corospondent

The Coronation Fund Managers Personal Investments Quarterly

January 2017, Summer Edition

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NOTES FROM MY INBOX

STAYING THE COURSE

By Pieter Koekemoer

Pieter is head of the personal investments business. His key responsibility is to ensure exceptional client service through a combination of appropriate product, relevant market information and good client outcomes.

The growth asset classes produced below-average returns in 2016. While this may make it more difficult to stay the course, a long-term commitment to your chosen investment strategy remains the best way to optimise outcomes over meaningful periods.

UNPACKING RECENT MARKET PERFORMANCE

Humanity would not have been able to become the dominant species on earth without an innate sense of optimism. The belief that things can be better is the primary driver of progress, and justifies why the capitalist system has become the chief and most efficient form of economic organisation. After all, if investors did not have the hope of receiving an inflation-beating return when committing to a long-term investment, there would not be much point to the existence of financial markets. Most of the time, this optimistic expectation is matched by reality. The SA equity market rewarded investors with a positive real return (of, on average, inflation +7%) around 90% of the time over all possible five-year holding periods since 1930. (Incidentally, the historical success rate over this holding period largely explains why the minimum recommended investment term for long-term growth funds is five years.)

Part of the justification for the higher expected equity return is a reward for accepting the risk of uncertain outcomes, especially over the shorter term. Since 1930, local equities failed to beat inflation over one-year holding periods for one out of every three years. Unfortunately, 2016 was one of these years, with a 2.6% return from the FTSE/JSE All Share Index, compared to CPI of 6.4%. More unusually, it was also only the second time in the last two decades that the local share market failed to beat local inflation for two consecutive calendar years.

A key contributor to the weak equity performance in 2016 was rand strength, as more than 50% of the JSE's earnings have rand-hedge qualities. This also impacted returns in our flagship multi-asset funds, such as Balanced Plus, Capital Plus and Balanced Defensive. In addition to local equities, these funds all typically hold between 20% and 25% of their portfolios in offshore assets to diversify risk. After a lengthy period of devaluation (the rand lost nearly 60% of its value in the five years to the end of 2015), the rand gain against the US dollar in 2016 (+13%) exceeded the healthy dollar return of global equities (+8% for the MSCI All Country World Index).

The markets therefore delivered a short-term result that is challenging the optimistic expectations of investors in our multi-asset funds. It is understandable that this outcome may be disappointing, especially for newer investors who made their initial investment during the past two or three years. While as investors we do not have any direct ability to influence the outcome of uncertain market-defining events, we do have the ability to define our response to a period of below-average outcomes. Pessimism may triumph, resulting in capitulation and wholesale changes to our portfolios. Alternatively, we can defer our optimism to a more meaningful holding period, because we understand that linear extrapolation of recent experience is rarely sensible in a cyclical system influenced by actors who often become more depressed or more euphoric than justified by reality. Staying the course has historically been the right choice, with strong performance recoveries after disappointing periods for local equities in 1997 to 1998, 2000, 2002, 2007 to 2008 and 2011. As should be clear: we continue to believe that equities will deliver positive real long-term returns, and remain committed to our disciplined, valuation-based investment approach, building the best portfolios we can on your behalf. We continue to find attractive opportunities that should add value over time, as you can read elsewhere in this *Corospondent.*

Another reason to be circumspect about reading too much into short-term performance numbers is that base effects can play a big and misleading role. The end of 2015 and early 2016 was an abnormal period, as market participants digested the implications of Nenegate (or '9/12') and the subsequent reappointment of Pravin Gordhan as finance minister. Sell-offs and recoveries in different asset classes happened either side of the arbitrary calendar year cut-off point. A pertinent example is the difference in behaviour

between government bonds and listed property in January 2016. While bonds recovered strongly (+4.6%) after a very weak December, property declined (-4.5%) after a relatively better December. This timing difference explains why bonds outperformed SA property by 5% in 2016. If you roll the evaluation window forward by only five trading days, the outcome is materially different, with property beating bonds by more than 1% over the 12 months to 10 January 2016. These base effects can materially amplify or depress performance over specific snapshots of time, making short evaluation periods a poor basis for decision-making in long-horizon investment portfolios.

Also note that, despite the below-average returns from markets over the last two years, returns over periods of five years and longer still reflect the expected reward for risk (with annual real returns of between 4% and 7% for our flagship multi-asset funds).

Our flagship funds generally had a good year, relative to benchmarks and competitors.

Most Coronation funds performed better than – or at worst, in line with – their respective average competitor fund over 2016. Some of our long-held views produced strong returns over the year. For example, we benefited from a significant recovery in mining shares and saw emerging market equities perform better than developed market equities. This contributed to healthy active returns for our SA equity funds (such as Top 20) and for our directly managed global funds (including Global Managed, Global Capital Plus, Global Equity Select and Global Emerging Markets). While our multi-asset funds benefited from the same views, positions in UK assets were negatively affected by the Brexit fallout, and an underweight holding in local government bonds cost us some return relative to benchmark. This explains why our multi-asset funds are typically in line with, rather than ahead of, their average peers over the year. Our fixed income funds, including Strategic Income, continued to produce very competitive returns in 2016. All our flagship funds have highly compelling track records over the more meaningful holding periods of five years and longer. You can read more about practical pointers for 2017 on page 9 of this edition, or refer to the fact sheets and commentaries published on www.coronation.com for detailed performance information and outlooks for your fund or funds. ■

MARKET MOVEMENTS

	4th quarter 2016 %	2016 %
All Share Index R	(2.1)	2.6
All Share Index $	(1.9)	15.9
All Bond R	0.4	15.5
All Bond $	0.5	30.4
Cash R	1.9	7.4
Resources Index R	(1.2)	34.2
Financial Index R	2.9	5.4
Industrial Index R	(4.7)	(6.6)
MSCI World $	2.0	8.2
MSCI ACWI $	1.2	7.9
MSCI EM $	(4.2)	11.2
S&P 500 $	3.8	12.0
Nasdaq $	0.1	7.3
MSCI Pacific $	(1.0)	4.5
Dow Jones EURO Stoxx 50 $	3.2	0.7

THE NEW *TRUMPIAN* WORLD

By Gideon Rachman

Gideon is the chief foreign affairs commentator at the Financial Times *and a globally respected journalist. He joined the* Financial Times *in 2006 after a 15-year career at* The Economist, *which included positions as a foreign correspondent in Brussels, Washington and Bangkok.*

The presidency of Donald Trump has the potential to be a revolutionary moment in global politics. The new US president appears to reject some of the basic principles on which American foreign policy has been based since the end of the Second World War. Ever since 1945, all US presidents have shared a commitment to an international order built around two central pillars. The first pillar is the promotion of international trade. The second is a global security system based on a network of US-led alliances.

But during his campaign for the presidency, Trump threatened to pull down both pillars. The 45th president of the United States is an avowed trade protectionist. And he is also a man who has consistently questioned the value of US-led alliances – calling NATO 'obsolete' and suggesting that America's alliances with Japan and South Korea are bad deals for the US. The question is what will happen when Trump's big ideas collide with the real world? Here is an issue-by-issue guide to the main places and problems to watch out for in 2017:

RUSSIA

Trump is an open admirer of Vladimir Putin. The new US president's desire for a rapprochement with the Kremlin could lead him to lift sanctions on Russia and to accept the annexation of Crimea. But any such policies are likely to bring Trump into direct conflict, with the US intelligence community and with influential members of his own Republican party. The new president poured scorn on the CIA's assessment that Russian hacking had played a part in the American presidential election. But can he afford to have a poisonous relationship with such a powerful interest group in Washington? After all, Trump will need the CIA's assessments to guide him through some of the most dangerous issues he faces – including North Korea.

NORTH KOREA

The biggest looming security crisis facing Trump is probably North Korea. By the end of the Obama years, concerns were mounting in the White House that North Korea is getting dangerously close to being able to fit a nuclear warhead onto a ballistic missile that could hit the west coast of the United States. It is conventional wisdom in the US security establishment that a North Korea armed with ballistic nuclear missiles is an intolerable threat to the US. Trump's initial comments on the subject suggest that he believes that increased pressure from China could force the North Koreans to abandon their nuclear programme. But gaining Beijing's co-operation could be impossible – against a background of rows over trade and Taiwan. Faced with frustration over North Korea, Trump may be tempted to revisit some of the military options that were discarded by President Obama as too dangerous.

TRADE

During the election campaign, Trump was visceral in his denunciations of China, proclaiming that, 'We have a $500 billion deficit with China ... We can't continue to allow China to rape our country ... It's the greatest theft in the history of the world'. Those who hoped that Trump would abandon protectionism, after winning office, were quickly disappointed. On the contrary, the new president placed protectionists in key positions in his administration. Peter Navarro, author of a book and film called *Death by China,* was appointed to head a new National Trade Council, based in the White House. Navarro's intellectual ally, Wilbur Ross, is Commerce Secretary.

Navarro's film begins by urging viewers – 'Don't buy made in China'. It points out the considerable loss in US manufacturing jobs, since China joined the World Trade Organisation in 2001, and blames this on a range of 'unfair' Chinese trading practices – including lax environmental standards, currency manipulation, intellectual property theft and illegal export subsidies. Some of the ills that Navarro highlights – such as commercial espionage – are real enough. Other complaints, such as the charge of currency manipulation, are outdated.

If Trump follows through on his threat to impose swinging tariffs on Chinese goods, he would certainly provoke

retaliation. A trade war would ensue, poisoning commercial relations between the first and second largest economies in the world – and damaging the entire global economy.

CHINA

The threat of a real war between the US and China has also risen, following Trump's election. The deliberate but careful attempts of the Obama administration to push back against Chinese ambitions in the Asia-Pacific region are likely to be replaced by a new Trump approach that is much more openly confrontational, and more impulsive in style. Even before taking office, the new US president demonstrated his willingness to antagonise Beijing – by taking a phone-call from the president of Taiwan, something that all US presidents have refused to do, since the normalisation of relations between the US and China in the 1970s. Mr Trump has also endorsed a significant expansion in the US Navy, which could signal a more aggressive American rejection of Beijing's ambitions in the South China Sea. If there is a broader strategic thrust to Mr Trump's thinking, it could be to split apart the informal alliance between Russia and China – and instead form a Washington-Moscow axis, designed at containing Chinese influence.

EUROPE

There are crucial elections in France, the Netherlands and Germany this year. There is now fear in the French and German governments, that Mr Trump may seek to help the European far-right – by supporting Marine Le Pen in the French presidential elections in May, the Party for Freedom in the Dutch elections in March and the Alternative für Deutschland party in the German elections in September. In that case, both the Kremlin and the White House would be working towards the defeat of the German chancellor. Such a scenario would once have been unthinkable. But it is possible in the new *Trumpian* world.

BREXIT

One huge disruptive factor for the global economy and for the Western alliance is Britain's determination to leave the EU. The formal negotiation process is likely to begin in early 2017. It is unlikely to go well because the gap between the expectations of the British and EU sides is enormous. The British want to restore control over immigration from Europe and restore the supremacy of UK law – while maintaining complete free trade with Europe. The EU will refuse to do this.

Unfortunately for the UK, the negotiating process hugely favours the EU because if no new agreement is reached, the UK will simply fall out of the EU after two years – with potentially chaotic consequences for trade and migration. Faced with this nightmarish situation, the British may look to the Trump administration for assistance – either in the form of pressure on the EU, or through the offer of an alternative free-trade deal with the US. That, however, would be very hard to deliver quickly.

IRAN

Republicans in Congress share Trump's disdain for President Obama's nuclear deal with Iran. Some of the new president's key appointees – including General Michael Flynn, his National Security Advisor – are particularly noted for their hostility towards Iran. But, in the long term, ripping up the nuclear deal could put the US on the road to a war with Iran. Will Mr Trump be prepared to take that risk?

TURKEY

Some investment bankers have talked of a fragile five countries, made up of South Africa, Brazil, Indonesia, India and Turkey. These five are said to be defined by their reliance on foreign capital. But, of the five, by far the most fragile looks to be Turkey – for reasons that are essentially to do with geopolitics.

The backwash of the Syrian war is now seriously destabilising Turkey. The country now hosts more than 3m refugees and has been hit repeatedly by terrorist attacks. It is also bitterly politically divided as President Erdogan seeks to consolidate his power – and purges both the press and the civil service. The year has started with the Turkish currency plunging. And given Turkey's significance – on issues ranging from refugees to the NATO alliance – turmoil there will inevitably affect Europe and the wider West. It cannot simply be ignored.

THE MIDDLE EAST AND TERRORISM

Trump has consistently advocated a much more ferocious approach to the war on 'radical Islamic terrorism'. But his advisers disagree about what that might mean. Some want the US military to go plunging back into the Middle East. Others argue that such a policy would push America back into the quagmire of war – while provoking new terror attacks. They will advocate a more isolationist approach that focuses on homeland security.

STYLE

Will Trump become a more conventional politician, as he settles into the Oval Office? The early signs suggest not. Foreign leaders may have to get used to the idea that changes in US foreign policy can emerge from a 3AM Tweet from the White House. Trump supporters relish the new president's confrontational style and his willingness to question the conventional wisdom – which they see as a refreshing contrast to the professorial style of Obama. Trump's critics fear that the new president will blunder into crises and will make the world a much more dangerous place. In 2017, we will learn which theory is closer to the truth. ■

SA POLITICS IN 2017

A DIFFERENT KIND OF DRAMA

By Simon Freemantle

Simon is the senior political economist and head of the African political economy unit at Standard Bank. He is a regular presenter on political and economic issues relating to SA and Africa on a variety of local and international platforms.

From an SA political perspective, 2016 was a bruising year. The year's extraordinary volatility was largely determined by the seismic changes brought about by a dominant ruling party losing its once casual hegemony on the popular vote; a president scrambling for reascendancy after an epochal political miscalculation, and in doing so fanning wider internal discord in the party he leads; and a body politic, best represented by a restive student population, growing increasingly frustrated by the stubbornly torpid pace of economic growth and transformation.

Various themes can be hauled from the debris of last year's political cycle, all of which will – in some form – carry through into the new year, and will shape the country's longer-term political and economic direction.

The first is undeniably the manner in which president Jacob Zuma's political authority has been so profoundly – and quite likely irreversibly – eroded. The turning point in this regard was undoubtedly the president's dismissal of former finance minister Nhlanhla Nene on '9/12' 2015, a moment that proved to be catalytic in mobilising those within the mechanics of the ANC and state, and from business and civil society, who had grown increasingly uneasy with the president's stewardship of the economy. Still buffeted by the manner in which he was forced to re-appoint Pravin Gordhan as finance minister, the president then faced a damning Constitutional Court judgement against him, compelling him, as the opposition EFF had demanded, to 'pay back the money' unduly spent by the state on his personal Nkandla home. He also encountered rising allegations of state capture against him and the Gupta family, articulated in a public protector investigation later in the year, as well as elevated internal criticism following the ANC's poor performance in the August municipal elections. In the final ANC National Executive Committee (NEC) meeting for the year, several senior party leaders rose to initiate a discussion on the removal of Zuma from the state presidency – a motion he survived largely as a result of crippling internal discord in the party and the related inability to find the consensus it demands to move forward on such matters, rather than due to the once-formidable grip he held on the party's leadership cluster.

