QUARTERLY INVESTOR COMMENTARY
31 DECEMBER 2016

CONTRARIUS GLOBAL EQUITY FUND

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The Fund aims to earn a higher Total Rate of Return than the average of the world's equity markets, as represented by the MSCI World Index, including the reinvestment of dividends net of withholding tax ("World Index"). It aims to achieve this without greater risk of loss, over the long-term. The Fund is an actively managed fund, and as such does not in any way seek to replicate its benchmark index, but may instead differ materially from the performance benchmark in order to achieve its objective.

CONTRARIUS GLOBAL EQUITY FUND AT 31 DECEMBER 2016

Total Rate of Return in US Dollars	Class	Since Inception on 1 Jan 2009	Latest 5 Years	Latest 3 Years	Latest 1 Year	Latest Quarter
			% Annualised		*% Not Annualised*	
Contrarius Global Equity	**Investor**	**19.7**	**15.0**	**5.7**	**48.3**	**1.2**
Contrarius Global Equity	**Institutional**	**20.2**	**15.4**	**6.1**	**48.6**	**1.3**
World Index		10.7	10.4	3.8	7.5	1.9

Past performance is not a reliable indicator of future results.

The Fund's Investor Class shares returned 1.2% for the quarter versus 1.9% for the benchmark MSCI World Index, including reinvested net income. For the year the Fund's Investor Class shares returned 48.3% versus 7.5% for its benchmark index. As we have highlighted previously, our investment philosophy is not benchmark cognisant and our portfolios would normally vary materially from the benchmark World Index. The Fund's returns are therefore likely to deviate from those of the benchmark. Investors are reminded that given the long-term, contrarian, valuation-based investment philosophy, there will be times when the Fund will materially underperform its benchmark in the short-term in order to achieve its objective of long-term outperformance.

The Fund remains overweight Energy, Materials, Consumer Discretionary and Technology stocks. In terms of geographic exposure, the Fund continues to be significantly overweight shares outside the major developed markets.

Sector Exposure 31 December 2016	Weighting (%) Fund	World Index[1]	Over/(Under) Weight
Energy	31	7	23
Materials	26	5	21
Industrials	0	11	(11)
Consumer Discretionary	18	12	5
Consumer Staples	0	10	(9)
Health Care	1	12	(11)
Financials	4	18	(14)
Real Estate	0	3	(3)
Information Technology	20	15	5
Telecommunication Services	0	3	(3)
Utilities	0	3	(3)
Total Shares	**99**	**100**	
Net Current Assets	1	-	
Net Assets	**100**	**100**	

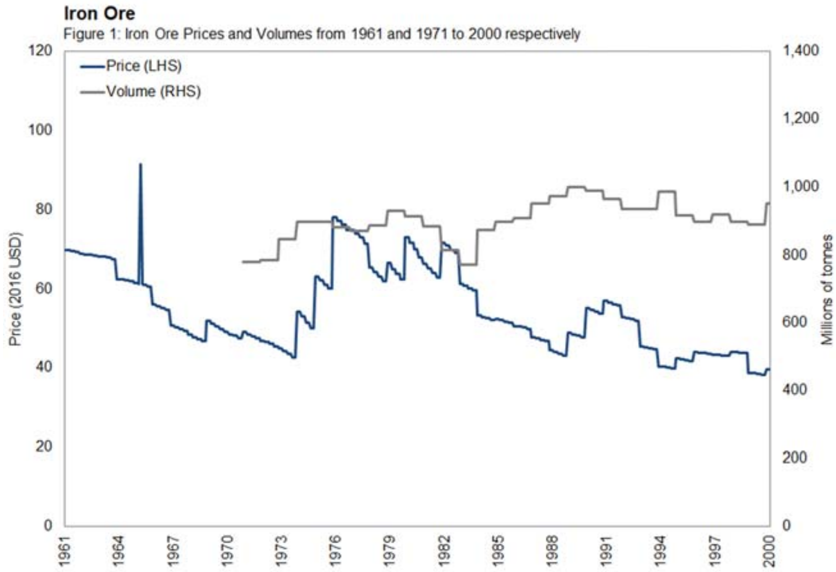
[1] *Source: MSCI (attention is drawn to MSCI disclaimer in 'Notices')*

Geographic Exposure 31 December 2016	Weighting (%) Fund	World Index[1]	Over/(Under) Weight
North America	57	64	(6)
Europe	15	23	(8)
Japan	2	9	(7)
Asia ex-Japan	6	2	4
Other	20	3	17
Total Shares	**99**	**100**	
Net Current Assets	1	-	
Net Assets	**100**	**100**	

