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The Personal Investments Quarterly

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CORONATION

TRUST IS EARNED™

JULY 2020 WINTER EDITION

IN THIS ISSUE

CORONATION FUND UPDATES

7th Floor, MontClare Place, Cnr Campground & Main Roads, Claremont 7708. PO Box 44684, Claremont 7735.
Client service: 0800 22 11 77 E-mail: clientservice@coronation.co.za **www.coronation.com**

Notes from my inbox

"Only a crisis – actual or perceived – produces real change. When that crisis occurs, the actions that are taken depends on the ideas lying around." – Economist Milton Friedman

By **PIETER KOEKEMOER**

Pieter is Head of Personal Investments

A WELCOME, BUT UNLOVED, RECOVERY

Financial markets around the world rebounded in the second quarter of 2020, restoring a large portion of the decline in asset values during February and March. The market revival occurred despite the widely held view that the economic recovery from the damage wreaked by the virus and the response thereto will be slow and painful in many parts of the world, especially in South Africa. The strongest driver of the market outcome was the unprecedented level of fiscal and monetary stimulus unleashed by governments and central banks around the world. Globally, governments have implemented fiscal support of more than 7% of GDP, compared to the International Monetary Fund's June forecast of a global economic contraction of -4.9% in 2020. So far, at least for financial markets, the economic life support has worked.

The recovery in equity markets was narrow. Global technology companies — obvious winners given the forced behavioural changes in response to the pandemic — have materially outperformed the broad market indices. In the US, the S&P 500 is at the time of writing flat for the year to date, while the major technology companies are up nearly 50% this year. Smaller companies are languishing, with the Russell 2000 Index still down 12%. Locally, Naspers (+35% this year) and Prosus (+52%) have performed much better than domestic bellwether businesses such as Shoprite (-18%) and Sanlam (-22%).

The number of unknowns remain high in the current environment. The interplay of the massively contrasting forces of an unprecedented economic recession and unprecedented

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stimulus will continue to drive markets. Uncertainty is increased by rising inequality and more social unrest around the world. Covid-19 has accelerated the future, turning historically investable businesses into value traps, and higher debt levels everywhere increase risks. Given this challenging backdrop, we continue to focus on protecting our clients' capital and growing their wealth by building resilient, diversified portfolios with a long-term view. For an example of how this plays out in practice, read Sarah-Jane Alexander's article on page 21, explaining how we used the market dislocation to improve the quality of the domestic equity holdings included in your funds.

NOT THE RESULT WE HOPED FOR

During April, all of us were concerned about the then emerging implications of the pandemic, but still hopeful that South Africa could get ahead of the virus. Sadly, we now know that we have not achieved this positive outcome. We appear on an unwanted leader board, with the fifth-highest number of total confirmed Covid-19 cases globally. With 0.8% of the world's population, we have 3% of the confirmed active cases. One positive is that we have a young population, with an average age of 27 compared to Europe's median age of 43 years. This means that, despite a raging epidemic, our death rate is still in line with our population share.

At the same time, we have paid a material economic cost. As Marie Antelme points out on page 13, we expect the domestic economy to contract by nearly 10% this year, complicating the already very challenging fiscal arithmetic facing the National Treasury. While some of the economic pain resulted from policy errors made by government, the pandemic is the primary driver of the damage. A small example can be found in comparing recent Google mobility data for South Africa and Sweden's capital Stockholm, where a hard lockdown was not imposed and where the active cases are a fraction of ours. Figure 1 shows how much lower than the pre-Covid-19 baseline activity levels in Stockholm still is — not very different from the situation in Gauteng.

Figure 1

MOBILITY MEASURES

	Gauteng	Stockholm
Retail and recreational	(32%)	(26%)
Workplace	(41%)	(61%)
Transit stations	(53%)	(37%)

Percentage change in visits on 17 July 2020, compared to baseline on 14 February 2020.
Source: Google

While we wait for a vaccine, the only viable response we have is a combination of hygiene, distancing and wearing masks, as we implore you to do on the cover.

RETURN EXPECTATIONS

We recently concluded our annual investor survey, primarily aimed at understanding how you feel about the investments you have entrusted to us. A key survey question is what the return is that you expect from your portfolio over time. Our aim is to understand how well the expectations of investors with different needs and time horizons calibrate to what we think the likely future market outcomes will be.

My first observation is that more than 25% of you said that you just don't know, which is the highest level of uncertainty since our first survey four years ago. This is understandable, given high volatility levels and the disappointing performance of domestic growth assets in recent years.

Overall, expectations have declined and 61% of the investors who expressed an opinion expect an annual return over time of 10% or more today, compared to 82% in 2017. Most of this decline can be ascribed to investors with a long-term growth goal, which is the cohort most likely to be exposed to the asset classes that disappointed over the last five years.

The average long-term growth return expectation is 10.9% per year (2017: 12%). Coronation's expected return forecast for a multi-asset fund, such as Balanced Plus, over the next decade is in the 9% to 12% range given current valuation levels across the different asset classes, and assuming that we manage to add around 1.5% annual outperformance to the benchmark. For long-term growth investors, we think expectations, albeit on the optimistic side, is achievable.

The situation is different for investors with needs consistent with the funds that have done well over the last five years. Investors with international diversification as their primary goal have unchanged return expectations of 11.8% per year (2017: 11.6%). This is also the case for those with immediate income needs (which the Coronation Strategic Income Fund is aimed at), who expect 9.3% p.a. (2017: 9.0% p.a.).

We think these expectations may be heroic. The S&P 500 had a golden decade, returning 13.6% per year in US dollar compared to the 119-year average return of 6.5%. The return over the last decade was fuelled by declining tax rates and lower interest rates, which allowed profit margins to widen and discount rates to drop. These tailwinds are not likely to blow as strong over the next 10 years. The US still makes up 58% of the MSCI All Country World Index, the most important benchmark for global equity funds. While the international investment universe offers many opportunities to add outperformance which may help to get closer to expectations, we expect global index returns of 7% to 9% per annum over the next decade.

Our key concern relates to investor expectations in the immediate income category. Income investors typically have shorter time horizons, often of two to three years. Policy interest rates, anchored by prevailing inflation, play a major role in return outcomes for these investors. Given the demand destruction caused by the pandemic, inflation declined to 2.1% in May, a 16-year low. We expect inflation to remain around the lower end of the 3% to 6% target range over the next three years.

The South African Reserve Bank has already cut interest rates materially, and given how weak the economy is, further cuts are likely. Over the next three years, we think that returns in the 5% to 6% range will be a good outcome for income fund investors, which is much lower than the 9.3% survey expectation and the 8.4% Strategic Income delivered over the previous decade. While investors could successfully ride out the storm in lower risk funds historically, the outlook for adopting this approach as your long-term strategy is less rosy.

OPPORTUNITIES AMIDST THE THREATS

As a country, we find ourselves in a tough situation. For those old enough to remember, conditions feel as daunting as in the late 1980s, hallmarked by a state of emergency and brutal policing in the townships, a low-intensity civil war in KwaZulu-Natal, sanctions, government's inability to pay its foreign debt on time and the enforcement of prescribed assets and strict capital controls. Yet we managed to step back from the cliff edge and entered a long period of growing prosperity over the next two decades as South Africa reinvented itself. As Milton Friedman concluded in the second part of the quote at the top of this Inbox, we need to make sure that we are ready with alternatives to existing policies, to keep them alive and available until the politically impossible becomes the politically inevitable. We will, through our own actions and engagement with government as part of organised business, continue to do our part to try and influence the direction of travel onto a more constructive path for our country and all of its people.

We remain committed as always to provide you with investment and service excellence. If you have any concerns, questions or issues, please do contact us via **clientservice@coronation.com**. We hope you and your loved ones stay safe and healthy.

Pieter

Key performance indicators and fund performance

AS AT 30 JUNE 2020

	QTD	YTD	1 YEAR	3 YEARS	5 YEARS	10 YEARS	15 YEARS	20 YEARS
DOMESTIC INDICES								
CAPI (J303T)	22.9%	(5.2%)	(5.6%)	3.8%	3.4%	10.5%	12.6%	-
ALSI (J203T)	23.2%	(3.2%)	(3.3%)	5.1%	4.2%	10.9%	12.6%	13.7%
Top 40 (J200T)	24.2%	0.4%	(0.5%)	6.7%	4.8%	11.2%	12.6%	13.5%
SWIX (J403T)	22.1%	(6.3%)	(6.1%)	2.0%	2.1%	10.6%	12.5%	-
ALSI Industrials (J257T)	16.6%	6.8%	4.0%	2.5%	3.3%	14.6%	15.8%	14.4%
ALSI Financials (J580T)	12.9%	(31.7%)	(34.5%)	(8.5%)	(5.3%)	7.9%	9.0%	9.9%
ALSI Resources (J258T)	41.2%	5.5%	12.4%	24.6%	10.5%	5.0%	8.8%	12.6%
All Property Index (J803T)	18.7%	(38.3%)	(40.2%)	(19.8%)	(11.0%)	3.8%	-	-
BEASSA (TR) All Bond Index	9.9%	0.4%	2.8%	8.1%	7.5%	8.3%	8.0%	10.2%
Short Term Fixed Interest 3 Month Cash Rate	1.3%	2.9%	6.4%	6.8%	6.8%	6.2%	7.0%	7.8%
CPI	(0.6%)	0.9%	2.2%	3.7%	4.5%	5.0%	5.6%	5.7%
INTERNATIONAL INDICES								
MSCI ACWI (USD)	19.2%	(6.3%)	2.1%	6.1%	6.5%	9.2%	6.4%	-
MSCI WORLD (USD)	19.4%	(5.8%)	2.8%	6.7%	6.9%	10.0%	6.6%	4.3%
MSCI GEM (USD)	18.1%	(9.8%)	(3.4%)	1.9%	2.9%	3.3%	6.3%	6.6%
S&P 500 (USD)	20.5%	(3.1%)	7.5%	10.7%	10.7%	14.0%	8.8%	5.9%
BGBA (USD)	3.3%	3.0%	4.2%	3.8%	3.6%	2.8%	3.5%	4.6%
3 Month Libor (USD)	0.2%	0.5%	1.6%	2.0%	1.5%	0.9%	1.7%	2.0%
MSCI ACWI (ZAR)	15.9%	16.2%	25.7%	16.7%	14.3%	18.4%	13.4%	-
MSCI WORLD (ZAR)	16.0%	16.8%	26.6%	17.3%	14.8%	19.3%	13.6%	9.3%
MSCI GEM (ZAR)	14.8%	11.8%	18.9%	12.0%	10.4%	12.1%	13.4%	-
3 Month Libor (ZAR)	(2.7%)	24.6%	25.1%	12.1%	9.0%	9.5%	8.4%	6.9%
SPOT RATES								
Rand Dollar exchange rate	17.9	14.0	14.1	13.1	12.2	7.7	6.7	6.8
Rand Dollar % change	2.9%	(19.3%)	(18.8%)	(9.0%)	(6.8%)	(7.8%)	(6.2%)	(4.6%)
Rand Euro exchange rate	19.7	15.7	16.0	14.9	13.5	9.4	8.1	6.5
Rand Pound exchange rate	22.2	18.6	17.9	17.0	19.1	11.4	11.9	10.3
Gold price (USD)	1609.0	1523.0	1409.0	1242.3	1171.0	1244.0	437.1	288.2
Oil price (USD barrel)	26.4	66.2	64.4	48.8	63.6	75.0	55.7	30.6

	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	19.8%	(4.7%)	0.6%	3.3%	3.1%	10.7%	13.6%	-	16.4%
ASISA Mean of South African Equity General	19.5%	(7.9%)	(7.3%)	0.6%	0.6%	7.9%	10.2%	-	12.7%
Coronation Market Plus Fund**	17.3%	(3.5%)	0.7%	2.4%	3.8%	10.3%	11.8%	-	14.3%
ASISA Mean of South African Multi-Asset Flexible	12.7%	(4.2%)	(2.2%)	2.0%	2.5%	8.8%	9.3%	-	10.2%
Coronation Balanced Plus Fund	14.9%	(2.8%)	1.7%	3.6%	3.7%	9.9%	11.6%	13.3%	13.6%
ASISA Mean of South African Multi-Asset High Equity	13.4%	(1.9%)	0.6%	3.6%	3.7%	8.5%	9.9%	12.5%	11.9%
Coronation Capital Plus Fund	11.8%	(1.8%)	0.4%	3.0%	3.4%	7.9%	9.4%	-	11.1%
ASISA Mean of South African Multi-Asset Medium Equity	11.3%	(0.6%)	1.9%	4.3%	4.1%	7.9%	8.5%	-	10.4%
Coronation Balanced Defensive Fund	10.3%	(0.2%)	2.8%	5.2%	5.4%	9.0%	-	-	8.9%
ASISA Mean of South African Multi-Asset Low Equity	8.3%	0.4%	3.2%	5.1%	5.2%	7.7%	-	-	7.4%
Coronation Strategic Income Fund	4.8%	1.1%	4.5%	7.1%	7.8%	8.4%	8.7%	-	10.0%
ASISA Mean of South African Multi-Asset Income	3.4%	1.9%	5.5%	7.1%	7.4%	7.0%	7.5%	-	9.0%
INTERNATIONAL FUNDS (PERFORMANCE IN USD)									
Coronation Global Opportunities Equity Fund	23.0%	(14.6%)	(6.7%)	1.4%	2.4%	7.2%	-	-	4.4%
Coronation Global Emerging Markets Fund	20.5%	(7.5%)	(1.0%)	3.6%	3.7%	5.3%	-	-	4.6%
Coronation Global Managed Fund	12.3%	(6.1%)	1.8%	1.8%	2.8%	6.5%	-	-	5.5%
Coronation Global Capital Plus Fund	6.5%	(3.8%)	1.3%	2.0%	2.5%	4.1%	-	-	3.7%
Coronation Global Strategic Income Fund	3.9%	(0.8%)	1.0%	1.6%	1.5%	-	-	-	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 30 June 2020; for detailed fund performance, refer to pages 52 and 54

Our ESG activities

- an excerpt from the Coronation 2019 Stewardship Report

THE QUICK TAKE

- Awareness of responsible investment and sustainability practices is increasing
- We believe that engagement with investee companies on ESG issues is key
- The mitigation of climate change and related risks is in sharp focus globally
- Good human capital management is strongly linked to long-term value creation

Kirshni is Global Head of Institutional Business. She joined Coronation in 2000.

INTRODUCTION

In 2019, we saw a strong trend of growing interest in, and awareness of environmental, social and governance (ESG) and sustainability issues from most clients and regulators. Today, we live in a more transparent and connected world. Poor practices are more easily exposed, and asset owners and their members are becoming increasingly intolerant of this.

This translated into our having more robust and holistic conversations, which helped improve and widen the ambit of our own stewardship activities and focus.

It has therefore, understandably, been a busy year within Coronation and our entire investment team has again, during this time, worked tirelessly to improve our stewardship efforts considerably.

In the early years of our stewardship journey, much of the focus was on governance issues, but our processes and analyses have evolved over time to also take into consideration the growing number of social and complex environmental issues.

For all of our portfolios, material sustainability issues are fully integrated and taken into account in the investment decision-making process. But they are not the main driving factor for investments. We do apply exclusions based on issues such as cluster munitions and anti-personnel mines. But, for the most part, our approach is about valuation and driving change through active engagement as opposed to exclusion.

Engagement with companies and voting at shareholder meetings are both powerful tools that we have considered to be an essential part of our active management offering since the very beginning of our stewardship journey. As you will see in this extract from our Stewardship Report, we believe that constructive dialogue with the companies in which we invest is far more effective than excluding companies from the investment universe. Only if enhanced engagement does not >

DURING 2019, WE PARTICIPATED IN 320 ENGAGEMENTS ACROSS 174 COMPANIES

320

ENGAGEMENTS

174

COMPANIES

472

AGMS

5 980

RESOLUTIONS VOTED

Figure 1

2019 CALENDAR YEAR

Assets under management	**R576 billion**
No. of engagements	**320**
No. of companies	**174**
No. of themes	**22**
% of multi-year engagements	**>65%**
Voting resolutions	**5 980**
Shareholder meetings	**472**

Source: Coronation

lead to a desired change do we consider alternative actions that may include collaboration with other shareholders to help achieve the desired outcome. If all else fails, we will look to disinvestment and exclusion.

THE PRI PEER REVIEW

This year, we achieved the highest Principles for Responsible Investing (PRI) ratings of either A or A+ in all categories. The PRI assessment is an important yardstick for us, as it helps us measure where we stand compared to the rest of the market, and also highlights the areas and competencies where we can improve. For almost all categories, we achieved a score ahead of the median of the market. We are extremely proud of this achievement, but we will not rest on our laurels and will continue to look to improve upon the work that we are doing and the impact we have made.

TACKLING THE ISSUE OF CLIMATE CHANGE

Dire warnings from scientists about the ill effects of climate change have become impossible to ignore and, in January 2020, all of the major risks identified by the World Economic Forum were related to the environment.

This was not surprising following a year characterised by floods and droughts, when fires ravaged Australia and the Amazon, and teenage climate activist Greta Thunberg was chosen as Time's Person of the Year.

Climate change is already a measurable global reality and our home country South Africa, along with other developing countries, is likely to see a more pronounced impact due to the perceived lack of financial resilience. South Africa has an energy-intense economy and as such is a significant contributor to global carbon emissions. The impacts of climate change are potentially significant if not mitigated. These include, among others, physical, transition and disclosure risks.

As economies change from being predominantly fossil fuel dominated to a lower-carbon world, the transition will impact all aspects of the economy and society as it has become clear that, in the long term, economic, environmental and social risks are linked.

The Paris Agreement of 2015 served notice that companies could not continue with a 'business as usual' approach. As active managers with a long history of engaging with companies to drive meaningful change, we believe that we are

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well positioned to be an active and meaningful change agent to influence favourable climate-related resolutions.

We have had, for example, had several discussions with fossil-intensive companies to fully understand the adequacy and appropriateness of their emission reduction plans.

Over the year, Coronation became a signatory to the Climate Action 100+, a large investor-led initiative focusing on systematically significant greenhouse gas (GHG) emitters. As a signatory, investors agree to engage with more than 100 of the world's largest such corporations to curb emissions, strengthen climate-related financial disclosures, and improve governance on climate change risks and opportunities.

