of the companies mentioned in this presentation. Cannon Asset Managers may from time to time provide or solicit investment banking, underwriting or other financial services to, for or from any company referred to herein. Cannon Asset Managers (or its directors, officers or employees) may, to the extent permitted by law, act upon or use the information or opinions presented herein, or research or analysis on which they are based prior to the material being published. Cannon Asset Managers may have issued other presentations that are inconsistent with, and reach different conclusions from, the information presented in this presentation. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them.

Cannon Asset Managers is an authorised financial services provider by the South African authority, the Financial Services Board under licence number FSP736. This publication is confidential for the information of the addressee only and may not be reproduced in whole or in part, copies circulated, or disclosed to another party, without the prior written consent of Cannon Asset Managers. Cannon Asset Managers does not allow the redistribution of this presentation to non-professional investors and cannot be held responsible in any way for third parties who effect such redistribution.

Cannon Asset Managers (Pty) Ltd Registration Number 2000/025176/07 is an authorised financial services provider under licence number FSP736.
Cannon Asset Managers (Pty) Ltd, PO Box 70997, Bryanston, 2021, South Africa, +27-11-463-3140.

cannon asset managers

DELIVERING VALUE