The scale of Zuma's loss of place is perhaps best emphasised by his inability to orchestrate a reshuffle of his cabinet in 2016 – particularly given how many of the ministers serving at his behest are now openly defiant of his directives.

2017 will be the final year of Zuma's functional political power. It will culminate in the ANC electing a new party president; surrounded by a reshaped 'top six' and an NEC which better represents the ANC's current dynamic. It is already instructive that the ANC's factional battles are now being openly fought over who will replace president Zuma this year, rather (as has been the case since 2007) than over support for and opposition to the president himself. As such, 2017 will be the year in which Zuma's centrality to the wider debate of the country's political and economic direction begins to weaken. Discussions will begin to focus more on what follows the president's damaging tenure, than on the tenure itself. Compounding the effects of this weakening for the president will be the legal challenges he will face in 2017 – none more important, perhaps, than his appeal against last year's High Court ruling that overturned the National Prosecuting Authority's (NPA) withdrawal of corruption charges against him in 2009.

In parliament, the ANC caucus, led by chief whip Jackson Mthembu, will likely seek to regain some of its lost ground by assuming a position in key matters which is more in line with public sentiment – such as in the inquiry into the errant former board at the SABC and the role of the broadcaster's indefatigable former chief operating officer Hlaudi Motsoeneng – and less subservient to the president's legislative whims, as with the resistance to the president's ordered review of the Financial Intelligence Centre Amendment Bill.

The ANC's succession battle will be an all-consuming political theme for the year. Early signs suggest that the primary battle will be between deputy president Cyril Ramaphosa and African Union Commission chairperson Nkosazana Dlamini-Zuma. Yet there are other party leaders whose aspirations cannot be underestimated – such as ANC chairperson Baleka Mbete, ANC treasurer Zweli Mkhize

and Free State premier Ace Magashule. If the 2007 and 2012 elective conferences are anything to go by, then rival factions will each put forward 'slates' of their preferred top six leaders, hoping to ensure that all their candidates are elected as a bloc and that challengers are completely sidelined. Given the toxicity of the ANC's current internal strife, such a winner-takes-all approach would likely threaten a further split in the party, one substantial enough to undermine the ANC's grip on the national majority in the 2019 elections. Given the spectre of this outcome, there is still the chance that a compromise slate could be formed – one led by Ramaphosa, deputised by Dr Dlamini-Zuma, and including some of the other top six candidates currently sparring for political elevation.

A further important theme that cut through last year was the persistent threat of a downgrade of the country's sovereign credit rating to junk status. Standard & Poor's in particular provided an important reprieve in June last year, but suggested that key reforms to substantially elevate economic growth, and a dulling in the intensity of political discord, particularly as it relates to the functioning of the National Treasury, were critical for retaining the country's investment-grade rating.

One of the positive features of 2016, which was somewhat lost in the general political clamour, was the relative stability in labour relations. Last year, three-year wage agreements were signed, without industrial action, for the three largest platinum producers and across the automotive sector, providing stability in these previously volatile areas of the economy out to 2019. 2017 will likely provide a continuation in this general stabilisation, with the major focus resting on negotiations in the metal, steel and engineering sectors, the agreement for which expires on 30 June. Elsewhere, the signing into law of the Mineral and Resource Petroleum Development Act and the agreement on the conditions of the reframed Mining Charter, particularly as it relates to the 'once empowered, always empowered' clause, will be critical.

Ratings agencies will announce their reviews of the country's status in June, the same month that the ANC gathers in Gauteng for its five-yearly policy conference (when the customary demands for 'radical economic transformation' can be expected), and again in December, when the ANC gathers to elect new leadership. Politics, and the shape and intensity of potential change in this regard, will therefore again be a central element for ratings agencies in their determinations of the country's credit status this year.

Gordhan will likely enter the year more assured, galvanised as he has surely been by the profound support he was able to accumulate from across the political spectrum, civil society, business and the public in response to his harassment by the Hawks in 2016. National Treasury will be less encumbered this year by the demands of an election cycle, which may somewhat ease populist pressures on the Budget process. However, balancing the demands of an ideologically divergent ruling party will remain a central challenge this year – particularly when a fringe cohort, trumpeted most consistently by ANC Youth League leader Collen Maine, continues to argue that the country's conservative fiscal course is largely responsible for the plight suffered by the poor.

Further, the Hawks may still seek to formalise charges related to their allegations that a SARS 'rogue unit' was operated under Gordhan's tenure, though they will likely find a less receptive audience at the NPA in driving these potential demands given the obvious breakdown in relations between Hawks boss Berning Ntlemeza and his NPA counterpart, advocate Shaun Abrahams.

With no lasting solution to the frustrations of the student groups that so profoundly disrupted university activities last year, some degree of unrest must again be anticipated, with a focus both on the beginning of the academic year and the announcement, towards the end of the year, of the anticipated fee increases for 2018. Beyond this, the South African Social Security Agency appears ill-prepared to assume control of the distribution of social grants to around 17 million vulnerable South Africans from current service provider CPS, whose contract expires on 31 March this year. Any disruption to the payment of grants could have serious social consequences.

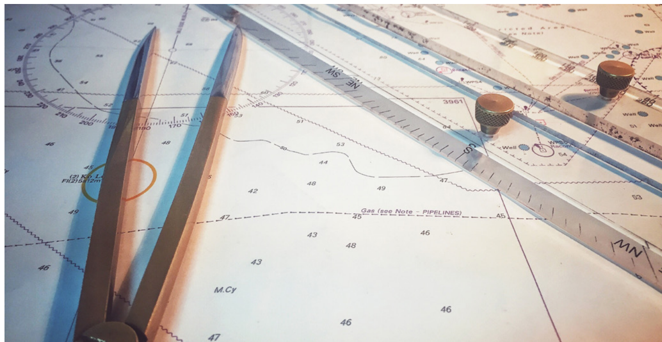
For the opposition, 2017 will be an important year, too. Both the EFF and the DA will have to begin to find new avenues to exploit voter sympathy as the ease with which they have simply assailed the ANC through attacks on the president's moral fortitude begins to lose its wider lustre. The primary focus for the DA will be on ensuring it is capable of providing a discernible improvement in the management of the metropolitan municipalities that it now runs. This will be far more straightforward in Nelson Mandela Bay, where the DA holds a fairly comfortable majority, and previous mismanagement was so acute, than it will be in Johannesburg, where the DA's hold is so much more brittle, and the prior performance of the metro under mayor Parks Tau more credible.

It will in many ways be a holding year for the EFF, one in which the party aims to retain its credibility through emphasising its kingmaker status in key metros; assailing the ANC in parliament; and growing its representation among the country's as-yet politically dormant 'born-free' population. 2017 should be the year in which the National Union of Metalworkers of SA's much-vaunted political party will be established, aided by former Congress of SA Trade Unions (Cosatu) general secretary Zwelinzima Vavi. Though such an addition would add valuable nuance to the broader political environment, the moment for such a formation to accumulate real national scale may have passed.

Though the context for the year ahead appears to be more benign than the year that has passed, it is unlikely that 2017 will be marked by decisive change. For this, we await the resolution of the ANC's leadership battle. Still, there will be gaps to be exploited by the president's loosened grip of the national discourse, and his inability to fundamentally disrupt the grinding process of stabilisation, which is headed in the state by the National Treasury and aided by re-formed partnerships with the private sector. Countering these incremental gains will be those seeking to maximise their current political access through legislative and state procurement channels – their urgency necessitated by Zuma's replacement by year-end. Focus will in this regard rest on the passage of the nuclear programme, which Eskom continues to champion despite wide public and political opposition.

A different kind of drama will seize SA politics this year – one that follows from the grinding shifts that took place in 2016, and that is determined in large part by the range of potential outcomes offered by the ANC's elective process. Though the ANC appears to be aware of its institutional and moral failings, it is less clear whether it has the capacity and institutional fortitude to correct them; and, if not, what political constellations will fill the void created by the party's demise. Answers to these pressing questions will begin to emerge from the fog this year. ■

Disclaimer: The views and opinions expressed in this article are those of the author and have originally been prepared and previously shared with other financial market participants, primarily institutional clients of Standard Bank.



TAKING STOCK OF YOUR PORTFOLIO

PRACTICAL POINTERS FOR 2017

By Pieter Koekemoer

Pieter is head of the personal investments business. His key responsibility is to ensure exceptional client service through a combination of appropriate product, relevant market information and good client outcomes.

We know that you invest with us to contribute to a more financially secure future for you and your family. It is easier to get there if you have clearly defined objectives. If you are uncertain whether your goals and financial plan make sense, we suggest that you consult an independent financial adviser. Meanwhile, we provide some practical suggestions that we think are relevant in the current environment.

CONTINUE TO MAKE REGULAR CONTRIBUTIONS

Woody Allen once said that 80% of success is showing up. The investment equivalent of this maxim is to save on autopilot while basically forgetting that you have the money until you get to the end of your investment horizon (e.g. retirement). It is relatively easy to follow this approach:

- Invest via monthly debit order to automate the administration.
- Contribute to an investment vehicle that offers tax breaks, such as a retirement annuity (up to R350 000 per year) or tax-free investment (up to R30 000 per year), to minimise or eliminate tax leakage.
- Select a growth-orientated multi-asset fund such as Balanced Plus (for savings in a retirement vehicle) or Market Plus (for discretionary and tax-free investments) as your investment engine. These funds aim to optimise growth over long periods of time, and by investing in them you grant us a wide enough mandate to alter portfolio allocations over time as market conditions change.

COPING IN A LOWER-RETURN ENVIRONMENT

We report elsewhere in this *Corospondent* that the most important growth asset classes underperformed inflation in 2016. This may make you wonder whether remaining committed to your investment strategy is worth it. However, it may be easier to do so if you keep the following in mind:

- While the immediacy of recent returns makes for an easy mental shortcut, remember that it is returns over the lifetime of your investment that matter. It is more useful to lengthen your time horizon in tough times than to shorten it. Consider the table overleaf, showing returns for selected funds with different levels of exposure to growth assets. Based solely on 2016 performances, you

may be tempted to conclude that it would be better to reduce risk. However, returns over the past five years more accurately reflect the expected outcomes for the different risk profiles.

SELECTED FUNDS: SHORT-TERM VS LONG-TERM RETURNS

Fund	Risk profile	Recommended term	Exposure limits	Annual return 2016	Annual return Past 5 years
Equity	High	5 years +	100% growth assets; 100% SA; 25% global	3.6%	14.3%
Global Managed [ZAR]	High	5 years +	100% growth assets; 0% SA; 100% global	(4.7%)	19.1%
Balanced Plus	Moderate-high	5 years +	85% growth assets; 100% SA; 25% global	0.5%	12.7%
Capital Plus	Moderate	3 years +	60% growth assets; 100% SA; 25% global	4.3%	9.9%
Strategic Income	Low	1-3 years	20% growth assets; 100% SA; 10% global	9.3%	8.5%

Source: Coronation

- Weaker historical returns increase the likelihood of stronger future returns. The local equity market moved sideways in real terms over the past four years, while the earnings of the underlying companies have continued to grow. This means that valuation levels are more attractive today than they were four or five years ago, making it realistic to expect better returns over the next five to ten years.

We remain of the view that as long as you own a fund with an objective, time horizon and risk budget appropriate to your needs, it makes sense to stay the course in your existing investment.

INVESTORS DRAWING AN INCOME SHOULD CONSIDER MODERATING INCREASES IN 2017

More conservative multi-asset funds such as Capital Plus and Balanced Defensive returned 6% to 7% per annum over the past three years, compared to an expected outcome of somewhere in the 9% to 10% range. Lower returns present investors requiring a growing income from their portfolios with tough choices.

The key challenge to get right is to balance immediate spending requirements with future quality of life. Drawdown strategies are more sustainable when you are able to defer some of your spending to periods following better investment returns. If you are still in the first half of retirement, the prudent response in the current environment would be a moderation in the income withdrawal rate from your portfolio, potentially deferring this year's increase in your drawdown rate. With inflation for 2017 expected to ease somewhat (as reported on page 14), investors may be in a better position to achieve this outcome. You can read more about retirement income trade-offs in the *Corolab Investment Guide: The Income & Growth Challenge* available in the Publications section of our website.

TAXES ARE LIKELY TO BE INCREASED FURTHER IN 2017

National Treasury is on record as again planning to increase taxes in the 2017/2018 tax year. Given political and competitive constraints, it is unlikely that the additional tax can be raised through increases in value-added tax or the company tax rate. While new and/or higher indirect taxes, closing loopholes and tightening the tax net may help, it is likely that the personal income tax system will bear a significant share of the load, as was the case in the preceding two budgets.

The table below shows how the effective rate of tax has changed over the last three years for different levels of taxable income. We can expect a similar increase across the income spectrum in the next tax year. It is also likely that very high income earners (taxable income above R1 million) may be impacted by a higher marginal rate. Judge Dennis Davis, the chair of a tax reform committee, has suggested that this rate may be 45%.

TAX INCREASES

	2013/2014	2014/2015	2015/2016	2016/2017	Average increases over past 2 years
Individual income tax (on salary, bonus, interest, rentals)					
Marginal rate	40%	40%	41%	41%	
Level of income for marginal rate (in rands)	638 601	673 101	701 301	701 301	
Effective rate on R250 000 in 2014/2015 (rands)	15.0%	15.0%	15.5%	15.8%	0.4%
Effective rate on R500 000 in 2014/2015 (rands)	23.4%	23.5%	24.4%	24.8%	0.7%
Effective rate on R1 000 000 in 2014/2015 (rands)	31.3%	31.3%	32.3%	32.6%	0.7%
Dividend withholding tax	15.0%	15.0%	15.0%	15.0%	
Capital gains tax (on realised price movement)					
Maximum rate	13.3%	13.3%	13.7%	16.4%	1.6%

The table assumes 6% salary inflation for the indicated starting salary to illustrate the impact of bracket creep and rate changes, where applicable. It assumes the taxpayer is below 65. Older taxpayers will have slightly lower effective tax rates, as they qualify for additional rebates. The capital gains tax rate is a function of the marginal rate and the inclusion rate (currently 41% and 40% respectively for individuals).

Sources: South African Revenue Service, Coronation

TAX ALLOWANCES FOR INVESTORS

As a reminder, investors qualify for the following investment-related tax breaks:

- Individuals pay a lower tax rate on capital gains (16.4%) and dividend income (15%) compared to interest, rental and salary income (41%). This means that investors not using tax-advantaged vehicles are, all other things being equal, better off holding equities in their portfolios than other assets.
- Tax-advantaged contribution to a tax-free investment of up to R30 000 per year. This is arguably the best tax break available to individual investors at the moment. While you use after-tax money to invest in a tax-free investment, all income and growth earned from the underlying funds are tax free, and all proceeds at the time of withdrawal will also be untaxed. Just do not over-contribute – contributions in excess of the annual R30 000 limit are taxed very punitively.
- Tax-advantaged contribution to retirement funds. You can contribute the lower of 27.5% of taxable income (excluding retirement benefits) or R350 000 annually to retirement funds, and deduct this amount from your taxable income in the year of contribution. Your capital and reinvested income will grow tax free as long as it remains in the retirement fund, and you will only pay tax on the way out when you start to withdraw from your retirement fund (at the then-prevailing tax rate).
- General interest exemption of R23 800 for investors under 65, and R34 500 for investors over 65. At the current yield of around 8% on funds such as Coronation Strategic Income and Coronation Money Market, this means that you can invest nearly R300 000 if you are under 65 and R430 000 if you are over 65 before starting to pay tax on interest earned.
- Annual capital gains exclusion of the first R40 000 gain. This exclusion makes it more efficient to stagger the realisation of capital gains over different tax years.