To date, signatories of Climate Action 100+ have been important catalysts for action, alongside significant moves by policymakers and civil society. As part of this initiative, Coronation has joined as a collaborating investor on both Sasol and Eskom.

The complexity of climate change for investors is compounded by factors that include the absence of historical data, the need for an ability to forecast probabilities into the future and a lack of standardised disclosure among companies.

As such, Coronation is an official supporter of the Task Force on Climate-related Financial Disclosures (TCFD), a private-sector international task force formed to develop recommendations for mainstream financial disclosure of climate risks and opportunities across sectors.

We will use their recommendations where appropriate and in engaging with our peers and investee companies on reporting challenges. In this way, we hope to gain improved information and disclosure from companies to help better understand and value climate-related risks.

Given all of the above, it is fair to conclude that the past year has seen major advances in our ongoing goal to understand the risks and opportunities posed by climate change. We are taking action today based on our understanding of the current situation and challenges. We constantly monitor new developments and our approach to climate change will evolve over time.

We have increased the sources from which we collate climate change-related data and have also started to measure the carbon footprint of our portfolios to give us a better idea of the starting point from which we need to launch our engagements. In addition, all our analysts have done a refresh on the ESG-related analyses of the companies for which they are responsible, identifying key risks and opportunities.

REDUCING SINGLE-USE PLASTIC IN SOUTH AFRICA

There is a growing trend of responsible consumption among consumers globally and an increased awareness of how this can positively contribute to a sustainable planet. Plastics have become a resource used in nearly every part of our modern economy, combining superior functional properties with low cost. Its use has increased twenty-fold since the 1970s and is expected to double again in the next two decades. Today, nearly everyone, everywhere, every day, encounters plastic packaging that is only used once. Tackling this issue of wasteful, single use plastic is now a major engagement theme among investors globally.

While delivering many benefits, the current use of plastic has drawbacks that are becoming increasingly apparent. Most of the plastic used escapes collection systems and is dumped – much of it ending up in the ocean, polluting the seas and endangering marine life.

TACKLING THE ISSUE OF WASTEFUL, SINGLE-USE PLASTIC IS NOW A MAJOR ENGAGEMENT THEME AMONG INVESTORS GLOBALLY.

Recognising the breadth and scale of the effort required to reduce pollution and, while remaining mindful of the complexity of the issue, we took the view that South African retailers could do more to reduce the impact of plastic bags on the environment. This view was also informed by the fact that many other countries around the world have already made significant progress in this area and we believed that South African retailers are well placed to make a visible impact.

Together with other asset managers, we wrote a letter to the management of large South African retailers to express our concerns regarding single-use plastics, recommending that management considers accelerating the reduction, or even total elimination, of single-use plastic shopping bags in their stores. This has started a constructive engagement process.

DEMONSTRATING ACTIVE OWNERSHIP

Active ownership is a key part of our investment tenet and our value proposition to our clients. As mentioned earlier, for us, it encompasses two key areas – our engagement with investee companies and our votes executed at shareholder meetings.

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GOVERNANCE MATTERS

The dangers of ignoring poor governance are well understood and are always significant. As such, governance issues have always been considered the biggest of the ESG triumvirate.

As a member of the International Corporate Governance Network (ICGN), a leading authority on global standards of corporate governance and investor stewardship, we are aligned with, committed to, and advocate for the highest standards of corporate governance. It has always been an important part of our investment process to ensure that the companies in which we are invested maintain high standards of corporate governance. As the emphasis on sustainable investing has increased, we have responded through greater engagement with companies. Coronation values the opportunity to join ICGN as a means of further improving our roles as stewards of our clients' capital. In addition, our investment team has spent a large amount of time during this year on several matters relating to corporate governance. The most material of these include:

Board composition, functioning and independence: Investors care deeply about good corporate governance and a well-functioning board is an important part of this equation. We believe that companies should be headed by an effective board that is responsible for setting the strategy, direction and risk appetite of the company. Yet, it remains difficult to truly assess the effectiveness of a board beyond the data metrics. Standardised data reporting is an important step forward; however, it provides a very limited insight into the true functioning and effectiveness of a board. Ticking good governance boxes does not necessarily translate into good governance in practice and, hence, as investors, our aim is to try and delve deeper, beyond the basic metrics.

A key part of our assessment is thus focused on trying to gain an understanding of the genuine independence and skills of a board. Our inherent aim is to ensure that boards comprise a diverse range of competencies, knowledge, perspectives and experiences to enable them to effectively carry out their duties and responsibilities. We believe that an independent chairperson is pivotal in creating conditions for overall board and individual director effectiveness.

Executive remuneration: we improved our principles and guidelines on voting in relation to executive renumeration. Consideration was given to important issues that centred on aspects such as enrichment versus compensation, alignment with shareholders, and whether it is sufficiently long term in nature and set against appropriate key performance indicators. Importantly, we pushed for the inclusion of malus and clawback mechanisms in all remuneration structures to ensure that shareholders are protected from fraud and/or material misrepresentations at the company in the context of being able to claw back or implement a forfeiture of executive bonuses.

Mandatory audit rotation: following a number of accounting-related scandals, we are of the belief that a regular rotation of company auditors would serve as a useful tool in safeguarding against fraud and corruption at a company. It is our belief that the audit process should be objective and independent to be effective and maintain market confidence. As such, we have become strong supporters of a mandatory audit firm rotation for all companies after a period of 10 years.

Our initial success in driving mandatory audit rotation has been high and encouraging, and we will continue in our efforts to champion this change.

A KEY PART OF OUR ASSESSMENT IS FOCUSED ON TRYING TO GAIN AN UNDERSTANDING OF THE GENUINE INDEPENDENCE AND SKILLS OF A BOARD.

SOCIAL CONSIDERATIONS

The social element within ESG considerations is often the most difficult to assess and require case-by-case consideration.

Having said that, we do have an overarching belief that a company's long-term strategy should take into account the development of its workforce. Labour rights and the treatment of human capital are an important part of an organisation's culture and are fundamental in driving good business performance. Good human capital management practices include the provision of a fair basic minimum wage, good health and safety standards, and an investment in training and development programmes. These help to ensure that the workforce is well equipped for completing its required tasks, operates under the latest and highest safety standards and regulations, and remains motivated. Good human capital management generates a culture that is demonstrably linked to more stable and productive workforces and, ultimately, long-term value creation.

Consequently, an interrogation of these practices forms part and parcel of our ongoing investment analysis and, where warranted, of our engagement process with investee companies.

Over the last year, our investment team conducted a detailed deep dive into the mining and resource industry, looking specifically at employee safety records. Besides minimising accidents and fatalities, health and safety also interrogate broader working conditions and the prioritisation of employee well-being. This has prompted the start of a longer and more nuanced engagement process with a number of companies, aimed at improving the safety of working environments for employees.

COVID-19

The Covid-19 crisis has highlighted, and in many ways exacerbated, some of the major social and political challenges facing the global community. As an immediate response, many of the issues that companies had to deal with had a social dimension, which included actions centred on protecting the health and welfare of individuals affected by the virus and the response.

However, the most vulnerable in society have been hardest hit by this pandemic and we understand that the longer-term social consequences are likely to be devastating, unless dealt with explicitly by governments, business and society as a collective.

TRANSPARENCY ON OUR INITIATIVES

Transparency is an important element of stewardship and is dealt with explicitly by various international codes. Transparency has also been a key part of our culture since our inception in 1993. As part of our stewardship commitment, we provide regular updates to clients on our wider stewardship activities, including our engagement activities, our voting activities and updates on ESG matters.

We communicate the results of these activities in our client interactions and, ultimately, through this document. Most of our engagement, however, takes place behind closed doors in order to preserve trust and achieve the greatest level of impact and understanding.

We also work with our institutional clients individually to ensure that we provide them with meaningful information that they need to fulfil both their stated stewardship objectives, as well as any regulatory reporting required.

Our voting activities are disclosed, and updated on a quarterly basis, on the Coronation website, along with our annual Stewardship Report.

As PRI signatories, we are required to report publicly on our responsible investment activities each year. These Transparency Reports, together with the Assessment Reports, are accessible to signatories on the PRI Data portal.

WORKING TOGETHER

Institutional investors are now, more than ever, working collaboratively to move the needle at companies, and the momentum for improving corporate practices in the long term is building.

The regulatory environment around the world has increased scrutiny of and the responsibility for long-term savings in respect of ESG incorporation into investment strategies, which is evidenced through portfolio holdings. Regulatory changes, such as the enactment of the EU Shareholder Rights Directive, the progression of global corporate governance and stewardship code requirements (PRI, UK Stewardship Code, Code for Responsible Investing in South Africa), coupled with mounting social pressures on companies and investors, will bolster the growth and adoption of more sustainable business practices. As such, we continue to work with our institutional clients on appropriate adjustments to their investment policy statements and their voting policies, as well as mechanisms to improve communication and reporting.

As a company, we believe in proactively engaging with the industry and policymakers to ensure that we help develop an environment that improves outcomes and protects the long-term savings industry. These discussions span a number of different topics and are conducted through various industry bodies in which we are active members and also directly with regulators, where appropriate.

SIGNATORIES TO MULTIPLE CODES

Coronation continues to be a signatory to multiple responsible investing codes, including the PRI and CRISA. In addition, we adhere to the principles denoted in the updated UK Stewardship Code which was published in the latter part of 2019.

As signatory to these codes, we work very hard to ensure that we continue to take cognisance of and champion their tenets and principles.

THE ROAD AHEAD

It is encouraging that the investment industry across the globe has stepped up its overall focus on a wide range of sustainability issues over the past decade. Long-term thinking about the impacts of a business and society across E, S and G has become increasingly important aspects and indicators of investment success.

While the crystallisation and awareness of stewardship concepts are improving dramatically across the industry, standardised and useful

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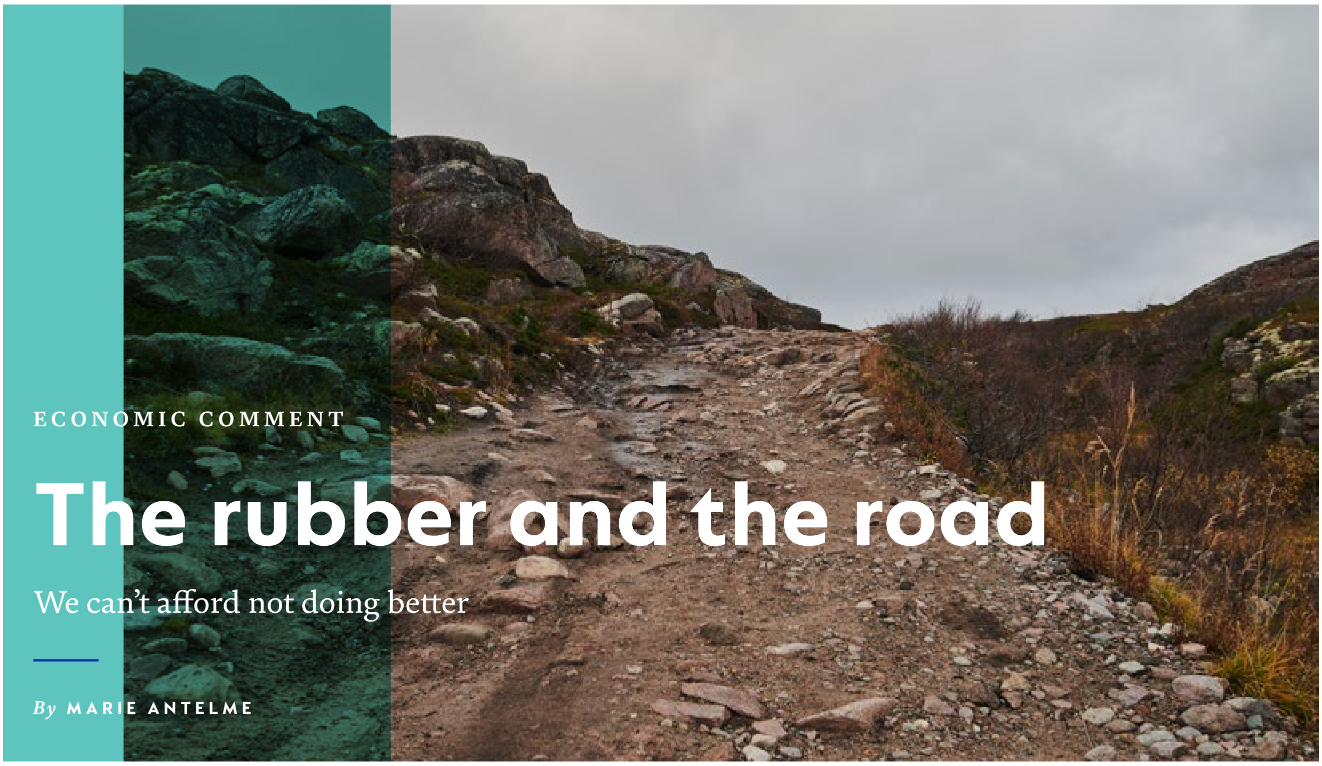
GOOD HUMAN CAPITAL MANAGEMENT GENERATES A CULTURE THAT IS DEMONSTRABLY LINKED TO MORE STABLE AND PRODUCTIVE WORKFORCES AND, ULTIMATELY, LONG-TERM VALUE CREATION.

reporting is still one of the biggest challenges that we continue to grapple with. We predict that this is a critical area that the industry and regulators will work hard at improving in the next few years. We would strongly support this initiative, as it will result in investors having access to improved and more meaningful data that can better inform our investment decisions.

For our part, we will continue to put our resources into growing and developing our understanding of this complex, ever-evolving and challenging field, and we will continually review, interrogate and enhance our processes. As an active steward of our clients' capital, we believe that this will be integral to achieving our goal of delivering significant and sustainable long-term benefits, not only for our clients but for the generations to come. ✚

This is an extract from the Coronation Stewardship Report 2019, *published June 2020. You can read the full report on our website, www.coronation.com*



ECONOMIC COMMENT

The rubber and the road

We can't afford not doing better

By MARIE ANTELME

THE QUICK TAKE

- SA's outlook is bleak, but firm action by the administration could soften the landing
- A clear plan to service inexorably rising debt is crucial
- National Treasury is the lead actor in how the Covid-19 drama plays out
- The possibility of zero to negative growth is a stark reality

Marie is an economist with 19 years' experience in financial markets.

SOUTH AFRICA'S FISCAL position is precarious. Finance Minister Tito Mboweni tabled a Special Appropriation Budget (SAB) on 24 June. This was necessary because the financial allocations associated with the Covid-19 pandemic response exceed the amount allowed by the Public Finance Management Act in a single fiscal year. The new baseline outlined in the SAB reflects the devastating economic and fiscal damage meted out by the Covid-19 pandemic on an already very weak economy. This is how things stand:

1. GDP growth is expected to contract 7.2% in 2020 and recover by just 2.6% in 2021 (Coronation: -9.8% and 3.4%, respectively). This implies that the level of GDP will only return to 2019 figures by late-2023.

2. The associated revenue loss is expected to be R300 billion, (6.1% of GDP; Coronation: R314 billion).

3. Expenditure is expected to rise by R36 billion, adding to the redirected R100.9 billion, to complete a R145 billion support package for the economy.

4. The main budget deficit is forecast at 14.6% of GDP from -6.8% in 2019/2020, and with a rise in debt service costs expected, the primary deficit is expected to widen from -2.7% of GDP to -9.7%.

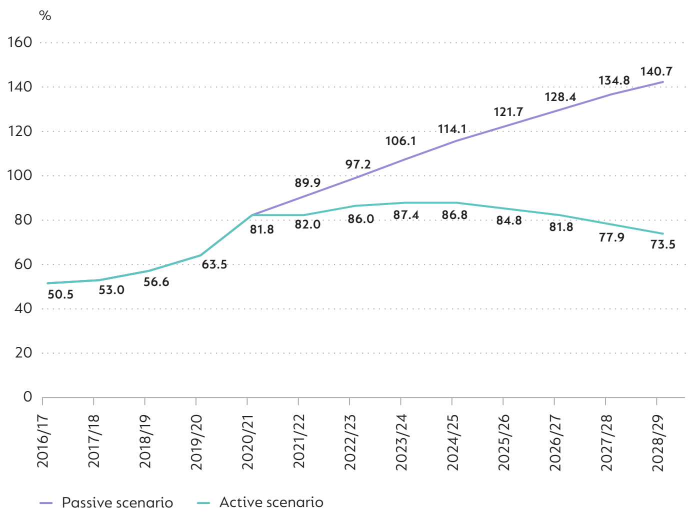
5. Gross government debt will rise from 63.5% to 81.8% in a year.

The SAB presents alternative 'active' and 'passive' approaches to managing the longer-term impact of the crisis on government finances, especially on its debt burden. The 'active' approach requires R250 billion of expenditure consolidation and revenue adjustments over the next two years, to return the fiscal balance to neutral and help stabilise the debt profile, with a peak at 87.4% in the fiscal year 2023/2024. The 'passive' approach makes no meaningful adjustment and leads to an explosion in government debt.

The National Treasury reportedly secured ministerial support for the 'active' scenario before tabling the SAB, which means government has, de facto, committed to a painful consolidation of its spending, even if the full amount seems unrealistic. Despite massive efforts by the National >

Figure 1

NATIONAL TREASURY'S 'ACTIVE/PASSIVE' CHART



Sources: The National Treasury, Coronation

Figure 2

GOVERNMENT DEBT ACCUMULATION EQUATION

$$\Delta d_t = d_{t-1} * \left(\frac{i_t - g_t}{1 + g_t}\right) - pb_t$$

Source: JP Morgan

Treasury to intervene in the most effective and sustainable manner, the weak starting position (low growth, poor policy execution, maladministration of State-owned enterprises [SOEs], and ongoing costly fiscal support of these entities) and the anticipated long-term impact on the fiscal position have made financial markets understandably more wary of its commitment.

BUT IS IT SUSTAINABLE?

There is no single empirical or widely agreed upon definition of what constitutes fiscal sustainability, and there is no inviolable measure for the tipping point into crisis. But there are points of general agreement. The International Monetary Fund (IMF) defines a sustainable fiscal position as one which allows the government to meet its debt servicing obligations in the short, medium and long term without the need to make policy adjustments, which is implausible from an economic or political standpoint, without default or renegotiation given the financing costs and conditions it faces.

