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The Personal Investments Quarterly

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JANUARY 2019 SUMMER EDITION

CORONATION
TRUST IS EARNED™

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Notes from my inbox

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.

"He who indulges in empty fears earns himself real fears. We should always allow some time to elapse, for time discloses the truth." – Lucius Annaeus Seneca

THE FOURTH QUARTER brought a dismal end to a jarring year for investors. Despite the global economy remaining in reasonable health, fear decisively trumped optimism across markets, leading to record outflows from active global equity funds in December. The result was the worst year since 2008, with all major equity markets around the globe losing money in dollar terms. The MSCI All Country World Index ended 9.4% down and the FTSE/JSE All Share Index declined by 21% in dollar terms and 8.5% in rand terms, while the shareholder-weighted index declined by 12% in rand. As your fund manager, we did not enhance the poor outcomes produced by the markets, with most of our flagship funds ending the year somewhat behind benchmark. While our long-term track record remains intact, the performance produced by our equity and multi-asset funds over the short to medium term have not met our own expectations.

During the tough times, our job is to remain resolutely focused on allocating the capital you have entrusted to our oversight

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to the best of our ability. This requires our investment team to find the right balance between remaining disciplined and committed in positions where market prices have declined but the long-term investment theses remain intact, and the humility and pragmatism to exit where we conclude that we have made a mistake. We share more insight into the current investment cycle in CIO Karl Leinberger's reflections on a tough year on page 6.

The better news is that long-term return prospects have improved. Valuations take a back seat at times that emotions drive markets, but in every single prior cycle, the fundamentals have eventually reasserted their influence on asset prices. We know from your feedback that the average return expectation among our clients with long-term horizons is 12% per annum. While our largest fund, Coronation Balanced Plus, returned only 4.9% per annum over the past five years, it delivered a return in excess of 12% per annum in three out of every four rolling five-year periods since its launch nearly 23 years ago (its 76% success rate compares to the 57% achieved by its peer group average over the same period). Achieving this return target over the next five years is much more probable given current valuation levels, which is the most attractive that we have seen in a decade.

In this edition, we cover some of the themes that will shape outcomes in the year ahead. Economist Marie Antelme sets out our thoughts on the prospects for the global and local economies, highlighting that despite the inevitable risks, there is some macro support for the view that assets, including in emerging markets such as South Africa, may have become oversold in 2018. With an erratic US president, an increasingly chaotic Brexit and a local election coming up, political risk remains one of the big concerns. Portfolio manager Suhail Suleman reports on political developments in Latin America, where two rather different leaders were recently elected in Mexico and Brazil, the region's two biggest economies. We also show how political uncertainty can create opportunity in Nic Stein's article on Quilter, which is well positioned to benefit from structural changes in the UK's pension and savings market while being priced undemandingly because of Brexit fears.

Another component of our role as stewards of your capital is to provide leadership to the companies we invest in with regards to governance, environmental and social issues. Portfolio manager Pallavi Ambekar gives a review of our approach to this increasingly scrutinised area and gives some examples of successful past interventions that helped to ensure that shareholders' agents, in the form of boards of directors, management teams and auditors, act in the best interests of their stakeholders. In our personal financial planning feature, we explain why 5, 15 and 75 are the numbers that drive retirement.

As always, I invite you to get in touch with us via clientservice@coronation.com if you have any concerns about your investment or any aspect of our service to you.

Here's to a more constructive 2019.

Pieter

Key performance indicators and fund performance

AS AT 31 DECEMBER 2018

	QTD	YTD	1 YEAR	3 YEARS	5 YEARS	10 YEARS	15 YEARS	20 YEARS
DOMESTIC INDICES								
CAPI (J303T)	(4.9%)	(7.7%)	(7.7%)	4.3%	5.8%	12.8%	15.0%	-
ALSI (J203T)	(4.9%)	(8.5%)	(8.5%)	4.3%	5.8%	12.6%	14.7%	15.8%
Top 40 (J200T)	(5.3%)	(8.3%)	(8.3%)	3.6%	5.4%	12.3%	14.3%	15.7%
SWIX (J403T)	(4.0%)	(11.7%)	(11.7%)	3.7%	5.9%	13.0%	15.3%	-
ALSI Industrials (J257T)	(6.5%)	(17.5%)	(17.5%)	(1.9%)	4.9%	15.9%	18.1%	15.5%
ALSI Financials (J580T)	(2.1%)	(8.8%)	(8.8%)	5.1%	8.9%	15.0%	15.4%	12.8%
ALSI Resources (J258T)	(4.5%)	15.5%	15.5%	22.3%	(0.4%)	3.9%	8.0%	15.2%
SA Listed Property (J253T)	(4.0%)	(25.3%)	(25.3%)	(1.2%)	5.7%	12.1%	16.8%	-
BEASSA (TR) All Bond Index	2.7%	7.7%	7.7%	11.1%	7.7%	7.7%	8.6%	11.3%
Short Term Fixed Interest 3 Month Cash Rate	1.7%	6.9%	6.9%	7.0%	6.6%	6.4%	7.1%	-
CPI	0.6%	4.6%	4.6%	5.4%	5.3%	5.4%	5.7%	6.1%
INTERNATIONAL INDICES								
MSCI ACWI (USD)	(12.8%)	(9.4%)	(9.4%)	6.6%	4.3%	9.5%	6.2%	-
MSCI WORLD (USD)	(13.4%)	(8.7%)	(8.7%)	6.3%	4.6%	9.7%	6.2%	4.4%
MSCI GEM (USD)	(7.5%)	(14.6%)	(14.6%)	9.2%	1.6%	8.0%	7.9%	8.5%
S&P 500 (USD)	(13.5%)	(4.4%)	(4.4%)	9.3%	8.5%	13.1%	7.8%	5.6%
BGBA (USD)	1.2%	(1.2%)	(1.2%)	2.7%	1.1%	2.5%	3.3%	3.8%
3 Month Libor (USD)	0.7%	2.4%	2.4%	1.5%	1.0%	0.7%	1.7%	2.3%
MSCI ACWI (ZAR)	(11.5%)	5.1%	5.1%	4.0%	11.3%	14.0%	11.8%	-
MSCI WORLD (ZAR)	(12.2%)	5.9%	5.9%	3.7%	11.6%	14.3%	11.8%	9.2%
MSCI GEM (ZAR)	(6.2%)	(0.9%)	(0.9%)	6.6%	8.5%	12.5%	13.6%	-
3 Month Libor (ZAR)	2.1%	18.7%	18.7%	(1.0%)	7.8%	4.9%	7.1%	7.0%
SPOT RATES								
Rand Dollar exchange rate	14.2	12.4	12.4	15.5	10.4	9.5	6.6	5.9
Rand Dollar % change	(1.4%)	(13.8%)	(13.8%)	2.5%	(6.3%)	(4.0%)	(5.0%)	(4.4%)
Rand Euro exchange rate	16.42	14.9	14.9	16.8	14.4	13.2	8.4	7.0
Rand Pound exchange rate	18.4	16.7	16.7	22.5	17.3	13.7	11.8	9.7
Gold price (USD)	1 187.3	1 296.5	1 296.5	1 062.3	1 201.5	8 69.8	4 17.3	2 87.80
Oil price (USD barrel)	82.9	66.5	66.5	37.3	110.8	45.6	30.2	11.0

	QTD	YTD	1 YEAR	3 YEARS	5 YEAR S	10 YEARS	15 YEARS	20 YEARS	SINCE LAUNCH
DOMESTIC FUNDS (PERFORMANCE IN RANDS)									
Coronation Top 20 Fund	(4.9%)	(12.2%)	(12.2%)	7.0%	3.4%	12.7%	16.5%	-	17.2%
ASISA Mean of South African Equity General	(5.0%)	(8.9%)	(8.9%)	2.1%	3.9%	10.5%	13.5%	-	13.9%
Coronation Market Plus Fund**	(5.3%)	(6.9%)	(6.9%)	2.6%	4.5%	11.9%	14.2%	-	15.0%
ASISA Mean of South African Multi-Asset Flexible	(4.1%)	(4.6%)	(4.6%)	1.9%	4.7%	9.6%	11.1%	-	-
Coronation Balanced Plus Fund	(5.9%)	(6.3%)	(6.3%)	2.0%	4.9%	11.3%	13.9%	14.1%	14.1%
ASISA Mean of South African Multi-Asset High Equity	(4.5%)	(3.6%)	(3.6%)	2.5%	5.0%	9.4%	12.2%	13.2%	12.2%
Coronation Capital Plus Fund	(4.1%)	(2.5%)	(2.5%)	2.8%	4.2%	8.9%	11.0%	-	11.6%
ASISA Mean of South African Multi-Asset Medium Equity	(3.7%)	(1.9%)	(1.9%)	2.8%	4.9%	8.6%	10.3%	-	10.9%
Coronation Balanced Defensive Fund	(2.3%)	2.0%	2.0%	4.5%	6.1%	9.8%	-	-	9.3%
ASISA Mean of South African Multi-Asset Low Equity	(1.8%)	1.3%	1.3%	4.3%	5.9%	8.2%	-	-	7.5%
Coronation Strategic Income Fund	1.8%	7.3%	7.3%	8.6%	8.0%	8.9%	9.2%	-	10.3%
ASISA Mean of South African Multi-Asset Income	1.9%	7.5%	7.5%	8.0%	7.3%	7.3%	7.7%	-	8.7%
INTERNATIONAL FUNDS (PERFORMANCE IN USD)									
Coronation Global Opportunities Equity Fund	(16.7%)	(13.8%)	(13.8%)	3.0%	2.2%	8.2%	-	-	4.3%
Coronation Global Emerging Markets Fund	(11.4%)	(26.2%)	(26.2%)	5.1%	-3.6%	8.1%	-	-	2.9%
Coronation Global Managed Fund	(10.7%)	(14.0%)	(14.0%)	2.8%	0.4%	-	-	-	4.8%
Coronation Global Capital Plus Fund	(5.0%)	(5.9%)	(5.9%)	2.4%	0.5%	-	-	-	3.3%
Coronation Global Strategic Income Fund	(0.6%)	(0.5%)	(0.5%)	1.3%	1.2%	-	-	-	2.3%

Meaningful periods

* All ASISA averages exclude Coronation funds in that category

** Highest annual return (Coronation Market Plus): 50.0% (Aug 2004 - Jul 2005); lowest annual return: -20.1% (Mar 2008 - Feb 2009); fund launch date 2 July 2001

Figures as at 31 December 2018; for detailed fund performance, refer to pages 34 and 36

Taking stock

Reflecting on a tough year

By Karl Leinberger

2018 WAS A bruising year for us, with many of our funds underperforming the already anaemic market benchmarks. I used my December break, away from the mania that is financial markets, to reflect on lessons learned, the defining positions in our funds and how this most recent cycle compares to previous cycles I have lived through in my 19 years at Coronation.

RECENT UNDERPERFORMANCE IN THE LONG-TERM CONTEXT

We have been here before – painful periods of underperformance have been a regular feature of our long-term track record.

Our last period of acute underperformance serves as an excellent case study in this analysis. Three years ago, in the late stages of the commodity bear market, in a piece to clients on long-term investing, I made the following comment: "The graphs … show how misleading short-term alpha is. Notwithstanding consistent and compelling delivery on a long-term cumulative basis, our portfolios have underperformed the market in one out of three years. However, in every one of those periods, the portfolio actions that caused short-term pain (buying dramatically undervalued assets that were falling, while selling overvalued assets that were rising) were the very same actions that delivered compelling results when the cycle (subsequently) turned."

Karl is Chief Investment Officer (CIO) and manager of Coronation's Houseview strategies. He joined Coronation in 2000 as an equity analyst, was made head of research in 2005 and became CIO in 2008. Karl has 19 years' investment experience.

In the three years since, this argument has been strongly vindicated. Commodity stocks were widely loathed at the time and our overweight position had, until that point, been very costly. In the article, I referred to Anglo American moving from $10 to $70 through the bull market, only to collapse to an absurdly low $3.50 at the time of writing. A week after writing, the cycle turned (if only we had known then that we were at the bottom of the market!). Anglo is up an eye-watering seven times in the three years since.

The article included an analysis of alpha in our flagship Houseview Equity fund over the full period of our history as an investment firm. This has been updated appropriately in the accompanying graphs and table, and merits the following observations:

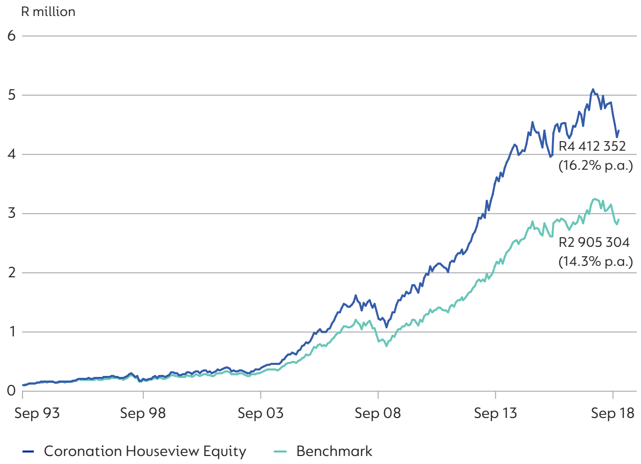
- *Short-term alpha*. Although it does not feel like it, the data show that this cycle to have been fairly mild compared to some of the seven other downcycles we have lived through over the years.
- *Long-term alpha*. Our long-term track record remains compelling in what has been a very challenging 25-year period in which to manage retirement capital – characterised by notable events such as the transition to democracy, emerging markets crises, currency collapses, the Global Financial Crisis (GFC) and more recently, Nenegate, to name but a few.
- *Medium-term alpha*. The graphs show quite neatly how this cycle has differed from previous ones, in that our five-year alpha turned negative in 2018 for the first time in our 25-year history. Although five years fall short of a full business and investment cycle, it is an important and closely watched performance metric.

WHY HAS THIS PARTICULAR PERFORMANCE CYCLE BEEN SO TOUGH?

Previous periods of Coronation underperformance were largely due to a single cycle playing itself out (examples include the currency blowout in 2001, the interest rate cycle in 2006, the commodity cycles in 2008/2016 and the GFC in 2008/2009). >

LONG-TERM ANNUALISED PERFORMANCE

Specialist South African equity mandate as at 31 December 2018



Benchmark: FTSE/JSE SWIX; FTSE/JSE Capped SWIX from 1 December 2016

Note: Performance is gross of fees (management and performance) and expenses in ZAR. It includes re-investment of dividends.

Sources: Coronation, IRESS

COMPOUNDING: THE MOST POWERFUL FORCE IN THE UNIVERSE

1.9% alpha takes a 29-bagger to a 44-bagger over 25 years

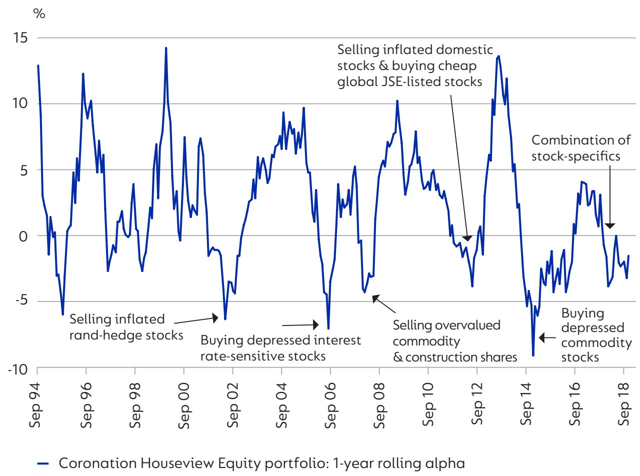
	Coronation Houseview Equity Portfolio	FTSE/JSE Capped SWIX**	Alpha
Since inception*	16.2%	14.3%	1.9%
20 years	17.0%	15.1%	1.9%
10 years	13.5%	12.7%	0.8%
5 years	3.6%	5.3%	(1.7%)
3 years	2.7%	2.7%	(0.1%)
1 year	(12.5%)	(10.9%)	(1.5%)

* September 1993
** Benchmark: FTSE/JSE SWIX; FTSE/JSE Capped SWIX from 1 December 2016
Note: Performance is gross of fees (management and performance) and expenses in ZAR. It includes re-investment of dividends.