LAST CHANCE TO REGULARISE OFFSHORE HOLDINGS

All local residents are subject to exchange controls and paying local taxes on their worldwide income and assets. Offshore assets that are held without the necessary SA Revenue Service (SARS) and SA Reserve Bank approvals may subject the holder to criminal prosecution, while incurring additional foreign exchange and tax penalties if the authorities obtain information about these assets without the taxpayer's assistance. Increased information sharing between international tax authorities, expected to be put in force later this year, makes this outcome more likely.

SARS announced a special voluntary disclosure programme, effective until 30 June 2017, which enables taxpayers to regularise their affairs by paying an effective tax rate of up to 20.5% of the value of the offshore assets irregularly held, in exchange for a waiving of prosecution. If you are in this position, regardless of the source of the offshore assets, you should obtain tax advice from a specialist to assist you with deciding on the right course of action.

By making sure that your portfolio continues to meet your investment needs, taking advantage of the tax breaks on offer and – above all – staying the course, you can ensure that you remain well on your way to achieve the financial future you are working towards.

We wish you all the best for 2017! ■

SA GROWTH

A LITTLE COULD GO A LONG WAY

By Marie Antelme

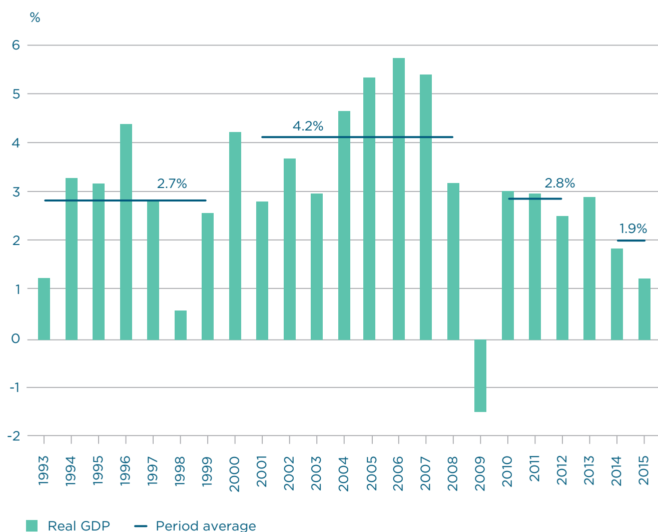
Marie is the chief economist within the fixed interest investment unit. She joined Coronation in 2014 after working for UBS AG, First South Securities and Credit Suisse First Boston.

LOOKING BACK

Last year was abysmal. SA's economy suffered as the drought deepened and inflation spiked, prompting two interest rate hikes. The political landscape remained in flux following the double replacement of SA's finance minister in December 2015, which also hit domestic financial markets, slammed the currency and pushed bond yields higher. With almost no help from global growth, real GDP probably barely managed to stand still in 2016.

Looking back, average growth in SA has slowed from 4.3% per annum in the eight years before the financial crisis in 2008, to 3% in 2010 to 2012, and just under 2% over the past four years. Since 2012, key developments have had a negative impact on growth and confidence, also impacting the currency. The first event was the tragic loss of life at Marikana in 2012, followed by a prolonged period of labour hostilities through 2014. In 2015 came Nenegate, allegations of high-level corruption and renewed turmoil in the ANC.

SA REAL GDP



Source: Statistics SA

Domestically, apart from policy uncertainty, capacity constraints also included (but were not limited to) the availability of electricity, high levels of household debt, fiscal consolidation, higher inflation and tighter monetary policy. In addition, the drought and rocketing food prices slowed growth.

OUTLOOK FOR 2017

The good news for this year is that many of these constraints have either started to ease, or have been remedied. Before we get into the details, let us first address the elephant in the room: the fluid SA political landscape. While the president has both the right and ability to change members of his cabinet, the internal power balance within the ruling ANC has so far limited the choices he has been able to implement. Still, it is difficult to monitor and assess shifts in the balance of power.

Politics will most likely continue to dominate markets from time to time this year. It is also important to remember that the ANC will hold its own elective conference at the end of 2017, ahead of the national elections in 2019. It is at this conference that the party will elect new leadership for the following five years. The likely presidential candidate for the national elections will emerge from these contenders. Accordingly, political positioning will be a constant feature in SA in 2017.

Turning to the economy, there is enough evidence to suggest that growth will improve this year, off a very weak base. The worst drought in decades saw agricultural output shrink by 8.8% by the third quarter of 2016, compared to the same period the year before. Mining output contracted 3.4% on the same basis and the secondary sectors – manufacturing, utilities and construction – were flat, with the only growth coming from trade, business services and government. In all cases the growth registered by these sectors was lacklustre at best, and slowed towards the end of the year.

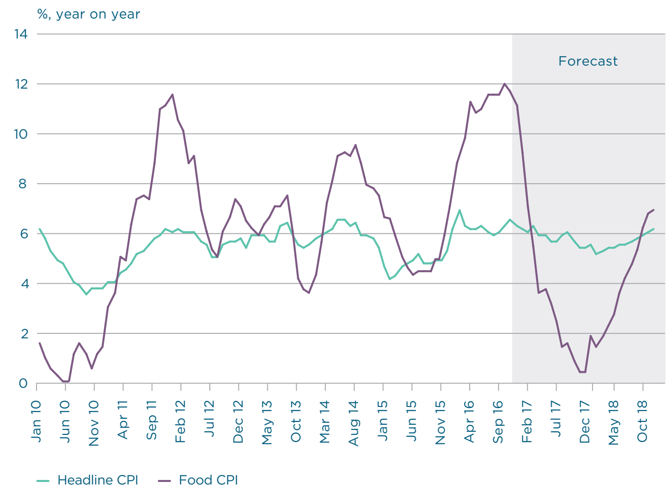
Looking at the data from the demand side, household spending – 60% of total GDP – weakened through the year

as the impact of rising inflation (notably in food prices, which hit 11.8% in the year to October) and a cumulative 200 basis points in interest rate hikes since 2014 compounded job losses. Gross fixed capital formation, including inventory restocking, has suffered amid ongoing weak global demand, falling commodity prices and (until recently) fraught labour relations. Poor confidence and political uncertainty still weighed, and capital expenditure was flat through most of 2016. Net trade, however, was a positive contributor to growth as domestic terms of trade improved and a combination of better exports and weaker imports saw a recovery in the trade balance.

Global growth is expected to accelerate from 3% to about 3.5% (International Monetary Fund: 3.4%), boosted by stimulus and improved confidence in the US, decent momentum from Europe, and better economic performance from emerging markets, notably Russia and Brazil, which have suffered recessionary conditions in 2016. This should help support commodity prices, and an improvement in investment in these economies should see an improvement in global trade.

from 10.7% in 2016), with fierce retail competition skewing the risk to lower rather than higher prices.

SA CONSUMER INFLATION



Sources: Statistics SA, Coronation

The good news for the SA economy should be supported by four other baseline assumptions. Firstly, lower inflation should help improve real incomes, and lower food inflation in particular should alleviate some of the pressure on middle- and lower-income households. Then, interest rates will not be hiked, and may even head lower late this year. Thirdly, improved confidence could see a modest rise in investment and, lastly, terms of trade should remain relatively favourable.

INFLATION

Headline CPI accelerated to 7% year-on-year in February last year, moderating slightly to a second peak of 6.6% in November. We expect CPI to average 6.3% in 2016. The main driver was rising food inflation, partly owing to the impact of the drought, but also reflecting the wider impact of a weaker currency on retail fuel and imported goods prices. Food inflation accelerated to almost 12% towards the end of the year, from 7.1% year-on-year in January. Decent rainfall in key crop-growing regions late last year has seen farmers planning to plant 26.5% more hectares of maize, and a total increase of 15% in the overall planting of summer crops.

The price of white maize has fallen almost 40% from its peak to current levels. Global stock levels remain high and imports could provide a possible reprieve in the early part of the year when domestic stocks run low. Accordingly, we expect grain input prices to moderate back towards export parity. Given the impact of the drought on cattle herds, meat prices could be a little slower to adjust, but base effects alone should ensure a significantly slower pace of food inflation (we estimate 3.4% on average this year

The rate of change in inflation (how quickly it rises or falls) has a meaningful impact on disposable incomes, and the deceleration in prices should bolster real household incomes. It is possible that fiscal drag (perhaps in combination with outright tax hikes) may offset some of these gains, but all else being equal there should still be an improvement in household spending power in 2017.

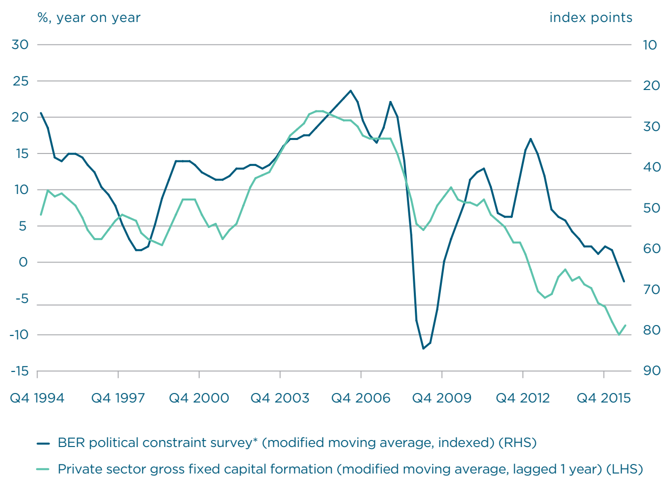
EXPECTED GROWTH

Fixed investment growth should also return to mildly positive rates. Overall investment spending has been boosted by government and state-owned entities since the financial crisis, while private sector investment remained weak. Here too, are signs of some improvement. Labour relations have become less hostile, and days lost to strike activity have fallen meaningfully in the past two years. Also, more stable commodity prices and even a modest pick-up in global trade volumes may boost investment, even for stock replacement. The intensification of political tension in 2016 has also prompted some improvement in dialogue between government and the private sector, which may support business confidence and increase companies' willingness to invest. This is of course vulnerable to political ructions, already a significant constraint on investment.

The prospects for the domestic terms of trade are very hard to assess. A revival in domestic demand could well support stronger import growth, but then again, key export commodities have rallied along with the recent rise in oil prices.

Taken together, our baseline growth forecast is for an acceleration in real GDP to 1.4% in 2017 from 0.3% last year.

SA POLITICS AND INVESTMENT

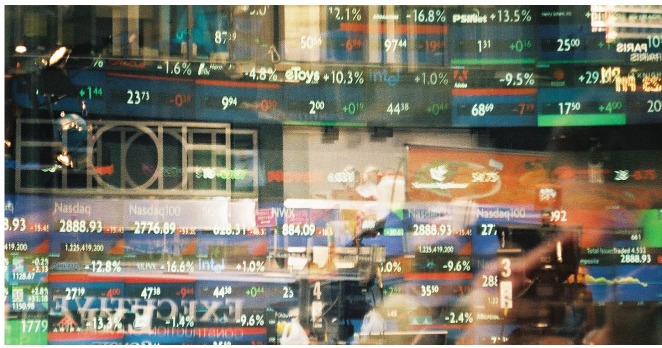


*The proportion of respondents in the manufacturing sector who see politics as a constraint on their investment plans.

Sources: SA Reserve Bank, Bureau for Economic Research (BER)

We expect inflation to moderate to 5.2% by year-end, and to average 5.8% this year. Early-year increases in retail fuel prices have put pressure on inflation, but there is still some downside risk: cooling food inflation could drag the forecast even lower. Given better growth and falling inflation, we think the SA Reserve Bank will keep interest rates on hold for some time, but modest rate cuts may even be expected by year-end.

These projections are hardly buoyant, and the rise in growth is not yet a reflection of easing structural constraints. Instead, it will be a cyclical improvement off a deeply constrained base. As with all baseline projections, and especially in a world where unpredictable political and economic shocks can jolt markets, forward-looking optimism can be derailed by unforeseen or low-probability events not included in our analyses. That said, just a little lower inflation should go some way to ease the pressure of 2016. ■



MARKET REVIEW

BRAVE NEW WORLD

By Duane Cable

Duane is head of SA equity and co-manages all strategies within the Coronation Absolute Return offering. He joined Coronation in 2013 and has 10 years' investment experience.

2016 was certainly a year full of surprises! Given the backdrop of Brexit and the election of Donald Trump as the next US president, not many would have anticipated the resilient performance of global markets last year.

In US dollars, the MSCI All Country World Index returned 1.2% for the quarter and 7.9% for the calendar year, while the MSCI Emerging Markets Index returned -4.2% for the quarter and 11.2% for the calendar year. Locally, the FTSE/JSE All Share Index (ALSI) returned -1.9% for the quarter and 15.9% for the calendar year in US dollars. Given the significant strengthening of the rand over the period, this translated into a rand return of 2.6% for the index for the calendar year.

The strong recovery in commodity prices in 2016 provided the tailwind for resource shares, which returned 34.2% in local currency terms for the calendar year, comfortably outperforming industrials and financials, which returned -6.6% and 5.4% respectively. Some of the notable moves in commodity prices (in US dollars) for the year include coking coal (+189%), thermal coal (+86%) and iron ore (+85%).

MARKET SUMMARY

Index	4th quarter 2016	1 year	3 years	5 years	10 years
All Share	(2.1%)	2.6%	6.2%	13.0%	10.5%
Resources	(1.2%)	34.2%	(10.3%)	(5.5%)	(0.1%)
Financials	2.9%	5.4%	11.8%	18.1%	10.8%
Industrials	(4.7%)	(6.6%)	8.0%	19.0%	15.7%
SA Listed Property	1.3%	10.2%	14.7%	17.3%	15.8%
All Bond	0.4%	15.5%	6.9%	7.4%	8.0%
Cash	1.8%	7.1%	6.3%	5.8%	7.1%

Source: Deutsche Bank

As expected, the US Federal Reserve raised interest rates by 25 basis points in December. Our base case remains that the pace of interest rate normalisation will be gradual and that interest rates will remain at historically low levels for longer. Despite the increased geopolitical uncertainty, the prospects for continued accommodative monetary policies, and the expected fiscal stimulus (lower taxes and increased state spending on infrastructure) in the US under the Trump presidency, this will most likely continue to be supportive of risk assets in the year ahead.

Locally, the political backdrop remains volatile; however, with the progress made since Nenegate, we have seen some improvement in investor sentiment since the end of 2015. Despite the weak base set in 2016, the SA economic growth outlook remains anaemic.