[1] *Source: MSCI (attention is drawn to MSCI disclaimer in 'Notices')*

Iron Ore

Industrial metals are not normally the sorts of things that set spines tingling. In 2000, iron ore contract prices were about $40 per ton (in 2016 dollars), having edged down 1.4% per annum for 39 years, which is our earliest price data (Figure 1). This did little to incentivise investment and, from 1971 (our earliest volume data) until 2000, global iron ore production grew a total of 22% (0.8% per annum). There was no open market and contracts were negotiated privately. This does not make for entertaining dinner party conversation.

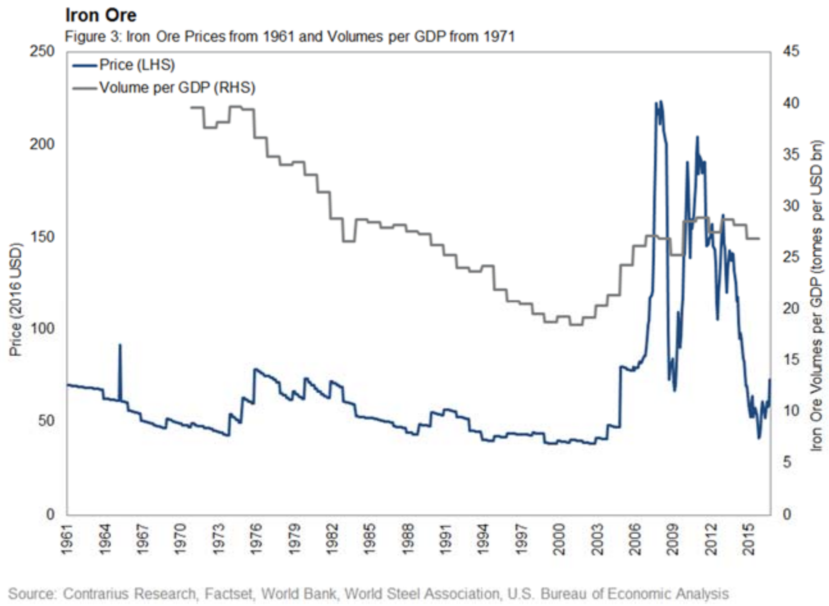


Source: Contrarius Research, World Bank, World Steel Association, U.S. Bureau of Economic Analysis

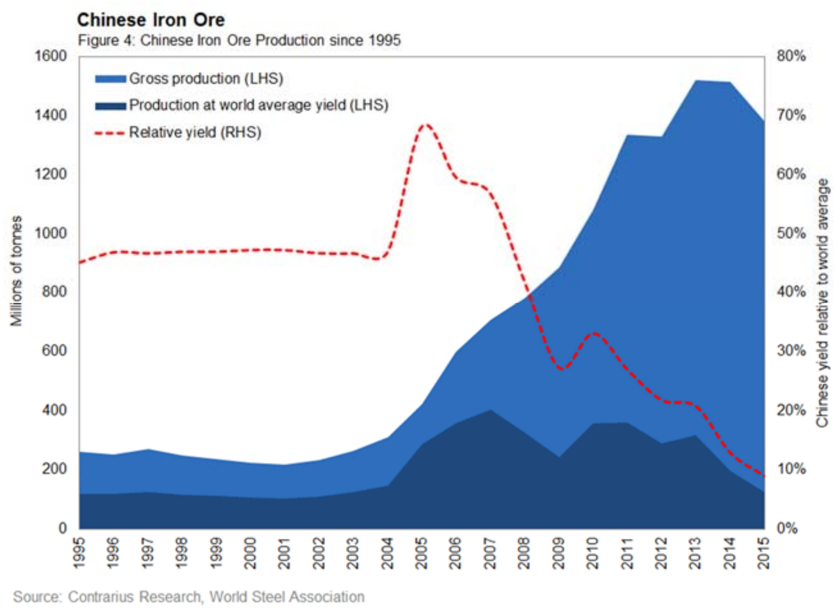
The next 16 years were rather more colourful (Figure 2). The price ended the period 99% up, but on the way surged more than 400%, and then collapsed 80%. The main reason was both iron ore demand and supply from China. Chinese production of crude steel (the end product of iron ore) went from 127 million tonnes (Mt) in 2000 to 803 Mt in 2015—almost what the whole world produced in 2000 (848 Mt). New iron ore supply was urgently needed, and the major producers could not develop projects quickly enough. The gap was filled by low-quality mines, largely those in China, whose output went from 105 Mt to a peak of 402 Mt in 2007, but subsequently fell back to 124 Mt. The only countries with any material increase from 2000 to 2015 were Australia and Brazil, which together added 849 Mt, while the rest of the world added 198 Mt. This only just kept up with demand: steel produced from ore (i.e. excluding scrap) increased 609 Mt, which needs about 933 Mt more ore (on average, 1.5 tonnes of ore produces 1.0 tonne of steel). Fortescue Metals Group went from not existing to delivering 165 Mt, making it one of the four biggest and cheapest suppliers.