Sources: Coronation, IRESS

SHORT-TERM ALPHA IS LUMPY

A successful track record comes with testing years

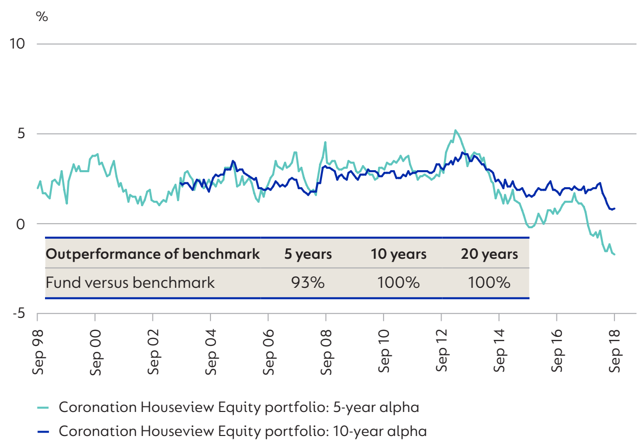


As at 31 December 2018
Benchmark: FTSE/JSE SWIX; FTSE/JSE Capped SWIX from 1 December 2016

Sources: Coronation, IRESS

ALPHA OVER MEANINGFUL PERIODS

It is over the long term that we measure results



Outperformance of benchmark	5 years	10 years	20 years
Fund versus benchmark	93%	100%	100%

As at 31 December 2018

Sources: Coronation, IRESS

This time around, things are a little different, with a combination of several meaningful but unrelated positions in out-of-favour asset classes and stocks all detracting in the same period (despite very different fundamentals).

Key detractors include:

- *Asset classes*: overweights in local equities, emerging market equities and high-quality property stocks.
- *Stock-specifics*: large positions in British American Tobacco, Northam Platinum, MTN, Intu, Hammerson, Anheuser-Busch InBev and Quilter.

NOTHING HAS CHANGED

We strongly believe that nothing has changed for us. The investment philosophy and process that have delivered through many performance cycles for two-and-a-half decades remain unchanged.

It is a process that has delivered an exemplary long-term track record across multiple asset classes and geographies (local equities, fixed income, asset allocation funds, emerging market equities and frontier markets).

The same people, working harder than ever, are managing your money and doing the hard yards in our research effort (albeit with a few more scars on our backs!). We remain intellectually curious, relentlessly searching for a deeper understanding of the world in which we invest your capital. For example, during the course of last year we had more than 35 calls with various stakeholders in the tobacco industry to try to better understand an industry undergoing dramatic change.

Finally, we remain flexible and determined not to fall into the trap of being stubborn. In this industry, if you do not have the humility to know that you live in an uncertain and unforecastable world, you will fail. We have an internal culture of championing minority views and challenging groupthink. Where we think we have made a mistake, we have either sold or reduced position sizes. Where we do not believe this to have been the case, we have either held our position or bought more at lower prices.

KEEPING THE FAITH

We are perplexed by the prices at which some stocks currently trade. The value we are finding in certain stocks is simply astounding.

Our view is that changes in market structure have driven a dislocation in the pricing of stocks. Anything with a whiff of value has been slaughtered – and with no apparent valuation floor. Much of this is likely a consequence of the global megatrend: out of value managers into high-quality (or 'Growth at a Reasonable Price') managers, into quant funds and, finally, away from active to passive funds. Although this is currently a source of great frustration, it is also an opportunity for the patient, long-term investor, given the fact that the fundamentals always ultimately assert themselves.

The performance cycle is part and parcel of managing money for the long term. Investing is fundamentally a non-linear activity and, in order to secure long-term gain, one needs to be prepared to endure short-term pain.

Although there are many investors who endeavour to deliver steady results in what is a random, inefficient and volatile market, I believe this to be an impossible task over long periods of time and analogous to the efforts of Isaac Newton, one of the great minds of all time, who expended an enormous amount of energy practising alchemy before ultimately failing.

History has shown, over and over again, that cycles always turn and that the surest path to wealth creation lies in long-term investing. Only this time horizon gives one the mandate one needs to fully exploit the inevitable differences between price and value.

SOME GOOD NEWS – LOOKING FORWARD

At a time when many are running for the safety of cash, we are more sanguine about the future.

- After being very negative about the South African equity market for most of the last five years, we are now much more optimistic about future returns:
  - We have taken advantage of depressed sentiment to significantly increase the quality of our equity portfolio (currently very high quality stocks comprise an abnormally high 57% of the portfolio).
  - We currently find an unusual confluence of value in the local market, both in the rand hedges (examples include British American Tobacco, Quilter and Anheuser-Busch InBev) and in domestic stocks. There are many examples of high-quality, defensive stocks that have endured a tough operating environment over the last few years and have low earnings bases. Many of these should see strong earnings recoveries if the economy recovers at all from a very depressed base. Examples include Pick n Pay, Spar, Netcare, Famous Brands and Afrox.
- We believe that some of the high-quality domestic property stocks offer value, notwithstanding the likelihood of an Edcon bankruptcy at some stage this year.
- Many emerging markets are very cheap after a miserable few years. It has been many years since we have been able to buy high-quality businesses at the undemanding ratings currently available in many of these markets.

Although there are no guarantees in life, and low prices do not guarantee high future returns, they certainly provide fertile ground in the search for above-average, risk-adjusted returns.

I conclude with an apt quote from one of the great investors of our time, Seth Klarman:

"In investing, nothing is certain. The best investments we have ever made, that in retrospect seem like free money, seemed not at all that way when we made them. When the markets are dropping hard … and an investment you believe is attractive, even compelling, keeps falling in price, you aren't human if you aren't scared that you have made a gigantic mistake. The challenge is to perform the fundamental analysis, understand the downside as well as the upside, remain rational when others become emotional, and don't take advice from Mr. Market, who again and again is a wonderful creator of opportunities but whose advice should never, ever be followed." ✚

We need to hurry up and deliver

"The trouble is, you think you have time." – Gautama Buddha

By Marie Antelme

Marie is an economist with 18 years' experience in financial markets. She joined Coronation in 2014 after working for UBS AG, First South Securities and Credit Suisse First Boston.

LAST YEAR WAS one in which South Africa celebrated a change in political leadership and, at least initially, had high hopes of a social and economic recovery. These were short lived, and a combination of consecutive growth-related disappointments, revelations of deeper and more intractable political (and private) malfeasance and the slow pace of change saw us end 2018 a little more bruised, possibly more realistic and certainly more downcast than we were at the outset.

Many forecasters, including ourselves, started 2018 believing that GDP growth approaching 2% was relatively easy to achieve. Within a supportive global environment, a great improvement in consumer confidence – reinforced by low inflation and low but positive real disposable income growth – provided a decent support for consumer spending acceleration despite the increased tax burden. A small amount of replacement capex and at the margin some rebuilding of commercial and industrial inventories from historically low levels all added up nicely.

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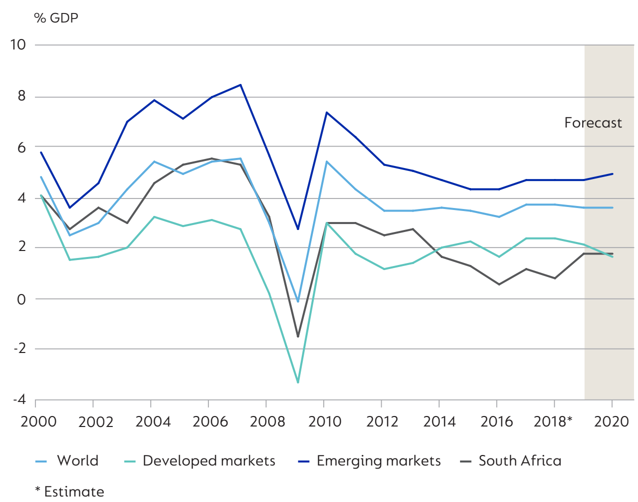
However, little came to pass. With a steady deceleration in compensation (wage) growth, a significant increase in the fiscal burden on consumers (tax bracket changes, a rising fuel levy, the VAT increase and rising utility levies) and not enough confidence to increase credit utilisation, consumer spending has remained weak. State capex retreat pulled overall gross fixed capital formation down.

On the supply side, the deep contraction in agriculture was exacerbated by a series of derailments, refinery outages and strikes that affected mining, manufacturing and transport output. South Africa slid into recession in the first half of 2018 and while there was a nascent recovery in the third quarter (Q3) of the year, it is now unlikely to deliver even half the growth that was forecast at the beginning of 2018.

SOUTH AFRICA VERSUS GLOBAL GROWTH



Sources: IMF, Statistics South Africa, Coronation

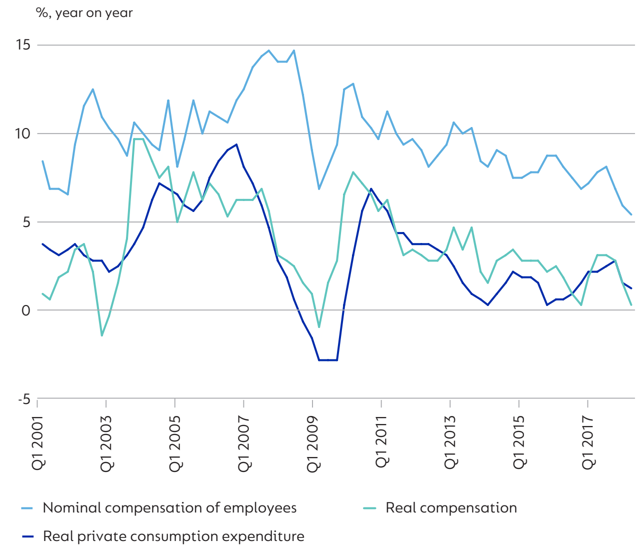
CHANGING MOOD

Through the course of these events, there has been a general deterioration in sentiment. Despite the meaningful and important political changes made in key economic institutions and ministries, the fact is that incomes remain under pressure and the political situation, although vastly improved from a year ago, has not yielded much visible economic benefit. The reality is also that ordinary South Africans simply have not felt that things are getting any better.

At the end of a hard year during which bad news seems to have come in waves, each more depressing than the next, the recent news about the full extent of Eskom's financial and operational failure feels like the proverbial last straw.

So it is hard to see how growth will pick up materially in 2019, and recent data continue to pose downside rather than upside risk to existing forecasts. There are certainly lots of reasons to think that growth momentum will remain under pressure. Household spending accounts for 60% of GDP and compensation growth slowed to 5.4% year on year (y/y) in Q3 2018. This is the lowest nominal growth since the 2008/2009 Global Financial Crisis (GFC). In real terms it is only just positive, and little better than the low point of -0.8% y/y in the second quarter of 2009. Additionally, gross fixed capital formation was 1.4% y/y in Q3 2018 – positive at least, but still historically weak. Private sector job creation is stagnant, while both consumer and business confidence retreated in Q3.

SOUTH AFRICAN NOMINAL AND REAL COMPENSATION VERSUS PERSONAL CONSUMPTION EXPENDITURE



Source: Statistics South Africa

NOT ALL BAD?

But there are areas where pressure has eased and momentum seems to be improving. Stability in compensation growth, which has been slowing steadily, should help improve momentum in disposable income. In December, retail fuel prices were cut heavily, and the rate of increase in monthly outlays should slow steadily. Inflation is set to remain relatively benign and we do not expect the same degree of fiscal pressure to be repeated in 2019/2020. We would again make an argument for some growth in replacement capex and inventory recuperation – now off even lower levels than last year – but uncertainty remains.

At the margin, some small boost from capital committed during President Ramaphosa's Investment Summit will also help. The falling oil price, if sustained, implies an improvement in terms of trade and a more positive contribution to growth from net exports. On the supply side, both mining and manufacturing output improved towards year-end. Our long-held forecast is for growth to accelerate to 1.8% in 2019.

THE ESKOM ELEMENT

Eskom is now the biggest and most immediate domestic threat to growth and a positive political outcome. From a growth perspective, meaningfully higher electricity tariffs will raise inflation and undermine household disposable income growth. Supply disruptions undermine not only business confidence but also inhibit the ability of companies to produce output.

The fiscal risk posed by Eskom is meaningful. Not only has Eskom asked for significant tariff increases of 15% per annum over the next three years, but the latest results also contained a request for R100 billion in debt to be transferred to the state balance sheet.

This amount represents about 2% of GDP and would – under this proposal – increase South Africa's government debt stock by as much. Government is already in a fiscally constrained position, with the October Medium-Term Budget Policy Statement detailing yet another deterioration in the government's debt profile over the next five years and the expectation that annual fiscal deficits are likely to be larger than previously budgeted for.

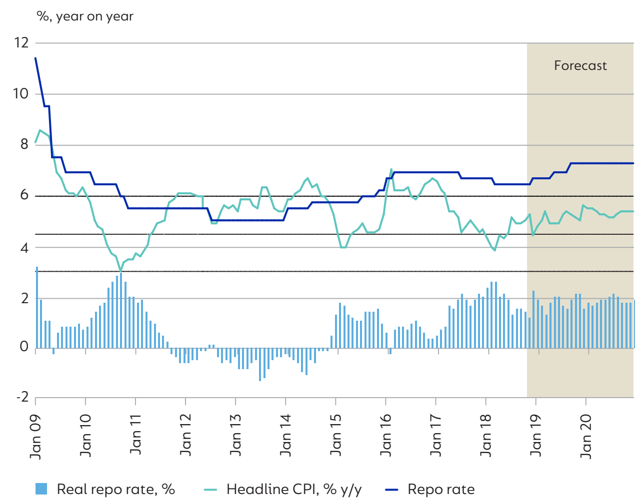
Gross debt is expected to continue to climb to a peak of 59.6% of GDP in 2023/2024 and moderate very slowly thereafter. The request potentially creates a dangerous precedent and the fallout might be enough to change South Africa's last remaining investment grade credit rating.

The good news is that inflation is unlikely to also become a big headwind for the consumer. Relatively low food inflation provides a good anchor for overall inflation, but a sharp decline in retail fuel prices – and base effects – help contain two large and potentially volatile influences of headline inflation. The weak economy has also seen a steady moderation in service prices and limited much of the pass-through from a volatile and weaker currency.

Administered prices, including Eskom, remain a large inflationary influence on headline inflation and arguably still represent a tax on consumption. We forecast average CPI at 4.6% in 2018, with a modest acceleration to 5.3% in 2019.

In this environment, we think there is limited scope for a steady interest rate hiking cycle, and anticipate moderate and slow rate increases by the central bank in 2019. Both our inflation and interest rate forecasts carry downside risk at this point. Incoming data suggest global growth momentum continued to slow into year-end.

INFLATION AND RATES



Sources: Statistics South Africa, Coronation

CAN WE AVOID THE GLOBAL HEADWINDS? MAYBE, MAYBE NOT

That we experienced a very weak progression in domestic growth during a period in which the global economy experienced the most joined-up recovery in a decade – albeit now slowing and becoming much less even – raises understandable concerns that any local recovery in a weaker global context is unlikely. Certainly, slowing global trade volumes and weaker growth in key export partners are a clear headwind.

What is possible is a cyclical recovery driven by domestic demand. This requires the alignment of some recovery in domestic growth drivers outlined above and the rehabilitation of a range of supply-side one-offs, including various outages, strike action and Eskom's load shedding. Because the economy has not grown, there are also few visible excesses – household balance sheets are in reasonably good shape, credit growth has been low and households have deleveraged. Employment has been poor, capex visibly weak and confidence is low. The current account deficit is relatively small. If the economy has not managed to grow, at least there are fewer parts which are exposed to a potentially sudden stop.

WHAT WE NEED IS TIME

While this is hardly an uplifting picture, it is a hopeful one. What now stands in the way is time. Linked to the clear frustration with an economy seemingly stuck in low gear has been a growing expectation that the necessary and painful reform needed to unlock better growth – much of which faces some opposition from the ANC-led alliance partners – will become manifest after the May 2019 election. However, we are more hopeful that the marginal changes to policy already announced will gain velocity and that the quality of the conversation between the public and private sectors will continue to improve than we are of an election delivering a political payload that would significantly impact economic policy.

But what we do not have is a lot of time. Growth has been low for so long that it is at risk of stalling. Low growth limits options: it reduces revenue and undermines the state's ability to more productively allocate capital, it limits employment opportunities and makes earning a wage capable of raising living standards impossible, and it discourages investment.

And those factors are just what we need. The swift delivery on some of the promises made, including the release of spectrum* and an accelerated and urgent review of visa regulations might only go a small way to boosting growth at first, but they could go a long way to bolstering confidence that there is more to these commitments than just words and to addressing some of the practical constraints to key growth areas. We also need an intervention which prevents Eskom from totally derailing these emerging green shoots, and we need it soon. ✚

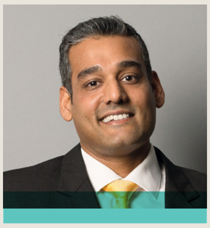
* Making additional radio frequencies available will boost wireless network capacity. This will bring down the cost of communication and increase internet access, which is essential to economic growth and innovation, ensuring that South Africa keeps pace with the 4th industrial revolution.