While the resource sector delivered a very strong performance in 2016, the longer-term underperformance relative to industrials and financials remains stark. Based on our assessment of fair value, resources are attractive enough to warrant a reasonable weighting in our equity and balanced portfolios. We have, however, trimmed some positions, given the reduced margin of safety.

Our preferred holdings remain Anglo American, Mondi, Exxaro and the platinum producers. We continue to favour platinum over gold producers and our preference remains the low-cost platinum producers Northam and Impala Platinum.

We believe the global businesses listed in SA are attractively valued and, as such, our portfolios have healthy weightings in stocks such as Naspers, Steinhoff International Holdings, British American Tobacco and Anheuser-Busch InBev. These businesses are exceptionally well managed and are diversified across numerous geographies and currencies, which make for robust business models and protect the companies from an earnings shock in any single market.

We continue to hold reasonable positions in food retailers and producers, as well as selected consumer-facing businesses (Woolworths and Foschini). These businesses are extremely well run and trade below our assessment of fair value.

Banks returned 11% for the quarter, outperforming the broader financial index. Valuations remain reasonable on both a price-to-earnings and price-to-book basis. These businesses are well capitalised, well provided for and trade on attractive dividend yields. Our preferred holdings are Standard Bank, Nedbank and FirstRand. Life insurers returned -2.2% for the quarter. We prefer Old Mutual and MMI Holdings, both of which trade on attractive dividend yields and below our assessment of their intrinsic value.

In terms of asset allocation, equities remain our preferred asset class for producing inflation-beating returns. We prefer global to domestic equities on the basis of valuation, and remain at the maximum 25% offshore limit in our global balanced funds. The rand strengthened by 11.5% against the US dollar during the year, which negatively impacted the rand returns of global assets.

The bond market returned 0.4% for the quarter, underperforming cash, which yielded 1.9%. We believe that yields on global government bonds are currently too low and do not offer value. We do, however, believe that the yields on local bonds are attractive, especially given a more favourable outlook for inflation in SA over the medium term. The risk premium implied when comparing the yields of local bonds to other developed and emerging market bonds suggests that the market has largely priced in most of SA's political uncertainties.

Listed property returned 1.3% for the quarter. We expect domestic properties to show reasonable nominal growth in distributions over the medium term. Combined with a fair initial yield, this offers an attractive holding period return. We continue to hold higher-quality property names that we believe will produce better returns than bonds and cash over the long term.

As we start a new year, we are bombarded with predictions from numerous financial experts about what lies ahead in 2017. History has taught us that our ability to forecast the immediate future is limited.

We will remain focused on long-term valuations and will seek to take advantage of whatever attractive opportunities the market will present to generate long-term rewards for our investors. In an incredibly uncertain world, we continue to strive to build diversified portfolios that can absorb the many surprises that are likely to come our way in 2017. ■

BOND OUTLOOK

AN ENCOURAGING ENVIRONMENT FOR SA BONDS

By Nishan Maharaj

Nishan is head of Coronation's fixed interest investment unit. He joined the business in 2012 and has 14 years' experience in the investment industry.

VOLATILE BACKDROP

The political earthquakes of 2016 have caused shock waves that will continue to reverberate across financial markets for much of the new year. Brexit and the election of Donald Trump as the new US president reflected a deep disdain and discontentment with the status quo among voters, who expressed their unhappiness with current regimes and policies. It was a stark reminder that eight years since the great financial crisis, growth in many countries has remained undesirably low, while income inequality has seen a marked increase.

Volatility remained elevated throughout last year, contributing to high levels of uncertainty and weighing on investor sentiment and conviction. Locally, although the shock of Nenegate was behind us, the political landscape remained volatile.

Despite the volatile local and global backdrop, SA bonds managed to perform much better in 2016. This was primarily due to bonds starting the year at quite elevated yields. After starting at 9.71%, the local 10-year benchmark bond traded in a range of 9.83% to 8.40%, settling at 8.91% at year-end. The All Bond Index (ALBI) delivered a total return of 15.5% for 2016, far ahead of cash at 7.4% (Short-Term Fixed Interest Composite Index) and inflation-linked bonds at 6.1%.

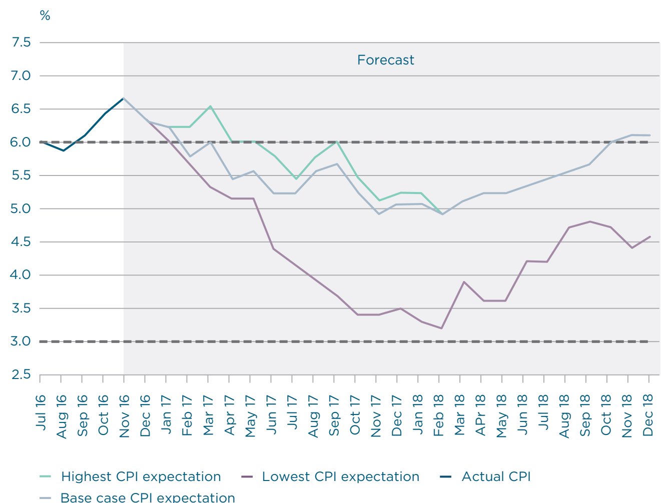
As one would expect, with 60% of the ALBI weighted towards the 12-year and longer range of the local bond curve, these bonds delivered the biggest contributon to overall performance: 17.5% – compared to 10.1% for bonds over 1 to 3 years; 13.4% (3 to 7 years) and 15.4% (7 to 12 years). Key to note here was that despite the absolute move lower in bond yields from their low starting point at the start of the year, the bulk of returns still came from the yield they provided. The ALBI's return of 15.5% was composed of a 5.85% capital return (return due to an appreciation in bond prices) and a 9.65% interest return (return due to yield earned from the underlying bonds).

INFLATION

Over the medium to longer term, domestic inflation will continue to direct local bond yields, as will the pricing of country-specific risks and developments in the global yield environment. The performance of local bonds will therefore depend on whether current yields provide a sufficient margin of safety against adverse developments in any of these drivers, or other unforeseen events.

The outlook for local inflation has improved, primarily due to the deceleration in food inflation. This is illustrated in our following base case scenario, which includes an assumption of average food inflation of 3.4% for 2017 and 4% for 2018. Even if we shock our inflation forecasts (as illustrated by the green line in the graph below) by including a move in oil to $65 per barrel and a rand slump (to R15.50/$ in the first quarter of 2017), it is still difficult to see a sustained breach of the top end of the SA Reserve Bank's (SARB) inflation band. In fact, inflation over 2017/2018 under our stressed scenario only averages 5.75%, compared to 5.45% under our base scenario.

INFLATION EXPECTATIONS



Source: Coronation analysis

The bottom line is that it is very hard, without a sustained shock to food inflation, to see the CPI persistently above target over 2017/2018, with the risk very much skewed to the downside (indicated by the purple line in the graph on the previous page). This is due to the abundant rainfall over much of SA during October to December 2016, as well as early indications that planting could increase by 15% in 2017 (measured even before the rainy period), providing a favourable environment for local bonds. Following on from this, it is very likely that we have seen the end of the interest rate hiking cycle in SA, with real policy rates expected to drift up to above 2% as inflation comes down next year. This will limit the SARB's ability to increase policy rates further and, if anything, shift expectations towards the start of a cutting cycle in late 2017 or 2018.

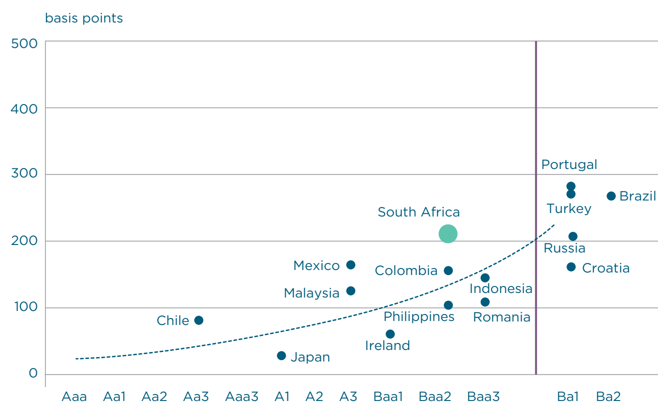
RISK PREMIUM

The local risk premium can be represented by two key measures: the SA credit default swap (CDS) spread, which measures the sovereign's riskiness as an issuer, and the spread between SA's 10-year bond yield and the US 10-year bond yield.

SA's current CDS spread sits at a level of 209 basis points (bps). Our local budget deficit, although still wide, is projected to contract meaningfully over the next three years (by approximately 1.5%), which should reduce financing needs and costs. In addition, the weaker rand and the stable mining and manufacturing environment should also continue to promote a strong trade recovery, which should reduce our current account deficit back towards -3%. The reduction in budget and current account deficits indicates that our twin deficit problem will become more manageable over time. Our expectations of a favourable inflation outlook further implies an increase in household disposable income, thereby suggesting stronger local consumption and a more stable underpin for growth. These improvements, although

SA RISK PREMIUM: TOO HIGH?

Credit default swap spread vs Moody's sovereign credit rating



Source: Bloomberg

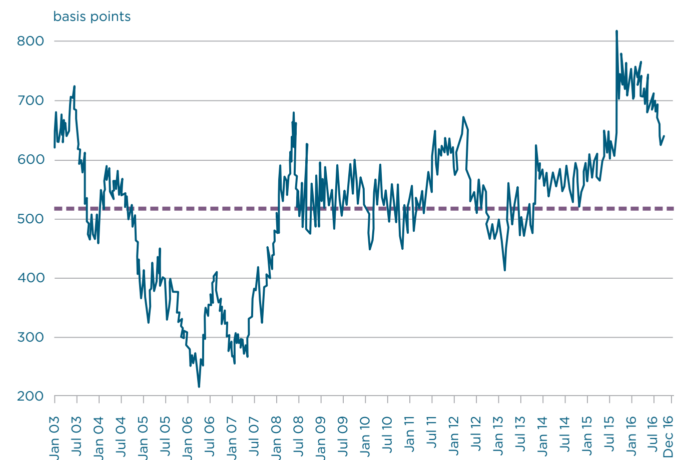
by themselves not sufficient to avoid a downgrade to below investment grade, do suggest that the risks are definitely tilting towards a more positive outcome on the ratings front, implying our CDS spread is somewhat too aggressively priced.

The spread between the SA 10-year government bond and the US 10-year government bond is representative of two factors, namely, the inflation differential between the two countries and the SA-specific risk premium:

(SA 10-year bond yield - US 10-year bond yield) =
(SA inflation expectation - US inflation expectation)
+ SA risk premium

Currently, the spread sits at 645 bps, well above the long-term average of 525 bps. But more important is its implication for SA's risk premium. The implied breakeven inflation rate for the US 10-year bond is 2%, in line with the US Federal Reserve's (Fed) target. Our expectation of average SA inflation over the next two years is 5.5%. Using these values and the formula above, the implied SA risk premium is 295 bps, compared to current market pricing of 209 bps. This suggests that the implied risk premium between the SA 10-year and the US 10-year bonds provides a decent buffer in terms of risk premium expectations, making local bonds particularly attractive on this basis.

SPREAD BETWEEN SA 10-YEAR AND US 10-YEAR GOVERNMENT BONDS



Source: Bloomberg

One could argue that the elevated SA-specific risk premium is due to the volatile local political landscape. However, the major local events of 2016, such as the reappointment of Pravin Gordhan as finance minister, the former public prosecutor's report on state capture, the ruling of the constitutional court against president Zuma and the results of the local government elections, suggest that political volatility is starting to abate and the perceived risk premium is too high.

GLOBAL BOND YIELDS

Global yields pushed higher after the shock result of the US election in November last year. However, to call this the start of a global bond bear market seems extreme. The prospects for EU inflation and growth have improved, but the need for monetary policy accommodation will remain for some time, as indicated by the extension of the EU quantitative easing programme. Even after the end of the programme, it will be a long time before base rates move materially above the zero level again, keeping bond yields anchored. German bond yields rose by 40 bps from their lows last year but remain at 0.2% – hardly a level that strikes fear into the heart of an SA government bondholder, who earns 9%! The Fed has a target on core inflation of 2% and on keeping unemployment below 6.5%. As history has shown, it is not likely that the Fed will allow inflation to spiral out of control, causing an inflation-driven yield sell-off. In addition, with steadily decreasing levels of productivity and an effective floor in the unemployment rate due to gains in technology, US real rates will be required to remain relatively low when compared to history, around the 1% to 1.5% level. This puts the medium-term nominal rate on a US 10-year bond at around 3% to 3.5% (assuming the 2% inflation target is met and maintained). We have long argued that yields of below 2% for the US long bond were too expensive and fair value was somewhere around 2.5% to 3.5% over the medium term. As such, we do not believe that this is the start of a multi-decade sell-off in US bonds, but merely a move towards levels that are more reflective of the underlying fundamentals and risks.

PROSPECTS FOR 2017

The combination of a more favourable inflation outlook in SA (with risks to the downside), flat local policy rates, an SA risk premium that prices in a good deal of conservatism and a global bond environment that should remain relatively stable, suggests a more encouraging environment for SA government bonds. SA's 10-year and 20-year government bonds trade close to 9% and 9.6% respectively, which, when taken against an inflation expectation of 5.5% to 6%, suggest a range of real returns of 2.8% to 3.9%. This is a very attractive level both from a historical and absolute perspective, enhancing the appeal of SA government bonds. The main risk to this outlook remains a resurgence in local political volatility that negatively influences the country's ability to implement policy effectively. While political uncertainty has forced a more tempered approach over the previous year as well as the very near term, we maintain a more positive and constructive view on medium- to longer-term outcomes. ■

INTERNATIONAL OUTLOOK

ON FIRMER GROUND

By Tony Gibson

Tony is a founder member of Coronation and a former CIO. He established Coronation's international business in the mid-1990s, and has managed the Global Equity Fund of Funds strategy since inception.

INCREASED GLOBAL ACTIVITY

At the start of 2016, there was widespread anticipation of a looming global recession. At the lowest point in the first quarter, global growth had fallen to around 2%, compared to a long-run trend rate of 4%. The risk of deflation was rising and the economic outlook was dire.

Significant contributors to the prevailing mood of gloom were a stagnating Chinese economy (accompanied by fears of a sharp devaluation in the yuan) and a dramatic decline in the oil price, which saw a cut in capital spending in the energy sector. Deflation risks dominated Japanese and European bond markets, while the US Federal Reserve appeared set to slowly start hiking interest rates, despite the strengthening dollar and global economic weakness.

Since then, however, there was a marked upturn in global activity, and in recent months this has become surprisingly strong – at least when viewed through the bearish prism that has been in place since the knock to growth expectations following the global financial crisis. The narrowing of capital flows that pulled investment capital away from economic risk in 2015 reversed direction by mid-2016. Fears that a fragile US recovery would buckle and lead to a self-feeding global contraction gave way to renewed expectations for economic resilience. A further point is that in the US, politically driven interventions to buoy the economy prior to elections have historically often created a favourable equity investment environment during the third and fourth year of a presidential term. However, due to the divided government in place over this period and the tepid pace of cyclical recovery, this pattern failed to generate positive returns for the Dow Jones Industrial Average Index as 2015 moved into 2016. These headwinds abated during the course of 2016, giving way to tailwinds that fed a 13.4% gain for the index in the presidential election year.