There are several important criteria implicit in this definition which need to be looked at more closely:

- Government needs to be able to service its debt, for which it needs to be solvent and have access to liquid financial markets.
- Servicing debt should not require a material change in behaviour – that means the government should not already have been running large deficits for a long period beforehand.
- The government's economic and fiscal strategy needs to be credible.

DEBT DYNAMICS

We have discussed debt accounting in a previous article, but it is worth highlighting again that debt dynamics are complex, and non-linear. The evolution of public debt is a function of three things: i) the existing stock of debt (a result of past policy decisions); ii) the interplay between growth and debt service costs (influenced by markets and past policy decisions) and iii) the primary balance (directly influenced by policy decisions) all captured in the simplified equation shown in Figure 2.

This equation highlights the complexities and interconnectedness of the dynamics that drive debt accumulation. For instance, for countries with a low stock of debt (dt-1), the primary balance plays a large role in debt dynamics, and government decisions to run surpluses can generally stabilise debt. For countries with a big existing stock of debt, the rate of growth relative to the cost of servicing debt has a bigger influence, potentially increasingly undermined by an unfavourable starting point. Managing this relationship doesn't guarantee stabilisation without an improvement in the primary balance, but it helps buy time.

THE DYNAMICS OF DEBT

This crisis is expected to profoundly impact government debt dynamics globally. In South Africa, the pandemic impact, which hit an economy already in recession, with rising debt service costs and weakening nominal growth, will add 18.3 percentage points of GDP to the stock of government debt this year. This puts us firmly in the latter camp, where growth and interest costs are most influential, but the primary balance also has to adjust to stabilise debt dynamics.

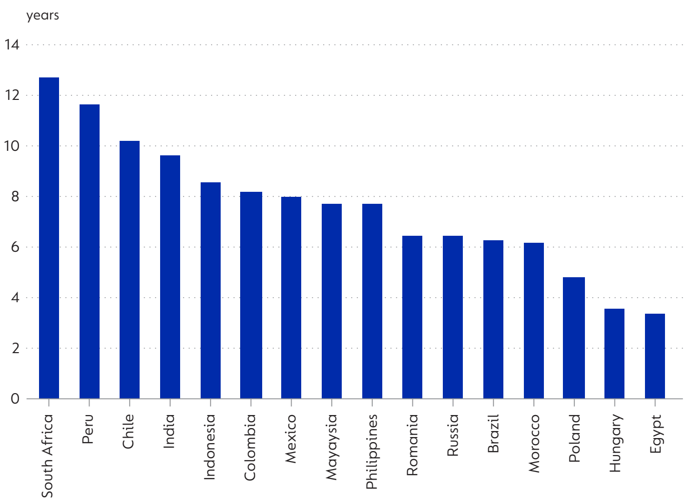
Before the crisis, South Africa had seen its debt stock grow from 26.5% in 2008/2009 to 63.5% last year. The IMF Debt Sustainability Analysis, published in January 2020, showed that most of this deterioration was because of the large deficits run from 2010/2011 to 2018/2019 – an average of 4.9% of GDP over the period. These persisted for a variety of reasons, including the growing public sector wage bill, ongoing support for SOEs and much weaker post-Global Financial Crisis growth. In parallel, government financing needs accelerated from 2% of GDP to 12% in 2018/2019, and an estimated 15.8% in 2020/2021.

Mitigating factors include a very favourable maturity structure of outstanding debt. South Africa's average term to maturity of its marketable debt is 12.8 years, which means it takes a long time for a change in market interest rates to materially impact the overall rate of interest government pays on its outstanding debt.

With these dynamics already at play in the accumulation of debt in South Africa, we are right to question the sustainability of government's position going forward. We believe government will be able to reduce some of its expenditure in line with the SAB commitment, but that the planned 8% of expenditure over two years will simply not be politically possible.

Figure 3

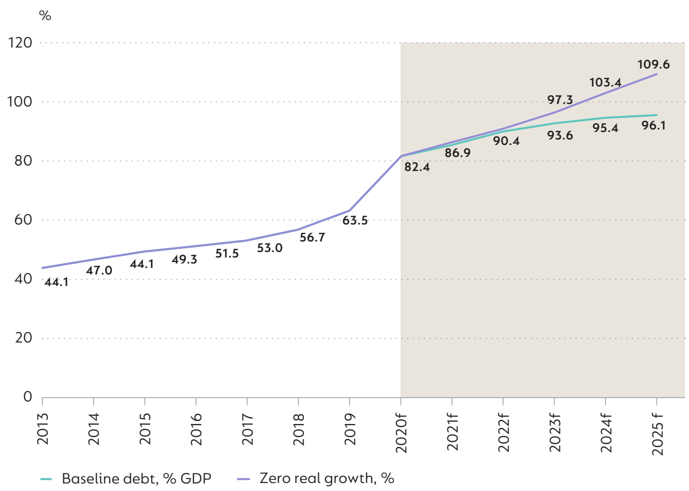
COMPARATIVE MATURITY PROFILE OF GOVERNMENT DEBT



Source: UBS

Figure 4

CORONATION'S BASELINE PLUS ZERO GROWTH



Sources: The National Treasury, Coronation

However, if much of the R101 billion reallocated in the current fiscal year is not back-tracked, government will be in a stronger starting position to limit spending in 2021/2022 and 2022/2023. Moreover, Finance Minister Mboweni has two powerful tools with which to impose some austerity – the reality that there simply is not additional revenue to spend (there is no money) and the real risk that ultimately South Africa may need additional financial assistance from an international organisation like the IMF, which will carry painful conditions.

We think a saving of R110 billion to R120 billion is possible through a combination of permanent reallocation of some departmental, ministerial spending and grant saving, the withdrawal of specific Covid-19-related support, and perhaps a more aggressive stance on public sector wages under a new agreement from next year. We expect taxes to rise in line with the SAB directives.

A LOW BAR

Under this baseline, we see the primary deficit narrowing from 10% of GDP in 2020/2021 to -3.2% in 2023/2024 and -1.1% in 2025/2026. While debt service costs are expected to rise only slowly given lower policy rates, changing funding strategies and the favourable debt structure, we think costs will rise. In addition, the persistently large deficits implied by the forecast will need to be funded.

This year's huge public sector borrowing requirement of almost 16% of GDP is being helped by international financing flows (the IMF and the World Bank) and a large increase in domestic issuance. Next year and the year after that will see smaller, but still-large financing needs without the support of these international flows. Local and foreign market participants will need to absorb this issuance and it is unclear to what degree they will be able to do so, and at what cost.

The alternatives are unattractive. The associated increase in debt would still see it approaching 100% of GDP over the next five years, albeit at a slowing pace. Whether or not this inexorable rise is sustainable comes down to whether the market thinks government's strategy is credible. This not only applies to its consolidation delivery, but its growth strategy too. Looking back at the IMF's definition of sustainable debt, it highlights that the policies needed to stabilise debt should not be inconsistent with past behaviour and therefore does not require a massive leap of faith from the market to believe its intentions.

Unfortunately, the government's inability to reign in deficits over the past decade, either by stimulating much-needed growth or by cutting spending >

are discouraging, and the steepness of the South African yield curve is testament to this uncertainty. However, past performance is not always a perfect predictor of future outcomes. There are powerful incentives to deliver, and an even more desperate economic imperative to help stimulate growth. Failure to grow will see debt explode – and risk the loss of market access.

THE TIME IS NOW

Because debt sustainability in South Africa's case is closely linked to its growth recovery, it could be argued that allowing fiscal accommodation to remain in place for longer would help build growth momentum and give the fiscus a firmer footing in the longer term.

However, unlike emerging markets that have stronger starting positions and may have headroom and credibility to delay crisis-related consolidation in order to support growth, South Africa can no longer rely on unconditional support.

There are signposts to watch. A growth strategy, starting with the allocation of spectrum later this year and progress with energy sector transformation, which could both boost productivity, is essential. The Medium-Term Budget Policy Statement in October will give some indication of baseline spending allocations, (possibly excluding the wage agreement which may not have been concluded at the time). Any payments to SOEs outside of existing allocations will be indicative of government's commitment – and political mettle. The February Budget in 2021 should provide a transparent framework by which government is measurable and accountable to markets going forward.

It is true that the post-Covid-19 world, especially for emerging markets, is going to be a precarious place and that relative performance will count. Markets will assess government nonetheless, and experience suggests that sovereign crises happen slowly at first, and then very fast. We cannot afford to waste the opportunity to do better. ✚

STOCK ANALYSIS

Aspen Pharmacare Holdings

"The margin of safety is always dependent on the price paid. It will be large at one price, small at some higher price, nonexistent at some still higher price." – Benjamin Graham, *The Intelligent Investor*

By QUINTON IVAN

THE QUICK TAKE

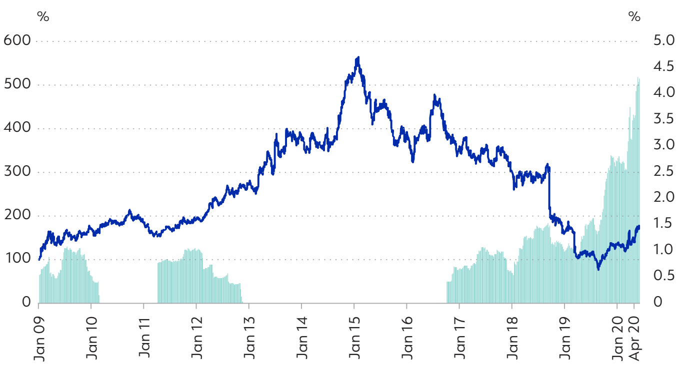
- To reap the benefits of a long-term view, the cost is often short-term discomfort
- Margin of safety is key when assessing the attractiveness of a share
- A high price earnings multiple can signal a death knell for a share should earnings expectations disappoint
- A focus on fundamentals is essential when investing in an unpredictable world

Quinton is Head of South African Equity Research and a portfolio manager.

THE DEFINING ASPECT of Coronation's investment philosophy is our long time horizon. We follow a common-sense, valuation-driven process through which we attempt to cut out the noise and buy undervalued stocks that offer a large margin of safety. Unfortunately, this usually coincides with periods when the share price is under pressure, either due to negative newsflow or the share falling out of favour with investors. Our time horizon, which spans at least five years, often accepts short-term underperformance to deliver market–beating returns over meaningful periods. While this sounds simplistic, it is hard to implement in practice. Long-term investing requires patience and courage. One must be prepared to own shares that are out of favour and almost guaranteed to underperform in the short term. While this goes against one's natural instinct, the results are rewarding over time.

Figure 1

ASPEN'S RELATIVE PRICE PERFORMANCE AND PORTFOLIO WEIGHTING



Sources: Aspen Pharmacare Holdings Annual Reports; CFM analysis

A good example demonstrating our investment philosophy is the history of our holding in Aspen Pharmacare Holdings (Aspen). We owned Aspen early on in its golden run as the business was transformed from SA Druggists into the leading South African generics company and then into a global specialist pharmaceutical company. From a base of R5, the share outperformed for more than a decade and peaked at R440 a share. Coronation sold early, missing much of the upside in later years. This is illustrated in Figure 1, which depicts the weighting of Aspen in Coronation's Houseview Equity Strategy and its share price performance relative to the FTSE/JSE All Share Index over time.

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Figure 1 above shows that post Coronation exiting its holding in Aspen in October 2012, the share continued to outperform significantly, returning more than double that of the market between 2013 and mid-2015. Aspen's share price peaked at R440, at which point it earned R12.19 per share to yield a price earnings multiple of 36 times. While the underlying fundamentals of the business remained unchanged, it continued to enjoy healthy returns and generate significant amounts of cash; this was more than discounted in its rating, with the share trading above our assessment of its fair value. In short, we believed the share price offered no margin of safety.

THE IMPACT OF GLOBALISATION

Aspen embarked in earnest on its globalisation strategy around 2009, when it concluded the first of three transformational deals with GlaxoSmithKline (GSK). Post-2009, it globalised at a rapid pace, concluding several large acquisitions with Pfizer, Merck, AstraZeneca and Nestlé. Today, the business is focused on three main therapeutic classes:

- Anticoagulants (blood thinners) – Aspen is the second-largest provider of injectable anticoagulants worldwide after Sanofi;
- Anaesthetics – Aspen has a 20% market share in anaesthetic products worldwide (ex-US); and
- High-potency and cytotoxic products, with a focus on oncology and female health.

These therapeutic classes have the following traits in common:

- They are niche and post-patent, which means that there is no pending earnings cliff. Once a patent expires, more affordable, generic products can compete and erode the profits enjoyed by the originator product. This also ensures predictability of future cash flows.

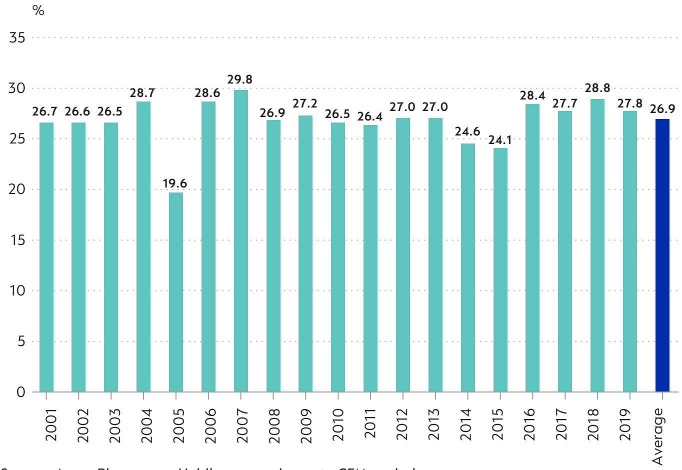
- Multinationals dispose of these products as they are regarded as non-core, which means that they are often neglected, resulting in product volumes declining over time. This presents Aspen with an opportunity to arrest the decline and eventually grow volumes. This can be achieved by placing more sales representatives behind these products and growing distribution in emerging markets where per-capita usage is lower.

- The products are complex to manufacture, which negates the competitive threat from Asian players that prefer products with long production runs (such as antibiotics) where they can drive down the cost of goods. Manufacturing is the cornerstone of Aspen's business model and it leverages its scale to reduce the cost of goods through better procurement and improved production efficiency.

  This is key to protecting gross margins – pharmaceutical companies are highly regulated and price increases are often controlled by government. Aspen's excellence in manufacturing has resulted in its operating margins remaining relatively stable over time, despite pricing pressure (regulatory and competitive), as shown in Figure 2.

Figure 2

NORMALISED GROUP EARNINGS BEFORE INTEREST, TAXES, DEPRECIATION AND AMORTISATION



Sources: Aspen Pharmacare Holdings annual reports, CFM analysis

Figure 3

COMPOUND AVERAGE GROWTH RATE IN NORMALISED HEADLINE EARNINGS PER SHARE

Compound average growth	Since listing	10-year	5-year	3-year
Normalised headline earnings per share*	21.1%	14.1%	5.8%	3.8%

* Compound annual growth rate per annum

Sources: Aspen Pharmacare Holdings Annual Report, CFM analysis

The transformation into a global pharmaceutical company was overseen by two of South Africa's most entrepreneurial managers, Stephen Saad (CEO) and Gus Attridge (deputy CEO), who together own 16.5% of the company, aligning their interests with those of shareholders. Aspen's track record of earnings delivery is impressive.

Figure 3 shows that the company has grown earnings at just over 21% per annum since its listing. Also apparent is the significant slowdown in earnings growth over the last three and five years. The combination of a high price earnings multiple and weak earnings growth resulted in the share de-rating relative to the market over the last five years.

Towards the end of 2018, the share price collapsed, eventually reaching a trough of R65 due to concerns about:

- A stretched balance sheet and the short tenor of debt borrowed to fund a series of company-transforming acquisitions.
- Although most of the recent acquisitions were successful, one of the largest (the purchase of anticoagulant products from GSK) has been disappointing.
- Organic earnings delivery in developed markets, especially Europe, has disappointed.
- The impact of African swine fever on the anti-coagulants business which uses pig mucosa (in the production of heparin) as an input.

These issues have damaged the credibility of management and called into question Aspen's business model of using debt to acquire post-patent products from multinationals and growing them in emerging markets.

After not owning Aspen for many years, we started buying in late 2016 and added to this holding as the share price continued to come under pressure as investor sentiment swung from euphoria to pessimism.

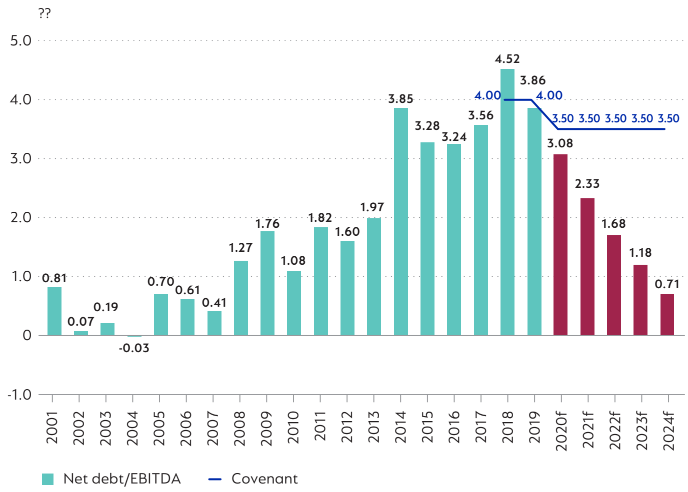
While the above concerns were real, and we believed they were adequately discounted by the market – at its low, Aspen's price earnings rating collapsed to just below five times, providing a significant margin of safety. The share now offered an attractive risk-adjusted return for the long-term investor.