Stormy weather

But South African bonds still offer a bulwark against global policy normalisation

By Nishan Maharaj

Nishan is head of Fixed Interest and is responsible for the investment process and performance across all portfolios within the fixed interest offering. He has 16 years' investment experience.



IF YOU WANT to see the sunshine, you have to weather the storm, but to weather and navigate the storm, you have to adjust your sails. At Coronation, we are constantly questioning the assumptions that underlie our valuation-driven approach to investing to provide our clients with portfolios that are anti-fragile and best positioned to withstand the shorter effects of adverse volatility.

2018 was a difficult year for emerging markets and more especially for emerging market fixed-income investors. The year started with tremendous promise as emerging market bond yields and currencies appreciated markedly. Then the tide turned. The US/China trade war escalated, raising concerns about global growth expectations, which we now know to be too high. Around about the same time, the US Federal Reserve (Fed) started to lift its expectations for the US economy and consequently, its expectations around US interest rates. This combination of higher-than-expected US rates, lower global investor confidence and slower global growth painted a very poor picture for emerging markets. This change occurred so suddenly that many authorities in these markets were left with very little time to react, so valuations of emerging market currencies and bonds had to adjust and act as the pressure valve. Emerging markets with large external deficits were the first to suffer, as was evidenced by Turkey and Argentina, which were both down between 30% and 50%. Emerging market bonds were down 7.9% in US dollars for 2018, while emerging market bonds in their local currencies only returned a paltry 2.9%.

South Africa did not fare much better, as concerns over key policies (land, the mining charter and state-owned enterprise [SOE] reform) and much slower growth weighed heavily on local asset price performance. The All Bond Index (ALBI) was up 7.7% for 2018; however, the rand was down 13.8% to the US dollar, bringing South African government bond returns in US dollars to -7.1%. Performance across the various parts of the yield curve was pretty balanced, with the very front end of the curve outperforming. We see the performance at the front end of the yield curve (one to three years) as unsustainable, given that this performance was in large part driven by the buyback of bonds in that area of the curve as part of National Treasury's switch auction programme. South African government bonds had a rollercoaster of a year, with the benchmark bond starting the year at 8.59%, hitting a high of 7.88%, then a low of 9.36% and ending the year at 8.87%. Inflation-linked bonds (ILBs) continued to suffer as real yields moved almost as much as nominal bonds (I2025 – low: 3.15%, high: 2.08%), primarily due to the adjustment lower in both medium- and longer-dated inflation assumptions. Due to the higher duration that these bonds carry, ILBs only managed to eke out a return of 0.3% for the year.

Are there rays of sunshine on the horizon for South African government bonds and emerging markets? Or are there more adjustments needed from a valuation and portfolio perspective for us to weather this storm?

Over the next two years, global growth is expected to decelerate from 3.2% to 3.0%, driven primarily by a slowdown in growth in developed markets (2.3% to 1.7%) and China (6.6% to 6%). Emerging market growth is expected to remain relatively stable around 4.6%, but with quite a bit of disparity. The only emerging market countries that are expected to see an increase in growth over the next two years are Brazil, Russia, India and South Africa. Russia remains at risk of further US sanctions and Brazil's outlook remains clouded by high debt levels and a new political regime, while India enters an election year in which the ruling party is at risk of losing its majority. This only leaves South Africa as a somewhat more 'stable' emerging market where growth is expected to pick up and inflation remaining relatively stable, closer to the midpoint (4.5%) of its target band.

South Africa itself still faces risks, the largest of which remains Eskom, which has been a concern for the fiscus and a headwind to sustainable growth. More recently, Eskom has suggested that government would need to take on close to R100 billion (2% to 3% of GDP) worth of debt onto its balance sheet to render the beleaguered SOE's debt servicing costs more practical. Although this is not enough to blow up South Africa's fiscal metrics, the precedent it sets for other SOE bailouts will not be looked at favourably. Discussions around Eskom in the last few months have intensified, with the intention now to reduce headcount in areas that have been bloated (mid- to high-level management). If the debt transfer is to happen, it has to be:

1. Temporary in nature (for example, government agreeing to meet debt servicing costs over the next three years only);
2. Accompanied by a plan to reduce costs in overextended areas; and
3. Accompanied by a plan to restructure the SOE into a financially viable vehicle (selling off assets or parts of the company to inject much-needed capital).

As has been the case in South Africa over the last year, revelations over how badly state capture has ruined SOEs have brought the stark realisation that many of them are in a much worse position than was initially suggested. Drastic action needs to be taken to turn these SOEs around and reignite the country's growth engine. The process has already started, but now needs to be accelerated to alleviate ratings agency concerns and prevent a full downgrade to subinvestment grade (Moody's is the only agency that still has South Africa on an investment-grade rating).

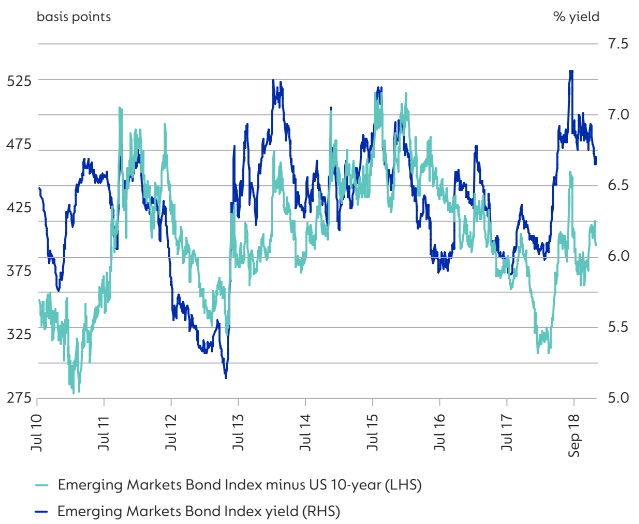
Thankfully, the economy has been relatively resilient and has the potential to grow quite quickly from here if key issues are addressed. Investment has been very low and capital stock replacement has not occurred for quite some time. If concerns around Eskom are alleviated and we have a market-friendly resolution to the land expropriation without compensation debate (as has been suggested by the government), we could see a meaningful pickup in growth, even well above the 1.8% consensus expectation over the next two years. In addition, with inflation remaining relatively well behaved and lower oil prices providing a boost to consumers, we could see this accompanied by a further boost to consumer spending (60% of GDP), which could provide additional upside. Overall, one can remain cautiously optimistic on the South African outlook for the next two years.

A change in the expectations for US interest rates and/or a resumption in the escalation of the US/China trade war could once again sour emerging market sentiment. However, valuations of emerging market bonds and currencies are now much more representative than when this occurred in mid-2017. Emerging market currencies are at the weakest point seen in the last 10 years (as indicated by the following JP Morgan Emerging Markets Currency Index), and emerging market bond spreads (relative to the US 10-year bond) and yields are now at their long-term average.

JP MORGAN EMERGING MARKETS CURRENCY INDEX

Source: JP Morgan

EMERGING MARKETS BOND YIELDS AND SPREADS



Source: Bloomberg

The graphs suggest that even if there is a resumption in the risk-off sentiment towards emerging markets, the valuation cushion that is now present is much healthier than in previously experienced episodes.

In the US, recent Fed rhetoric and revisions have all suggested more downside to growth over the coming year, which has lowered

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expectations for both interest rate hikes and the long-term level of interest rates in the US. The Fed has signaled two more hikes in 2019 (taking the policy rate to 2.9%) and a long-term neutral interest rate of 3%. Although the front end of the US curve currently fully prices this in, the US 10-year treasury bond remains well below this, at 2.7%. This suggests that the level of US 10-year rates is once again too low. In our assessment, it should be closer to 3.25% (1.25% real policy rate + 2% inflation). Despite this, South African government bonds do not look unattractive.

Our fair value analysis – using the US 10-year rate of 3.25%, South Africa's expected inflation rate of 5.5% (which is above our expectations), US expected inflation of 2% and the 10-year average South African credit spread of 2.9% – results in a fair value for South African government bonds of 9.65% (3.25% + 5.5% - 2% + 2.9%), which is close to current levels of the South African 10-year bond yield (9.59%), implying there is still some value in South African government bonds. However, with only a cautiously optimistic view on the local yield, how does one protect a bond portfolio?

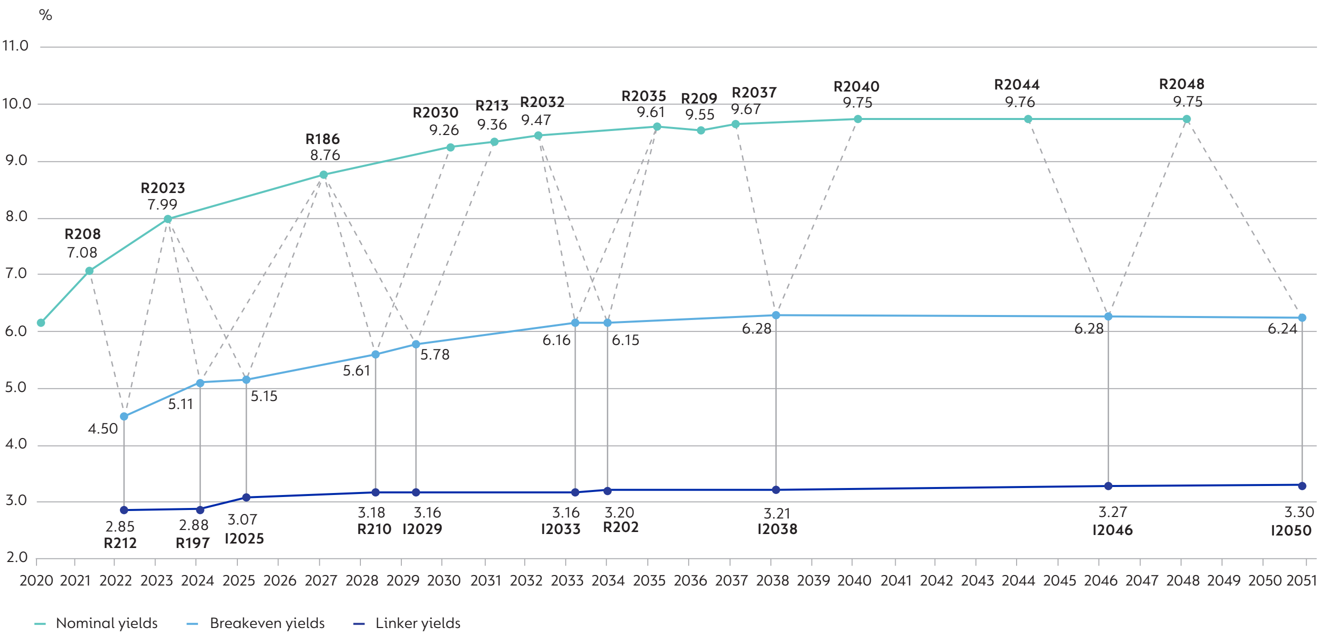
The natural answer to this would be ILBs, given that in the event of a risk-off sell-off, the rand would also sell off, pushing inflation higher and causing the central bank to readjust rates. However, given the very high duration that these instruments carry, one has to be very careful which part of the ILB curve one invests in. The light blue/middle line in the graph below shows where the market expects inflation to average over various maturities.

Given that we only expect inflation to average 5.3% over the next two to three years, it is only the bonds that have an implied breakeven inflation of close to 5.3% that look interesting. This rules out any ILB with a maturity longer than the year 2025. In addition, ILBs carry a materially longer modified duration (capital at risk) than nominal bonds; for example, I2046 has a modified duration of 18.7 years, while the R2048 (equivalent nominal bond) has a modified duration of 9.2 years. If both the ILB and nominal curve move 100 basis points higher, one would lose 9.5% more being invested in the I2046 than in the R2048.

This means that to be invested in longer-end ILBs, the implied breakeven needs to be quite a bit lower than the current 6.5% (closer to 5.5%, actually) for it to be an attractive investment. Shorter-end ILBs, however, at current levels of a 3% real return and a more realistic breakeven inflation do look much more attractive and do warrant positions in a bond portfolio (albeit not materially large).

South African government bonds mostly reflect realistic expectations for the local economy, although they have benefitted from a turn in global sentiment recently. South African bonds compare favourably to their emerging market peers, relative to their own history, and still offer a respectable cushion against further global policy normalisation. At current levels, the yields on offer in the local bond market are fairly valued relative to their underlying fundamentals and warrant a neutral to modestly positive allocation. The relative underperformance of ILBs versus nominal bonds in past quarters has resulted in real yields moving to levels that have not been seen in at least the last eight years. While nominal bonds continue to compare favourably to ILBs, the balance in the front end of the curve has shifted towards ILBs. ✚

NOMINAL BONDS VERSUS INFLATION-LINKED BONDS



Source: Coronation

Engaging responsibly

Responsible investing involves constructive, behind-the-scenes communication

By Pallavi Ambekar

Pallavi is co-portfolio manager of Coronation's Absolute Return strategies. She joined Coronation in 2003 as an investment analyst and has 16 years of investment industry experience.

RESPONSIBLE INVESTING HAS risen in prominence over the last few years as companies, investors and asset managers have had to respond to and deal with the investment impact from ethical and governance lapses, environmental challenges and social pressures. Integrating an assessment of environmental, social and governance (ESG) factors into the investment process has now become standard operating procedure. The manner in which ESG is built into the process can, however, differ significantly across the industry.

At Coronation, we believe the evaluation of ESG should be handled within the investment team who has a better understanding of the complex issues that underpin each individual company. As each potential investee company operates in different industries and geographies, there is no overall generic checklist of factors that can be uniformly applied. While we do subscribe to the services of 'specialist' ESG research providers and >

consider their views, the intricacies of each investment also mean that it is inappropriate to outsource this function.

As long-term investors, we have always explicitly identified and factored in the impact of environmental and social issues on the long-term health of the business and its various stakeholders. In addition, we strive to ensure that the companies we are invested in maintain high standards of corporate governance. Responsible investing is a dynamic environment, and our ESG process has been enhanced and adapted over the years as we have taken learnings on board. Recently it has been tightened to include additional governance requirements involving mandatory audit firm rotation every 10 years and increased scrutiny of the tenure and capability of directors.

As the emphasis on responsible investing has increased, we have responded through greater engagement with management and directors of investee companies. Our engagement process focuses on the most material issues that a company must address and can be broken down into two main categories:

- A continuous engagement on ESG issues that are unresolved and can have a material impact on the investment case. Examples of this would be pending new carbon tax legislation, outstanding legal claims relating to health and safety risks, and changing environmental regulations. These engagements allow us to quantify the impact of uncertain variables on our valuation, which assists us to make informed investment decisions based on robust valuations.
- A continuous engagement on ESG issues that relate to the stewardship of the company. This will commonly involve discus-sions relating to capital allocation strategy, the composition of the board in terms of skills and diversity, and the adequacy of key performance indicators and targets in setting the remuneration policy for senior management. In addition, as investors with a long-term time horizon, we think it is important to understand what companies are doing to protect the sustainability of their business and the environment in which they operate.

Our engagement process involves discussions on several topics, including but not limited to waste management, health and safety processes, and labour relations. This helps us to assess whether the company has a coherent strategy to deal with the environmental and social impact of its everyday operations. A company's awareness of these affairs and its willingness to address them in a formal, proactive manner indicate that the business is committed to be a good corporate citizen and to protect its sustainable long-term value.

The issues that we engage on are often complex and require that we have multiple discussions with the relevant companies. Our ultimate intention is to drive the change we feel will be most beneficial for shareholders in the long run. We find that a strategy of constructive, behind-the-scenes engagement directly with a company is far more productive than debating issues at a public annual general meeting (AGM) or through the press. Conversely, a strategy of merely selling out of companies without any engagement does not address societal needs and merely shifts the burden elsewhere.

ESG issues can often be resolved in direct meetings with a company's senior management team. Where appropriate, we escalate issues by writing a letter to the board of directors, setting out our key concerns. In addition, we also engage with fellow shareholders to apply more pressure for change.

If these actions still do not result in the desired outcome, we will take the appropriate steps at either the AGM or call a special meeting to highlight our grievances and make the necessary recommendations. If our best efforts are unsuccessful, we will reassess our investment case and valuation and take the appropriate investment action in our portfolios. All our interactions are fully documented in a central ESG database which records the relevant issue, the company's response and how the issue was resolved.

Below we have included three examples of issues that we have engaged on in the past.

ESG ISSUE: CAPITAL ALLOCATION

Sector: South African resources company

Brief details
Since 2012, we had numerous engagements with and wrote two letters to the board of a listed resources company to discuss its capital allocation strategy. We highlighted that the company's track record of past acquisitions and investments had not created value for shareholders. We encouraged the company to consider using higher hurdle rates when embarking on future investments to mitigate execution risk. We also suggested that new capital projects should be assessed against the value created from returning cash to shareholders via increased dividends or buybacks.