This improved sentiment pulled money back towards oversold raw materials, energy and economically sensitive cyclicals. Collectively, this rotation back towards economic risk fed a broadening of flows into equities – led by sectors oversold and out of favour in 2015. Gold, energy, financials, transportation stocks and cyclicals all rallied strongly. In contrast, the safe havens favoured in 2015 (such as pharmaceuticals) lagged. Among selected US equities, many that were oversold in 2015 bounced back strongly in 2016, while others that were overbought by the end of 2015 faltered or lagged in 2016. The sector rotation also appears to have carried over into the start of 2017.

While the US dollar rose sharply in 2016 against currencies such as the British pound and Mexican peso, the trade-weighted US Dollar Index rose by only 3.6% in 2016. Over the year, the US dollar rose by 6.9% against the Chinese yuan and 3.3% against the euro, but was down 2.7% against the yen. Meanwhile, commodity-sensitive currencies that were deeply oversold in 2015 – such as the Russian rouble and Brazilian real – rebounded strongly in 2016, exaggerating the liquidity-sensitive rebound in their equity markets. Simultaneously, the apparent resilience of the US economic recovery fed a widening divergence among major market bond yields: ten-year yields rose in the US and Canada, while yields fell for the year in the UK, Japan and the eurozone.

Emerging equity markets, most of which fell sharply in 2015, began to turn around in 2016 – led by strong rebounds in commodity-sensitive markets such as Brazil, Russia, Chile, Argentina and SA. Mexico failed to benefit from this reversal due to a sharp drop in the peso/dollar exchange rate. Meanwhile, Shanghai China A-shares, which rose strongly in 2015, fell sharply in 2016. Taking a medium-term perspective, over recent years both developed and emerging markets have been responding to the long-term effects of the global financial crisis, and their cycles have moved in different directions. The recovery of developed economies has been hampered by slow balance sheet repair (especially among banks) and the side-effects of quantitative easing (QE). This has resulted in lacklustre growth, persisting unemployment, low wage growth and discontented voters. By comparison, emerging economies implemented strong stimulus programmes between 2008 and 2010. These proved so effective that certain economies

– including China, Brazil and Russia – had to change course in 2011 and 2012. As a result, they too experienced economic downturns and currency weakness in the years that followed. As we enter 2017, much will depend on how these issues are managed.

Considering the global economy collectively, the latest forecasts estimate the growth rate in global activity to be 4.4% (compared to 2016's low point of 2.2%). This is the highest forecast by economists since April 2011 and is also supported by other data sources, such as the Goldman Sachs Global Leading Indicator (which has reached its highest point since December 2010). As to be expected, heightened global activity has also seen a steady rise in headline inflation in almost all major economies, albeit small and largely driven by the partial recovery in oil prices. US wage inflation has also been trending upwards for some time, and will result in higher consumer prices in that economy.

TRUMP'S ECONOMIC APPROACH

On 20 January 2017, Donald Trump became the 45th US president, with Republican control of both houses of Congress. He is expected to propose a range of stimulus measures designed to promote the growth of the US economy, including tax cuts for both individuals and businesses, and several infrastructure spending programmes. He may also implement a number of reforms, including the easing of energy production restrictions (thereby encouraging the use of various different energy sources) and revisiting existing banking regulations. In doing so, he has said that he is targeting a growth rate of between 3.5% and 4%. Consensus expectations are for real GDP growth to improve to 2.5%.

It seems that the defining feature of Trump's economic approach – as proposed by his advisers – is likely to be a rebalancing of the policy mix. This will see the US move away from an exclusive reliance on easy monetary policy to jump-start the US economy towards a more balanced reliance on the deregulation of economic activity and on expansionary fiscal policy. Trump believes that this will significantly buoy the performance of the US economy. In fact, we cannot rule out the possibility of real US GDP growth doubling in the next couple of years, which will also drive up equity valuations and underpin dollar strength. Certainly, investment markets are buying into these promises.

EUROPE AND UK

In Europe, the outlook is less promising. In particular, the weakness of the European Central Bank's QE programme and its decision to lower one of its key policy rates into negative territory have proved to be significant stumbling blocks to economic recovery. Unemployment remains high across the continent, while income growth is weak. Consequently, we have seen the emergence of fervent populism and nativism, with both far-right and far-left political movements growing. With upcoming elections in the Netherlands, France and Germany this year, there is the risk of further disruptive political outcomes.

In the UK, real GDP growth had averaged 2.3% since 2013, aided by gradual balance sheet repair and supported by expansionary QE measures. Unlike in the eurozone, deflation has also not been a concern. However, it still remains to be seen how Brexit will be negotiated, and what this will mean for the UK's access to the EU market and international investment. To date, the brunt of the fallout has been borne by the British pound, which has seen a significant decline in value. Once formal Brexit negotiations begin, it could easily fall further. This has the potential to push up import prices and filter through to CPI, undermining real wage growth. In turn, a reduction in consumer spending (which makes up 65% of British GDP) will negatively impact economic growth. In 2017, growth of 1.4% and a CPI rate of 2.5% are expected.

CHINA

Within emerging markets, China remains the largest – and the largest global buyer of commodities. Having embarked on a new round of credit expansion from the start of 2014, the Chinese economy could see yet another period of inflation. This could threaten the country's sought-after shift to more consumption-led growth, and would also hold significant repercussions for other emerging markets, especially the commodity producers and China's neighbouring economies. To date, excess credit growth has been largely confined to the Chinese financial and government sectors, but there are concerning indications that the broader economy may soon be impacted. This includes a series of mini-bubbles in equities, the housing market and then commodities. In addition, producer prices have started to rise for the first time in four years. The country will need to address these issues decisively to minimise the impact on its economy, but how it will go about doing so remains to be seen.

EXPECTATIONS FOR 2017

As we have highlighted before, far lower emphasis has been placed on valuation in the recent years of below-trend economic growth. Rather, stocks with low levels of volatility gained favour, outperforming more cyclical counters. Often, this was due to their bond-like qualities rather than their fundamental attributes – and it made these stocks expensive. Such valuations are likely to prove unsustainable, and are already starting to reverse. Furthermore, anticipated fiscal stimulus in the US under the Trump administration will support those parts of the market that have lagged 'safe haven' assets. In particular, the banks should continue to perform well. Being better capitalised now than they were in the wake of the financial crisis, these entities have also generally reduced the volatility of their earnings streams (despite operating under heightened regulation and in an environment of exceptionally low interest rates).

The sharp drop in commodity prices from mid-2014 into early 2016 weighed heavily on global equity indices, capital investment, and the economies and currencies of commodity-sensitive countries. Due to the lag between investment and production for most nonagricultural commodities, it takes time for lower prices to reduce supply, or for a price rebound to increase production. Energy inventories remain high, and the scope of pledged 2017 oil production cutbacks remains uncertain. However, the supply headwinds created by the sharp drop in energy sector capital investment from 2014 through 2016 will more than offset the near-term impact of a modest 2017 rebound in drilling and spending. It is the increasing recognition of this reality that fuelled the sharp year-on-year rise in oil and natural gas prices in 2016, and modest rebounds in other raw materials (where prices had fallen below the cost of production by early 2016).

The global economy and markets enter 2017 on considerably firmer footing than last year. The outlook has improved for developed economies as growth momentum has picked up in recent months and risk assets across the board have continued the rally sparked by Trump's unexpected victory. But far more importantly, markets are exhibiting that the election of Trump as the president of the US – as divided as public opinion on him may be – will make a fundamental impact on the performance of the US economy. A faster growing US is positive for the global economy, but the impact outside the US will be limited until 2018.

The outlook has also improved for emerging markets, but in the near term it is likely that there will be further capital outflows due to a stronger dollar and rising interest rate risk, imposing financial stress.

A caveat to be borne in mind is that an ‘America First’ policy from Trump will add significant further global stress, as will a closer ‘friendship’ between the US and Russia based on common economic and security interests, which will be to the detriment of Europe. ■

CONSUMER STAPLES

INVESTING WHEN THE PRICE IS RIGHT

By Louis Stassen

Louis is a founding member of Coronation and a former CIO. Today he heads up the global developed markets investment unit, and co-manages Coronation's global multi-asset and direct developed market equity strategies.

On the face of it, the international consumer staples sector is a no-brainer for investors seeking global exposure.

These companies produce essential products (food, beverages, tobacco and household goods) that remain in demand even when times are bad. From Unilever, Nestlé and Anheuser-Busch InBev (ABI) to Heineken and British American Tobacco (BAT) – the sector has some of the best management teams, strong global brands, solid margins and defensive business models.

Intuitively, it feels less risky to invest in these global brand names, especially since consumer staples remain resilient in uncertain times – ideal for those seeking a secure offshore investment.

Still, we largely steered clear of these go-to companies in recent years. As always, our concern is valuation. While it would be easy to justify an investment in these upstanding companies, we only invest in shares that are trading below our estimation of their long-term intrinsic value. We do not invest in companies because we feel comfortable with them or can associate with their brands. We are solely focused on valuation; we do not want to overpay.

In recent years, consumer staple companies have rerated to trade at a much higher premium to the rest of the market than the historical average. They were in demand not only for their defensive qualities amid a weaker world economy, but also as alternatives to developed market government bonds.

Compared to the record-low returns offered by bonds, these respectable behemoths offered attractive dividend yields, low risk and the high probability of strong earnings growth. Return-hungry investors have been piling into these companies for many quarters, pushing share prices higher.

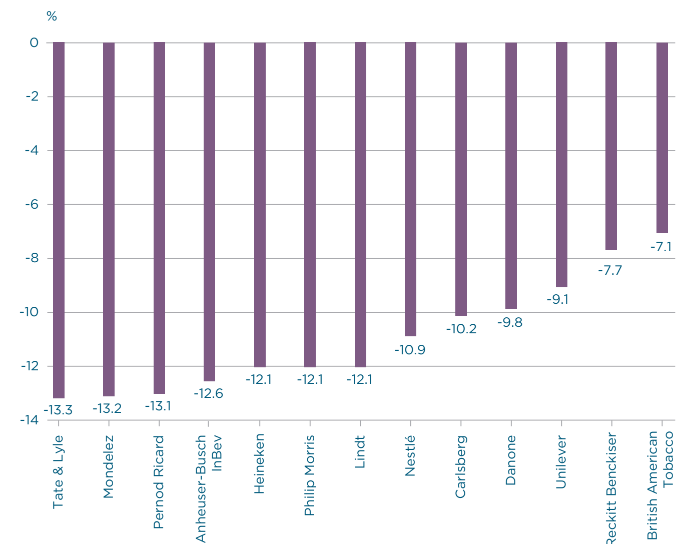
This trend promptly reversed following the US presidential election results. The market expects the Trump regime to pump money into infrastructure and, in combination with corporate tax cuts, bolster US economic growth. Along with this, inflationary pressures are anticipated, which triggered a sharp increase in long-term interest rates in the developed world. As bond proxies, the consumer staples were dumped in favour of perceived better value elsewhere.

With the prospect of a bump in growth, equity investors pivoted away from defensive workhorse investments to more exciting cyclical companies. Some of our current key holdings – including car companies and the mattress group Tempur Sealy – saw strong gains as investors recognised their value.

But without any change in their underlying prospects, consumer staples lost large chunks of their value. Almost overnight, for example, Unilever's price earnings ratio went from 21 times to 18.5 with no change in the company's outlook.

Now our interest was piqued.

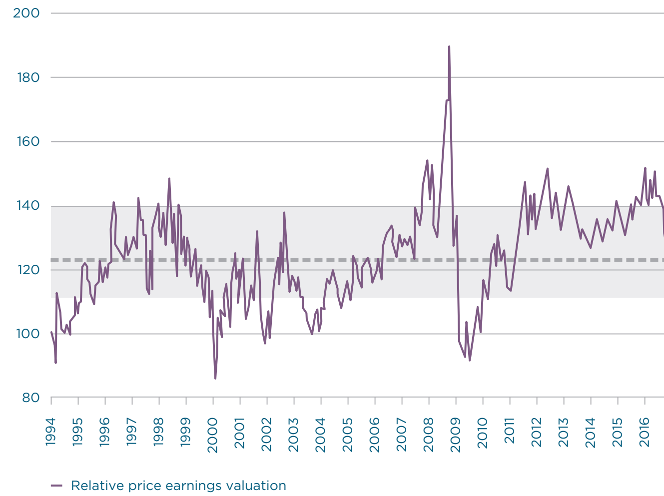
CONSUMER STAPLE SHARE DECLINES SINCE THE US ELECTIONS (PEAK-TO-TROUGH)



Source: Bloomberg

Some of the biggest names in the consumer staple sector suffered large losses since the presidential election, with Heineken and ABI both losing more than 12%. In relative terms, most consumer staples grew much cheaper. Compared to the broader market, the sector's premium retreated by almost a third in the past 12 months, while its relative price earnings valuation reverted back to the long-term mean.

GLOBAL CONSUMER STAPLES VS THE BROADER MARKET



Sources: Thomson One, IBES, Morgan Stanley Research

The sell-off in consumer staples was somewhat illogical. Nothing changed in the underlying fundamentals of these companies, and in fact, stronger economic growth will be a boon for consumer-facing corporates, particularly well-managed consumer staples.

We have moved quickly to benefit from the irrational selling in the sector. Over the last two months, we have increased our exposure to consumer staples in our Equity, Global Managed and Global Capital Plus portfolios.

We have added to the following holdings (in brackets, the weighting in the Coronation Global Equity Strategy portfolio):

BAT (1.7%) AND PHILIP MORRIS (1%)

Long-term cash flow conversion across the tobacco industry is excellent, as working capital requirements are low and capital spend is constrained. The tobacco companies have demonstrated extraordinary pricing power and shareholder-friendly capital allocation. Both groups continue to look attractive from a valuation perspective. New tobacco products – particularly the IQOS, Philip Morris's non-burning cigarette which has found a large market in Asia – could provide a growth fillip in future. In addition to its promising new-generation products, BAT has sizeable activities in the US, which will benefit from the anticipated lowering of corporate tax rates. It is also currently in negotiations to increase its US exposure with the proposed takeover and delisting of Reynolds American, the second largest cigarette seller in the US and owner of the Camel brand.

ABI (1.4%) AND HEINEKEN (1.2%)

The world's largest brewers enjoy high barriers to entry, powerful brands (with the associated pricing power this affords), distribution muscle, access to cheap capital and top talent, and most importantly, a high level of free cash-flow generation. ABI is currently digesting the SABMiller acquisition that will allow the group to reduce its cost base and improve margins.

UNILEVER (1.2%)

The British-Dutch multinational consumer goods company owns brands like Omo, Surf, Dove and Knorr. The company's share price is down more than 9% (in dollars) since the US election, despite its aggressive margin and cash targets for the medium term. We are confident that the company's adoption of a zero-based budgeting process will assist in achieving these goals.