Source: Contrarius Research, Factset, World Bank, World Steel Association, U.S. Bureau of Economic Analysis

It is tempting to conclude that iron ore is coming off the top of the cycle and, after a period of overinvestment, the price will shortly collapse and take the share prices of the major miners with it. But joining the above two charts together, and comparing to world GDP, tells a different story (Figure 3). The current iron ore price of $78.87 is not too different to the 56-year average of $67. Production grew 157% over 44 years, lagging the global economy which grew 279%. If your perspective starts only in 2000, then you don't see the preceding 39-year investment-starved bear market.



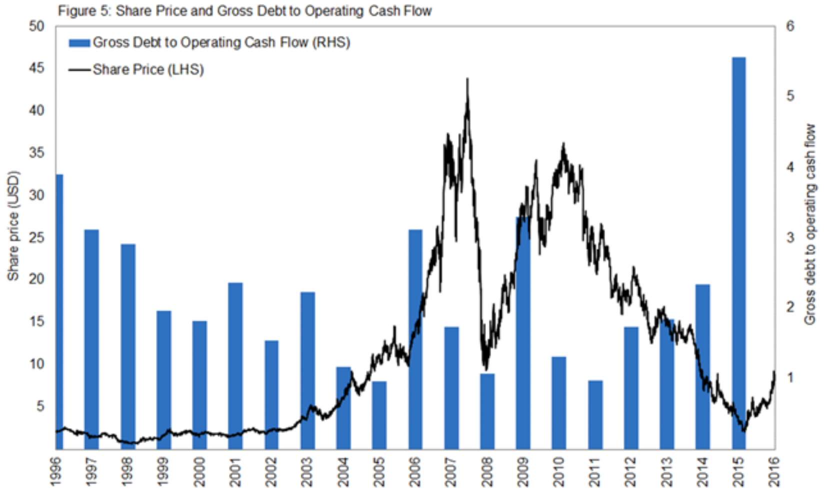
The difference between the four major suppliers – Rio Tinto, BHP Billiton, and Fortescue in Australia, and Vale in Brazil – and everyone else is striking. From being 13% of supply in 1971, Australia and Brazil grew to 40% in 2000, and 61% in 2015. Other countries simply do not have ore bodies that can compete and it seems likely that the expansion outside of these regions in the last 15 years is to a large extent a stopgap. Although elemental iron is abundant, it is only economically useful when in a large, rich, surface deposit. These are relatively easy to spot with magnetic and gravitational surveys so the probability of major new discoveries is diminishing. The last remaining large project, Vale's S11D, is due to start shipping in early 2017, after which there are no planned major developments. There are some large undeveloped deposits, such as Simandou in Guinea, but from the time management decides to go ahead it takes a number of years for a new project to start delivering. Since the iron ore price started falling, projects have been postponed or cancelled. From Figure 4 it appears that, in order to secure raw material, China pumped investment into domestic mines with little concern for cost. With Chinese yields relative to the world average continuing to collapse, even the remaining 124 Mt looks unsustainable. Once S11D has ramped up, the four big suppliers are expected to account for more than half of global production.



Vale

In addition to its holding in Fortescue (discussed in Q1 2016) the Fund now also has a meaningful position in Vale, the biggest and lowest cost of the big four iron ore miners. A year ago investor sentiment was terrible. Net debt had ballooned from $6 billion in 2008 to $25 billion. Free cash flow had done the opposite: fallen from $8 billion to an outflow of $4 billion. In November 2015 a tailings dam at the Samarco mine (jointly owned with BHP Billiton) in Brazil burst, leaving an unknown liability in its wake. With increasing financial risk (Figure 5) and worsening sentiment towards Brazil, it is no wonder investors were wary.