Outcome
Following the initiation of our engagement process in 2012, the board of directors took note of our suggestions and in late 2017 announced a new capital allocation framework to the market. This new framework presented a medium-term focus on strengthening the company balance sheet while improving the dividend payout ratio. Once the balance sheet had been returned to a healthy state, the company would evaluate small- to medium-sized growth options and further increase the dividend payout ratio. We felt this revised capital allocation framework was properly constructed and balanced the need for the company to continue to invest in a considered manner as well as improve returns to shareholders.

ESG ISSUE: EMPOWERMENT DEAL

Sector: South African resources company

Brief details
To comply with the provisions of the Mining Charter in force at the time, a resources company was required to enter into a black economic empowerment (BEE) deal to replace a previous transaction that had ceased to exist. As significant shareholders, we engaged extensively with company management and external advisers over a period of approximately six months to shape a

deal with an innovative funding structure that achieved genuine broad-based empowerment while at the same time addressing the concerns of potential dilution for existing shareholders.

Outcome

A deal was concluded that resulted in the raising of significant capital for the company's expansion plans funded through a high-yielding tradeable instrument, making it attractive to investors. The resulting BEE ownership comfortably exceeds the minimum requirements. More importantly, the deal incorporates a significant allocation (75% of the deal) to employees, surrounding communities, women's groups and historically disadvantaged organisations. We ensured that long-term incentives were created to align management with the objectives of the transaction and we continue to engage on issues such as board representation of BEE participants.

ESG ISSUE: CORPORATE RESTRUCTURE

Sector: South African listed property company

Brief details

A property company was listed as a property unit trust (PUT). While this is allowed by the JSE, it significantly limits the ability of shareholders to influence the governance of the company, and as a result the company failed to attract meaningful shareholding on the JSE. The essence of a PUT structure is that the fund is managed under the Collective Investment Schemes Control Act guidelines, with unit holders having no say in the governance of the vehicle, while the fund manager is outside the listed vehicle. Through extensive engagement with the company itself and its ultimate controlling shareholder, we reached an agreement whereby the PUT structure would be converted into a real estate investment trust (REIT), allowing better governance via requiring normal shareholder meetings and AGMs. In addition, the company internalised its management company and the holding company chose to cancel its greenfield put option to place properties into the structure.

Outcome

The restructuring of the company from a PUT to a REIT resulted in a significantly more investable company, with appropriate levels of governance and control in place. A more sustainable company structure should provide for greater returns over time.

CONCLUSION

The examples above highlight that the ESG engagement process involves sincere communication with the company, usually taking place over multiple instances to help us shape the outcome that is most value enhancing for shareholders. We believe this understated approach is far more constructive than airing the issues in a public forum for the sake of a few headlines. Our aim is to resolve these matters in a way that leads to more sustainable and better corporate behaviour. This, we believe, is one of the ultimate aims of responsible investing. ✚

What a year it was!

The way in which financial markets respond to US rate expectations is important

By Marie Antelme

AGGREGATE GLOBAL GROWTH is expected to be 3.7% in 2019, above potential for the second consecutive year. The strong growth performance has seen unemployment in most developed economies fall to multi-decade lows. Subsequently, tight labour markets have put pressure on wages and inflation has started to rise. An increasing number of countries have inflation running ahead of their central bank targets, prompting a general, if uneven, normalisation in global monetary accommodation in developed economies. However, the way in which this unfolded was far from smooth, especially for financial markets, and the outlook remains highly uncertain.

In recent weeks there has been a significant shift in the way in which financial markets are pricing growth and policy settings, especially in the US. Following a year in which the US led the growth outperformance, the duration of the upswing, as well as

Marie is an economist with 18 years' experience in financial markets. She joined Coronation in 2014 after working for UBS AG, First South Securities and Credit Suisse First Boston.

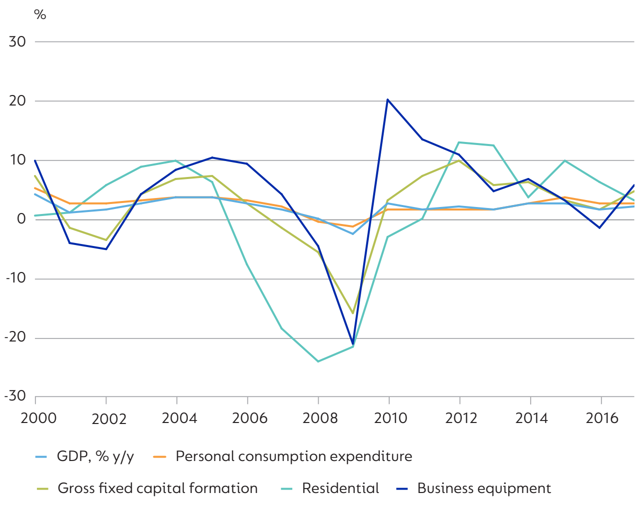
the combined weight of escalating trade tensions and weakness in other economies, has seen weaker data emerge. Financial markets have slowed, and with a significant adjustment in US equity markets, no further US Federal Reserve (Fed) rate hikes are expected for the coming year.

Because US policy rates influence global funding costs, the way in which financial markets respond to US rate expectations is important. For now, we think the recent adjustment is overdone. Market concerns about a US recession have been heightened by a flattening in the US yield curve, but additional signposts for a pending recession in the US are visibly absent. There are certain signs of slowing, but abject weakness seems unlikely.

PAST RECESSION SIGNPOSTS

A closer look at past recessions offers some good guidance in assessing current risk. The first thing to note is that US recessions are always driven by domestic demand. External economic dynamics, including the global manufacturing cycle, have not to date driven a growth contraction in the US. And typically, domestic demand in the US shows several consecutive quarters of subtrend weakness before contracting. The graph below indicates that the main components of domestic demand are still growing strongly.

US GDP BREAKDOWN, LONG-TERM



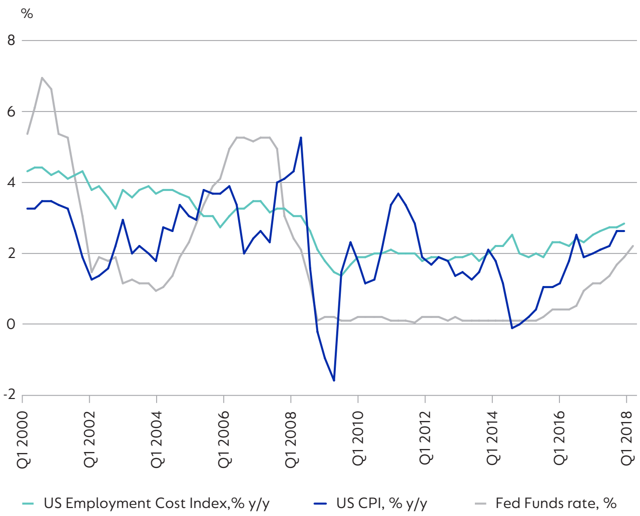
Source: Datastream

US recessions also broadly tend to follow a pattern: a sharp slowing in capital formation, which usually takes the form of a collapse in residential housing investment, followed by falling consumption expenditure and a collapse in business investment. This is not always the case, but when a collapse in business investment comes early, it is usually accompanied by weakness in household investment and outlay. To date we have not yet seen even one quarter of real weakness across any of these factors.

Another characteristic of past recessions has been the buildup of excesses; again, often in housing or business investment. Excessive housing inventory accumulation undoubtedly aggravated the recession in the US between 2008 and 2010. These inventories also delayed the recovery and contributed to the muted growth in housing activity through this expansion. That said, despite the softness in the housing market due to rising interest rates, there is more scope for it to become a point of resilience in the current environment (very low employment and excess demand) than a source of vulnerability.

Household spending accounts for almost 70% of real GDP in the US. Unemployment is currently 3.7% and survey data suggest that it is becoming harder to fill vacancies. A tight labour market has seen an increase in wage inflation and a moderate rise in headline consumer prices. While inflation has also tended to accompany recessions in the past, with prices outpacing wage increases, choking disposable incomes and prompting ever-rising policy rates, this dynamic is also not yet visible in the current data. Wage growth has exceeded inflation, and with lower oil prices may continue to do so for some time. This could, in fact, improve in 2019 relative to 2018.

US WAGE GROWTH VERSUS HEADLINE CPI, INCLUDING FED FUNDS



Source: Datastream

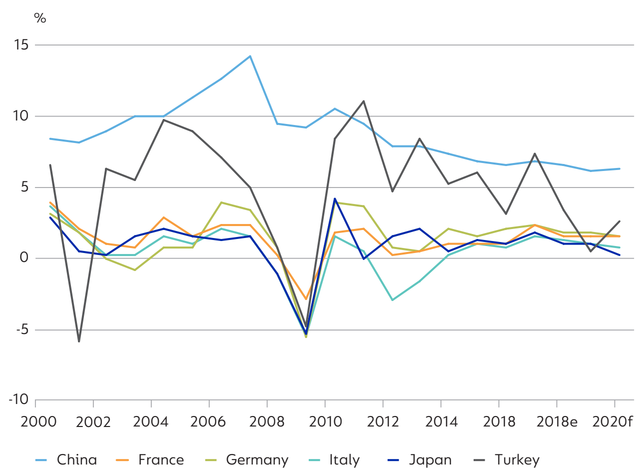
Lastly, the corporate sector is often a factor in the path to and severity of recessionary periods. Rising wage costs, rising debt costs and past-peak profitability are likely to put increasing pressure on margins. Certainly, both wage and interest expenses are likely to rise in coming quarters, but for now, corporate balance sheets remain in reasonably good health and are considerably less stressed than at the tipping point of previous recessions.

Considered together, we do not think that US growth is at risk of a sudden slowdown in 2019. What we do expect for now is that domestic demand will continue in line with the current trend, with some areas of softness, namely housing, being largely offset by stronger consumer spending. It also suggests that the Fed is more likely than not to continue hiking, as data stay consistent with an economy operating at or above potential, and almost certainly by more than current market pricing anticipates. In turn, this implies a relatively resilient US dollar, although we do not anticipate significant additional appreciation from current levels, given a somewhat overvalued starting position.

GLOBAL GROWTH OUTLOOK – DOWN, BUT NOT OUT

Under this US baseline, the outlook for other major markets is also reasonably benign. Europe, which was considerably weaker in 2018 than initial expectations, suffered a series of idiosyncratic hits to growth. While poor weather is a regular disruptor of first-quarter activity, a debilitating flu, strikes in France and changing automobile emissions regulations all affected growth in the two largest economies, with repercussions for the periphery. Italy's political challenges and weak underlying fundamentals saw growth stagnate in the third quarter. A full recovery of lost momentum is unlikely and there is still clear political risk across Italy, Germany and France. Tight labour markets, a recovery in investment and some fiscal support should offset most of the drag from weaker trade.

GROWTH COMPARISON (REAL GDP)



Source: IMF

Similarly, growth in Japan was disrupted by weaker global trade, slowing growth in China and a series of natural disasters. The latter interrupted supply chains and saw a meaningful slowdown in GDP growth during the second half of 2018. Some recovery and rebuilding activity should offset some of the headwinds created by the increase in VAT planned for October 2019, while more stable growth in China will likely provide support for net exports. Japan should also benefit from some 'payback' as disrupted export shipments normalise, even if the global environment is softer than in 2018.

Trade tensions and a long period of credit tightening has seen Chinese economic growth slow from 6.8% year on year (y/y) in the first quarter of 2018 to 6.5% y/y in the third quarter. The recent reprieve in the pace of escalation in tariff increases planned by the US after the G20 summit in December probably will not last, and we expect some increases in tariffs in early 2019. The implementation of policy support by the Chinese authorities has thus far been reasonably constrained and it remains to be seen if materially weaker growth triggers a more dramatic policy response. For now, it looks as though growth of about 6% is achievable under current policy settings. That said, a broader base and higher tariffs are the biggest threat to Chinese growth and would materially increase the risk of a more extreme policy response.

EMERGING MARKETS AT ROCK BOTTOM?

A number of emerging markets suffered market-related disruptions in mid-2018, which had material impacts on their real economies. Turkey saw its currency depreciate almost 40% between January and August as concerns over total foreign-denominated financing needs gave investors pause. The high oil price, excessive credit growth and a wide current account deficit, coupled with relatively high external corporate borrowing, all contributed to the slide. Recent data suggest that the real economic fallout has been severe, with inflation surging to 24.7% y/y, interest rates at 24% and economic growth dwindling to 1.6% y/y.

Elsewhere, Argentina turned to the IMF as liquidity dried up with the withdrawal of investment support. Inflation remains high and any economic adjustment is likely to be painful and slow. Nonetheless, both these economies are expected to stabilise, albeit at weak levels, in 2019. A modest recovery in South African GDP growth and a reasonably steady Russia should contribute to a resilient emerging complex.

NOT WITHOUT (CONSIDERABLE) RISK

There are always risks: probably the most obvious in this context is the heavy reliance on the US as the current driver of global growth. While we think that some stability in Europe, Japan and some emerging markets will buffer a slowing US through 2019, there is significant risk – either that the US slows faster than data currently suggest, or that the economy starts to overheat and the Fed hikes more aggressively into a restrictive policy stance. Over the longer term, the US faces fiscal challenges that could disrupt growth and confidence. An escalation in trade aggression would see China's growth path under considerably more pressure and the Brexit outcome is a clear unknown but looking increasingly chaotic. In Europe, peripheral economies still carry high government debt levels that could become strained should Italy's fiscal position weaken.

Another challenge – especially in the case of a crisis – will be the much tenser and more polarised political positions of major economies. Brexit will isolate the UK from its European peers and affiliated policymakers, while the US is becoming increasingly insular. The consolidation of political power in Russia and China may also be increasingly disruptive and certainly, taken together, may make the coordination of a global policy response much less likely than that seen through the last financial crisis.

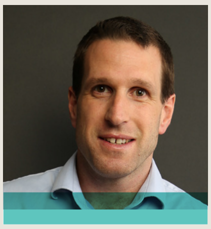
For now, we broadly expect a continuation of 2018 – relatively strong, if increasingly uneven and generally more moderate global growth – throughout 2019. In line, monetary policy should continue a slow path to normalisation in developed economies, while emerging market policy settings are likely to be more mixed. This is a reasonably supportive cyclical context for oversold asset classes, including emerging markets. ✚

Quilter

Reaping the rewards of pension reform

By Nicholas Stein

Nicholas is an equity analyst with 10 years' investment experience. He currently co-manages Coronation's Aggressive Equity strategy and is the manager of the Coronation Resources unit trust fund.



OLD MUTUAL INVESTORS will have had indirect exposure to Quilter for many years. Old Mutual's managed separation process resulted in a core African life insurer, with its UK wealth business (Quilter) and the majority of its Nedbank stake being distributed to shareholders. As a result, investors are now able to own Quilter directly.

In the years leading up to the listing, Quilter management reshaped the business from a pan-European life insurer to a UK-focused wealth management business, with a sizeable presence across the wealth management value chain (advice, platform, multi-manager and discretionary wealth management). It retains a closed book of life business that is in run-off, the contribution of which will decrease in significance over time.

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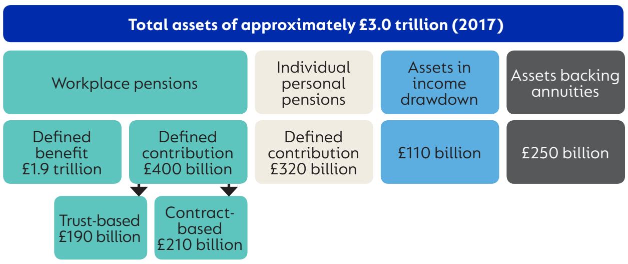
OVERVIEW OF THE UK'S PENSION LANDSCAPE



Source: The Investment Association

The UK pensions market is attractive and has undergone a seismic shift in recent years, following four notable milestones:

- The UK adopted the Retail Distribution Review (RDR) in 2012, which improved disclosure to clients, specifically on fees, and set very onerous requirements that advisors had to meet before being able to describe themselves as independent. It also shifted the industry in several ways – from a commission-based payment structure to one in which the client pays the advisor directly, and with increased advisor qualification requirements, thereby increasing the burden of being an independent advisor. This led to a drop in the number of advisors, from 27 000 in 2009 to 24 000 in 2016, and a switch from independent to restricted advice, and drove industry consolidation. These changes benefitted larger advice firms, of which Quilter is one.

- In 2012, the UK government also introduced pension auto-enrolment, compelling employers to enroll employees in a pension fund. While the initial impact has been minor, this will, over time, improve long-term savings rates and wealth accumulation. It essentially creates a wave of potential future clients for Quilter and its peers.