RECKITT BENCKISER (1.2%)

The world's leading consumer health and hygiene company (with brands including Dettol, Harpic, Durex and Nurofen) has strong pricing power and sells its products across 200 markets. Arguably, Reckitt Benckiser has the most shareholder-friendly management team in the sector, with a proven ability to deliver operational results.

We have increased our collective exposure to this group of companies by 8% in the immediate aftermath of the US election. Also, we would not be surprised to see more weakness in the US bond market, which should create further opportunities in the largest consumer staples, given their correlated performance of late. As always, we will continue to be disciplined, valuation-based investors, and will only consider an investment that offers a sufficient margin of safety to our estimate of fair value. ■

HAMMERSON

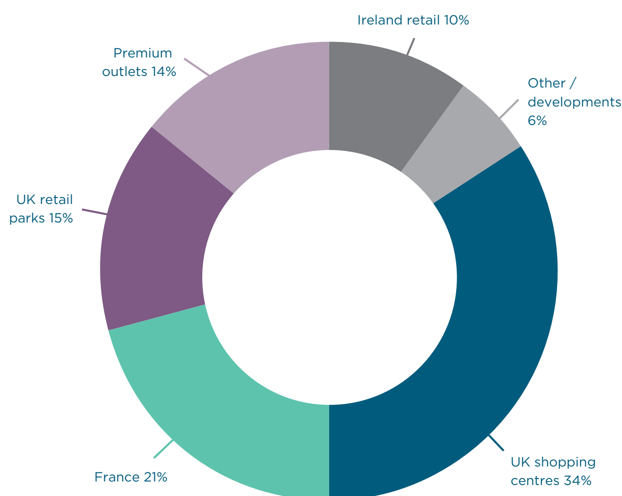
BACKING QUALITY

By Kanyane Matlou

Kanyane is an analyst within Coronation's fixed interest investment unit. He joined Coronation in 2013, and has various analytical responsibilities related to listed property research.

Hammerson is a dominant property group in the UK, owning some of the leading shopping centres across the country. The company, which is listed both in London (it is included in the FTSE 100 Index) and Johannesburg, also owns a portfolio of UK retail parks and shopping centres in France, as well as premium outlet centres in other European countries. Most recently, Hammerson gained exposure to Ireland, acquiring a stake in a portfolio of retail assets towards the end of 2015, which included that country's largest shopping centre, Dundrum.

HAMMERSON PORTFOLIO SPLIT



Source: Hammerson

DOMINANT SHOPPING CENTRES

Following years of a relatively stagnant retail environment, the UK has shown signs of recovery in recent years, with both consumer confidence and retail sales exhibiting green shoots. While it is unclear what the impact of Brexit will be on these metrics when the UK eventually leaves the EU, we expect Hammerson's portfolio to continue to benefit from the ongoing recovery in the retail environment thanks to its relatively limited exposure to London and the dominance of its assets.

In addition to giving the landlord leverage with retailers, having a dominant shopping centre is also defensive. In downturns, retailers would sooner close an average store in a secondary location than a flagship shop in a prime location. We view Hammerson's portfolio of UK shopping centres as among the most prime of the various UK landlords. Management has consistently invested in the centres over the years, optimising their leisure proposition and securing strong tenants, thereby creating ideal shopping destinations. Partly owing to the work that has gone into the portfolio, we expect the estimated rental value (ERV) of Hammerson's UK shopping centres to show growth in the low single digits over the next few years, broadly in line with the 2.2% compound annual growth recorded in the three-and-a-half years to June 2016.

With the rise of e-commerce, the sustainability of shopping centres has increasingly come under scrutiny. The UK is among the leading adopters of internet shopping, which already represents a mid-teen percentage of total sales. The need for bricks-and-mortar outlets in an age where product can be bought online and delivered on the same day, remains a key question going forward for all owners of shopping centre real estate. However, not all shopping centres are created equal. Mid-tier centres whose only offering is product that can be found online will likely feel the impact of 'e-tailing'. On the other hand, we believe that dominant shopping centres, with flagship stores and a sufficient entertainment offering, complement the e-tailing trend and remain a key avenue in a retailer's omnichannel arsenal.

While its UK shopping centre portfolio may be among the best in the country, the strength of Hammerson's retail park portfolio is not at the same level. Its retail park portfolio has seen like-for-like net rental income growth that is some 100 basis points below the average growth achieved by the Hammerson shopping centre portfolio over the past five years.

However, the retail park market has managed to maintain a healthy occupancy rate and rental growth rates have been more than decent in recent years. While we do not expect retail park rentals to go backwards, given the relatively high base rates, we see limited to no growth in rental over the next five years.

GEOGRAPHICAL DIVERSIFICATION

Unlike its London-listed peers, whose portfolios are almost exclusively UK focused, Hammerson's domestic exposure represents only 60% of its asset base. The balance is in euro-denominated assets in Ireland, France and a few other countries on the continent. This substantial euro exposure means that an investor in Hammerson faces much less UK-idiosyncratic risk than with its peers, and this is particularly pertinent in the wake of the UK referendum outcome on EU membership. While the details of the Brexit process remain murky, it is clear that the impact of any fall in asset values should hit Hammerson's net asset value (NAV) less than other members of the 'big four' (British Land, Land Securities and Intu) given its euro exposure.

On balance, this diversification element outweighs what we perceive as a relatively weaker portfolio of French shopping centres. The French retail market is facing headwinds and we expect rentals in the French portfolio to chug along sideways over the next few years, as the retail environment remains lacklustre, while occupancy cost ratios are close to their maximum levels.

Meanwhile, despite much criticism in the market relating to the full price paid for the Irish acquisition, the fundamentals of the Irish retail market are the strongest in over a decade. As a result, we see strong growth potential in ERV at Dundrum, which should lead to substantial value accretion. As long-term investors, we judge the soundness of an investment by its potential return over the long term, not just the acquisition yield in year one. With an expected compound annual growth rate in ERV of 4% to 5% over the next five years, we see Dundrum adding substantial value to the Hammerson business.

PREMIUM OUTLETS

In addition to traditional shopping centres and retail parks, Hammerson owns premium outlet centres both in the UK and on the continent, via its stakes in Value Retail and VIA Outlets (through joint venture holdings). Luxury brands are sold at discounted prices at these centres, which have attracted growing interest from tourists, both local and international. The outlet market has seen sales growth of 8% to 10% per annum since the financial crisis, with rental growth coming in at a similar level, as the rentals charged are mostly based on turnover. In recent months, Hammerson has invested additional capital into the VIA Outlets business, reflecting management's confidence in continued growth in the sector. On mainland Europe, saturation levels for outlet centres are at different points, but some runway remains for this part of the business to make up a greater portion of the Hammerson asset base.

DEVELOPMENTS

Good managers of real estate continuously work and invest in their assets to fend off competition and keep shoppers visiting. Hammerson has a pipeline of development opportunities representing just over a quarter of its standing investments. These include plans either awaiting approval or already approved, and range from leisure extensions to existing centres to the construction of new phases on vacant pieces of land adjacent to standing developments. The company recently completed phase one of its Victoria Gate development in Leeds, and is in the process of completing a dining and leisure extension at Westquay in Southampton. Additionally, three major projects are in the planning phase, expected to be completed around 2021/2022. Two of these are Croydon and Brent Cross, which are expected to breathe new life into the company's assets in South and North London respectively, cementing the dominance of its shopping centres in these regions. Together with the development of the Goodsyard project in London, these three major projects should see an investment of about £1.3 billion, which should be accretive to NAV upon completion.

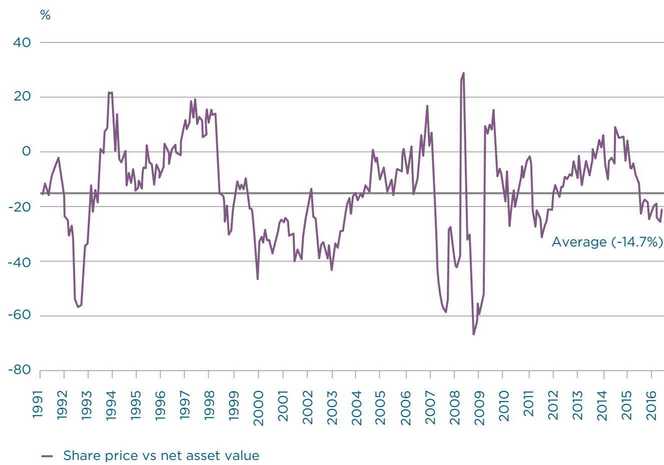
MANAGEMENT

Hammerson's management team is among the leading managers of real estate in the UK. The team has consistently delivered growth in ERV across the portfolio, and in addition to that has been able to sign rentals that are consistently above the passing rent (the previous rent amount before the renewal). In the four-and-a-half years to June 2016, Hammerson has achieved leasing levels that were on average an impressive 10% above passing rent. This has been reflected in the compelling growth in NAV per share since the financial crisis, as well as similarly impressive growth in earnings and dividend per share.

Strategically, the decision to exit the office sector in 2012 has shown management to be good allocators of capital, with the proceeds from the sale put to better use in the outlet business. While management could not have anticipated the Brexit vote, the group is also now in a better position than its peers who are more exposed to office space, which is coming under pressure following the referendum.

We believe management's decision to enter the Irish market confirms its prudence. As highlighted earlier, given the strong retail market backdrop in Ireland, the ERV growth prospects of the Irish acquisition more than outweigh the perceived 'overpayment' from an initial yield perspective.

HAMMERSON PREMIUM/DISCOUNT TO NET ASSET VALUE



Sources: Bloomberg, Coronation

CONCLUSION

We like Hammerson's portfolio of dominant assets, its geographical diversification as well as its management team. With the company having recently listed on the JSE, we are now able to gain exposure to a quality portfolio under an excellent management team, without using our offshore allowance.

We expect the value creation that should come from the UK shopping centre business, the Irish acquisition as well as the strong outlet business to outweigh the pedestrian performance of the UK retail parks and French business. With the counter trading at a discount of 20% to 25% to its last stated NAV, we believe that at these levels, Hammerson is a quality stock that is worth adding to our portfolios. ■

FRONTIER CEMENT COMPANIES

SIX DEGREES OF SEPARATION

By Gregory Longe

Gregory is an investment analyst within the Global Frontiers investment unit. He joined Coronation in February 2013 after completing his audit training at Ernst & Young.

Six degrees of separation; I am sure you have heard of it. The idea that any person in the world can be connected to any other person in six or fewer steps. Coined by Hungarian author Frigyes Karinthy in 1929, this idea entered mainstream culture in the 1990s with John Guare's play and subsequent film. The idea that we are all linked individually can also be applied to companies, especially in today's globalised world. Expanding the Coronation Frontiers offering from being focused solely on Africa to include the other global frontier markets provides examples of many such connections and, I believe, makes us better investors as a result.

After many years of investing in African frontier markets, Coronation recently launched Coronation Global Frontiers, which includes countries in Southeast Asia, the Middle East, Eastern Europe and Latin America. Heading out across the globe in the lead-up to the launch of this new portfolio, I thought that it would be our eight years of experience investing in companies across Africa that would assist in analysing frontier businesses elsewhere. While this was certainly the case, I did not expect my experience in Pakistan to help me better analyse our African and even SA investments. We have seen examples in mobile money, banking and brewing, but in no sector has this connection been quite as apparent as in the cement industry.

PAKISTAN

One of our earlier investigative trips was to Pakistan. After visiting many companies across a variety of industries, we met with one of the large cement manufacturers, Lucky Cement (Lucky). Its management was impressive, focusing on a number of areas that we viewed as important, and the meeting was a good one. From our history of investing in Africa we knew cement companies well and two things in particular caught our eye. Firstly, Lucky's energy costs and secondly, its plant location.

- Energy: In cement, energy costs make up a large proportion of total costs, as part of the production process involves the heating of limestone and clay to over 1 500 degrees Celsius. This is expensive and any saving in heating costs is a competitive advantage. What makes Lucky special is that it has optimised its plant to burn alternative fuels, such as old tyres or waste, that are cheaper than the coal or diesel used by its peers.

- Location: Lucky has two main production plants, one in the north of the country and a second in Karachi in the south. The Karachi plant is situated within the port, providing a very cheap and convenient route for overseas exports. This is another competitive advantage over its peers, who incur costs getting their cement to the port before they can export.

These two factors mean that Lucky is the lowest-cost producer in the market and very competitive globally. This cost advantage allows Lucky to export cement to many other markets – more on that later.

NIGERIA

Dangote Cement (Dangote) is the market-leading cement company in Nigeria. Dangote is a company we know well, both through a past investment in a key competitor and our current shareholding. About the same time as we were visiting Pakistan and meeting Lucky, Dangote was embarking on an ambitious expansion plan across Africa. The first phase saw cement plants built in Senegal and Cameroon as well as an investment in Sephaku, an SA company. Subsequent plants were opened in Ethiopia, Tanzania, Côte d'Ivoire, Zambia and the Congo. Like Lucky, Dangote can produce cement significantly cheaper than competitors and is often the low-cost producer in its respective markets.

SA

Dangote's entry into SA in 2014 caused an immediate stir and the company rapidly established itself, taking a national market share of 15%. By leveraging plant efficiencies and then passing these savings on to the consumer, Dangote could charge lower prices than the incumbents, whose older plants were more expensive to run. Because Dangote's

plants are situated in the interior of the country, its market share was higher in Gauteng, as it is more expensive to send cement to the coast. This was further exacerbated by cheap Asian imports into the coastal regions around Durban.

Throughout the course of 2014 and early 2015, we began to hear complaints from SA cement manufacturers, including Dangote and Pretoria Portland Cement (PPC), about the 'dumping' of cement by Pakistani companies. One of the largest exporters to SA was in fact Lucky, the low-cost Pakistani cement producer we had recently met. We were thus able to leverage our exposure in global frontier markets like Pakistan, and our African experience in Nigeria, to deepen our understanding of the investment case for Dangote and the SA cement industry.

This connection of markets and companies has recurred numerous times since, whether it is PPC and Dangote with plants in Ethiopia, or Lucky and PPC in the Democratic Republic of the Congo. The benefits of knowing all of the affected companies, and of hearing both sides of the story, have been invaluable in helping us form our investment views. More than just providing insight into the investment case for Dangote or Lucky, it has also helped us relook the investment case of their competitors. By avoiding investments in some of their competitors, we have escaped the occasional rights issue or two. The move into global frontier markets has improved the depth of our understanding of companies in our 'home' markets.

On an individual level, Facebook has been instrumental in driving down the number of steps needed to connect to any other person. Across their user base, the average number is now only 3.6 steps, down from 5.3 steps in 2008. In an increasingly globalised world, I have no doubt that the interconnectedness of markets and companies will continue to deepen in a similar way, even in the frontier parts of the world that one would not expect. ■

Coronation Global Frontiers is an institutional-only portfolio. Another institutional portfolio, Coronation Africa Frontiers, is managed by the same team and included as an underlying holding in our multi-asset funds such as Coronation Balanced Plus.

DOMESTIC FLAGSHIP FUND RANGE

Coronation offers a range of domestic and international funds to cater for the majority of investor needs. These funds share the common Coronation DNA of a disciplined, long-term focused and valuation-based investment philosophy and our commitment to provide investment excellence.