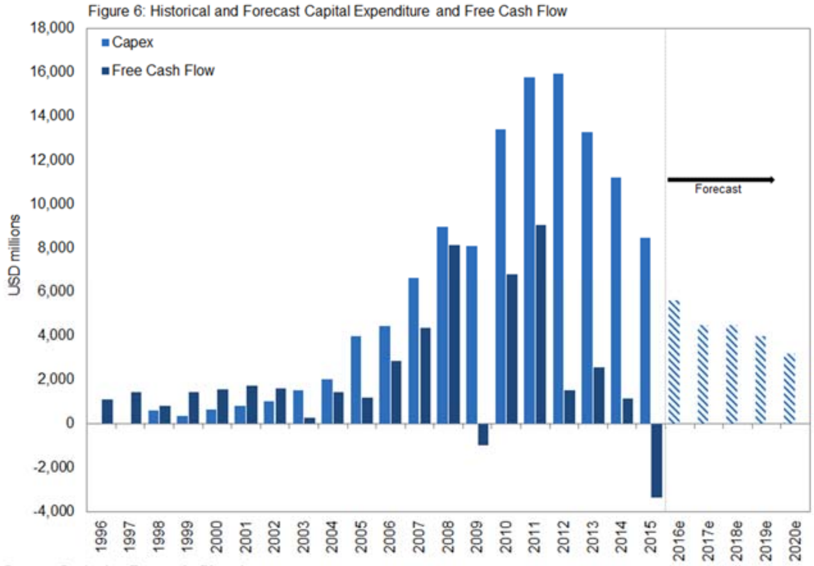
Vale
Figure 5: Share Price and Gross Debt to Operating Cash Flow



Source: Contrarius Research, Bloomberg

There's more clarity today. To manage the debt Vale has been divesting non-core assets since 2011, so far raising $15 billion. The enormous investment in S11D (the highest quality large ore body in the world) is substantially complete, and capital expenditure should halve from its peak (in Brazilian real) in 2012. Since its 2011 peak, the real has weakened 52% against the US dollar, so in US dollars (in which it gets paid) capital expenditure has fallen even more dramatically (Figure 6). At current iron ore prices, Vale would generate approximately $8.9 billion of free cash flow ($13.4 billion with the addition of S11D). Vale has agreed a settlement with the government relating to the Samarco accident. The financial risk is much reduced.

Vale
Figure 6: Historical and Forecast Capital Expenditure and Free Cash Flow



Source: Contrarius Research, Bloomberg

It is of course possible for Vale to generate negative free cash flow in certain market conditions, for example if the iron ore price fell around 60% while energy and shipping prices stayed flat or increased. In those conditions the industry as a whole would be in a dire state, and Vale would have the cost advantage. China's growth rate may have slowed but it is a long way from being considered "mature". India, whose population is expected to overtake China's within a few years, is behind on the industrialisation curve. Relative to the Australian producers, Vale is at a geographic disadvantage because of the transport distance to Asia (although right now the difference is not very significant because of low shipping rates) but it makes up much of the difference with lower costs and is in a strong position to benefit from any increase in US infrastructure spending. Furthermore, in addition to iron ore it is also the leading producer of nickel, and is a profitable producer of other base metals.

Many investors intuitively feel that miners are low-quality, high-risk, marginal businesses with poor management, and at the mercy of mercurial market forces. This may often be true, but not always. Consider Fortescue, for example. (Because it started from nothing quite recently, it offers the cleanest illustration.) It invested $17 billion building an operation that ships 165 Mt of iron ore annually. At current market prices we expect Fortescue to earn free cash flow of approximately $4.5 billion in a year, which could reduce its net debt to zero in less than a year (despite having the lowest-yielding ore of the big four). Google and Facebook may not find that return on investment terribly impressive, but the vast majority of companies would surely be envious. Naturally, there is risk: commodity prices can indeed be hard to predict.

But despite Fortescue and Vale already contributing to outperformance, they are on price to free cash flow multiples of 2.9x and 4.2x (2.8x including S11D), respectively. With both having new and substantial resources, we think that there is ample margin of safety. Vale's preferred shares (the vast majority of the Fund's position in the company) trade at a discount of about 10% to the ordinary shares, and so are even cheaper. And if times really did become tough, they have young valuable infrastructure that could be used to raise cash. Iron ore is a vital material, and is increasingly a four-player (and two-country) industry. For a long-term, bottom-up investor, it can indeed make riveting dinner party conversation.

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