- In 2015, the UK Chancellor of the Exchequer, George Osborne, announced 'pension freedom', which removed the requirement to buy an annuity at retirement. Consumers could now withdraw their pensions in cash and/or make use of flexible drawdown products. Data from the Financial Conduct Authority (FCA) show that the annuity/drawdown sales mix in 2014 was 81% and 19%, respectively, which evolved to 24% and 76%, respectively, by 2017. As Quilter did not offer fixed annuities, this change represented a massive tailwind to the group and its peers.

- Meanwhile, the UK is shifting away from a defined benefit-dominated market to a defined contribution market. As it stands, 83% of UK workplace pensions are defined benefit funds, accounting for £1.9 trillion of UK retirement savings. Around 88% of these funds are closed to new members, with employers opting to offer defined contribution funds instead. In addition, many companies are opting to remove the funding uncertainty that comes with a defined benefit fund by encouraging members to transfer their pension pots into defined contribution funds. While Quilter and its peers do not offer defined benefit fund solutions, they do offer defined contribution fund solutions (directly in the case of a self-invested personal pension [SIPP] and indirectly in the case of defined contribution fund pots being consolidated in the future). The companies also offer retirement solutions in the form of drawdown products for fund members when they do retire.

If we consider Quilter's core addressable market to be defined contribution funds, SIPPs and drawdown products (they do also participate in discretionary savings), it amounts to £830 billion. According to our assessment, this is likely to expand threefold in the next decade. Quilter's own net flows target over the medium term is 5%, which we believe could prove conservative. So far, it has averaged 7% per annum over the last three years.

QUILTER IS WELL PLACED

Quilter is well placed to take advantage of the supply/demand mismatch created as a result of the introduction of pension freedoms (which are increasing the demand for financial advice) and the RDR (which is reducing the supply of this advice). Alongside industry peer St James's Place, Quilter is the only player to offer every key component of an integrated wealth manager at scale. It also has the second-largest advisor force, the second-largest advice platform and a credible and well-performing multi-manager, and includes the fifth-largest discretionary wealth manager in the country.

SELF-HELP OPPORTUNITIES

Due to its acquisitive history, Quilter remains an inefficient business, although we believe these inefficiencies are being addressed. Over the past decade, Quilter has sold out of most of its European life businesses, bought advice businesses and a discretionary wealth manager, and sold its single-strategy asset manager. While this has set the group up strategically, the company has yet to optimally integrate these businesses. This is, however, likely to be addressed soon, given that the key component parts of the value chain are now in place and that the board has prioritised costs, integration and efficiencies.

A further benefit of a more cohesive business is integrated flows, which occurs when a client makes use of more than one part of the value chain, allowing for greater margin retention by Quilter. Integrated flows have grown from one third of flows in 2015 to half of flows in 2017.

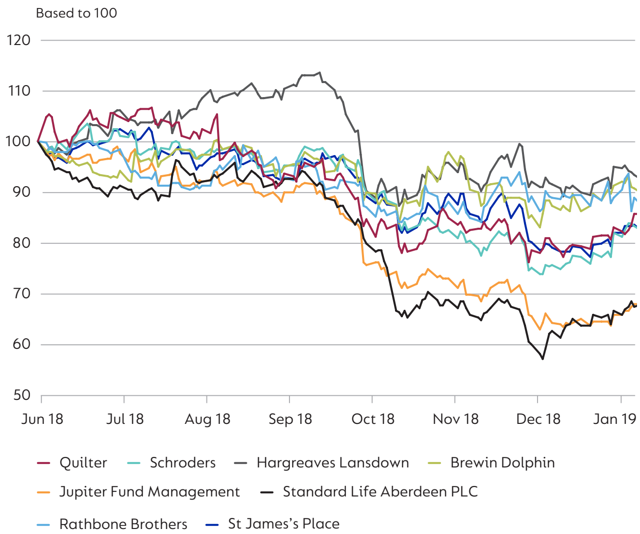
Quilter currently operates off an ageing, proprietary back-end investment platform that has seen no operating leverage, with costs and headcount moving in lock-step with new assets being placed on the platform. Positively, the company is currently in the process of transitioning to a new, third-party investment platform that is expected to show operating leverage, given that the platform provider is responsible for regulatory developments and that the fee reduces as the business scales.

Many investors will recall that this is not Quilter's first attempt to re-platform. Its much-publicised first attempt with International Financial Data Services, which cost £330 million and was subsequently terminated, remains fresh in investors' minds. We believe Quilter has taken the lessons from the first attempt to heart.

We take comfort in the fact that the new provider, FNZ, is used by a number of players in the industry and is held in high regard. Quilter has also strengthened its IT team, and appointed a non-executive director with IT and system migration skills to the board. With a focus on costs and a successful re-platforming, we see scope for margins to improve meaningfully off the current profit-before-tax margin level of 29%.

Quilter is a cash-generative, capital-light business. We find it surprising that they only target a dividend payout ratio of between 40% and 60%, and sit on a Solvency II cover of 1.95 times.

QUILTER SHARE PRICE VERSUS PEERS



Source: Bloomberg

Our view is that, after the successful re-platforming, management and the board have scope to improve the payout ratio while reducing the amount of capital retained to run the business. This should go some way towards driving the share's rating higher.

EARNINGS GROWTH

We expect earnings growth to be muted in the short term as Quilter's tax rate normalises and their closed life insurance book runs off. This masks a strongly growing core UK wealth business, which should grow earnings at double-digit rates over the medium to long term, on the back of strong net client cash flows and positive operating leverage. This is an attractive growth rate in hard currency.

WHAT GAVE RISE TO THIS OPPORTUNITY?

Apart from the risks associated with re-platforming, Brexit concerns also appear to have placed pressure on Quilter and its peers. Our view on Brexit's impact on Quilter in the longer term is fairly benign. Brexit might impact flows if money sits on the sidelines while uncertainty abounds. However, we think the longer-term structural tailwinds will ultimately reassert themselves. To the extent that the pound weakens, this will likely benefit Quilter, given that its fund range is largely global equities. Operationally, the vast majority of operations and clients are UK based, so the impact here should be muted.

CONCLUSION

Quilter operates in a market with structural tailwinds and is well positioned to take further market share, driving good earnings growth. Its business model possesses attractive fundamentals, being cash generative and capital light. The share price offers more than 50% upside to our assessment of fair value, trades on 10.5 times our assessment of normalised earnings, and offers a 5% dividend yield and is, in our view, an attractive proposition. ✚

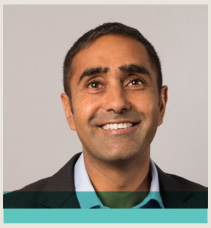
GLOBAL POLITICS

The winds of change blow through the Americas

But overcoming deeply rooted economic problems remains challenging

By Suhail Suleman

Suhail is a portfolio manager within the Global Emerging Markets investment unit. He joined Coronation in 2007 and has more than 16 years' investment experience.

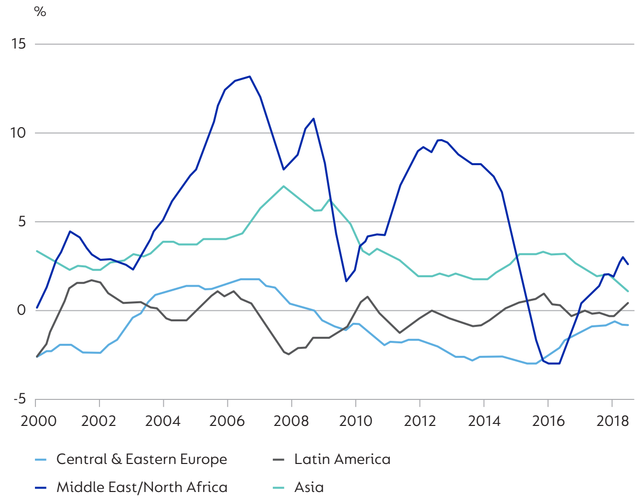


IN RECENT YEARS there has been a gradual shift away from leftist parties which have held sway across the Latin American region for the greater part of the last 20 years. In their national elections, countries such as Chile and Argentina elected presidents who are to the right of the political centre, while countries like Colombia and Ecuador have also recently elected presidents closer to the centre than their left-leaning predecessors. There is a variety of reasons for this shift, but the central theme has been that government spending in many countries had ramped up to unsustainable levels and change was needed.

Regrettably, Venezuela, the country most in need of a change in government, remains ruled by the same clique responsible for its decline from the wealthiest country in Latin America (in GDP per capita terms) to a socioeconomic basket case. Venezuela's descent is unprecedented for a non-war nation in Latin America and seems to be interminable as more and more refugees depart for neighbouring countries, fleeing the effects of a perfect storm of policy weakness, corruption, housing and food shortages, and hyperinflation. Estimates of an exodus of four million people out of a population of 32 million indicate the scale of the humanitarian crisis at hand.

CURRENT ACCOUNT BALANCE BY REGION

12-month cumulative, % GDP



Source: Emerging Advisors Group, December Monthly Chartbook, derived from national accounts data

STRONG-ARM TACTICS BY REGIONAL HEAVYWEIGHTS

With the above in mind, 2018 served up two very interesting elections in the region's two biggest economies – Mexico and Brazil. First up in Mexico was far-left Andrés Manuel López Obrador, known to most by his initials 'AMLO', having lost the previous two elections to Felipe Calderón (2006) and Enrique Peña Nieto (2012). In the case of his defeat to Calderón in 2006, the margin was so narrow (35.9% for Calderón to 32.3% for AMLO) that he proclaimed himself the 'legitimate' president after alleging electoral fraud in favour of Calderón. Mexico's election tribunal ultimately ruled against these allegations, but the perceived lack of legitimacy took its toll on Calderón's presidency.

In 2018, there was no doubt about the election result – AMLO won an absolute majority of votes and beat his nearest challenger by over 30%. The result was greeted with some fear by the market, given the new president's historic aversion to market-based solutions to economic problems. Obrador has railed against neoliberalism and has been very critical of the energy sector reforms introduced by his predecessor that ended the monopoly of state-owned oil producer, Pemex. These reforms were necessitated by years of declining infrastructure investment and a drop in output from 3.5 million barrels per day (bpd) in 2004 to under two million bpd in 2017, with a corresponding impact on Mexico's fiscus. Should these reforms be reversed, and if the new government acts on its promise to freeze energy prices, the fiscal situation in Mexico could deteriorate rapidly.

The experience with fuel subsidies in other countries (such as Indonesia) suggests that freezing fuel prices benefits the middle classes far more than the poor and is rarely good policy, as it diverts scarce state resources away from investment. Another worrisome early action was an informal referendum called by AMLO shortly after winning the presidential election and prior to his inauguration. The referendum, which was not carried out by the official electoral authority, asked the public whether the planned new airport for Mexico City should go ahead.

After a large majority of those who took part voted against the new airport, AMLO announced that he would respect the vote outcome despite the negligible turnout of one million voters in a country of 130 million people, and despite the new airport being one third built and billions of dollars in financing having already been raised.

The direction of Mexico under AMLO will be important during his tenure. His six-year term will have at least two years of overlap with Donald Trump's presidency and the US president's historical animosity toward migrants from Mexico (and those from elsewhere who use Mexico as their transit route to the US) looks set to have a substantial impact on their relationship. AMLO has been characterised by Western media as a "fiscally responsible populist" which, if accurate, suggests that Mexico should muddle along for his six-year term. This is better than a Venezuela-style implosion but does not suggest that Mexicans will experience a sustained improvement in their living standards either.

FROM PEAK TO TROUGH

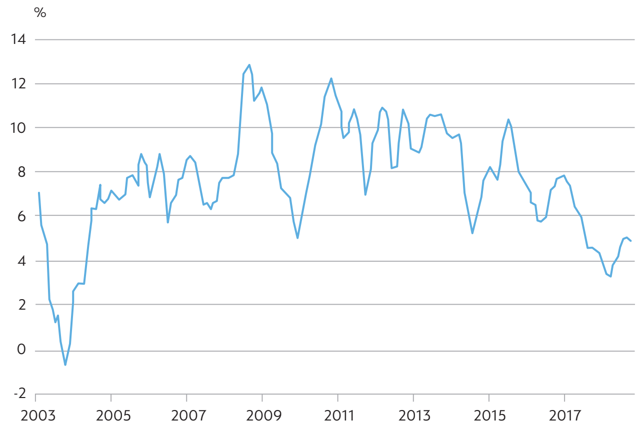
From an investment perspective, the bigger impact on the emerging markets universe will be made by the election in Brazil. The country has been under left-wing PT (Workers' Party) rule since Lula da Silva's election in 2002 through to the removal of his successor, Dilma Rousseff, via impeachment in 2016. (Rousseff, like Lula, also won two consecutive presidential elections.) The early years of PT government went well, largely sustained by the commodity boom, as Brazil is a big exporter of iron ore and agricultural products. The country rebounded very quickly from the 2008/2009 Global Financial Crisis (GFC) and looked set to finally break its historical reputation as being the perennial 'country of tomorrow'.

Alas, the foundations of Brazil's growth under the PT government were quite poor – heavily reliant on consumer spending, unsustainable minimum wage increases, fiscal largesse and the commodities boom. There was also substantial corruption in Petrobras, the state-owned oil company that had been used to enrich many politicians and businessmen through rigged contracts and outright bribery.

The boom years also saw Brazil's currency appreciate significantly against its trading basket, which made manufactured exports uncompetitive and imports much cheaper. Brazil therefore maintained historical tariff and non-tariff barriers while the rest of the world was reducing these, further eroding >

INFLATIONARY WAGE INCREASES

Growth rate (%, year on year)

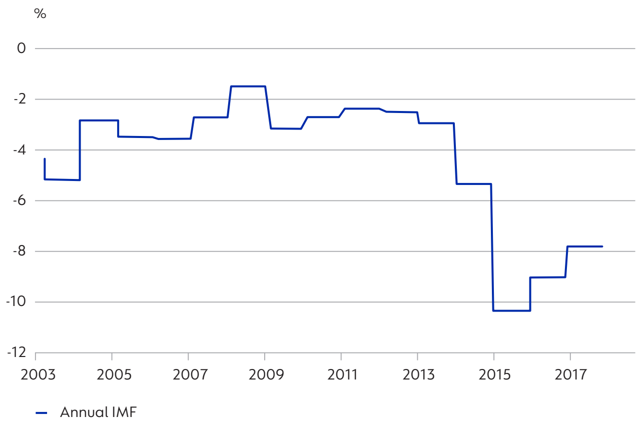


Source: Emerging Advisors Group, December Monthly Chartbook, derived from national accounts data

international competitiveness. The deterioration in the fiscal situation eventually led to a hard landing in 2015 and 2016 when a combination of an economic contraction of 7% and double-digit inflation plunged the country into its most severe recession on record. The currency also depreciated by 85% against the dollar over the one-year period from September 2014 to record lows since the introduction of the Brazilian real in 1994, an event that brought an end to persistent hyperinflation.

Despite having just been re-elected in 2014, public opinion moved rapidly against then-president Rousseff as the economy continued to deteriorate. This led to her eventual impeachment by Brazil's Congress and Senate on charges of breaching Brazil's budget laws. Vice President Michel Temer served the remainder of her four-year term, achieving very little during those two years due to corruption allegations against him. This hindered his ability to attain Congressional support for some of the tough reforms that Brazil needs to enact to deal with its perilous fiscal position and very burdensome regulations that retard economic growth.

FISCAL BALANCE (% GDP)



Source: IMF

The 2018 election therefore resulted in a showdown between left and right. Da Silva intended to run again, as the constitution imposes a two-term limit for consecutive elections, but after sitting out at least one cycle, a former president is free to run again. Unfortunately for him, he was jailed earlier in the year for corruption and, after losing several appeals, was declared ineligible to stand. His party nominated Fernando Haddad, a former mayor of São Paolo, as its candidate. With centrist parties failing to gain traction, Haddad came up against Jair Bolsonaro, a congressman for close to 30 years.

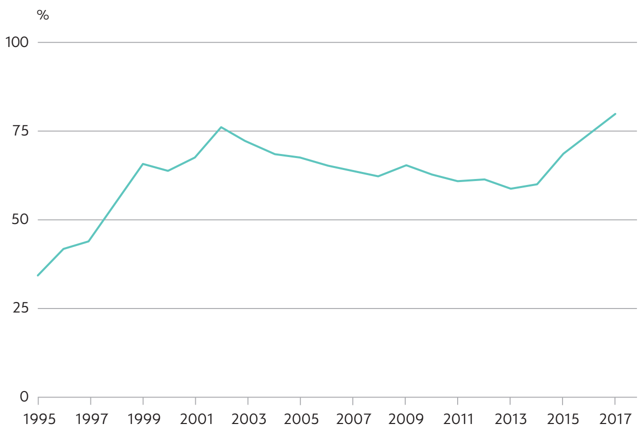
Bolsonaro has been described in the media as Brazil's Donald Trump, due to his tendency to make provocative and unconventional statements. He has spoken fondly about Brazil's time under military rule (he served in the military before entering Congress) and denigrated certain groups of people based on his staunch religious views.