■ INCOME ■ GROWTH

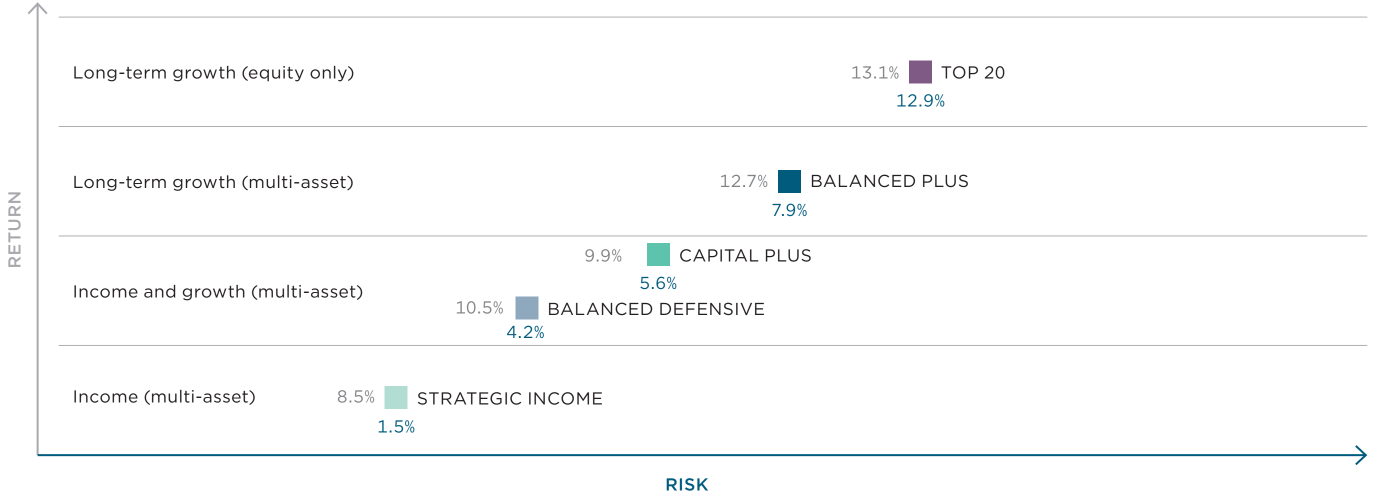
	INVESTOR NEED				
	INCOME ONLY	INCOME AND GROWTH		LONG-TERM CAPITAL GROWTH	
FUND	STRATEGIC INCOME Cash†	BALANCED DEFENSIVE Inflation†	CAPITAL PLUS Inflation†	BALANCED PLUS Composite benchmark† (equities, bonds and cash)	TOP 20 FTSE/JSE CAPI†
FUND DESCRIPTION	Conservative asset allocation across the yielding asset classes. Ideal for investors looking for an intelligent alternative to cash or bank deposits over periods from 12 to 36 months.	A lower risk alternative to Capital Plus for investors requiring a growing regular income. The fund holds fewer growth assets and more income assets than Capital Plus and has a risk budget that is in line with the typical income-and-growth portfolio.	Focused on providing a growing regular income. The fund has a higher risk budget than the typical income-and-growth fund, making it ideal for investors in retirement seeking to draw an income from their capital over an extended period of time.	Best investment view across all asset classes. Ideal for pre-retirement savers as it is managed in line with the investment restrictions that apply to pension funds. If you are not saving within a retirement vehicle, consider Market Plus, the unconstrained version of this mandate.	A concentrated portfolio of 15-20 shares selected from the entire JSE, compared to the average equity fund holding 40-60 shares. The fund requires a longer investment time horizon and is an ideal building block for investors who wish to blend their equity exposure across a number of funds. Investors who prefer to own just one equity fund may consider the more broadly diversified Coronation Equity Fund.
INCOME VS GROWTH ASSETS[1]	92.1% / 7.9%	61.8% / 38.2%	44.1% / 55.9%	19.5% / 80.5%	0.2% / 99.8%
LAUNCH DATE	Jul 2001	Feb 2007	Jul 2001	Apr 1996	Oct 2000
ANNUAL RETURN (Since launch)	10.5% †7.9%	10.2% †6.3%	13.0% †6.0%	15.3% †13.6%	19.2% †14.7%
QUARTILE RANK (Since launch)	1st	1st	1st	1st	1st
ANNUAL RETURN (Last 10 years)	9.0% †7.1%	– –	9.5% †6.3%	11.1% †10.7%	12.5% †10.4%
QUARTILE RANK (Last 10 years)	1st	–	1st	1st	1st
ANNUAL RETURN (Last 5 years)	8.5% †5.8%	10.5% †5.6%	9.9% †5.6%	12.7% †12.8%	13.1% †13.4%
QUARTILE RANK (Last 5 years)	1st	1st	2nd	1st	2nd
STANDARD DEVIATION (Last 5 years)	1.5% †0.2%	4.2% †1.4%	5.6% †1.4%	7.9% †6.8%	12.9% †11.4%
FUND HIGHLIGHTS	Outperformed cash by 2.7% p.a. over the past 5 years and 2.7% p.a. since launch in 2001.	Outperformed inflation by 3.9% p.a. (after fees) since launch, while producing positive returns over all 12-month periods. A top performing conservative fund in South Africa over 5 years.	Outperformed inflation by 7% p.a. (after fees) since launch, while producing positive returns over 24 months more than 95% of the time.	No. 1 balanced fund in SA since launch in 1996, outperforming its average competitor by 2.4% p.a. Outperformed inflation by on average 8.8% p.a. since launch and outperformed the ALSI on average by 1.5% p.a.	The fund added 4.5% p.a. to the return of the market. This means R100 000 invested in Top 20 at launch in Oct 2000 grew to more than R1.7 million by end December 2016 – nearly double the value of its current benchmark. The fund is a top quartile performer since launch.

[1] Income versus growth assets as at 31 December 2016. Growth assets defined as equities, listed property and commodities (excluding gold).

Figures are quoted from Morningstar as at 31 December 2016 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

RISK VERSUS RETURN

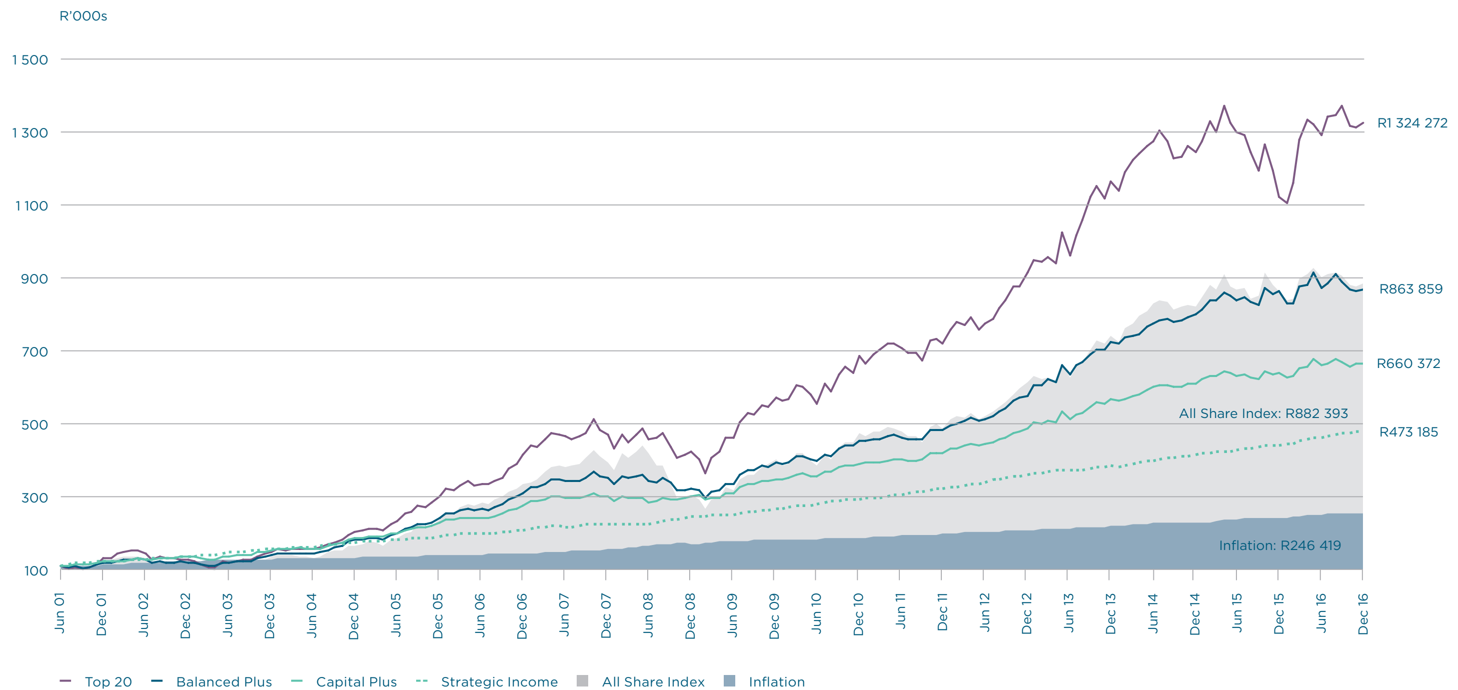
5-year annualised return and risk (standard deviation) quoted as at 31 December 2016.
Figures quoted in ZAR after all income reinvested and all costs deducted.



Source: Morningstar

GROWTH OF R100 000 INVESTED IN OUR DOMESTIC FLAGSHIP FUNDS ON 1 JULY 2001

Value of R100 000 invested in Coronation's domestic flagship funds since inception of Capital Plus on 1 July 2001 as at 31 December 2016. All income reinvested for funds; FTSE/JSE All Share Index is on a total return basis. Balanced Defensive is excluded as it was only launched on 2 February 2007.



Source: Morningstar

INTERNATIONAL FLAGSHIP FUND RANGE

■ INCOME ■ GROWTH

INVESTOR NEED

	DEPOSIT ALTERNATIVE	CAPITAL PRESERVATION	LONG-TERM CAPITAL GROWTH (MULTI-ASSET)	LONG-TERM CAPITAL GROWTH (EQUITY ONLY)	
FUND[1]	**GLOBAL STRATEGIC USD INCOME [ZAR] FEEDER** **GLOBAL STRATEGIC USD INCOME** US dollar cash (3 Month Libor)†	**GLOBAL CAPITAL PLUS [ZAR] FEEDER** **GLOBAL CAPITAL PLUS [FOREIGN CURRENCY][4]** US dollar cash (3 Month Libor)*	**GLOBAL MANAGED [ZAR] FEEDER** **GLOBAL MANAGED [USD]** Composite (equities and bonds)†	**GLOBAL OPPORTUNITIES EQUITY [ZAR] FEEDER** **GLOBAL OPPORTUNITIES EQUITY [USD]** MSCI ACWI†	**GLOBAL EMERGING MARKETS FLEXIBLE [ZAR]** **GLOBAL EMERGING MARKETS [USD]** MSCI Emerging Markets Index†
FUND DESCRIPTION	An intelligent alternative to dollar-denominated bank deposits over periods of 12 months or longer.	A low-risk global balanced fund reflecting our best long-term global investment view moderated for investors with smaller risk budgets. We offer both hedged and houseview currency classes of this fund. In the case of the former, the fund aims to preserve capital in the class currency over any 12-month period.	A global balanced fund reflecting our best long-term global investment view for investors seeking to evaluate outcomes in hard currency terms. Will invest in different asset classes and geographies, with a bias towards growth assets in general and equities in particular.	A diversified portfolio of the best global equity managers (typically 6-10) who share our investment philosophy. An ideal fund for investors who prefer to own just one global equity fund. Investors who want to blend their international equity exposure may consider Coronation Global Equity Select, which has more concentrated exposure to our best global investment views.	Our top stock picks from companies providing exposure to emerging markets. The US dollar fund remains fully invested in equities at all times, while the rand fund will reduce equity exposure when we struggle to find value.
INCOME VS GROWTH ASSETS[2]	97.4% / 2.6%	54.7% / 45.3%	27.3% / 72.7%	0.6% / 99.4%	0.1% / 99.9%
LAUNCH DATE	Aug 2013 Dec 2011	Nov 2008 Sep 2009	Oct 2009 March 2010	Aug 1997 May 2008	Dec 2007 July 2008
ANNUAL RETURN[3] (Since launch)	2.8% † 0.4%	5.4% †0.5%	6.5% †6.0%	6.2% †5.3%	0.8% †(1.4%)
QUARTILE RANK (Since launch)	1st	1st	1st	1st	1st
ANNUAL RETURN (Last 5 years)	2.8% 0.4%	3.7% 0.4%	7.0% 6.2%	8.7% 10.9%	2.3% 1.6%
QUARTILE RANK (Last 5 years)	-	1st	1st	1st	4th
FUND HIGHLIGHTS	Outperformed US dollar cash by 2.4% p.a (after fees) since launch in December 2011.	The fund has outperformed US dollar cash by 5% p.a. (after fees) since launch in 2008.	No. 1 global multi-asset high equity fund in SA since launch in October 2009.	Both the rand and US dollar versions of the fund outperformed the global equity market with less risk since their respective launch dates.	Both the rand and US dollar versions of the fund outperformed the MSCI Emerging Markets Index by more than 2.2% p.a. since their respective launch dates.

1. *Rand- and US dollar-denominated fund names are included for reference.*
2. *Income versus growth assets as at 31 December 2016 (for US dollar funds). Growth assets defined as equities, listed property and commodities (excluding gold).*
3. *Returns quoted in US dollar for the oldest fund.*
4. *Available in US dollar Hedged, GBP Hedged, EUR Hedged or Houseview currency classes.*

Figures are quoted from Morningstar as at 31 December 2016 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

Collective Investment Schemes in Securities (unit trusts) are generally medium- to long-term investments. The value of participatory interests (units) may go down as well as up and past performance is not necessarily an indication of future performance. Participatory interests are traded at ruling prices and can engage in scrip lending and borrowing. Fluctuations or movements in exchange rates may cause the value of underlying investments to go up or down. A schedule of fees and charges is available on request from the management company. Pricing is calculated on a net asset value basis, less permissible deductions. Forward pricing is used. Commission and incentives may be paid and, if so, are included in the overall costs. Coronation is a member of the Association for Savings and Investment SA (ASISA).