While the share has recovered from its lows, we think the market has underappreciated the significant strides management has made in addressing investor concerns:

- Net debt levels have been significantly reduced following several large disposals. Aspen sold its infant milk nutritional business to French dairy group, Lactalis, for R11 billion. It also recently sold its Japanese operations to Sandoz for R5.2 billion. These disposals reduced Aspen's net borrowings from a peak of R53.5 billion to just over R33 billion as at 31 December 2019, thereby creating some covenant headroom. Furthermore, cash-flow generation in its most recent results was very strong as management focused on reducing the investment in working capital. Aspen's capital expenditure cycle reduces significantly from 2020, which should allow debt to be paid down faster. The reduction in net debt levels removes the risk of Aspen needing to raise equity to bolster its balance sheet. This is depicted in Figure 4.
- Management has a stated target of reducing the net debt to earnings before interest, taxes, depreciation and amortisation ratio to close to two times. They believe that this will allow for sufficient financial flexibility to allow Aspen to capitalise on acquisitive opportunities. We believe this is achievable given the focus to unlock the investment in working capital and the reduction in future capital expenditure requirements.
- Aspen has built up a significant buffer in heparin stock and has nearly two years of supply. This is due to it being vertically integrated into the manufacture of its anti-coagulant products. The buffer stock protects it from short-term spikes in heparin prices caused by African swine fever and reduces the risk of stock-outs. This should allow it to either supply competitors, capitalise on high heparin prices, or gain market share in the event of competitors being unable to meet demand.
- There are plans to address the weak performance from its anticoagulants division by introducing a strategic partner into its developed European business. This will result in an initial cash injection (once a portion of this business is sold) and should result in better volume performance as the strategic partner assists in placing more sales representation behind these products. >

Figure 4

NET DEBT TO EARNINGS BEFORE INTEREST, TAXES, DEPRECIATION AND AMORTISATION



Sources: Aspen Pharmacare Holdings annual reports, CFM analysis

ASPEN'S CAPITAL EXPENDITURE CYCLE REDUCES SIGNIFICANTLY FROM 2020, WHICH SHOULD ALLOW DEBT TO BE PAID DOWN FASTER.

Furthermore, emerging markets currently contribute 46% of the revenue generated by anticoagulants. Per capita anticoagulant usage is lower in emerging markets, which should support future volume growth as the contribution of emerging markets to sales increases.

- Demand for Aspen's sterile portfolio of anticoagulants and anaesthetics has increased due to the Covid-19 pandemic:
    - Blood clots are treated by administering anticoagulants, and there is increasing evidence that Covid-19 leads to blood clots in patients that may result in pulmonary embolism.
    - Anaesthetics, especially muscle relaxants, are administered to patients who require ventilation. This should support volume growth for the foreseeable future until such time that a vaccine is developed.

At the time of writing, the Aspen share price has recovered to R150, after reaching a trough of R65. It has outperformed the market by a factor of two from this low.

Despite some recovery, Aspen trades on an attractive one-year forward price earnings multiple of 9.3 times and just under nine times our assessment of normal earnings, and remains a 4.2% holding in our clients' portfolios.

Recent newsflow has also been supportive – an injectable steroid, dexamethasone, has proven to reduce Covid-19 deaths by a third in patients on ventilators and has also shown to reduce fatalities by a fifth among patients who were receiving oxygen support. Aspen is a major manufacturer of dexamethasone injections in South Africa as well as other markets such as the UK. We had no special insights into these extraordinary developments, and we simply owned Aspen as we believed that the risk-adjusted returns and resultant margin of safety were attractive.

In today's volatile financial markets where asset prices are determined by the news of the day, it's easy to miss the wood for the trees. Patience, courage and a long time horizon are required to make rational, long-term decisions. In a world where time horizons are collapsing, we remain committed to our proven philosophy of investing for the long term. ✚

SOUTH AFRICAN STOCK SELECTION

The Covid-19 crisis

A chance to add good quality domestic businesses to your portfolio

By **SARAH-JANE ALEXANDER**

THE QUICK TAKE

Covid-19 has reset prices and expectations across asset classes, creating investment opportunities.

The quality of the domestic stocks held in the house portfolio has meaningfully increased. We believe the market is underpricing the resilience of these businesses.

Markets rebounded off their lows rapidly, despite lingering uncertainty. We remain committed to investing where there is long-term value, regardless of current market sentiment.

Sarah-Jane is a portfolio manager with 14 years of investment experience.

WAS IT JOHN F Kennedy who said, "In a crisis, be aware of the danger, but recognize the opportunity"? For Coronation's portfolios, the Covid-19 crisis has meant an ongoing search for mispriced opportunities across asset classes. And we have found value.

At the start of 2020, many of the global asset classes were reasonably fully valued. The broad sell-off in March gave us an opportunity to rebuild offshore equity exposure across our multi-asset and house equity portfolios. The risk diversification and more resilient economic outlook of developed markets should benefit these portfolios in the years ahead.

The crisis also reset inflationary expectations very low, which enabled the multi-asset funds to buy well-priced local protection (in the form of South African inflation-linked bonds) against the medium-term risks of a rise in inflation.

The JSE did not escape the turmoil, with many domestic stocks now trading materially below their year-end levels. While the past few years have not been easy for South African companies, the outlook has further deteriorated. Already-fragile South African consumers and businesses will not experience the financial support offered to those in more prosperous nations.

With this hard truth in mind, we have selectively added to companies whose strong business models should deliver earnings resilience in what will be an even more challenging environment than we expected as we headed into 2020. As a result, our equity portfolios currently have higher exposure to quality local stocks than previously. This is not an uncontentious statement, given the subjectivity of 'quality'.

RESETTING VALUE

Defining a quality stock requires a combination of numeric and qualitative assessment. High-quality businesses should grow over time by using their strong free cash flows to reinvest in their businesses and generate good returns on capital

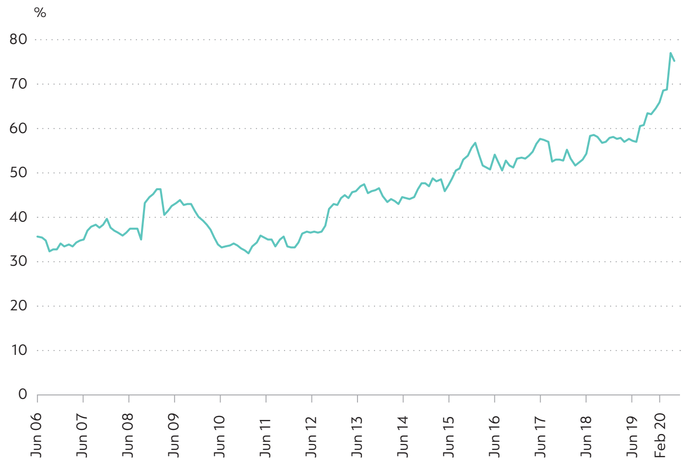
>

invested. A huge amount of judgement is involved in assessing a business's ability to grow and sustain these high levels of returns going forward. Given that disclaimer, we think the overall quality of the equity portfolio has meaningfully increased.

Figure 1 reflects the percentage of the portfolio invested in quality stocks today. It would include the investments in high quality, international businesses listed in South Africa and which we believe continue to offer good value, such as Naspers, Quilter and Bidcorp. It also includes our increased exposure to several domestic businesses during this period of economic constraint.

Figure 1

PORTFOLIO EXPOSURE TO HIGH-QUALITY STOCKS



Source: Coronation

Figure 2

HOLDINGS: JUNE 2020 VERSUS JUNE 2015

Stock	Owned as at 30 June 2015	Owned as at 30 June 2020
AVI	N	N
Capitec	N	N
Clicks	Y	N
Dischem	n/a	Y
Famous Brands	Y	Y
FirstRand	Y	Y
PSG Konsult	Y	Y
Pepkor	n/a	Y
Santam	N	Y
Sanlam	N	Y
Shoprite	Y	Y
Spar	Y	Y
Total	6/10	9/12

Source: Coronation

Coronation may be seen to have a bias in quality. We concede that we are happy owners of a good quality business, but only where we are able to acquire it at the right price. While quality has been a winning strategy in the past few years, many of these businesses were trading on lofty multiples at the start of the year. The Covid-19 crisis provided investors with an opportunity. It reset prices, enabling investors to increase portfolio quality at a reasonable price. This is especially true in South Africa where we believe the testing times ahead will cause a divergence in performance. Good quality businesses are best poised to navigate the choppy waters ahead.

Five years ago, we owned very few South African domestic stocks, as expectations and valuations were high. A dramatic reset in investor expectations and price means that today we can own more of these.

Figure 2 provides a comparison of quality stocks held in the house portfolio five years ago versus our holding at 30 June 2020, and shows that of the 12 best local businesses, we own 75% of these names versus 60% in 2015. Within the context of the house portfolio, our holdings of the names below have grown from 5.5% to 16%.

STOCK ANALYSIS

This is a brief overview of the characteristics that should support the resilience of our quality domestic holdings:

Shoprite

Shoprite's financial metrics over the past few years understate the true quality of the business. This is a business that has invested heavily in fixed assets (distribution centres, property and stores), expanded its working capital and consistently added new stores. All this was achieved while profitability collapsed in its African operations. Under a new CEO, we expect a reduction in capital intensity to improve free cash flow and returns. New accounting standards will partly disguise this (International Financial Reporting Standard 16 [IFRS16] is brutal for retailers with large leased-store portfolios), but, looking through this, Shoprite trades on 10.8 times our assessment of normal IFRS-adjusted earnings.

Spar

Spar has a long track record of delivering strong like-for-like growth as its franchised stores are run by entrepreneurs who are focused on delivering store-level growth. The business has a long history of generating returns on equity in excess of 30%, while delivering above-average free cash flow conversion. Spar's international expansion has been successful in Ireland where it owns a dominant convenience retailer, while the Swiss and Polish acquisitions are still a work in progress. The business trades on 10.8 times normal earnings.

Famous Brands

The franchise business model is attractive for the high returns it generates on invested capital due to low capital intensity and good profitability. This profitability is converted to cash at a high rate, with Famous Brands boasting a long-run average free cash flow conversion ratio of 92%. This places it among the highest in our investable universe.

Famous Brands has a portfolio of recognised and trusted brands, which builds a strong moat against competitors. The quality of its offering has been further improved by backward integrating up the value chain through logistics, and manufacturing enables the company to offer franchisees world-class support and low prices, while capturing a full margin on sales to the end-consumer. Return on equity (ROE) is well above the cost of capital, averaging 31% over the past decade.

FirstRand

Within the banking sector, we have built a position in FirstRand, which has delivered high ROEs over the past decade. Its attractive customer proposition has achieved strong asset growth resulting in a dominant 'main bank' market share in the middle- to upper-income market.

FirstRand has leveraged its position of strength, diversifying its sources of non-interest revenue, reinvesting in its digital offering and driving down its cost to income ratio. These actions stand it in good stead to continue gaining market share even in a tough economy. FirstRand trades on 7.7 times our assessment of normal earnings.

Pepkor

Pepkor is a value retailer offering consumers everyday products at affordable prices. A culture of low costs and the reinvestment of excess margins ensure prices remain low. The large store base is conveniently located near transport nodes, with flexible store sizes allowing it to trade profitably in small towns where competitors typically struggle.

In a tougher economy, Pepkor's low prices should benefit from downtrading, while defensive everyday items (kidswear and babywear) represent approximately 60% of PEP and Ackerman's sales. Over the past decade, this business has delivered double-digit sales growth and currently trades on 9.7 times normal earnings.

Sanlam

Sanlam is an insurance business with an enviable track record. Management has allocated capital well over time and there is a long history of conservatively stating earnings. Earnings are underpinned by cash due to fully expensing new business costs. Operating variances are positive, reflecting the conservative assumptions underpinning profit recognition.

Santam

Santam is a short-term insurer that has consistently grown premiums above GDP. It has navigated the challenges of direct insurance on its intermediated business while successfully launching a direct insurer, MiWay. It has done this through constant reinvestment in its business while maintaining an ROE in the 20% range.

Dischem

We like the pharmacy sector where the listed pharmacy players have successfully grown their revenues by rolling out stores and taking market share for a decade. In a not uncompetitive sector, Dischem is an entrepreneurial business focused on offering consumers low prices. They continue to innovate and expand their consumer offering into primary care and via Baby City.

PSG Konsult

PSG Konsult is an advice-led financial services group focused on wealth management, short-term insurance and asset management. It has a track record of delivering good profitability with high free cash flow conversion (five-year average: 89%) and attractive returns (five-year average: ROE 23%). This, while continuing to grow in a tough economy. The wealth business boasts the largest independent advisor network in South Africa and should continue to benefit from further consolidation of the network.

LOOKING AHEAD

We believe our holdings represent quality businesses in South Africa that trade at prices that understate the relative resilience of their prospects. As a result, we expect them to deliver attractive returns in the years ahead. We remain vigilant of current market conditions and committed to our long-term valuations-based investment philosophy that helps us to look through the noise to identify the prevailing risks and opportunities. ✚

BOND OUTLOOK

On the brink

"When the world is running down, you make the best of what's still around." – Musician and actor, Gordon Sumner (aka Sting)

By **NISHAN MAHARAJ**

THE QUICK TAKE

- Bond yields are wildly volatile in the Covid-19 economy
- SA is on the brink of a debt trap as the drop in tax revenue bites
- Interim funding from international lenders will be a temporary plug
- Firm policy action remains crucial to SA's recovery

Nishan is head of Fixed Interest and has 17 years of investment experience.

WE ARE ALREADY six months into 2020, a year that truly defies description, with a landscape that still presents as volatile and treacherous. At the beginning of the year, it was hard to find a pessimist in financial markets until the novel coronavirus turned into a fully-fledged pandemic. The subsequent global lockdown sent both the global and local economies into severe recession.

Global monetary and fiscal policy then unleashed a flood of money into the economy, the likes of which has never been seen before, spurring expectations for a quick recovery. Asset prices started to recover in the second quarter of the year (Q2-20) as economies across the globe started to open up from 'hard lockdowns'. However, concerns about a second wave of infections in developed markets and escalating infection rates in emerging markets threaten to derail the recovery.

THE SOUTH AFRICAN SITUATION

The local economic backdrop is concerning, but valuations were considerably cheaper by the end of the first quarter. South Africa's asset price recovery was buoyed by better risk sentiment in global markets. The All Bond Index (ALBI) was up 9.9% in Q2-20, but its return remains flat year to date and a paltry 2.9% over the last 12 months. ALBI performance continues to be driven by the performance of bonds in the zero- to seven-year area of the curve, as cash rates have pulled down aggressively on the 275 basis points (bps) of repo rate cuts carried out by the South African Reserve Bank (SARB).

The 12-year-plus area of the curve has continued to underperform due to the deterioration in government finances and increased public sector borrowing requirements. Inflation-linked bond (ILB) performance has been dismal, with the Composite Inflation-Linked Index down 3% over the last 12 months, led again by ILBs in the seven-year plus area. Despite poor index performance, ILBs out to seven years have still generated a return more than cash (2.9%) year to date. Overall, bond yields have had a rollercoaster year and are currently only marginally higher than they were during the 'Nenegate' aftermath and considerably lower than during the March sell-off, but still embed a significant risk premium.

Emerging market debt crises have traditionally occurred in countries that predominantly have foreign-denominated debt; face an accelerated decline in their currency, resulting in an increased debt burden that they are unable to service; and an inflationary problem that re-enforces the downward spiral in their currency. South Africa is slightly different in that inflation will remain modest over the next two to three years.

However, due to an incapacitated State, the poor shape of State-owned enterprises, a lack of targeted structural reform and a dearth of political direction, government finances have deteriorated to such an extent that debt service costs are the fastest rising government expenditure item. In the fiscal year 2020/21, the fiscal deficit will register a whopping -15%, the debt-to-GDP ratio will exceed 80%, tax revenue will be down R300 billion and nominal growth will be down 3.5%. Many countries around the world, both developed and emerging, will face a similar reality as the fiscal taps open to soften the fallout from the Covid-19 pandemic.

Unfortunately, due to its poor starting position, the glacial pace of reform implementation and reliance on foreign portfolio flows, South Africa is teetering on the edge of a debt trap; with local public sector borrowing requirements pushing up to almost R800 billion this year, due to the drop-off in tax revenue. Over the longer term, more steps are needed to ensure that the underlying growth engine is restarted through targeted, efficient and transparent investment into the local economy by government and the private sector. In the interim, South Africa will have to rely on funding from international finance institutions (IFIs) such as the International Monetary Fund and the World Bank, and capital markets to keep the ship afloat.

IFI funding is relatively cheap and has little conditionality but will still need to be repaid in foreign currency, while local capital market funding will have to be accompanied by a strong commitment to reel in wasteful expenditure, refocus current expenditure and implement key sector reforms (e.g. energy, labour and transport) in order to increase investor confidence and trust. South Africa has a long history of not delivering on key policies and reforms, which has resulted in the current debt nexus and erosion of investor confidence in the country.

Consumer price inflation will average 2.7% over the next year and 3.5% over the next two years. Following the cumulative 275bp rate cuts since the beginning of this year, the SARB has room to reduce rates by another 50bps over the next three to six months and is likely to keep them at similar levels over the next 12 to 18 months to support the economic recovery. The 10-year South African Government Bond (SAGB) currently trades at 9.5%, which implies a real yield (return after inflation) of 6.6% and a breakeven to cash (the extent to which bond yield can widen before its return equals cash) of 93bps over the next year. In figures 1 and 2, one can clearly see that both the implied real yield and breakeven relative to expected cash remain at very extended levels relative to history and to their long-term average. This suggests that, from a local perspective, there is a significant risk premium in place due to the poor fiscal outlook.