With the Brazilian electorate very angry with the PT party for its failings under Da Silva and Rousseff, it was almost inevitable that whatever the shortcomings of the alternatives, the leading non-PT candidate would win.

That eventually came to pass, as Bolsonaro won comfortably in the second round of the election by around 10 percentage points. The scale of the task awaiting his administration is daunting – Brazil runs a budget deficit that has exceeded 5% of GDP for each of the last four years. Government debt to GDP is now in excess of 70% and continues to rise. With close to double-digit interest rates and a poor credit rating, Brazil must spend 6% of GDP just servicing the interest on its debt.

Brazil's generous pension and social security system allows many public employees to retire in their fifties (with a life expectancy of 75 years) and spending on these benefits consumes over half the federal budget. Without drastic entitlement reform, it will be impossible to get Brazil into a sustainable fiscal situation. Bolsonaro lacks a majority in Congress to force through reforms without cross-party backing, so there is potential for continued deadlock and for the fiscal situation to spiral further out of control.

BRAZILIAN DEBT TO GDP



Source: IMF DataMapper

Because of these challenges, the administration put in place by Bolsonaro is very important. Early indications are that good technocrats will be in charge of key administrations and that the incoming government is committed to cutting red tape and making Brazil an easier country to do business with.

There are many attractive domestic industries in Brazil that we believe have good investment opportunities. The fragmented nature of the higher education sector, the clothing and food retail sectors and the healthcare industry overall provides an opportunity for market leaders and entrepreneurial management teams to deliver high returns for shareholders over the medium to long term. Our Global Emerging Markets Strategy continues to identify and research these potential investment ideas to complement the 12% of the strategy that is currently invested in Brazil. After several tough years, valuations in Brazil remain very attractive in a variety of businesses, even relative to the overall global emerging markets universe after its decline last year. ✚

The numbers that drive retirement

How much do you really need?

TO MATHEMATICIANS, the numbers 5, 15 and 75 may have no fascinating correlation or geometric relationship. They are not the Golden Ratio, nor did they help to solve Fermat's Last Theorem. But to retirement specialists, they provide the starting point for calculating how much you really need in your retirement.

The '5' relates to the generally accepted 'safe' percentage South African retirees can draw down from their retirement capital on an annual basis to receive a sustainable, inflation-adjusted retirement income for life. The '15' refers to the percentage of salary that is recommended that you should save for retirement each month. It is also the number by which your current annual income is multiplied to give the required amount of capital needed at retirement. Lastly, '75' is the percentage of your salary which should be received in retirement to maintain your standard of living.

5: HOW MUCH YOU CAN WITHDRAW FROM RETIREMENT SAVINGS

No one really knew how much you needed for retirement until 1994 when American financial planner, William Bengen, crunched the numbers and came up with 4% as the 'safe withdrawal rate'. That meant, by US standards, you could withdraw 4% from your retirement portfolio every year without seeing a decline in living standards late in retirement.

Bengen investigated the highest withdrawal amount that – as a percentage of retirement-date assets and with inflation adjustments – would be sustainable for the full 30 years estimated for retirement. He based his findings on returns gathered from historical data using the Standard & Poor's (S&P) 500 Index and intermediate-term government bonds, and constructing 30-year rolling periods. He then focused on what was called 'SAFEMAX', which was the highest withdrawal rate for the worst-case retirement scenario in the historical period. It was from these origins that the world of financial planning received the 4% rule.

In South Africa, the number is higher, at 5%, mostly because of a historically higher interest rate environment and the positive effects higher interest rates have on retirement portfolios. But even the 5% withdrawal rate should be used mainly as a guideline. Bengen acknowledged in his study that volatility in asset returns during retirement would cause the safe withdrawal rate to fall. So it is advisable to be somewhat flexible. This is especially relevant for recent retirees, given how disappointing returns have been in the recent past. Older retirees have shorter time horizons and can therefore justify higher withdrawal rates.

In South Africa, the current legal drawdown limits applicable to living annuities fall between 2.5% and 17.5%, but unless assets exceed needs by a large amount, the higher side of the spectrum is not advisable. There are many ways to manage withdrawal rates to compensate for risks which may be encountered over the retirement period (refer to the information box later in this article).

15: THE SAFE SAVINGS RATE

Much like the safe withdrawal rate for retirees, there is also a 'safe savings rate', expressed as a percentage of the income earned while still working. Much research has been done on this aspect of retirement too, with US academic Wade Pfau coming up with the term 'SAFEMIN'. Pfau believes that you will be better prepared if you start your working life thinking in terms of a safe savings rate than waiting for retirement to set a safe withdrawal rate, but even that is not fail-safe. Eventual outcomes will vary based on assumptions about asset allocation, market returns, lifestyle needs and the expected duration of the accumulation (while working) and decumulation (while retired) phases.

The overwhelming fact which stands out is the importance of starting to save early. In South Africa it is generally accepted that 15% of a monthly income should be saved for retirement, though that will increase the later you start saving. Currently, up to 27.5% of your annual taxable income can be saved tax free.

75: THE PERCENTAGE OF YOUR ANNUAL SALARY YOU NEED WHEN YOU RETIRE

The replacement ratio (the percentage of your final salary required at retirement) is generally considered to be around 75% in South Africa. This ratio is based on the actuarially calculated amount that defined benefit pension funds paid out when they were still applicable to most people's pension funds. Unless you are a government employee, you are much more likely to be invested in a defined contribution pension fund today, where the retiree needs to take responsibility for having adequate retirement capital to fund their future income needs. The rationale for replacing only 75% of your final salary is that retirees will need less than 100% of their annual salary in retirement.

As a start, you will no longer be saving 15% of your salary for retirement. Other costs may reduce too, such as those for debt servicing, transport, children's education and housing. Generally, the highest cost for a retiree, particularly in the latter years of retirement, is predictably medical costs, making continued membership of a quality medical aid very important.

THE AMOUNT YOU WILL NEED AT RETIREMENT: 15X

Based on a withdrawal rate of 5% and the replacement ratio of 75% of annual salary, the amount that is required at retirement is 15 times your final annual salary.

The numbers in action

- An investor starts saving 15% of their income at age 23.
- The investor receives a salary increase of 2% per annum above inflation over time and receives a 6% return per annum over inflation leading up to retirement.
- At retirement age of 65, the investor will have accumulated 15 times their final salary and invests the capital in an appropriate portfolio with a real return of 4% per annum.
- A 5% initial drawdown rate in retirement allows the retiree to earn 75% of his final annual salary.
- Increasing the salary at the pace of inflation every year results in the investor reaching the 17.5% living annuity income cap at the age of 95.

Assumptions	
Real income increase from job	2.0%
Inflation	6.0%
Real investment return pre-retirement	6.0%
Real investment return post-retirement	4.0%
Savings rate	15.0%
Post-retirement drawdown rate	5.0%
Results	
Multiple of final salary at retirement	15.38
Replacement ratio	77%

Note: Real refers to after inflation
Source: Coronation

THERE ARE RISKS

However, if the numbers were fail-safe and the process was risk-free, retirement would not be the complicated process which it has become. Like an obstacle course, numerous hazards lie in your way.

Sequence of returns: being in the right place at the wrong time
Even if retirees do all the right things, they may still fall victim to retiring at the wrong time. The sequence of returns is a risk that affects retirees, depending on the order in which returns on their retirement investment occur. If a higher proportion of negative returns takes place at the beginning of retirement, it will have a lasting negative effect and reduce the amount of income you can withdraw over your lifetime. To avoid crystallising big losses, you need a portfolio that limits large losses.

Outliving your retirement income
Most people in their early sixties can expect to live another 20 to 30 years. But of course, no-one can predict when they will die. It is therefore considered prudent to plan for a longer lifespan of at least 30 years.

Even this is not always fail-safe, particularly as people are living longer. Japan, for example, revealed in 2017 that it has 67 824 citizens who are older than 100 years, resulting in an ageing population that is putting severe strain on the country's economy. You can manage this risk through insurance though, by using some of your capital to buy a guaranteed income for life.

Inflation
Preserving the purchasing power of your capital is crucial. If the rate of inflation exceeds returns, capital, and therefore retirement income, will be eroded, so the aim of all retirement funding portfolios should be to achieve real returns of at least 3% to 4% over time. Growth assets such as equities and property provide the best protection against inflation over time; moderate growth exposure is therefore an essential element in the fight against inflation.

Most people in South Africa do not plan sufficiently for retirement and leave saving for it too late. However, the numbers, 5, 15 and 75 may provide some guidance on how to plan as efficiently as possible and not be caught unawares. It is always advisable to know how much is enough. ✚

HOW TO MAKE YOUR MONEY LAST LONGER

Delay your retirement by five years by continuing to earn an income and not drawing from your retirement fund. If you keep all else equal and earn the expected rate of return on your assets, you will retire with 67% more capital if you can delay retirement by five years.

Manage spending to enable a lower withdrawal rate, particularly at the beginning of retirement. The general rule is that if your capital is still intact after the first 10 years of retirement, you are highly unlikely to run into financial difficulties late in life.

Optimise asset allocation[1] by investing in a portfolio that holds a balance of growth assets (equities and property) and income asset (bonds and cash). If you do not need to draw down a large initial amount (less than 2.5%), you can invest more aggressively in equities and property.

[1] Reduce income requirements after periods of low returns on your retirement capital.

Flagship fund update

INVESTOR NEED: LONG-TERM GROWTH

Domestic general equity funds

Top 20 and Equity

Over the last decade, the Top 20 and Equity funds showed compelling returns of 12.8% and 12.7% per annum, respectively. However, the fourth quarter of 2018 (Q418) proved to be the most challenging period in a difficult year, with Top 20 declining by 4.9% and Equity by 7.9%.

Top 20 is a concentrated portfolio of locally listed shares only, while Equity is more diversified, with 80% invested locally and 20% in offshore shares.

Both funds were impacted by the ebbing of investor sentiment in South Africa as so-called 'Ramaphoria' evaporated and structural concerns reasserted themselves, particularly in the case of state-owned enterprises (SOEs). In Equity, the inclusion of global equities in the portfolio over the past three years has benefitted performance while enhancing diversification, but detracted in the most recent quarter.

The fourth quarter's major disappointment was the withdrawal of the bid for Intu Properties by a consortium that included Intu's current major shareholder, the Peel Group. Despite a successful conclusion of the due diligence, the other partner in the transaction decided to withdraw amid concerns over Brexit. However, we remain convinced of the value in Intu and continue to engage with the board to ensure that this is unlocked for all shareholders.

British American Tobacco, a major holding in both funds, ended the quarter at -27.4% and the year at -43.4%, on the back of negative regulatory developments in the US. Trading on 7.6 times its forward earnings and with a dividend yield above 8%, we believe the share offers exceptional value, and ultimately, we believe fundamentals will assert themselves.

The best-performing portion of these portfolios remained their resources positions, with prices for Anglo American commodities remaining strong, which allowed the de-gearing of its balance sheet. Exxaro also performed well, and recently announced further value accretion from the finalisation of its exit from Tronox, the mineral sands business. The proceeds from the sale of its final stake should be received in 2019, the majority of which will be returned to shareholders.

Meanwhile, the December decision by the Central Bank of Nigeria to reverse the $8 billion penalty it had applied to MTN for allegedly avoiding exchange controls was a welcome one for both funds. This means MTN can proceed with the planned listing of MTN Nigeria and can also repatriate profits from Nigeria, which will support its current dividend policy. However, despite the resolution, shaken investor confidence means MTN continues to trade well below our opinion of fair value, as we view investors as placing an excessive discount on African operations.

While both funds remain significantly exposed to offshore shares such as Naspers, British American Tobacco, Quilter and Mondi that happen to be listed in Johannesburg, we have increased exposure to defensive domestic holdings such as hospital groups and food retailers, resulting in a more balanced portfolio.

While this has been a disappointing quarter for both funds, given the extent of share price declines, we see compelling value in many names that now trade at significant discounts to our assessment of fair value.

Multi-asset class funds

Balanced Plus and Market Plus

While the Balanced Plus and Market Plus funds compounded at 11.3% and 11.9% per annum over the past decade, both funds declined in the last quarter of 2018, by -6.3% and -5.3%, respectively.

The funds benefitted from exposure to global equities over time, but during Q418 this detracted from performance, as global markets sold off sharply. The MSCI All Country World Index (ACWI) declined by 12.8% and the US market was down 14.0%, as trade wars and slowing global growth plagued market sentiment. In the UK, Prime Minister Theresa May survived a vote of no confidence, but the chances of a no-deal Brexit rose and the FTSE 100 Index declined 11.7%. Emerging markets (-14.6%) underperformed the developed world (-8.7%) over the year, but did relatively better in Q418. It has been many years since we have been able to buy high-quality businesses at the undemanding ratings currently available in many emerging markets.

The funds entered 2018 with a relatively low level of exposure to local and global equity markets, and we have taken advantage of the sell-off to increase exposure to shares, with exposures similar to the general equity funds above. We have primarily increased local equity exposure, as the South African market is offering levels of upside we have not seen since the financial crisis. While our multi-asset funds remain significantly exposed to offshore stocks, we have increased the domestic holdings, resulting in more balanced portfolios.

Overall, equity exposure is now around 70% in both portfolios.

We remain cautious on global bonds, given the very low yields at which they trade, coupled with an environment of normalising interest rates and the risk of rising inflation. In South Africa, the All Bond Index returned 2.7% for the quarter, bringing annual performance to 7.7%, which compares favourably to other domestic asset classes.

Both funds added domestic bonds during 2018 as yields rose and valuations became more reasonable. Domestic bonds have generated a positive return for the year, but we believe the position remains justified, given reasonable valuation.

It has been a challenging year. Share prices plummeted on disappointing news flow and there have been few marginal buyers for assets with uncertainty. Given the extent of share price declines, we see compelling value in many names which now trade at significant discounts to our assessment of fair value. The team continues to do as we have done before; cut out the noise, work hard to interrogate investment theses and invest for the long term, where we believe the inherent value in many of our holdings will reassert itself.

INVESTOR NEED: INCOME AND GROWTH

Capital Plus and Balanced Defensive

The final quarter of 2018 unfortunately saw the downtrend already prevailing in most stock markets accelerate to even bigger losses. Against this backdrop, the Balanced Defensive fund's relatively high exposure to bonds helped to offset the negative returns from risky assets, resulting in a positive return of 2% for the year. Capital Plus, with relatively more exposure to risky assets, declined by 2.5% over the year. Over the past 10 years, the Balanced Defensive and Capital Plus funds returned a commendable 9.8% and 8.9% per annum, respectively – both ahead of inflation, which ran at 5.4% per annum over the period.

The Balanced Defensive portfolio carries an almost 50% exposure to domestic bonds, including inflation-linked bonds, at an expected real yield of close to 5%, while Capital Plus's domestic bond exposure is just over 30%. Both funds' weighting to domestic equities has been increased into price weakness and we are

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finding many stocks that now offer very good value. The fund's global exposure has been trimmed marginally to make space for the more attractive local assets. We expect these bond holdings to be a key building block in the coming year to help us achieve our targeted return.

We have been adding to JSE-listed equities, taking Balanced Defensive's exposure to 20% at year-end and Capital Plus's exposure to 32% – the highest levels for the year. We added to a range of stocks, including British American Tobacco, Standard Bank, FirstRand and Shoprite. As far as Naspers is concerned, we used the extreme volatility in the share price to vary exposure actively.

Cash has now outperformed these funds, and most balanced funds, even over a five-year period. It is therefore understandable that investors will question the relevance of staying invested in balanced funds. In our view, cash will not deliver inflation plus 3% in the long term. One therefore requires exposure to some risk assets where the potential return is far higher.

INVESTOR NEED: IMMEDIATE INCOME

Strategic Income

The fund returned 1.8% in Q418, bringing its total return to 7.3% for the year. This is ahead of the returns delivered by cash (6.9%) and slightly behind its benchmark (7.6%) over the same one-year period. Over two and three years, the fund remains well ahead of both cash and its benchmark.

2018 was a difficult year, with almost all investable asset classes underperforming cash. The exceptions were bonds (7.7%), preference shares (15.0%) and offshore assets (the rand depreciated 13.8% against the US dollar). Over the years, we have continuously flagged that, during times of high volatility and over shorter measurement periods, investors should expect returns that are in line with that of cash. Last year was such a year; however, the fund remains well positioned to benefit from the attractively priced assets that it currently owns.