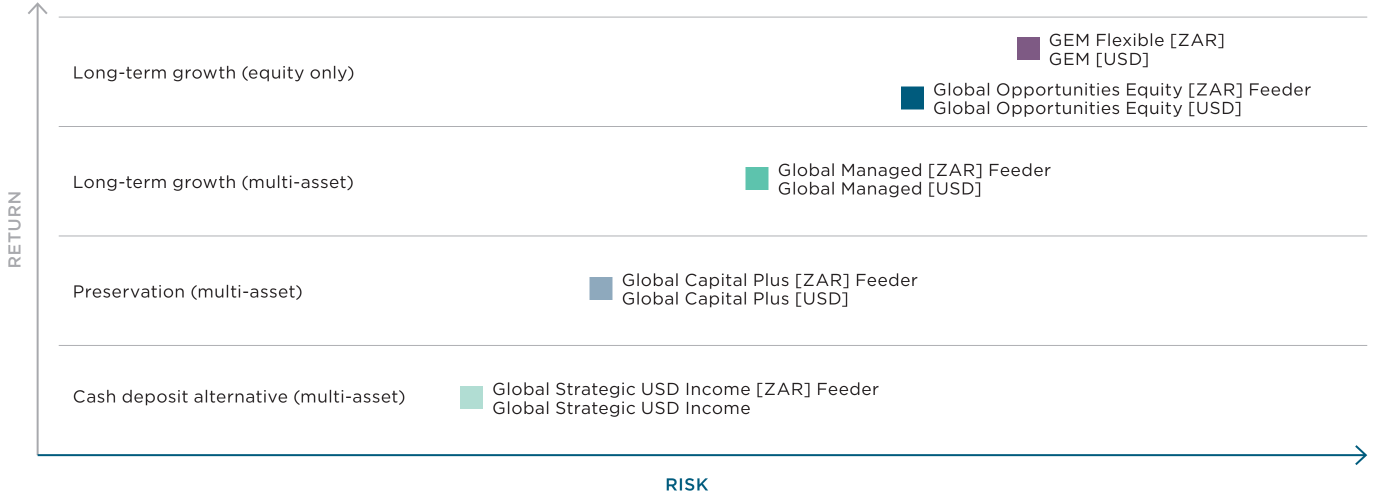
HAVE YOU CONSIDERED EXTERNALISING RANDS? IT'S EASIER THAN YOU MIGHT THINK.

The SA Reserve Bank allows each resident SA taxpayer to externalise funds of up to R11 million per calendar year (R10 million foreign capital allowance and a R1 million single discretionary allowance) for direct offshore investment in foreign currency denominated assets. If you want to invest more than R1 million, the process is as easy as:

1. Obtain approval from SARS by completing the appropriate form available via eFiling or your local tax office. Approvals are valid for 12 months and relatively easy to obtain if you are a taxpayer in good standing.
2. Pick the mandate that is appropriate to your needs from the range of funds listed here. You may find the 'Choosing a Fund' section or 'Compare Funds' tool on our website helpful, or you may want to consult your financial advisor if you need advice.
3. Complete the relevant application forms and do a swift transfer to our US dollar subscription account. Your banker or a foreign exchange currency provider can assist with the forex transaction, while you can phone us on 0800 86 96 42, or read the FAQ on our website, at any time if you are uncertain.

EXPECTED RISK VERSUS RETURN

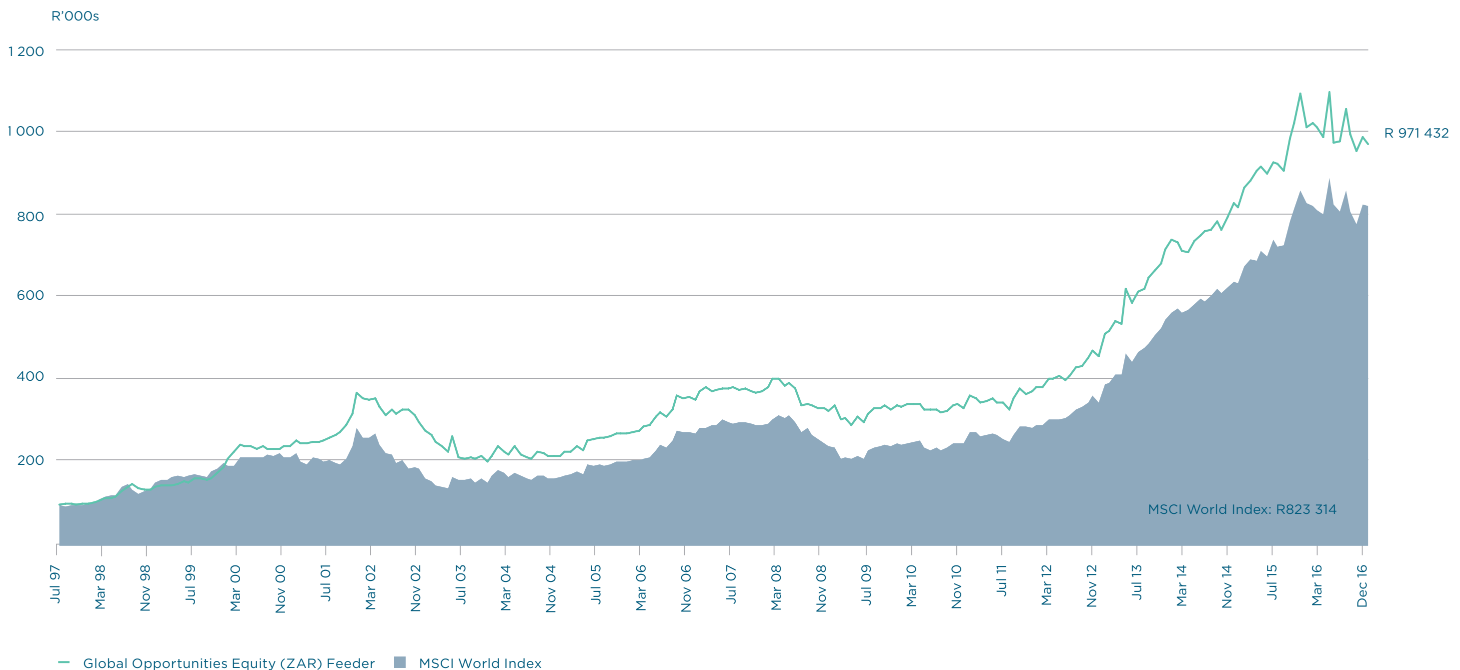
Expected return and risk positioning for both rand- and dollar-denominated funds after all income reinvested and all costs deducted.



Source: Morningstar

GROWTH OF R100 000 INVESTED IN GLOBAL OPPORTUNITIES EQUITY [ZAR] FEEDER ON 1 AUGUST 1997

Value of R100 000 invested in Global Opportunities Equity [ZAR] Feeder on 1 August 1997 as at 31 December 2016. All income reinvested for funds; MSCI World Index is on a total return basis. Global Capital Plus [ZAR] Feeder, Global Emerging Markets Flexible [ZAR], Global Managed [ZAR] Feeder and Global Strategic USD Income [ZAR] Feeder, which were launched between 2007 and 2012, have not been included.

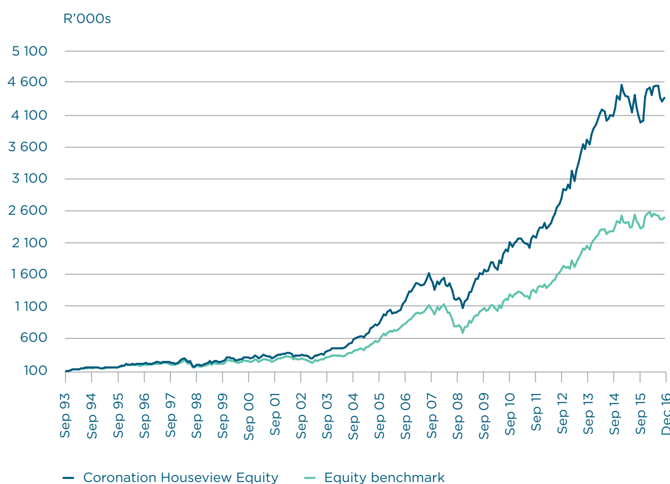


Source: Morningstar

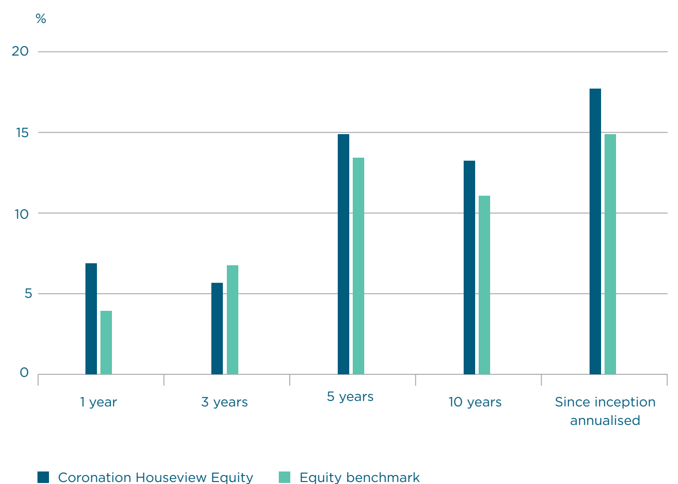
CORONATION HOUSEVIEW EQUITY* RETURNS VS EQUITY BENCHMARK

5-YEAR ANNUALISED RETURNS	CORONATION HOUSEVIEW EQUITY	EQUITY BENCHMARK	ALPHA
1998	8.15%	6.49%	**1.66%**
1999	14.23%	10.91%	**3.33%**
2000	10.93%	7.52%	**3.41%**
2001	10.95%	9.38%	**1.57%**
2002	9.46%	7.80%	**1.66%**
2003	18.02%	13.78%	**4.24%**
2004	14.12%	9.63%	**4.49%**
2005	23.35%	18.94%	**4.41%**
2006	28.38%	23.66%	**4.72%**
2007	33.79%	29.55%	**4.24%**
2008	23.36%	19.73%	**3.63%**
2009	22.23%	20.67%	**1.56%**
2010	18.55%	15.73%	**2.82%**
2011	11.58%	8.73%	**2.85%**
2012	13.39%	10.10%	**3.29%**
2013	24.37%	20.21%	**4.16%**
2014	19.39%	16.08%	**3.31%**
2015	14.05%	13.14%	**0.91%**
2016	14.77%	13.33%	**1.44%**
ANNUALISED TO 31 DECEMBER 2016			
1 year	6.83%	3.94%	**2.89%**
3 years	5.61%	6.68%	**(1.08%)**
5 years	14.77%	13.33%	**1.44%**
10 years	13.16%	11.01%	**2.16%**
Since inception in October 1993 annualised	17.62%	14.82%	**2.80%**
Average outperformance per 5-year return			**3.04%**
Number of 5-year periods outperformed			**19.00**
Number of 5-year periods underperformed			**-**

CUMULATIVE PERFORMANCE



ANNUALISED RETURNS TO 31 DECEMBER 2016



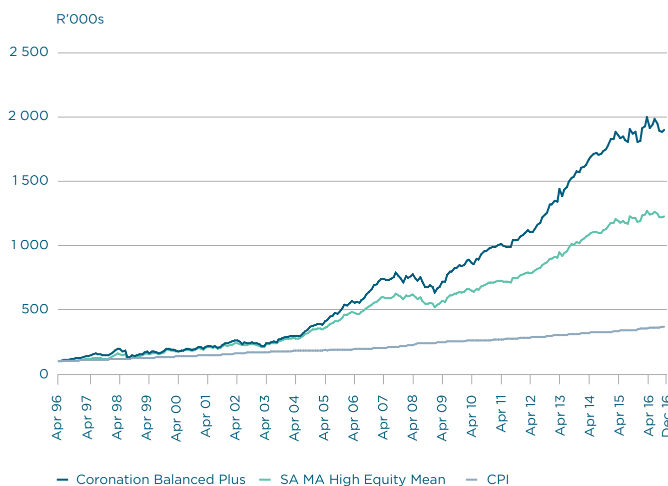
An investment of R100 000 in Coronation Houseview Equity on 1 October 1993 would have grown to **R4 354 657** by 31 December 2016. By comparison, the returns generated by the Equity Benchmark over the same period would have grown a similar investment to **R2 487 973**.

** Coronation Houseview Equity, which is an institutional portfolio, has been used to illustrate Coronation's investment track record since inception of the business in 1993.*

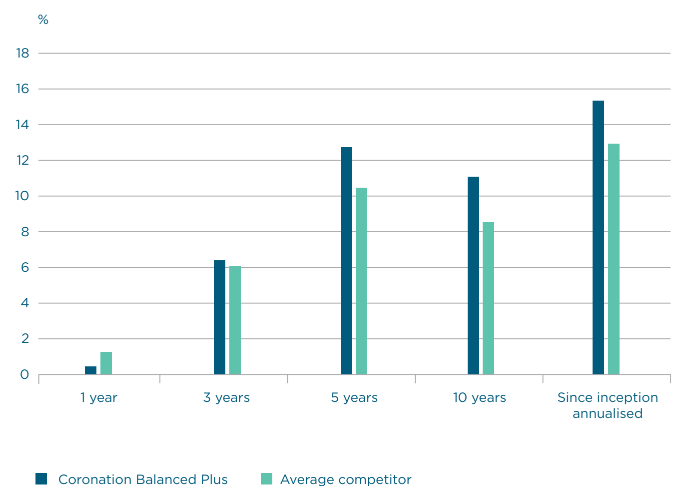
CORONATION BALANCED PLUS FUND VS INFLATION AND AVERAGE COMPETITOR*

5-YEAR ANNUALISED RETURNS	CORONATION BALANCED PLUS	INFLATION	REAL RETURN
2000	16.00%	7.90%	**8.10%**
2001	14.38%	7.41%	**6.97%**
2002	10.73%	8.04%	**2.69%**
2003	14.68%	7.33%	**7.35%**
2004	13.82%	6.68%	**7.14%**
2005	20.53%	5.85%	**14.68%**
2006	22.43%	5.54%	**16.89%**
2007	25.35%	5.17%	**20.18%**
2008	19.28%	6.41%	**12.87%**
2009	17.60%	6.82%	**10.77%**
2010	13.97%	6.71%	**7.26%**
2011	9.49%	6.94%	**2.55%**
2012	10.81%	6.36%	**4.45%**
2013	17.98%	5.39%	**12.58%**
2014	15.57%	5.19%	**10.38%**
2015	14.05%	5.54%	**8.51%**
2016	12.69%	5.59%	**7.10%**
ANNUALISED TO 31 DECEMBER 2016	**CORONATION BALANCED PLUS**	**AVERAGE COMPETITOR**	**ALPHA**
1 year	0.54%	1.31%	**(0.77%)**
3 years	6.41%	6.10%	**0.31%**
5 years	12.69%	10.39%	**2.30%**
10 years	11.08%	8.57%	**2.50%**
Since inception in April 1996 annualised	15.30%	12.90%	**2.40%**
Average 5-year real return			**9.44%**
Number of 5-year periods where the real return is >10%			**7.00**
Number of 5-year periods where the real return is 5% – 10%			**7.00**
Number of 5-year periods where the real return is 0% – 5%			**3.00**

CUMULATIVE PERFORMANCE



ANNUALISED RETURNS TO 31 DECEMBER 2016



An investment of R100 000 in Coronation Global Balanced on 1 October 1993 would have grown to **R1 897 148** by 31 December 2016. By comparison, the SA multi-asset high-equity sector over the same period would have grown a similar investment to **R1 228 281**.

** Median of Peer Group is the median of the fully-discretionary retirement portfolios of the largest managers as published in performance surveys and calculated by Coronation Fund Managers.*

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