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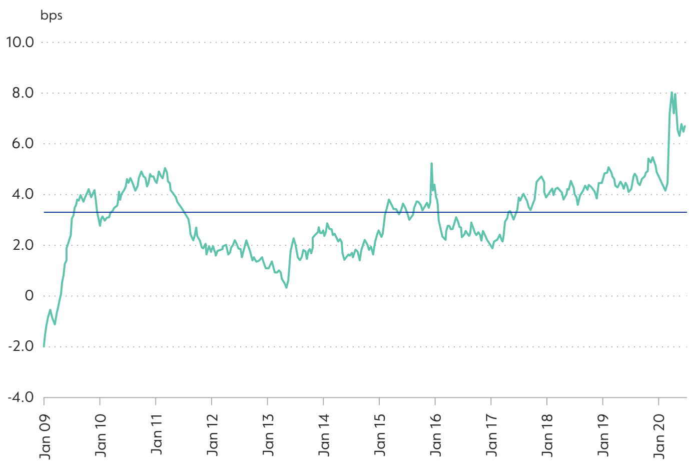
Figure 1

10-YEAR SOUTH AFRICAN GOVERNMENT BOND IMPLIED REAL YIELD



Sources: Bloomberg, Coronation

Figure 2

10-YEAR SOUTH AFRICAN GOVERNMENT BOND BREAKEVEN RELATIVE TO CASH

Sources: Bloomberg, Coronation

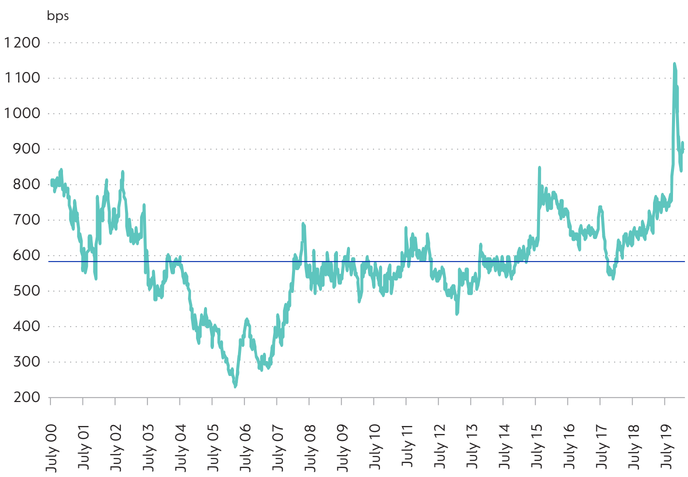
THE GLOBAL OUTLOOK

Globally, bond yields and policy rates are testing their zero bounds. US 10-year yields, which are widely accepted as the proxy for global bond yields, are trading at historic lows. The Federal Reserve Board (the Fed) has injected massive amounts of stimulus through its open-ended quantitative easing programme, and policy rates and bond yields are not expected to move materially away from their current levels at any time soon.

Even if bond yields do push higher due to structural changes in employment and inflation, fair value is not materially more than 1.5% on the US 10-year bond. South African 10-year bonds trade at a spread of 9% above US 10-year bonds which, once again, is considerably above historic levels and the long-term average. If US bonds were to gravitate towards the 1.5% level, unless this is accompanied by a massive inflation shock, the South African spread over US bonds does have a significant cushion to absorb this move, and would still trade at a historically wide spread (Figure 3). Add to this the fact that the 10-year SAGB trades at a significantly wider real yield than its emerging market peer group, and one can see that even from a global perspective, a significant risk premium remains in place (Figure 4).

Figure 3

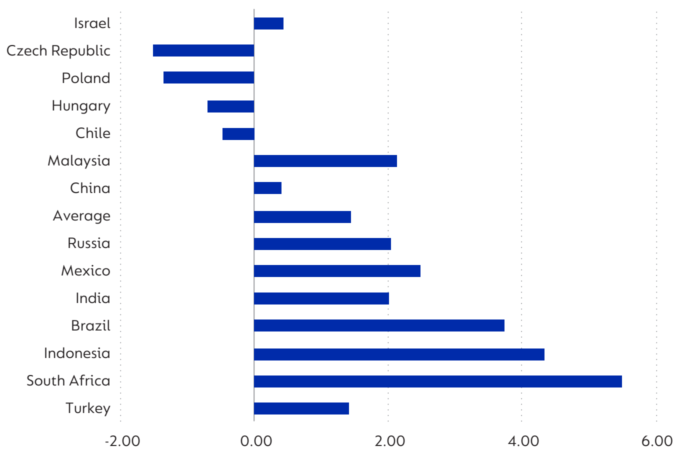
10 YEAR SPREAD: SOUTH AFRICAN GOVERNMENT BOND VERSUS US TREASURY NOTE



Sources: Bloomberg, Coronation

Figure 4

EMERGING MARKET REAL YIELD COMPARISON



Sources: Bloomberg, Coronation

A VOLATILE CURVE

The yield curve has been as volatile (if not more so) as outright bond yields. South Africa now has the steepest yield curve in the tradeable emerging market universe. The 10-year bond trades 1.7% above the 6.5-year bond, the 15-year bond trades 1.5% above the 10-year bond, and the 20-year bond trades 2% above the 10-year bond. Due to the higher yields on offer in the 10-year plus area of the curve, the inherent breakeven protection in these yields, both relative to cash and inflation, is attractive.

Our base-case assumption is that the repo rate settles at 3.25% over the next six months and stays there for at least the next 12 months. This implies a cash average of 3.35% over the next 12 months. If we assume inflation comes through more strongly and base rates rise more aggressively to average 4% over the next year, this implies a peak repo rate of close to 5% at the end of year one (250bps of hikes). We use similar assumptions over two and three years, and then run a total return analysis to understand how much the various bonds can sell off before their returns equal cash – illustrated in Figure 5 overleaf. As can be deduced from the table, the 15-year area of the curve offers the most protection. Combine this with the fact that the 15-year point is steeper than it has ever been relative to the 10-year area (1.5% above), the five-year area (4.4% above) and cash (7.3% above), and its appeal increases.

In addition, at the Special Adjustment Budget in June, Finance Minister Tito Mboweni reinforced the point that the National Treasury plans to shorten the duration of its issuance profile to seven to 10 years, suggesting less issuance and hence less supply pressure in the >10-year area of the curve. The intentions set out in the June Budget are ambitious, and the lack of the flattening of the yield curve bears testament to that. However, if the Treasury were able to get just half of its intentions through, the result would still be more positive than current market pricing and the yield curve should enjoy significant flattening. The current valuation >

of the 15-year point is quite attractive due to its inherent breakeven protection relative to cash and inflation, as well as the negativity priced into its elevated spread relative to shorter-dated bonds. We therefore view it as an attractive relative allocation on the local bond curve.

The fallout from the Covid-19 pandemic will linger for some time to come. In South Africa, the impact will be felt most in a much dimmer growth outlook, which will have a severe impact on government finances. The effects of the very hard lockdown and poor policy choices will weigh heavily on the economy going forward. As it was not well positioned going into the crisis, strong reforms are needed to return the country to a structurally better growth path, although lower interest rates will lend support to the economy through this difficult phase.

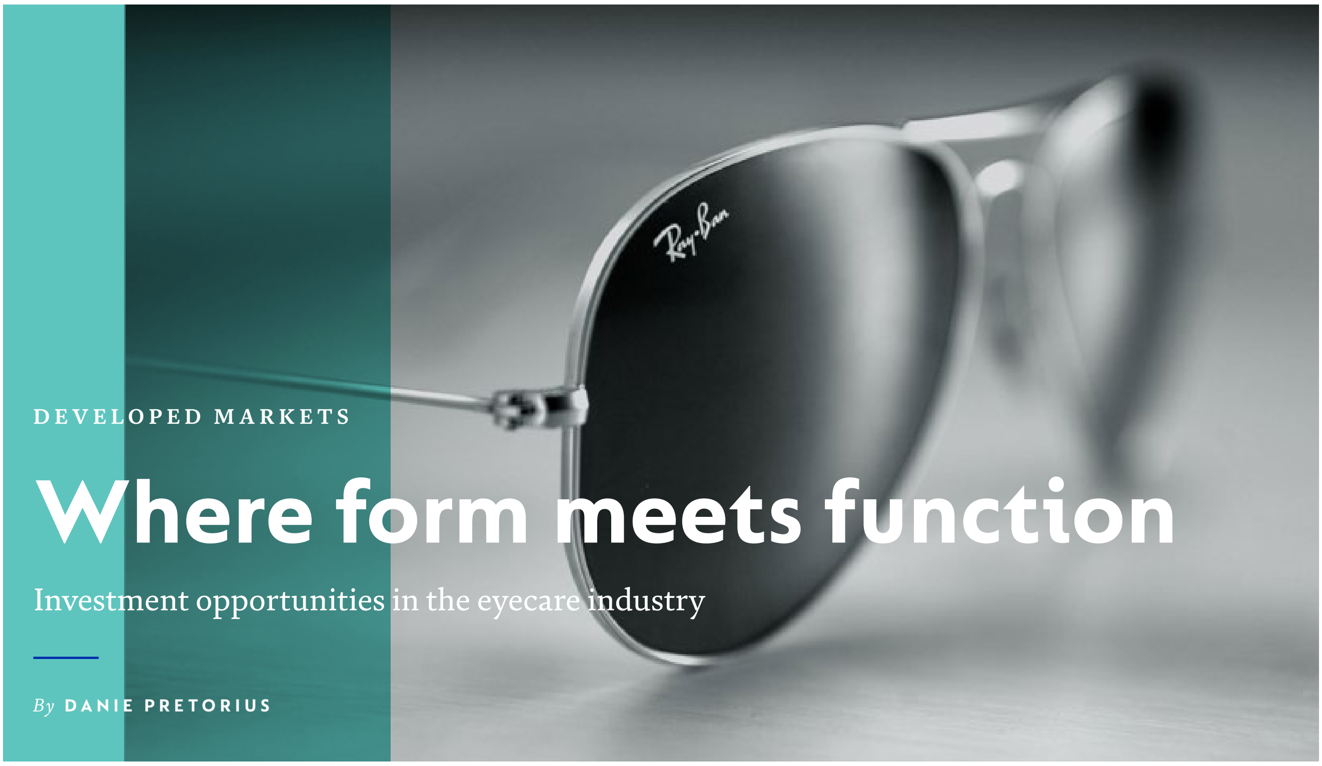
SAGBs do embed a decent risk premium, although this premium has reduced slightly post the recovery in Q2-20. As mentioned, South Africa is on the brink of a debt trap and, although promises have been made to restore the country to a more sustainable debt trajectory, the implementation risks remain elevated. The valuation of SAGBs does provide some offset to this, implying that local bonds do warrant at least a neutral allocation in portfolios. ✚

Figure 5

AVERAGE BREAKEVEN RATES

Bond	Maturity	Yield	1-year breakeven (cash at 4%)	2-year breakeven (cash at 5.25%)	3-year breakeven (cash at 6.25%)
R186	21 Dec 26	7.71%	0.92%	1.50%	1.70%
R2030	31 Jan 30	9.41%	0.94%	1.65%	2.15%
R2032	31 Mar 32	10.33%	0.99%	1.77%	2.38%
R2035	28 Feb 35	10.99%	1.01%	1.83%	2.49%
R2040	31 Jan 40	11.44%	1.00%	1.81%	2.47%
R2044	31 Jan 44	11.56%	0.98%	1.78%	2.43%
Average breakeven			**0.97%**	**1.72%**	**2.27%**

Sources: Bloomberg, Coronation



DEVELOPED MARKETS

Where form meets function

Investment opportunities in the eyecare industry

By **DANIE PRETORIUS**

THE QUICK TAKE

- Vertical integration and scale provide an enviable edge
- A stable management team is key to unlocking value
- Increased efficiencies cut costs and improve margins
- Vision correction is a €113 billion market globally, and growing

Danie is an investment analyst with 12 years of investment industry experience.

THE GLOBAL MARKET for eyecare and vision correction is large and growing. According to the World Health Organization, at least 2.6 billion people worldwide suffer from myopia (near-sightedness) and a further 1.8 billion from presbyopia (age-related farsightedness). Due to a variety of environmental and demographic factors, the incidence of these conditions is expected to rise – the number of myopes is projected to grow by 28% over the next decade, and presbyopes by 17%. Asia in particular is seeing rapid deterioration in eyesight – for instance, some studies suggest that over 80% of high-school students in China are nearsighted.

Luckily, these refractive errors can be relatively easily corrected with eyeglasses or contact lenses. Similarly, regular wearing of sunglasses to protect the eyes from UV or blue light can help reduce the risk of developing cataracts or macular degeneration later in life. Against this backdrop, global eyewear sales is a €113 billion market, growing at mid-range single digits (Figure 1 overleaf).

Due to the nature of the product – part medical device, part fashion accessory – success in the eyewear industry relies not just on functionality, but equally on aesthetics, brands and distribution. While online challengers like Warby Parker are trying to disrupt the market, the need to have a physical eye exam, frames fitted and lenses aligned to the correct orientation on the wearer's face has seen e-commerce penetration grow much more slowly than in other consumer categories. As a result, industry profitability remains very healthy and is largely controlled by current incumbents.

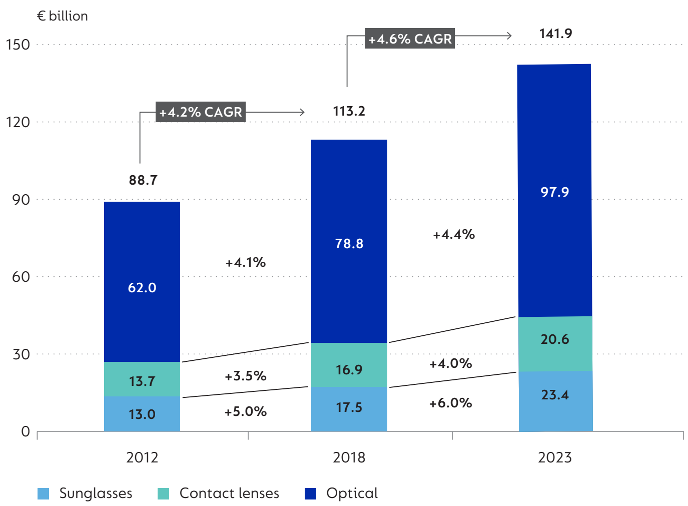
ESSILORLUXOTTICA – FRENCH FLAIR AND ITALIAN STYLE

A typical consumer may visit a LensCrafters store where an optometrist performs an eye exam and fits a Prada frame with Varilux lenses, and pay for the experience by using insurance benefits provided by EyeMed Vision Care. On her way home, she may pop into a Sunglass Hut store and pick up a new pair of Oakley or Ray-Ban sunglasses. What she may not realise, is that every product and service was provided by one company – EssilorLuxottica.

In a highly fragmented industry, French-Italian EssilorLuxottica is the undisputed 800-pound gorilla. The group was created through the 2018 merger of the global leader in sunglasses and frames, Luxottica, with the global leader in corrective lenses, Essilor. With operations spanning the full value chain (including the manufacturing of frames and lenses, wholesale and retail), EssilorLuxottica holds a more-than 50% market share in sunglasses, 31% in lenses and 23% in frames. Figure 2 shows that in each category it is at least three times larger than its closest competitor. Its unrivalled scale and vertically integrated model afford EssilorLuxottica a number of important and hard-to-replicate advantages over rivals, which we believe will help the group to grow ahead of the overall market.

Figure 1

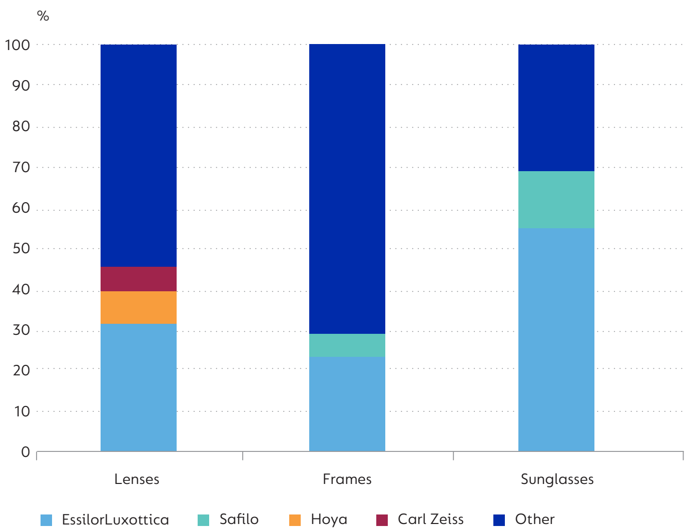
EYEWEAR MARKET DEVELOPMENT BY CATEGORY (GLOBAL EYEWEAR SALES € BILLION)



Source: Euromonitor

Figure 2

GLOBAL MARKET SHARE



Sources: Euromonitor, Credit Suisse

The individual businesses are formidable in their own right. Luxottica has very successfully built the industry's most valuable brands that span frames and sunglasses, including owned brands such as Ray-Ban, Oakley and Vogue, as well as licensed brands such as Prada, Armani and Ralph Lauren. For example, when Luxottica acquired the Ray-Ban brand in 1999, it was seemingly in terminal decline. A pair of poorly constructed Aviators could be bought for $19 from convenience stores and gas stations. Luxottica shifted production to Italy, rationalised distribution and repositioned the brand. Today, Aviators sell for $150 – revenue from the brand has grown tenfold under Luxottica's stewardship.

In turn, Essilor has built a dominant position in lens manufacture and finishing, with manufacturing facilities around the world and control of over 70% of optical laboratories in the US.

Combined, as the only fully vertically integrated player, EssilorLuxottica is uniquely positioned to offer consumers distinctive value propositions. For instance, it is the only major player that can sell a complete pair of branded prescription glasses. In the current model, frames and lenses are typically sold separately (usually consumers choose a frame, which is then sent to an offsite laboratory to have the lenses finished and fitted). An integrated model allows for less inventory to be kept, reduces logistics costs and ensures faster turnaround times, benefiting the consumer.

In addition, by increasing the share of Essilor lenses sold through Luxottica channels and by leveraging Essilor's lens technology in developing prescription sunglasses, the group is in a position to not only capture a greater share of the revenue, but also to grow the pie through product innovation. And by rationalising overlapping functions, EssilorLuxottica can reduce its cost base and improve margins. These factors should allow EssilorLuxottica to grow ahead of the market over the next few years, despite its size.

While many large mergers are often fraught with risk and unforeseen challenges in integration, the marriage between Essilor and Luxottica has been tumultuous from the start. From the get-go, the entrepreneurial, marketing-oriented culture of Luxottica, led by its charismatic octogenarian founder Leonardo Del Vecchio, clashed with the more corporate culture of Essilor.

The relationship has at times been downright antagonistic, resulting in management departures and a formal transition agreement, by the end of which an external candidate is likely to be >

appointed CEO. The full benefits of the merger are unlikely to be realised until the legacy businesses are fully integrated.

The uncertainty created by this management power struggle has weighed heavily on the stock price, which has underperformed the market by 15% since the merger. We believe this has created an opportunity to acquire the dominant franchise in an attractive industry at a very compelling valuation.

WHAT ABOUT CONTACT LENSES?

Another vision correction business we follow closely is Alcon. A recent spin-off from Swiss pharmaceutical giant Novartis, Alcon is a global leader in contact lenses, intraocular lenses and ophthalmic surgical equipment.

The contact lens market is effectively a four-player oligopoly, dominated by Johnson & Johnson, Alcon, Cooper and Bausch & Lomb. The market is growing faster than the overall vision-correction market, driven by higher penetration rates and more frequent replacement cycles (particularly as more consumers opt for daily replacement). The consumable nature of the product and low propensity for customers to switch between brands (usually they stick to the one recommended by their optometrist) means contact lenses generate stable, recurring revenues.