During the year, the US/China trade war escalated, raising concerns about global growth expectations, which we now know to be too high. Around about the same time, the US Federal Reserve (Fed) started to lift its expectations for the US economy and consequently, its expectations around US interest rates.

This combination of higher-than-expected US rates, lower global investor confidence and slower global growth painted a very poor picture for emerging markets. Emerging market bonds were down 7.9% in US dollars for 2018, while emerging market bonds in their local currencies only returned a paltry 2.9%.

South Africa did not fare much better, as concerns over key policies (land, the mining charter and SOE reform) and much slower growth weighed heavily on local asset price performance. The All Bond Index was up 7.7% for 2018; however, rand weakness brought South African government bond returns in US dollars to -7.1%.

South African government bonds had a rollercoaster of a year, with the benchmark bond starting the year at 8.59%, hitting a high of 7.88%, then a low of 9.36% and ending the year at 8.87%. Inflation-linked bonds (ILBs) continued to suffer as real yields moved almost as much as nominal bonds (I2025 – low: 3.15%, high: 2.08%), primarily due to the adjustment lower in both medium- and longer-dated inflation assumptions. Due to the higher duration that these bonds carry, ILBs only managed to eke out a return of 0.3% for the year.

The US Federal Open Market Committee (FOMC) raised the Fed Funds rate by 25 basis points (bps) to a 2.25% to 2.5% range in December. Rates markets have since priced out further US policy rate tightening in 2019.

Domestic inflation accelerated modestly to 5.2% year on year (y/y) in November from 5.1% y/y in October. In a tied 3:3 vote, the South African Reserve Bank's Monetary Policy Committee (MPC) raised the repo rate 25 bps to 6.75% in November, with the Governor casting the deciding vote. The MPC has reiterated its desire to see CPI and inflation expectations closer to the midpoint of the target band (4.5%), implying that despite prevailing low inflation and slow growth, we can expect modest increases in interest rates in coming months.

At the end of November, shorter-dated, fixed-rate negotiable certificates of deposit (NCDs) traded at 8.45% (three-year) and 8.96% (five-year), slightly tighter over the month. The spreads of floating-rate NCDs have dulled in appeal over the last few quarters due to a compression in credit spreads. There has been a reduced need for funding from banks in South Africa, given the low-growth environment. Fixed-rate NCDs continue to hold appeal due to the inherent protection offered by their yields and relative to our expectations for a stable repo rate. However, credit spreads remain in expensive territory (less than 100 bps in the three-year area and 110 bps in the five-year area).

The fund continues to hold decent exposure to these instruments (less floating than fixed), but we will remain cautious and selective when increasing exposure. NCDs have the added benefit of being liquid, thus aligning the liquidity of the fund with the needs of its investors.

The fund maintains its healthy exposure to offshore assets, and when valuations are stretched, it will hedge/unhedge portions of its exposure back into rands/dollars by selling/buying JSE-traded currency futures (US dollar, UK pound and euro).

We remain vigilant of risks emanating from the dislocations between stretched valuations and the underlying fundamentals of the local economy. However, we believe that the fund's current positioning correctly reflects appropriate levels of caution. The fund's yield of 9.3% remains attractive relative to its duration risk. We continue to believe that this yield is an adequate proxy for expected fund performance over the next 12 months.

INVESTOR NEED: OFFSHORE DIVERSIFICATION

Global Managed

The last quarter of 2018 brought misery to most investors as the market's focus shifted to growing concerns around global growth prospects. December's sell-off was the worst end to a year in the last 45 years. Q418 ended up returning negative 12.8% for the ACWI, and many markets officially entered bear market territory, with declines of more than 20% from previous highs. Long bond rates declined, given the poorer outlook for global growth, resulting in a marginally positive return quarter for the asset class.

Within equities, utilities and real estate (both beneficiaries of lower long-term interest rates) did the best in relative terms. For once, consumer staples lived up to their defensive reputation and outperformed the overall ACWI by about 6%. On the other side of the spectrum, energy was the laggard, given the spectacular drop in the price of oil. The indiscriminate selling of longer duration (higher growth) assets resulted in information technology shares being punished, while other cyclical sectors such as consumer discretionary, industrials and materials also performed poorly. The US equity market slightly underperformed the rest of the world, and surprisingly, emerging markets marginally outperformed the developed world over the quarter.

As mentioned above, long rates in the US declined against this backdrop, with global bonds producing a marginally positive performance. Credit spreads, however, widened, given the concerns over global growth, resulting in a negative quarter for credit. Global listed property yielded a negative return of 5.5% over the three-month period, which was better than equities but still disappointing, given the drop in long rates. Europe was particularly hard hit, and the UK had a disastrous period with the increased uncertainty around Brexit and a significantly poorer outlook for the sector. Commodities, as expected, had a very tough time because of global growth concerns, and gold, for once, lived up to its safe-haven status in a world of increasing uncertainty. The gold price rose by 7.5% over the quarter.

Bonds yielded a negative return of just over 1% for the 2018 calendar year, as did property with a negative 4.7% return. Gold was also marginally negative, highlighting the fact that investors really had no place to hide but in US dollar cash. There were no major moves in the currency markets over the quarter, but over the last 12 months the US dollar strengthened by about 14% against the euro, and by about 4% against the yen.

During these turbulent times, the fund did not perform well. It was down 10.7% over the quarter, underperforming its benchmark by over 3%. Most of the underperformance took place in the month of December. This was particularly disappointing given our defensive asset allocation, but a combination of stock-specific issues and a weak property market more than offset our lowish equity allocation. The fund is now slightly behind the benchmark since inception. This unsatisfactory situation is receiving our full attention, and we are determined to correct it.

Positive contributors over the year include Advance Auto Parts, a position we have now exited in favour of shares where we anticipate greater upside from current levels, on a risk-adjusted basis. Other notable positive contributors over the last year included long-time holdings such as Amazon, Alphabet and Blackstone. After a period of underperformance, Pershing Holdings also contributed positively.

Our position in the tobacco stocks were the biggest detractors, costing the fund about 2% in relative performance. Limited Brands, Tata Motors, Aspen, JD.com and Comcast were other detractors. We have exited Tata given the increasingly murky outlook for auto sales in China and we have sold out of Comcast because of the concerns around future capital allocation decision-making. The other detractors remain in the portfolio, with our assessment of upside in many of these cases being very appealing.

Spotify, the leading global music streaming platform with almost 100 million paying subscribers, is a relatively new position in the fund. We expect to see continued strong growth in Spotify's user base, as people increasingly embrace streaming. We therefore believe that Spotify is well placed in a recovering music market that only returned to growth in 2015 (driven solely by streaming), after almost two decades of decline.

Although currently loss-making, Spotify is cash generative and has a growing cash balance of around $2 billion (9% of market capitlisation) along with a valuable stake in China's dominant music platform, Tencent Music Entertainment (8% of market capitalisation). We believe Spotify has multi-year growth potential (management's target is 25% to 35% per annum) and a roadmap to sustained profitability as the dominant player in a changing, but growing, global music market.

When assessing the prospects of our holdings in the fund, we are excited about their potential. The equity holdings are managed by capable executive management teams, and most of them have strong value propositions for their customers. While it is difficult to assess where we are in the equity market cycle, we see more opportunities following the recent sell-off and we have added to some of the longer-duration stories such as Spotify and Facebook.

We have also increased the equity allocation somewhat to the fund's highest level in more than six months. We continue to be positive about the prospects for our property holdings and we are starting to find selective value in the credit market. We are clearly not satisfied with the fund's more recent performance, but have not changed our process or philosophy, and remain confident that those factors that have yielded success over the longer term will continue to serve us and our clients well in future. ✚

For more information, please refer to the fund fact sheets available on www.coronation.com

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.

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] ● INCOME ● GROWTH	94.4% 5.6%	60.3% 39.7%	42.9% 57.1%	18.9% 81.1%	0% 100%
LAUNCH DATE	Jul 2001	Feb 2007	Jul 2001	Apr 1996	Oct 2000
ANNUAL RETURN[2] (Since launch)	10.3% 7.8%†	9.3% 6.0%†	11.6% 5.9%†	14.1% 13.0%†	17.2% 13.5%†
QUARTILE RANK (Since launch)	1st	1st	2nd	1st	1st
ANNUAL RETURN (Last 10 years)	8.9% 6.4%†	9.8% 5.4%†	8.9% 5.4%†	11.3% 11.8%†	12.7% 12.4%†
STANDARD DEVIATION (Last 10 years)	1.5% 0.3%†	4.2% 1.3%†	6.0% 1.3%†	8.5% 8.7%†	14.2% 14.1%†
FUND HIGHLIGHTS	Outperformed cash by 1.5% p.a. over the past 5 years and 2.5% p.a. since launch in 2001.	Outperformed inflation by 3.3% p.a. (after fees) since launch, while producing positive returns over all 12-month periods.	Outperformed inflation by 5.8% p.a. (after fees) since launch, while producing positive returns over 24 months more than 99% of the time.	No. 1 balanced fund in South Africa since launch in 1996, outperforming its average competitor by 1.9% p.a. Outperformed inflation by on average 7.8% p.a. since launch and outperformed the ALSI on average by 1.1% p.a. (since launch).	The fund added 3.7% p.a. to the return of the market. This means that R100 000 invested in Top 20 at launch in Oct 2000 grew to more than R1.8 million by end-December 2018 – 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 2018. Growth assets defined as equities, listed property and commodities (excluding gold).*

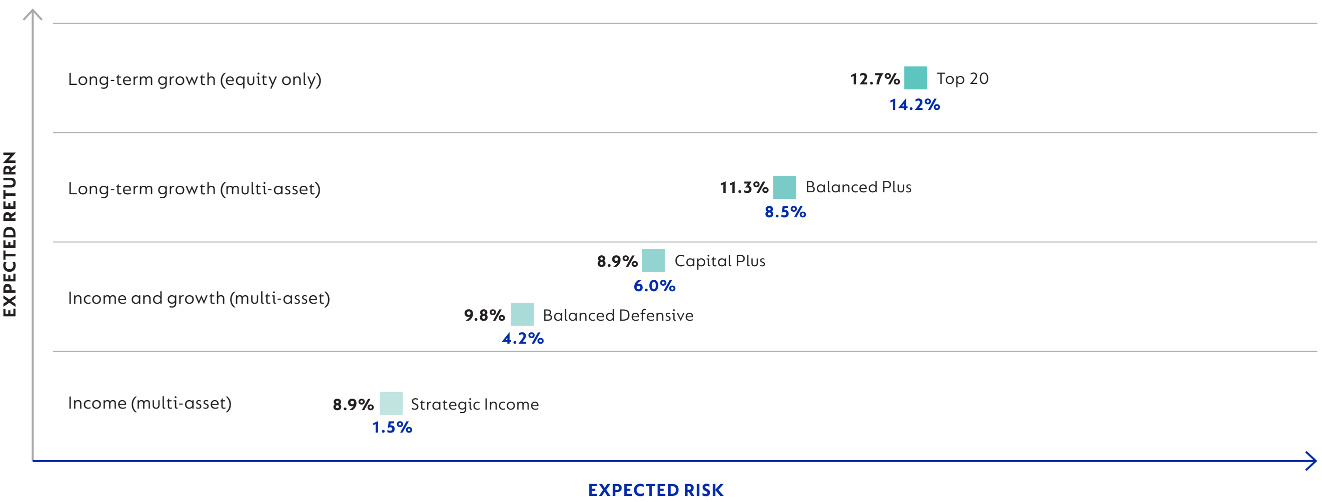
[2] *Highest annual return*
Balanced Defensive: 21.2% (Jun 2012 - May 2013); Balanced Plus: 49.3% (Aug 2004 - Jul 2005); Capital Plus: 33.8% (Aug 2004 - Jul 2005); Strategic Income: 18.7% (Nov 2002 - Oct 2003); Top 20: 68.9% (May 2005 - Apr 2006)

Lowest annual return
Balanced Defensive: 0.54% (Dec 2017 - Nov 2018) ; Balanced Plus: -17.4% (Sep 1997 - Aug 1998); Capital Plus: - 6.2% (Nov 2007 – Oct 2008); Strategic Income: 2.6% (Jun 2007 – May 2008); Top 20: -31.7% (May 2002 – Apr 2003)

Figures are quoted from Morningstar as at 31 December 2018 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

RISK VERSUS RETURN

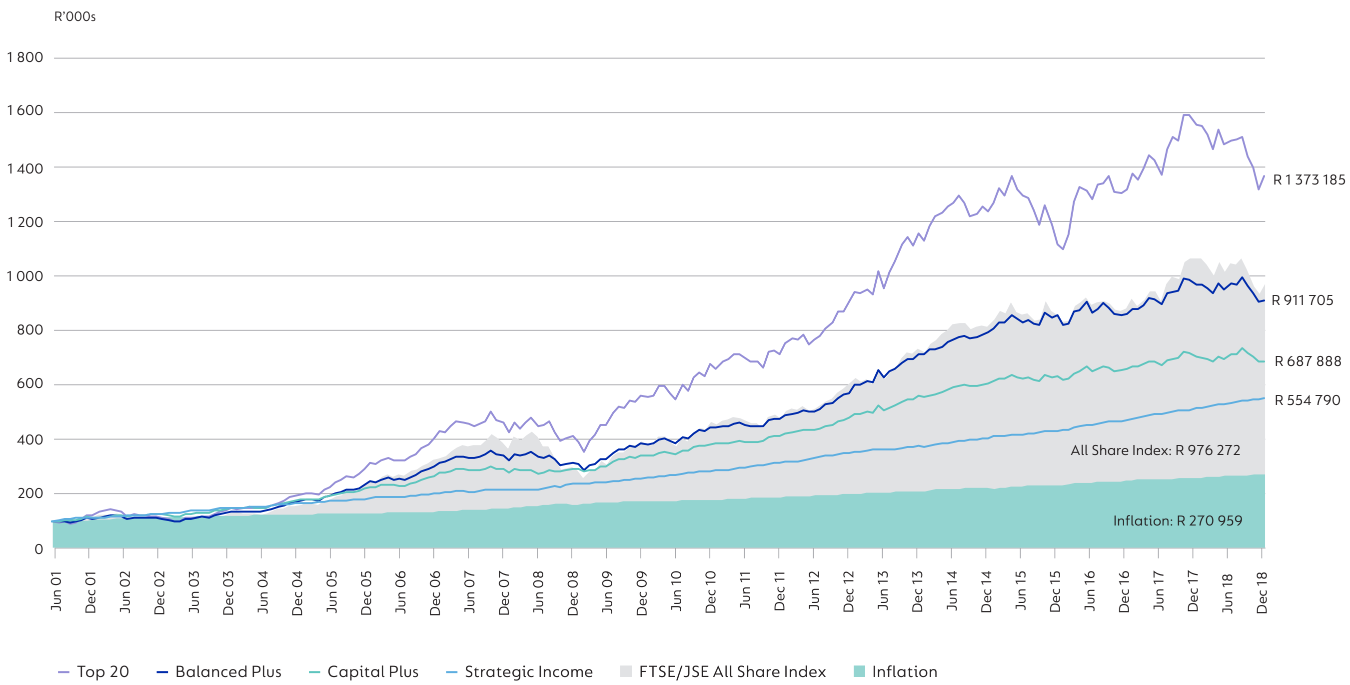
10-year annualised return and risk (standard deviation) quoted as at 31 December 2018.
Figures quoted in ZAR after all income reinvested and all costs deducted.



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 2 July 2001 as at 31 December 2018. 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 1 February 2007.



Source: Morningstar

International flagship fund range

INVESTOR NEED

	DEPOSIT ALTERNATIVE	CAPITAL PRESERVATION	LONG-TERM CAPITAL GROWTH (MULTI-ASSET)	LONG-TERM CAPITAL GROWTH (EQUITY ONLY)	
FUND[1]	**GLOBAL STRATEGIC USD INCOME** US dollar cash (3 Month Libor)†	**GLOBAL CAPITAL PLUS** US dollar cash (3 Month Libor)†	**GLOBAL MANAGED** Composite (equities and bonds)†	**GLOBAL OPPORTUNITIES EQUITY** MSCI ACWI†	**GLOBAL EMERGING MARKETS** 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] ● INCOME ● GROWTH	97.6% 2.4%	59.7% 40.3%	29.9% 70.1%	0.3% 99.7%	8.1% 91.9%
LAUNCH DATE OF OLDEST FUND	Dec 2011	Nov 2008	Oct 2009	Aug 1997	Dec 2007
ANNUAL RETURN[3] (Since launch)	2.3% 0.8%†	4.4% 0.7%†	5.0% 5.8%†	6.0% 5.4%†	1.0% 0.3%†
QUARTILE RANK (Since launch)	–	1st	1st	–	4th
ANNUAL RETURN[3] (Last 5 years)	1.2% 1.0%	0.3% 1.0%	0.3% 3.4%	2.1% 4.8%	(3.8)% 1.8%
ANNUAL RETURN[3] (Last 10 years)	–	4.5% 0.7%	–	8.2% 10.1%	7.3% 8.3%
QUARTILE RANK (Last 5 years)	–	1st	4th	–	4th
FUND HIGHLIGHTS	Outperformed US dollar cash by 1.4% p.a. (after fees) since launch in December 2011.	The fund has outperformed US dollar cash by 3.7% p.a. (after fees) since launch in 2008.	Number one global multi-asset high equity fund in South Africa since launch in October 2009.	Both the rand and dollar versions of the fund have outperformed the global equity market with less risk since their respective launch dates.	Both the rand and dollar versions of the fund have outperformed the MSCI Emerging Markets Index by more than 0.8% p.a. since their respective launch dates.