As is often the case with spin-off companies, the business was somewhat neglected as part of a bigger pharmaceutical conglomerate. It had noticeably underinvested in new product development and manufacturing capacity, and as a result had lost market share. However, newly independent, the business has been re-energised. For instance, with its new PanOptix intraocular lens, a synthetic lens that is used in cataract surgery, Alcon has already captured 60% of the market for multi-focal lenses.

A more profitable product mix driven by new products and a more critical focus on costs as a stand-alone company should allow Alcon to meaningfully expand profit margins going forward and deliver double-digit earnings growth for a number of years.

COVID-19 HAS HURT, BUT IT'S TEMPORARY

Both EssilorLuxottica and Alcon will see disruption to their business from Covid-19. The closure of retail stores around the world in response to the epidemic has resulted in fewer visits to opticians and hence reduced sales. Similarly, capacity constraints in the global healthcare system (and patients' reluctance to undergo elective procedures) have meant fewer cataract and other ophthalmic surgeries. We see this as a temporary setback in a structurally attractive, long-term story with the underlying demand intact.

At some point in our life, most of us will need corrective glasses, contact lenses or surgery. Most of us will own at least one pair of sunglasses. EssilorLuxottica and Alcon will be there to meet those needs. +

ECONOMIC COMMENT

The debt mountain

"If you owe your bank a hundred pounds, you have a problem. But if you owe a million, it has."
– Economist John Maynard Keynes

By **MARIE ANTELME**

THE QUICK TAKE

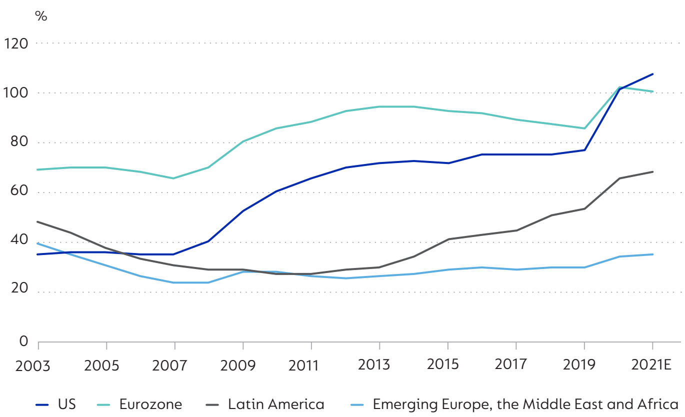
- The level of global debt is staggering at c.$11 trillion, up from $8 trillion at end-April
- QE measures have reached unparalleled levels, far exceeding those seen during the 2008/09 GFC
- Developed markets are more resilient in terms of repayment and should stage rapid recoveries
- Many emerging markets went into the Covid-19 crisis on the back foot and will struggle to bounce back

Marie is an economist with 19 years' experience in financial markets.

THE INTERNATIONAL MONETARY Fund (IMF) estimates that average public debt will rise by almost 20 percentage points of global GDP to above 100% in 2020. In advanced economies, this is pegged even higher at 131.2%, while in emerging markets the estimate is lower at 63.1% (Figure 1), but this is arguably more worrying given fewer policy resources and possibly more lasting economic damage in the wake of the Covid-19 pandemic. This increase in debt raises a plethora of difficult questions about debt sustainability, mitigating policies, the challenges of funding and the risk of default.

Figure 1

GROSS GOVERNMENT DEBT, % GDP



Source: UBS

The spreading pandemic prompted swift policy responses from governments and central banks. At the time of writing, fiscal efforts to mitigate the social and economic impacts of the pandemic have reached $11 trillion globally, amounting to 3.8% of global GDP. This is up from $8 trillion at the end of April 2020 (Figure 2 overleaf). About half of this ($5.4 trillion) reflects additional expenditure and lost revenue that directly affect government budgets. The remainder is made up of various forms of liquidity support, including loans with guarantees – which may or may not fall to governments to fund in due course. These measures have certainly helped save lives, protect livelihoods and cushion businesses from the sudden loss of income, but they all have fiscal recourse. While some fiscal support programmes are intended to be self-destructing and should contribute to >

some consolidation in fiscal deficits, the risk is that a long, disrupted recovery will require extended fiscal support for vulnerable households, health-care and companies.

HOW WORRIED SHOULD WE BE?

This magnitude of global debt accumulation puts us in unchartered territory, and naturally raises concerns about its sustainability. There are a number of considerations here and there is no 'one size fits all', as challenges facing developed and emerging markets differ.

It's hard to know what to monitor. The ratio of government debt to GDP doesn't tell us a great deal about sustainability. It measures the stock of debt to the flow of GDP (output) and gives us a measure and context for what ultimately must be repaid. But what matters, especially in the short to medium term, is a country's ability to service its ongoing debt obligations, and this is a function of interest and growth rates, and what then influences the stock of debt along the way.

Throughout history[1] there have been five things that have combined to reduce government debt ratios: i) economic growth; ii) substantive fiscal adjustment/austerity; iii) default or restructuring; iv) a surge in inflation; and v) a steady imposition of financial repression. The latter two are only applicable to local currency denominated debt, but historic episodes of debt liquidation have been owed to a combination of these factors.

The automatic debt dynamics (the equation[2] that explains how government debt is accumulated) shows that while the cost of debt is below the growth rate (r-g), governments can shrink their stock of debt, as long as the primary deficit isn't growing. This is because the numerator is growing more slowly than the denominator. If the differential becomes positive (interest costs rise above the rate of growth), government will add to the debt stock unless it cuts spending elsewhere (the primary balance moves into surplus), forcing the numerator to grow more slowly.

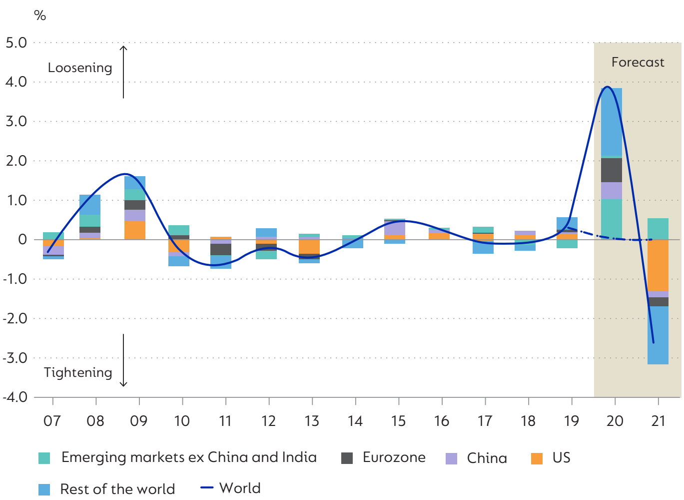
These dynamics tell us three things: i) that it is useful to look at debt service costs relative to growth rates or revenues (which is also methodologically cleaner because it measures a flow to a flow); ii) that while interest rates are below growth rates, governments can continue to service debt reasonably comfortably; and iii) that governments can reduce the stock of debt through time by reducing expenditure, with the help of lower debt service costs.

Indeed, this is what a few developed markets successfully achieved in the post-Global Financial Crisis (GFC) period. Germany saw debt stock fall from 81.1% of GDP in 2012 to 59.8% in 2019, the UK saw debt stabilise at about 80% of GDP and the US was able to slow the pace of accumulation because growth rates outstripped borrowing costs, despite persistent deficits (Figure 3). For this happy dynamic to continue after this crisis therefore requires interest rates to remain low

Figure 2

UBS FISCAL STIMULUS BY COUNTRY

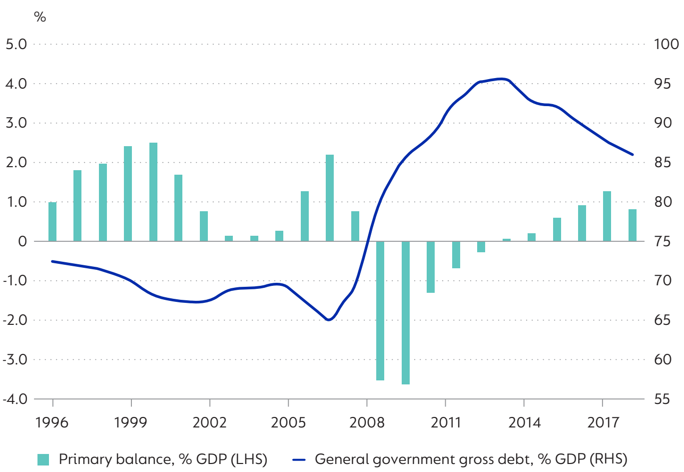
Change in cyclically adjusted primary fiscal balance as % of global GDP



Source: UBS

Figure 3

EURO AREA DEBT AND PRIMARY BALANCE, % GDP



Source: Haver

[1] Carmen M Reinhard and M. Belen Sbrancia "The Liquidation of Government Debt", IMF working paper WP/15/7.

[2] $\frac{(1+r)}{(1+g)} * d_{t-1} + \frac{(1+i^*)*(1+e)}{(1+g)*(1+\pi)} d^*_{t-1}$

where g is real GDP growth rate, r is the real weighted domestic interest rate, π is the GDP deflator, i* is the weighted nominal interest rate on fx debt, e is the currency depreciation, d is local currency debt/GDP and d* is fx debt/GDP.

>

long enough for GDP growth to recover which, in turn, will certainly require central banks to continue to play their part in repressing the cost of government borrowing.

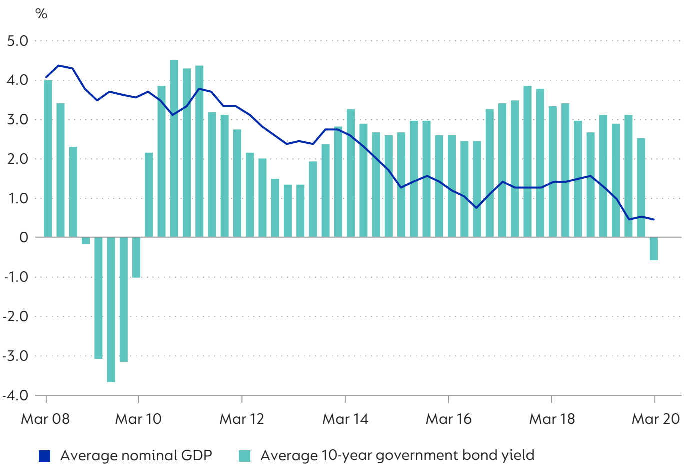
Central banks have again dusted off the toolkit and aggressively revived quantitative easing (QE) policies, especially in developed economies, and, more recently, new 'QE' ventures by emerging markets. The nature of these programmes differs but, essentially, in developed markets where policy rates are at or near zero, QE targets the expansion of the monetary base through the purchase of financial assets, mostly government bonds, but across asset classes in some economies. In the absence of inflation, the expansion of the monetary base lowers the cost of money (interest) (Figure 4). In emerging markets, the stated intent is different, and is more generally aimed at rectifying market dysfunction and providing bond market liquidity through the unsterilised purchase of government bonds. Here emerging market central banks are signaling a willingness to be buyers of last resort during periods of market stress.

Figure 5 shows that UBS estimates 15 out of 40 economies covered have announced some form of QE, with the large developed-economy central banks committing to purchase assets in amounts unimaginable just a few months ago. These programmes typically see the central bank buying fixed-income assets – mostly government bonds – in the secondary market from banks, and crediting the banks with reserve money held by the central bank. This encourages the banks to reduce unprofitable, low (or negative) interest-earning deposits at the central bank, and to either on-lend into the economy or buy more government paper. This theoretically creates a virtuous cycle of demand for government bonds, and hopefully facilitates economic growth.

There is also more to QE than just the provision of a bid for government paper. Most central bank assets are in fact owned by their governments (although this is not the case with the Federal Reserve Board or the South African Reserve Bank, but this doesn't materially change the arrangements), and central banks transfer interest payments on the debt they hold to the taxpayer (government) after expenses. This effectively means that the debt held by the central bank costs the government very little and, on balance, reduces the funding cost. Moreover, this debt is more likely to be rolled over than redeemed. Taking central bank holdings of government debt into account may be a better indication of what the ultimate cost to the taxpayer will be.

Figure 4

DEVELOPED MARKETS: AVERAGE 10-YEAR YIELDS VERSUS GDP GROWTH

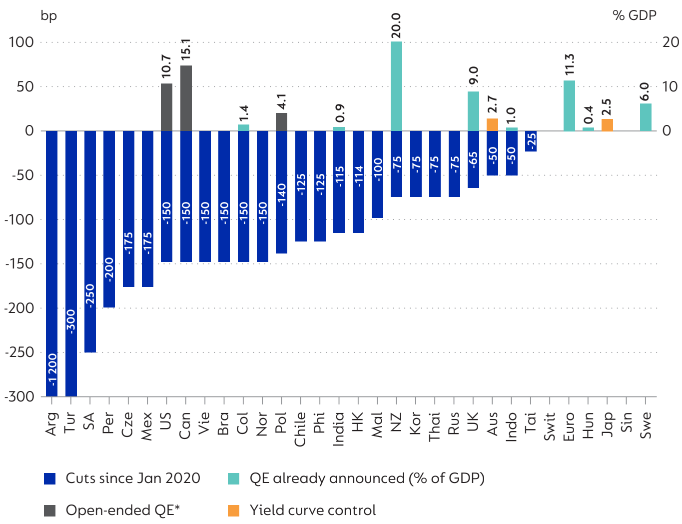


Source: Haver

Figure 5

CENTRAL BANK MONETARY STIMULUS

Monetary easing since January 2020



* Size of bar denotes Central Bank balance sheet increase since January 2020

SO MUCH FOR THE THEORY, CAN IT WORK?

Year to date, the large developed-market central banks have, with credibility, successfully managed to help lower interest rates, and their balance sheets have expanded in line. The process has been supported by demand for less risky assets, as well as general expectations that inflation will remain low because of the combined impact of low oil prices, income loss, excess capacity and much wider output gaps. Such success is less evident in emerging markets where interest rates at the long end of the curve are generally not back at pre-crisis levels. These economies face several challenges in this regard, but perhaps the most important >

factor is that, in many cases, the pandemic has hit those that were already weak and will struggle to recover (undermining efforts to reduce r-g). South Africa is a case in point, but India, Brazil, Mexico, Argentina and Turkey are all in this position to varying degrees. Also, the fiscal positions of these countries have deteriorated since the GFC and the inflation-targeting credibility of the central banks may be questionable.

Taken together, these factors may make markets uncertain about long-term efficacy of such an intervention as concerns about fiscal dominance increase. Governments will therefore either have to consolidate aggressively, with painful growth repercussions, or may risk defaulting on their debt. Market concerns about the risk of such outcomes are therefore more visible in emerging markets where, on average, long-term interest rates are well above short-term rates, and curves are steeper. Again, South Africa is a very visible example.

We have concentrated here mostly on domestic debt, but external debt stock adds to the challenge for many emerging economies and low-income poor countries (LIPCs). Here, external debt had risen ahead of the crisis, and now, for many countries, in the moment of the crisis (the IMF has granted emergency funding to 77 countries to date). While some external debt is extended on favourable terms, much carries market-related interest rates. Taken together with weaker currencies and large domestic debt obligation, external debt is another risk to developing economies servicing debt burdens and their ability to facilitate a growth recovery. With this in mind, the crisis has prompted a new discussion about emerging market debt.

From 1 May 2020, the G20 suspended repayment of official bilateral credit by the world's poorest countries. There are also growing calls for the cancellation of some external debt accumulated by emerging markets and LIPCs, and a number of criteria have been put forward. While this discussion might end in some debt forgiveness, it's hard to see that it will be sufficient to materially change the debt dynamics for the larger emerging markets, and may carry long-term, adverse funding repercussions.

WHAT WORKS NOW MAY NOT BE A LONG-TERM SOLUTION

Finally, another risk to the global debt strategy hides in the wings. The successful monetisation of developed market government debt has been possible because inflation has remained very low. This may continue for a while, but may not last.

Given the sheer size of monetary expansion in developed markets, coupled with the combination of targeted income-related fiscal support that may remain in place until labour markets recover and central banks are actively targeting higher inflation, supply disruptions could see inflation accelerate. In emerging markets, weak growth and fragile fiscal positions, failed QE, weaker currencies, supply shortages and rising commodity prices could all contribute to higher prices.

For a while, central banks may also tolerate higher inflation, and continue funding the governments with some success. History tells us that in all periods of post-World War II, debt liquidation has been characterised by financial repression in some form, along with rising inflation[1]. But this is unlikely to be the case for developed and emerging markets alike – history also suggests that such crises materially raise the risk of sovereign default. ✚

[1] Carmen M. Reinhard and M. Belen Sbrancia, "The Liquidation of Government Debt", IMF WP/15/7.

FRONTIER MARKETS

Hotel California

South African investor heaven or hell?

By PETER LEGER

THE QUICK TAKE

- When it comes to investing in Africa, negative newsflow obscures the facts
- Allocating to Africa is akin to selecting any other stock
- Our Africa Frontiers Strategy has outperformed SA equities against meaningful time periods
- Seldom have valuations been so attractive and many countries across Africa have superior prospects relative to SA

Peter is head of Global Frontiers with 21 years' investment experience.

FRONTIER MARKETS HAVE been on the bleeding edge of the listed-equity universe. A number of countries have swung from being failed states to show some promise, only to collapse back into an economic pile of questionable future. The share of news airtime has sadly been tilted in favour of high drama as opposed to the promise of high returns. Egypt's Arab Spring, Argentina's record International Monetary Fund default, Nigeria's multiple-currency default, and Zimbabwe's eternal death spiral, to name a few stories.

Having managed an African portfolio for 12 years now, it has started to feel like 'Waiting for Godot', with me telling the story of future returns to come, while these continue to remain elusive. As my colleague likes to serenade – you can check in, but you can never leave. The question is, though, is this true – has Africa been the Hotel California of investments?

FIRST SOME BACKGROUND

In 2004, then-President Thabo Mbeki granted South African pension funds the flexibility to invest 5% of their assets in Africa (ex-South Africa). Few took up his offer, and those that did, nibbled, staying well shy of the 5%. And judging from the introduction above, if you ask anyone whether they should have held more Africa in their balanced funds, they will shout, "No!" But would they be right?

Index returns have been terrible. Since the inception of the Coronation Africa Frontiers Strategy, the FTSE/JSE All Africa (ex-South Africa) 30 Index has returned 4.2% p.a. in rand and a negative 2.1% p.a. in US dollars. However, Coronation's Strategy has returned 12% in rand and 5.2% in US dollars. Frontier markets lend themselves better to stock pickers, given the dearth of quality compounders.

'Smoke and mirrors', I hear you say when using a rand return. However, I would argue that a rand return comparison is appropriate, as an Africa allocation would have come from a portfolio manager's rand bucket, and not the precious outright US dollar allocation they have available. So, the right measure is to compare the Strategy's returns to a South African equity benchmark that balanced funds would measure against and which would be Regulation 28 compliant[1].

[1] Regulation 28 of the Pension Funds Act of South Africa.

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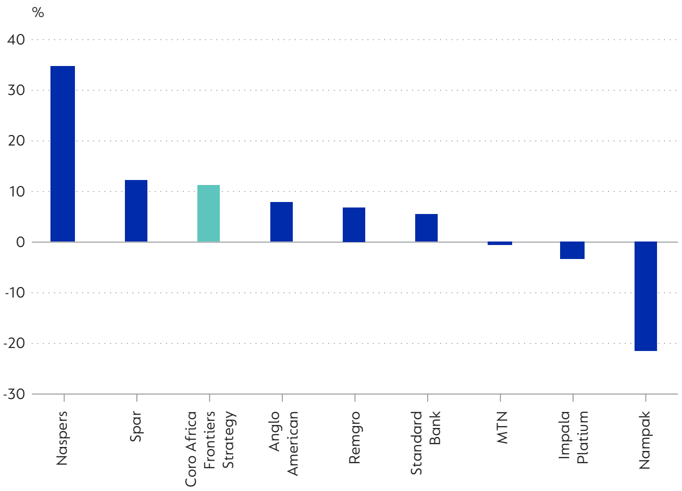
IT'S AN ALLOCATION DECISION

In fact, the decision to allocate to Africa is just like selecting a stock – not a massive off-piste investment idea. And, while any one country at any time might look challenging, when considered in a portfolio context, over time, returns are diversified and the bumps smoothed out. Yes, we have taken hits in different countries, but, these are appropriately valued at realisable values and, in my view, will add to returns over time rather than detract.

Figure 1

10-YEAR ANNUALISED RETURN (IN RAND) TO JUNE 2020



Source: Bloomberg

Figure 2

AFRICA FRONTIERS STRATEGY'S OUTPERFORMANCE

Returns in rand outperformed South African equities over all periods

	Year to date	1 year	3 years (p.a.)	5 years (p.a.)	10 years (p.a.)	*Since inception (p.a.)
Coronation Africa Frontiers portfolio (gross in ZAR)	(2.2%)	1.4%	3.3%	1.7%	11.0%	12.0%
SA equity benchmark**	(10.7%)	(10.8%)	(0.8%)	0.3%	9.6%	9.5%
Outperformance	8.5%	12.2%	4.1%	1.4%	1.4%	2.5%

* Since inception – October 2008 / Return as at 30 June 2020
** Performance measured against dominant benchmark in the composite index at the time (JSE Low Mining, FTSE Capped Swix from 1 May 2017)

Investing often comes with a large dose of dissonance – where we think one thing is perfectly normal, yet something else is an uncomfortable departure for our senses. If, when casting an eye over the top holdings in a balanced fund, a position that is high conviction and somewhat differentiated will catch your attention, but will also be what you'd expect from a stock-picking manager – after all, that is how value is added over time. A 5% Africa allocation, however, causes more of a stir – and the question is: why should it be, relative to the comfort of our more known benchmark universe?

THE PROOF OF THE PUDDING

Stripping out emotion, the past decade's returns (the timespan that is becoming a meaningful period for manager measurement) are as shown in Figure 2.

We have outperformed South African equities against every time period. Within these returns, we have marked down virtually all of Zimbabwe, conservatively valued the Nigeria naira and, wherever there is doubt, looked to value assets as realistically as we can. In short, these returns are very realisable. In the life of our Strategy, we have never had to gate[2] it due to liquidity constraints and have handled large inflows and outflows seamlessly.

WORTHY OF DEBATE

It does feel like investors in the asset class are at a point of capitulation. I urge investors to be aware that their fatigue is more because of the noise around the asset class as opposed to its delivered and expected returns. Seldom have I seen more attractive valuations and, relative to South Africa, many countries and companies across Africa have superior prospects. The asset class should really be afforded more debate when it comes to an allocation within a South African pension fund.

In conclusion, Hotel California hasn't been as inhospitable as one might feel, and relative to South Africa, it has delivered more. Don't let a bad story spoil the facts – it's not the dark desert highway people make it out to be. ✚

[2] A manager's right to limit or halt redemptions.

Note: While the Coronation Africa Frontiers Fund is not directly available to investors, it is a holding in the portfolios of the Balanced Plus Fund and the Market Plus Fund.

MARKET REVIEW

Covid-19 economic shock and stimulus reflected in financial markets

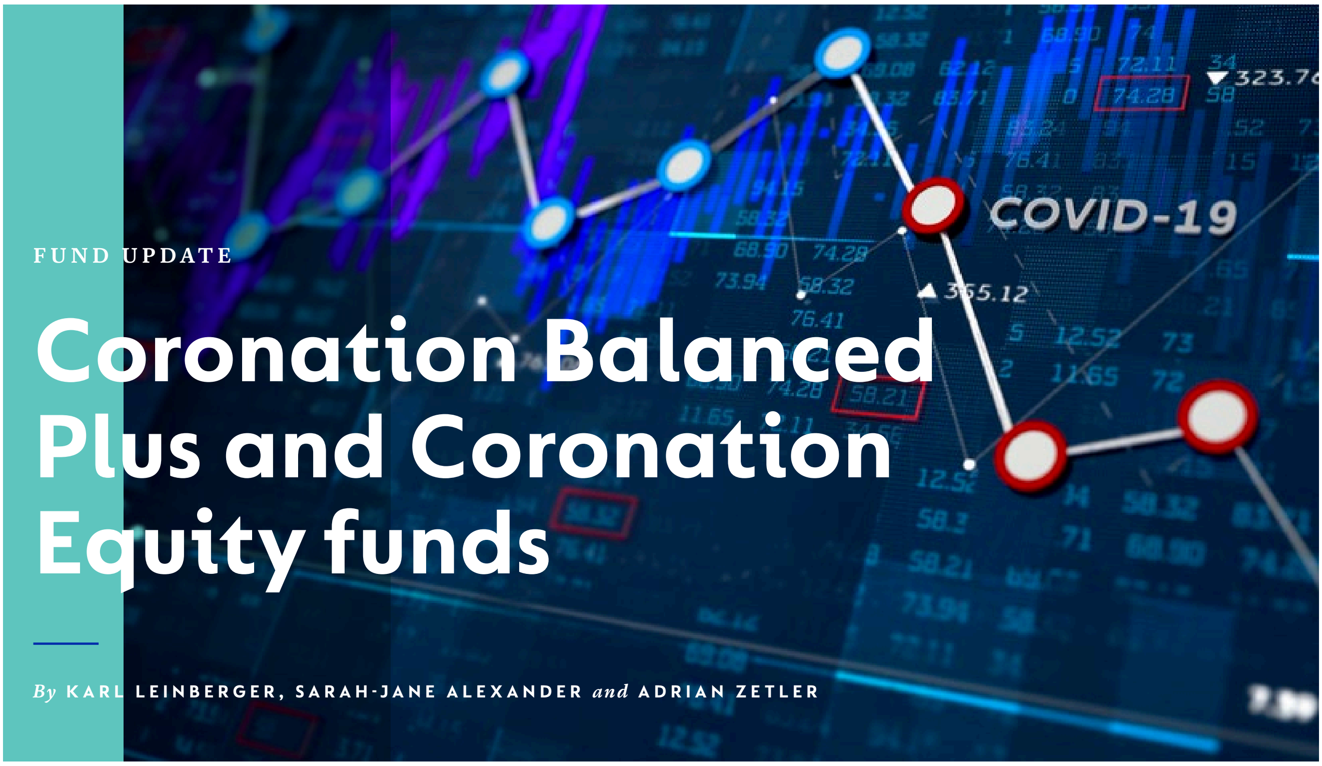
CAPITAL MARKETS RESPONDED dramatically to the unprecedented levels of fiscal and monetary stimulus that most developed markets unleashed in response to the Covid-19 lockdowns. After the record decline in equity markets during the first quarter of 2020, a record-breaking recovery followed in the second quarter (Q2-20).

The recovery was led by technology shares, reflected in the NASDAQ 100's return of 30%. The MSCI All Country World Index (ACWI) recovered 19.2% in Q2-20, while the MSCI Emerging Markets Index (EM Index) was up 18.1%. Both indices are down, ACWI is down 6% and the GEM index down 9.8% year to date. Over 12 months, the ACWI is up by 2%, but the EM Index declined by -3%. The FTSE World Government Bond Index rose 2% in Q2-20, for a year-to-date return of 4%. This further tightening in bond markets leaves the benchmark US 10-year government bond with a yield well below 1%. The gold price continued its upwards trajectory (+12.9% in Q2-20 and +26.3% as per commentary over the past 12 months), given investor concerns around building risks in the financial system and monetary debasement.

The rand strengthened slightly against the US dollar (2.9% in Q2-20) but has still declined meaningfully year to date (-19.3%), reflecting the damage the Covid-19 economic shock has wrought on an already-weak economy. The All Bond Index responded to assertive policy actions by the South African Reserve Bank and returned 9.9% during the quarter, bringing the year-to-date number into positive territory. Over one year, the bond return was behind inflation at 2.9%.

Along with its global counterparts, the FTSE/JSE Capped Shareholder Weighted Index experienced a significant rebound during Q2-20 (+21.6%) but is still down -10.7% for the year to date. All sectors saw rising returns. The resources sector (+41.2%), due to its high offshore exposure; tighter markets as a result of Covid-related supply shocks; an improving demand outlook due to a resurgent Chinese economy; and the easing of restrictions elsewhere, outperformed industrials (+16.6%), financials (+12.9%) and property (+20.4% as per commentary).

All international returns are expressed in US dollar terms.
All domestic returns are in rand.



FUND UPDATE

Coronation Balanced Plus and Coronation Equity funds

By KARL LEINBERGER, SARAH-JANE ALEXANDER *and* ADRIAN ZETLER

Karl is Chief Investment Officer (CIO) and manager of Coronation's Houseview strategies.

Sarah-Jane is a portfolio manager with 16 years of industry experience.

Adrian is a portfolio manager with 11 years of investment industry experience.

GIVEN THE STRONG period for asset class returns, the Equity Fund (our diversified general equity fund) and the Balanced Plus Fund (our flagship multi-asset fund for pre-retirement investors) had a good second quarter in 2020, returning 18.8% and 14.9% respectively. Both funds continue to perform well against their peer groups over all meaningful, longer-term periods.

Market participants remained indifferent to the risks that high and growing levels of government indebtedness present to bondholders. The very low yields offer a poor expected return for the rising risk and we continue to avoid global developed market sovereign bonds. We also remain concerned about the ability of lower income emerging markets to withstand the economic shock, given their limited ability to provide financial support to businesses and households.

Having increased our exposure to global equities to an overweight position towards the end of the first quarter, the sharp upward moves in markets resulted in us bringing back the position to a more neutral level. Our expectations for a faster economic rebound in more robust developed market economies and the risk diversification benefits for South African investors continue to justify a sizeable holding.

South African bonds continue to offer attractive yields in a low inflation environment. However, the deteriorating fiscal position will require meaningful issuance to fund in the coming years and increases the risk of a debt trap. While June's Supplementary Budget acknowledged the challenge, it will take considerable political will to implement the level of structural reform required. We continue to watch this closely. The Covid-19-related demand shock provided the opportunity to add well-priced protection (in the form of inflation-linked bonds) against the longer-term risks of a rise in inflation.

PORTFOLIO ACTIVITY

The portfolios remain skewed to rand-hedge stocks, which are attractive for stock-specific reasons and should also benefit from exposure to economies that are expected to rebound more rapidly. Early in the quarter, we added meaningfully to positions in Bidcorp (+33.3%) and Anheuser-Busch InBev (+9.1%), as both had sold off significantly. Buying was largely funded by a reduction in the size of Naspers and British American Tobacco holdings, both of which have performed well and remain considerable holdings in the funds.

Bidcorp is a well-run food services business with a long-term growth opportunity. It has grown through international expansion, but also in-country by expanding product ranges and getting closer to customers. Its investments in local distribution centres and focus on small, profitable customers enable it to distinguish itself with high levels of service. While the Covid-19 pandemic has restricted out-of-home food consumption, we believe long-term demand remains intact. This was evident in the rapid resumption that Bidcorp has witnessed in its Chinese operations. Bidcorp is expected to continue its growth trajectory and trades on 15 times earnings three years out.

In the case of Anheuser-Busch InBev, poor results, growing concerns over Covid-19-related weaker beer consumption and high debt levels saw the share sell off markedly towards the end of the first quarter. We were able to acquire shares at a price of less than 10 times our assessment of normal earnings. Subsequent clearance by Australia's competition authority to dispose of an Australian subsidiary will assist in the de-gearing process. The stock is attractively priced for a global staples business benefiting from the compelling economics of the brewing industry.

LOCAL EQUITY EXPOSURE

Domestic equity holdings remain concentrated in the higher quality South African shares, such as the food retailers (Shoprite and Spar), whose more resilient business models are best placed to weather the very tough local macroeconomic environment. Having held up well during the first quarter's sell-off, many of these underperformed during the second quarter, with the food and drug retail sector declining 2.0%. We acknowledge that many of the more cyclical domestic businesses look cheap, but are concerned that the long-term headwinds they face are considerable and threatening. Weak revenue prospects due to an already weak economy are now expected to be compounded by rising retrenchments, which will ultimately feed through to consumer demand. An underweight position in domestic shares continued to benefit the funds.

The strong rebound in resources benefited the funds' sizeable positions in Anglo American (+31.9%) and the platinum shares. Platinum miners rose as concerns over weak automotive demand subsided and major markets reaffirmed their commitment to a reduction in emissions. The funds remain invested in Impala Platinum (+53.2%) and Northam Platinum (+67.4%).

While Balanced Plus has direct exposure to gold, we do not hold a position in the locally listed producers, whose capital intensity and high-cost mines have resulted in lacklustre returns to shareholders over time.

OFFSHORE MOVES

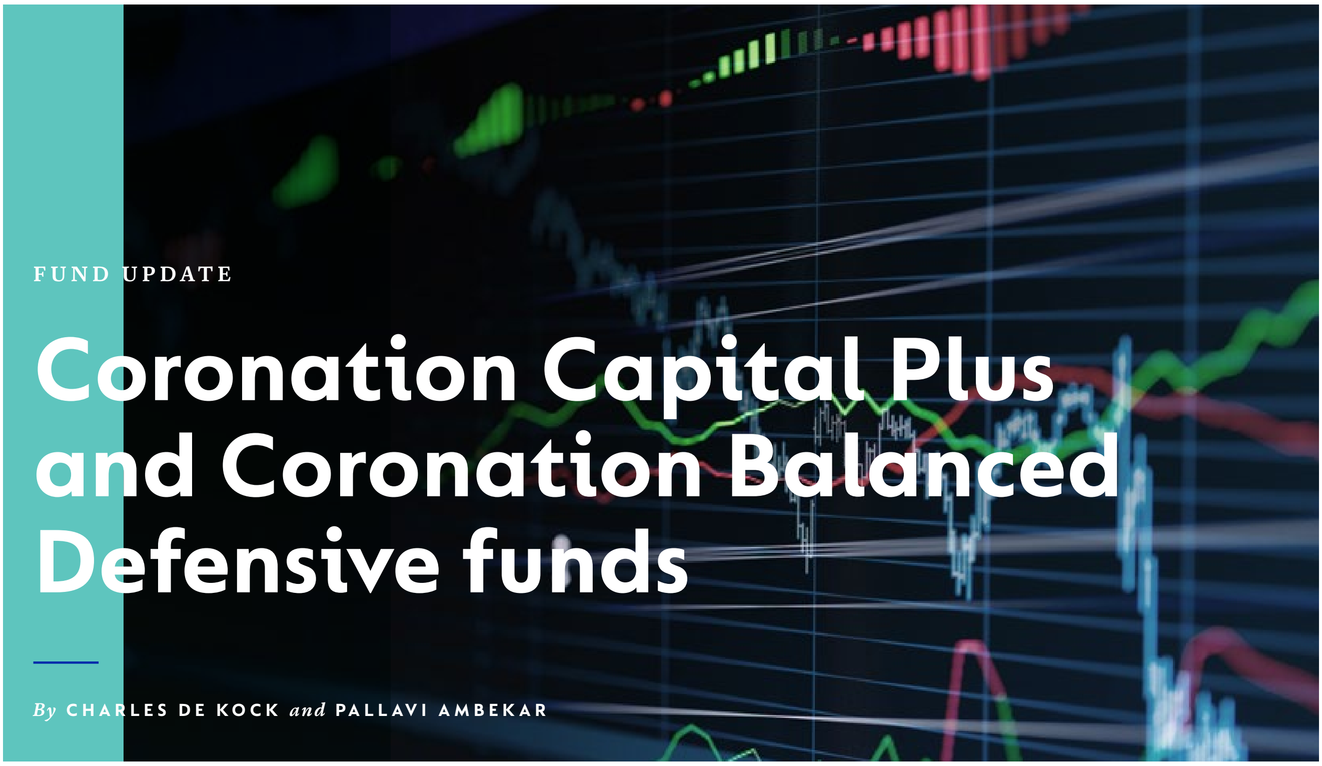
In the Equity Fund, we exited one of our larger positions, 58.com, after a take-private offer became definitive. Although the price offered to minority shareholders is below our assessment of fair value, the deal is likely to go ahead. As a result, we redeployed the proceeds into some of our other high-conviction ideas. Airbus was a case in point. The share sold off over investor fears of reduced demand for air travel and an orderbook overhang. While the Covid-19 pandemic has created large amounts of uncertainty, we do not believe this will result in a permanent impairment to the business's long-term value. Airbus is a high-quality business operating in a global duopoly. We believe it will still benefit from growth over a long time horizon. As long-term investors, this is the kind of opportunity that we can take advantage of.