[1] *Funds are available as rand-denominated feeder funds and foreign currency-denominated funds. The Global Capital Plus fund is also available in US dollar Hedged (launched 1 December 2011), GBP Hedged (launched 1 December 2011), EUR Hedged (launched 1 December 2011) or Houseview currency class (launched 1 September 2009).*

[2] *Income versus growth assets as at 31 December 2018 (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.*

Highest annual return
Global Strategic USD Income: 7.1% (Jan 2012 - Dec 2012); Global Capital Plus [ZAR] Feeder: 31.4% (Mar 2009 - Feb 2010); Global Managed [ZAR] Feeder: 23.1% (Jul 2010 - Jun 2011); Global Emerging Markets Flexible [ZAR]: 96.0% (Mar 2009 - Feb 2010); Global Opportunities Equity [ZAR] Feeder: 56.9% (Apr 1999 - Mar 2000)

Lowest annual return
Global Strategic USD Income: -1.0% (Mar 2015 -Feb 2016); Global Capital Plus [ZAR] Feeder: -7.0% (Mar 2015 - Feb 2016); Global Managed [ZAR] Feeder: -14.9% (Mar 2015 - Feb 2016); Global Emerging Markets Flexible [ZAR]: -51.9% (Mar 2008 - Feb 2009); Global Opportunities Equity [ZAR] Feeder: -41.3% (Mar 2008 - Feb 2009)

Figures are quoted from Morningstar as at 31 December 2018 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 South Africa (ASISA).

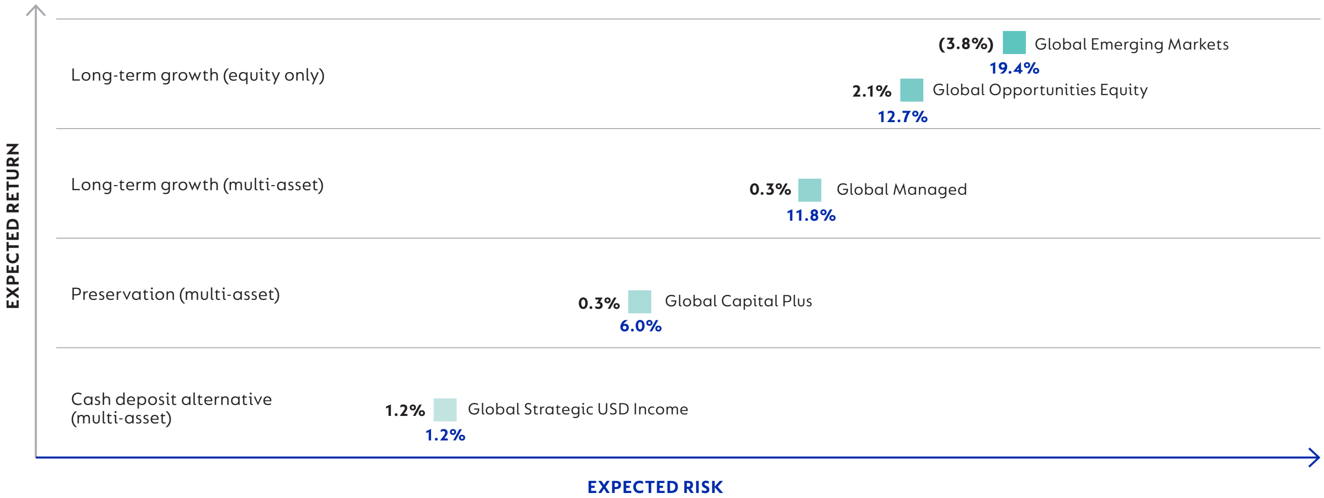
HAVE YOU CONSIDERED EXTERNALISING RANDS? IT IS EASIER THAN YOU MIGHT THINK.

The South African Reserve Bank allows each resident South African taxpayer to externalise funds of up to R11 million per calendar year (a 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 the South African Revenue Service 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.

RISK VERSUS RETURN

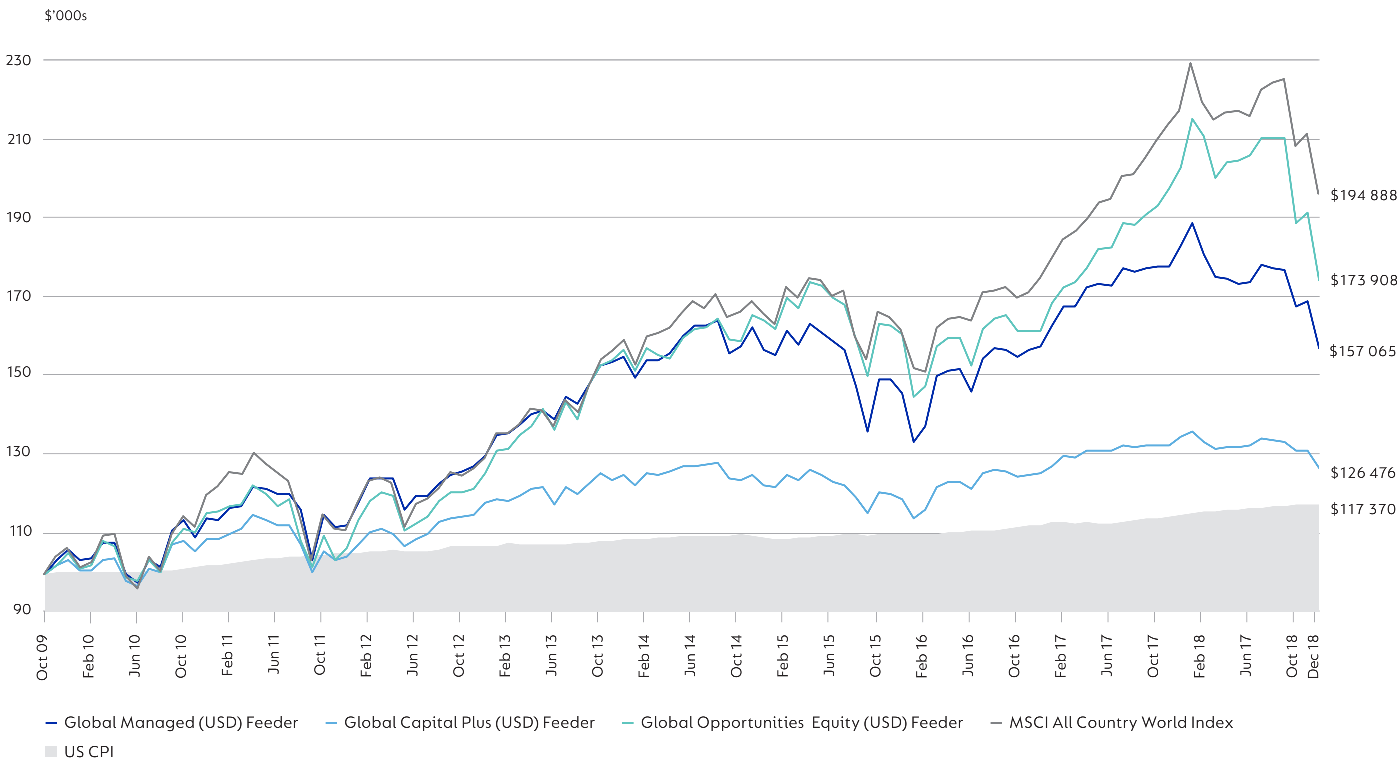
5-year annualised return and risk (standard deviation) quoted as at 31 December 2018. Figures quoted in USD (for the oldest fund) after all income reinvested and all costs deducted.



Source: Morningstar

GROWTH OF $100 000 INVESTED IN OUR GLOBAL MULTI-ASSET FUNDS ON 29 OCTOBER 2009

Value of $100 000 invested in Global Managed [ZAR] Feeder, Global Capital Plus [ZAR] Feeder and Global Opportunities Equity [ZAR] Feeder since inception of Global Managed [ZAR] Feeder on 29 October 2009. All returns quoted in USD. All income reinvested for funds. MSCI World Index is on a total return basis.



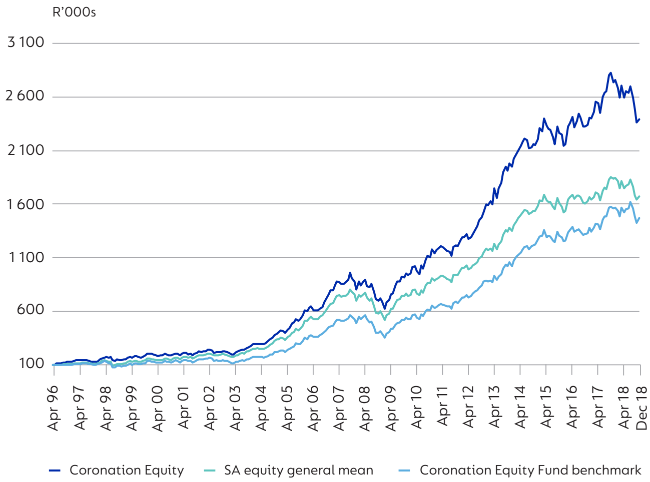
Source: Morningstar

Long-term investment track record

CORONATION EQUITY RETURNS VS EQUITY BENCHMARK

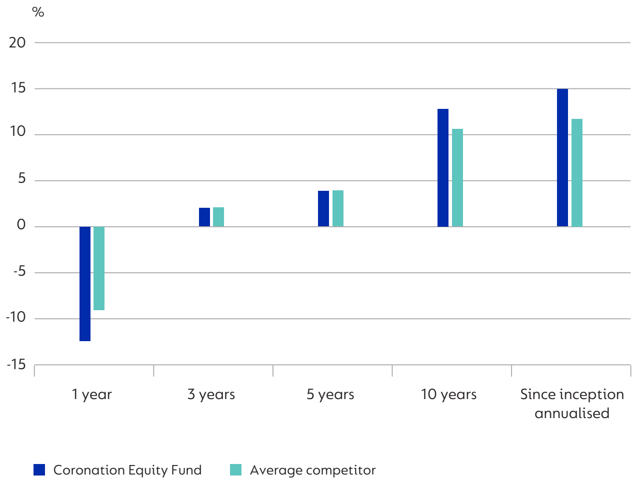
10-YEAR ANNUALISED RETURNS	CORONATION EQUITY	AVERAGE COMPETITOR	OUTPERFORMANCE OF AVERAGE COMPETITOR
2006	19.38%	17.09%	2.30%
2007	21.45%	19.23%	2.22%
2008	17.62%	18.47%	(0.84%)
2009	16.53%	16.68%	(0.15%)
2010	19.59%	19.14%	0.45%
2011	18.03%	16.98%	1.05%
2012	21.12%	18.94%	2.19%
2013	21.60%	18.68%	2.92%
2014	18.44%	16.32%	2.12%
2015	14.86%	12.62%	2.24%
2016	11.95%	9.54%	2.41%
2017	11.99%	8.90%	3.09%
2018	12.77%	10.54%	2.23%
ANNUALISED TO 31 DECEMBER 2018	**CORONATION EQUITY**	**AVERAGE COMPETITOR**	**ALPHA**
1 year	(12.61%)	(9.13%)	(3.48%)
3 years	2.03%	2.07%	(0.04%)
5 years	3.81%	3.87%	(0.06%)
10 years	12.77%	10.54%	2.23%
Since inception in October 1993 annualised	15.03%	11.64%	3.39%
Average outperformance per 10-year return			1.71%
Number of 10-year periods outperformed			11.00
Number of 10-year periods underperformed			2.00

CUMULATIVE PERFORMANCE



Source: Morningstar

ANNUALISED RETURNS TO 31 DECEMBER 2018



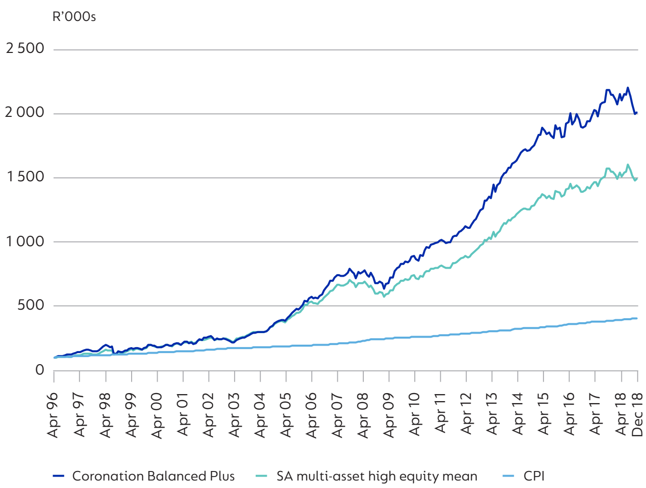
Source: Morningstar

An investment of R100 000 in Coronation Equity on 15 April 1996 would have grown to **R2 387 716** by 31 December 2018. By comparison, the returns generated by the fund's benchmark over the same period would have grown a similar investment to **R1 467 504**, while the South African equity general sector would have grown a similar investment to **R1 668 860**.

CORONATION BALANCED PLUS FUND VS INFLATION AND AVERAGE COMPETITOR*

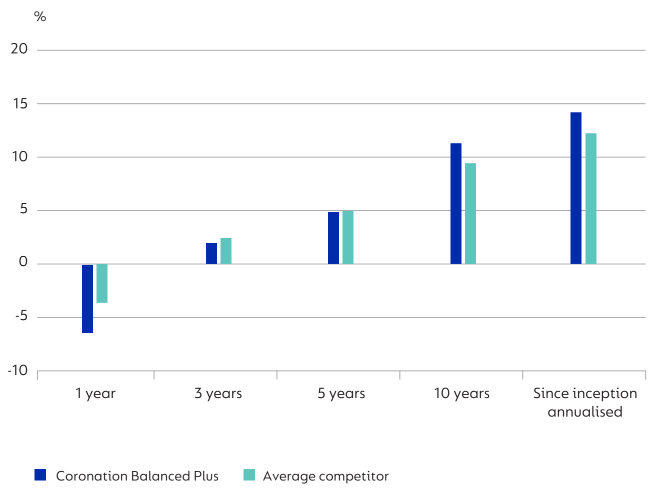
10-YEAR ANNUALISED RETURNS	CORONATION BALANCED PLUS	INFLATION	REAL RETURN
2006	18.33%	6.47%	11.86%
2007	17.81%	6.59%	11.22%
2008	16.96%	6.87%	10.09%
2009	15.69%	6.75%	8.94%
2010	17.20%	6.28%	10.93%
2011	15.78%	6.24%	9.54%
2012	17.85%	5.76%	12.09%
2013	18.63%	5.90%	12.73%
2014	16.58%	6.00%	10.57%
2015	14.01%	6.12%	7.89%
2016	11.08%	6.30%	4.77%
2017	11.04%	5.92%	5.12%
2018	11.26%	5.36%	5.90%
ANNUALISED TO 31 DECEMBER 2018	**CORONATION BALANCED PLUS**	**AVERAGE COMPETITOR**	**ALPHA**
1 year	(6.34%)	(3.57%)	(2.77%)
3 years	2.00%	2.49%	(0.49%)
5 years	4.92%	5.01%	(0.09%)
10 years	11.26%	9.41%	1.85%
Since inception in April 1996 annualised	14.14%	12.21%	1.93%
Average 10-year real return			9.36%
Number of 10-year periods where the real return is >10%			7.00
Number of 10-year periods where the real return is 5% - 10%			5.00
Number of 10-year periods where the real return is 0% - 5%			1.00

CUMULATIVE PERFORMANCE



Source: Morningstar

ANNUALISED RETURNS TO 31 DECEMBER 2018



Source: Morningstar

An investment of R100 000 in Coronation Balanced Plus on 15 April 1996 would have grown to **R2 002 223** by 31 December 2018. By comparison, the South African multi-asset high-equity sector over the same period would have grown a similar investment to **R1 484 084**.

* *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.*