TO CONCLUDE

The market correction began at a point when investors were still being bombarded daily with negative newsflow about the extent of the pandemic's economic shockwave. The massive sell-off created a value opportunity. We retain our commitment to look through the short-term noise and use valuation as our anchor point when investing, selecting assets where we believe the market is mispricing the long-term fundamentals. ✚

Coronation Balanced Plus Fund: Highest annual return 49.3% (Aug 2004 - Jul 2005); Lowest annual return (17.4%) (Sep 1997 - Aug 1998)

Coronation Equity Fund: Highest annual return 62.5% (Aug 2004 - Jul 2005); Lowest annual return (28.7%) (Mar 2008 - Feb 2009)



FUND UPDATE

Coronation Capital Plus and Coronation Balanced Defensive funds

By CHARLES DE KOCK and PALLAVI AMBEKAR

Charles co-manages the Absolute Return funds with Pallavi Ambekar and has 34 years of investment experience.

Pallavi co-manages the Absolute Return funds with Charles De Kock and has 16 years of investment experience.

THE FUNDS ARE managed to meet the needs of more conservative investors drawing an income from their portfolio over an extended period, and to provide a well-considered balance between risk and return. The more conservative Balanced Defensive Fund recovered by 10.3% in the second quarter of 2020 (Q2-20), taking the one-year return to a positive 2.8% and the three-year return to 5.2% p.a., ahead of inflation but unfortunately not at the targeted level of inflation plus 3%.

The moderate-risk Capital Plus Fund recovered by 11.8% in Q2-20, taking the one-year return to a positive 0.4%. Its three-year return of 3% p.a. did not beat inflation. Both funds' longer-term returns are still comfortably ahead of inflation and achieved their real return targets of inflation plus 3% and 4%, respectively.

The increased volatility in the markets presented opportunities to add value through active asset allocation decisions. After adding to bonds during the crisis in March, we reduced our position during Q2-20 as long-term bond yields recovered. The South African fiscal situation has deteriorated alarmingly and a budget deficit of near 15% of GDP is now expected this financial year. The additional bond issuance this requires will keep pressure on the market and we are concerned about the possibility of entering a debt trap. Although real yields appear very attractive, the risk has also increased, and we will not add more duration risk at this point.

LOCAL EXPOSURE

Within domestic equities, we added to Bidcorp and Anheuser-Busch InBev, two companies that operate globally and should reap some benefits from the recovering global economy. We switched some Northam Platinum into Impala Platinum, but still retain a sizeable position in Northam. We also added to domestically exposed businesses FirstRand and Mr Price at very attractive prices. These two companies are, in our view, well-managed, high-quality companies that will survive the crisis and gain market share.

OFFSHORE ACTIVITY

In the global portion of the funds, we were also active, adding to global equities and then, later in the quarter, buying put protection on the view that the market recovery may have been too rapid and that a second wave of the pandemic was not priced in.

These actions, plus the effect of the rising market, took our exposure to growth assets from 38% at the end of Q1-20 to 43%, and our effective international exposure increased from 21% to 26.6% in the case of Balanced Defensive. For Capital Plus, growth asset exposure increased from 50% to 53% and effective international exposure increased from 22% to 27.4%.

MORE RISK IS KEY

The outlook amid this unfolding pandemic remains murky. However, the unprecedented stimulus and massive liquidity provided are positive for the markets. In addition, inflation is far lower than expected over the near term and the South African Reserve Bank has acted aggressively to cut interest rates to the lowest level we have seen since 1973. This is supportive of risk assets. Returns on cash will likely be below 4% for the next few years, a rate unlikely to exceed inflation. To reach our return targets, a reasonable exposure to risk assets will therefore be required.

Over the longer term, we are watchful of a resurgence in inflation globally as well as locally, as there will eventually have to be a cost to the massive monetary and fiscal stimulus provided in an attempt to limit the devastating impacts of the lockdown on economies around the world. +

Coronation Capital Plus: Highest annual return 33.8% (Aug 2004 - Jul 2005); Lowest annual return (9.3%) (Apr 2019 - Mar 2020)

Coronation Balanced Defensive: Highest annual return 21.2% (Jun 2012 - May 2013); Lowest annual return (5.8%) (Apr 2019 - Mar 2020)

FUND UPDATE

Coronation Market Plus and Top 20 funds

By NEVILLE CHESTER *and* NICHOLAS STEIN

Neville is a senior portfolio manager with 23 years of investment experience.

Nicholas is an equity analyst with 11 years' investment experience.

THE MARKET PLUS Fund, a multi-asset fund aimed at long-term investors growing wealth outside the retirement system, delivered a return of 17.3% in the second quarter of 2020 (Q2-20), against the benchmark return of 16.7%. Top 20, our concentrated South African equity fund, returned 20% in Q2-20 and is ahead of benchmark year to date. The aim of Top 20 is to deliver outperformance over longer time periods, and the since-inception return remains compelling, with alpha of 3.7% per annum, net of fees.

While our domestic equity holdings continue to be more exposed to global businesses than to local businesses, we added to the latter in Q2-20. South African equities are unloved, and a lot of bad news is now discounted in the price. Foreign investors have been exiting South Africa and several good-quality defensive businesses are now priced at attractive levels. Given the ongoing Covid-19 pandemic, near-term earnings forecasting is difficult. Our focus is on assessing the quality of the franchise and balance-sheet strength to find the domestic businesses most able to resume robust earnings delivery once the economic situation normalises. We now own meaningful positions in the food retailers, hospitals and some of the more defensive retailers.

We also added exposure to the insurance and specialised finance sector. As markets rebounded very rapidly, asset bases are close to where they were at the start of the year, while many of these companies are still trading well below their intrinsic value. We hold UK-based wealth manager, Quilter, and insurer, Momentum, in both funds. In Market Plus, we added exposure to the life insurance sector, buying Sanlam and Liberty as well as Ninety One, the recently listed asset manager. While all will face a much tougher economic environment, financial services businesses can operate under lockdown conditions with more ease than many other industries.

AUTOMOTIVE METALS ATTRACTIVE

The strongest performance in Q2-20 came from the platinum group metal (PGM) miners. Last quarter, we wrote about our surprise at the divergence between PGM share prices and the underlying fundamentals, with Northam Platinum and Impala Platinum having fallen 44% and 46%, respectively. This reversed in Q2-20, with the shares rising 69% and 54%, respectively. South Africa is the largest source of primary mine supply. While the lockdown will hurt near-term earnings, the shutting of mines helped to keep supply-demand balances in check. We continue to forecast meaningful deficits in the coming years, which underpins our expectations of strong PGM pricing. The diversified miners also performed strongly over the quarter. Anglo American, Exxaro and Glencore all increased over 30%.

We added Glencore to Top 20's portfolio. The company has attractive commodity exposure, with over 40% of normal earnings exposed to the so-called electric vehicle metals (copper, nickel and cobalt). The long-term supply-demand outlook for each is promising.

We also believe the supply-demand fundamentals for thermal coal, another key commodity for Glencore, remain favourable. The current low thermal coal price makes a large portion of supply loss-making. With limited investment in new mines and growth in power station demand from India and Southeast Asia, thermal coal prices should trend higher. Glencore's marketing business, which sources and supplies commodities globally, earns a consistently high return on assets.

The reason why the company trades at a discount to the other major diversified miners are concerns related to governance. We have done significant research into this area and are pleased that it has taken several steps to improve governance since listing in 2011. Some risk remains from the investigation into past practices related to the acquisition of a mine in the Democratic Republic of Congo, particularly relating to the vendor Glencore bought it from. While impossible to forecast, we believe most of the risks related to this are reflected in the price. Glencore trades on around six times our assessment of normal free cash flow, which we consider compelling.

INTERNATIONAL EXPOSURE BENEFITS

Aspen shares delivered a 55% return in Q2-20 after announcing good free cash flow generation at interim results stage. Coupled with the disposal of its Japanese business, this allayed investor fears over its levels of debt. Demand for Aspen's products has remained robust throughout the Covid-19 pandemic. Upside optionality is provided by two products in Aspen's portfolio.

There is evidence of increased blood clotting in some Covid-19 patients, which can be treated with anticoagulants. Secondly, early evidence from a UK trial testing the drug Dexamethasone on Covid-19 patients has displayed promising results. Despite the recovery from 2019 lows, the share still only trades on eight times our assessment of normal earnings, which do not factor in any of the upside optionality. For more on Aspen, read the share analysis on page 17.

The strong share price performance of both Naspers and Prosus continued this quarter, rising 23% and 30%, respectively. Tencent has been a beneficiary of Covid-19, which is accelerating the switch to a digital economy. Recent results were well ahead of market expectations, with games performing strongly. Naspers/Prosus is still the biggest holding in both funds. We reduced our exposure marginally towards the end of the quarter as the shares performed strongly.

DEBT VERSUS EQUITY

In Market Plus, we remain very underweight global government bonds. Currently, 90% of developed market bonds offer yields below 1%. Should any inflation return to the system (always a risk given unprecedent money printing), there will be significant losses in this asset class. We continued adding exposure to our South African government bond (SAGB) holding. This is a market with two strong counteracting forces. The uncertain state of South Africa's fiscal position is top of mind for global investors who have significantly reduced their holdings of SAGBs. Against this, real yields are at record highs, as rising nominal yields (due to increased supply) and falling inflation combine to offer a compelling opportunity.

At the longer end of the curve, real yields are more than 6% under all but the most extreme inflation scenarios. While the short end of the curve is anchored by the exceptionally low repo rate, the long end reflects the lack of appetite to take on long-dated South African government risk. Given that South Africa has managed its existing debt well and is not very exposed to US dollar liabilities, we think the possibility of a local currency default is unlikely. As a hold-to-maturity investor, the only downside we can see is the risk of inflation reaching double digits for a meaningful time over the coming decade. In our opinion, with the current South African Reserve Bank leadership in place, this is a fairly low probability risk.

We also cut our put protection and raised our global equity weighting as markets fell. Our view was that the significant support offered by developed market governments would allow their businesses to survive the lockdown, in contrast to South Africa, where limited resources mean little support for the corporate sector, implying that any domestic bounce back will be marginal at best. And this is how it played out in Q2-20.

While the S&P 500 Index has recovered to close to its all-time high levels, the FTSE/JSE All Share Index, excluding the global companies that happen to be listed in Johannesburg (e.g. Naspers and Prosus), is still down closer to 20%. While we >

were adding to global equities in March and April, we are now cutting exposure. There is a battle between the vast amounts of liquidity provided by global central banks trying to find investment destinations and the reality of a tougher economic outlook, coupled with concerns about how the cost of the relief efforts will ultimately be paid for. For now, the liquidity is winning, but the gravitational pull of delivered earnings will see reality reassert itself over time. We expect some normalisation of ratings on global equities.

A DISRUPTED SECTOR

Listed property has been the economic 'ground zero' of the global lockdowns. Behavioural changes and shelter-in-place instructions have a large impact on retail centres and office blocks. While it is too soon to tell when life will return to normal, and to what extent work-from-home and online purchasing has become the new normal, we can identify some of the likely winners and losers. Property owners with sufficiently strong balance sheets or defensively positioned assets will survive. In Market Plus, we have included small positions in this sector, but very much on a case-by-case basis. This is a sector where more opportunities will present themselves over time, as stressed balance sheets result in distressed selling of quality assets.

TO CONCLUDE

We have reached the halfway mark of the year with the funds down marginally year to date, which we would not have seen as a win at the beginning of the year, but it is undoubtedly better than where we would have expected to be at the end of the first quarter of this year. While the recovery in stock prices has reduced the margin of safety, we are confident in the holdings in our funds, which still show meaningful upside from current levels. ✚

Coronation Market Plus: Highest annual return 50.0% (Aug 2004 - Jul 2005); Lowest annual return (20.1%) (Mar 2008 - Feb 2009)

Coronation Top 20: Highest annual return 68.9% (May 2005 - Apr 2006); Lowest annual return (31.7%) (May 2002 - Apr 2003)

FUND UPDATE

Coronation Strategic Income Fund

By **NISHAN MAHARAJ** *and* **MAURO LONGANO**

Nishan is head of Fixed Interest and has 17 years of investment experience.

Mauro is Head of Fixed Interest Research and a portfolio manager and has nine years of investment industry experience.

THE CORONATION STRATEGIC Income Fund, our managed income fund aimed at investors with a time horizon between one and three years, recovered strongly after the market dislocation in March, returning 4.8% during the second quarter of 2020 (Q2-20). Over one year, the fund returned 4.5%, which is 1.9% behind cash (measured using the STeFI 3-month Index) and over three years, it returned 7.1% per annum, which is 0.3% p.a. ahead of cash.

Domestic income assets continued their roller-coaster ride during Q2-20, with bond prices recovering strongly after the unprecedented sell-off in the first quarter of the year. Shorter-dated bonds performed better than longer-dated bonds due to concerns about the deterioration in government finances. The current yield on the 10-year South African government bond (SAGB) is still high at 9.5%, which represents an elevated risk premium over cash, inflation and bonds issued by other governments around the world.

This reflects the reality that South Africa is on the brink of a debt trap, and although promises have been made to restore the country to a more sustainable debt trajectory, implementation risks remain elevated. However, the valuation of SAGBs does provide some offset to this, implying that local bonds do warrant at least a neutral allocation.

STATE OF PLAY

We expect inflation to remain modest over the next three years, with a forecast annual inflation rate of 3.5% p.a. The South African Reserve Bank has room to reduce rates by a further 50 basis points and is likely to keep rates low over the next 12 to 18 months to support the economic recovery. Our base-case assumptions imply a cash return of 3.35% over the next 12 months.

The rand was stronger, ending June at $1/R17.05. The easing of lockdown measures globally served to buoy risk sentiment and supported emerging market currencies. However, the local fundamental backdrop remains poor. The Fund therefore maintains its healthy exposure to offshore assets and, when valuations are stretched, will hedge/unhedge portions of its exposure back into rands/dollars by selling/buying JSE-traded currency futures (US dollar, UK pound and euro). These instruments are used to adjust the Fund's exposure synthetically, allowing it to maintain its core holdings in offshore assets.

The local listed-property sector was up 18.7% in Q2-20 but is still down 40% over the rolling 12-month period. Despite starting the period with a small allocation, listed property was the largest drag on performance over the past year. We remain cautious about this asset class. The crisis will reduce rental income, put pressure on asset values, increase the cost of borrowing for lower-quality businesses and test inexperienced management teams. This increases balance-sheet risk across the sector. It is entirely possible that many of the companies will require additional capital and that dividends will be suspended to preserve capital. The Fund is invested only in select large-cap counters that satisfy our stringent conditionality.

CAUTIOUSLY POSITIONED

We believe that the Fund's current conservative positioning correctly reflects appropriate levels of caution. We continue to invest only in assets and instruments that we believe have the correct risk and term premium to limit investor downside and enhance yield. The Fund's current yield of around 6% 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. ✚

For a comprehensive review of the local and global bond markets, refer to Bond Outlook on page 24.

Coronation Strategic Income: Highest annual return 18.7% (Nov 2002 - Oct 2003); Lowest annual return 2.0% (Apr 2019 - Mar 2020)

FUND UPDATE

Coronation Global Capital Plus, Global Managed and Global Equity Select funds

By NEIL PADOA, HUMAIRA SURVE *and* LOUIS STASSEN

Neil is Head of Global Developed Markets and has 12 years of investment experience.

Humaira is a portfolio manager with eight years of investment industry experience.

Louis is a founding member of Coronation and a former CIO.

OUR FUND RANGE with a developed market bias includes Global Equity Select and two multi-asset funds – the long-term, growth-oriented Global Managed Fund and the more conservative Global Capital Plus Fund.

As you would expect during a period when markets recovered strongly, the funds performed in line with their risk budgets over the quarter in review, with Global Equity Select, Global Managed and Global Capital Plus producing US dollar returns of 18.4%, 12.3% and 6.5%, respectively.

At quarter-end, Global Managed was positioned in 62% growth assets and 38% more stable, diversifying assets. The growth-asset allocation consists of 53% effective equity exposure and smaller positions in listed property, convertible bonds and high-yield corporate bonds. The more stable part of the portfolio consists of Treasury bills, hedged equity, inflation-protected securities, commodities and investment-grade corporate bonds.

The more conservative Global Capital Plus owned 40% in growth assets, including 22% effective equity exposure and 60% more stable and diversifying assets, including 20% in investment-grade corporate bonds and 13% in Treasury bills.

STREAMING RETURNS

Spotify, which more than doubled in value over the quarter, was the largest single contributor to returns in Global Equity Select and Global Managed. Streaming now accounts for the majority of music industry revenue. While there are now over 300 million paying music streamers globally, music remains extremely under-monetised in our view, given the 3.5 billion smartphones in the world today. Headline subscription prices have not changed much in years and average revenue per user has in fact declined due to family and student discount plans.

Music spending per capita has halved in real terms since 1999. As the largest audio platform outside of China with 130 million paying subscribers and an additional 163 million ad-supported users (compared to Apple Music, which has 60 million to 70 million subscribers), and with a better product and ongoing innovation, Spotify is well placed for long-term growth.

We are also bullish on Spotify's podcast strategy. Terrestrial radio remains a large advertising revenue pool globally and Spotify is trying to disrupt this, acting decisively and investing in leading podcast creation tools, studios and exclusive content from top podcasters such as Joe Rogan.

Since 2015, Spotify has grown its revenue by 37% per annum and we expect strong growth to continue. In the words of co-founder and CEO Daniel Ek, "everything linear dies". As the leading player and innovator in the fast-growing audio streaming market that is led by an exceptional management team, we believe Spotify is well positioned to capitalise on this trend.

Other contributors to returns include long-held positions in Alphabet, Charter Communications, Naspers, UnitedHealth and Bayer.

SMOKE WITHOUT FIRE

Philip Morris International (PMI) was the largest detractor from performance, although with a decline of -2.6% the effect was only marginally negative. PMI is a global tobacco company and the leader in potentially reduced-risk, next-generation products through its IQOS heated tobacco franchise. IQOS is already contributing c.20% to company revenues. PMI has invested significantly in the IQOS franchise over a sustained period and has first-mover advantage in the heated tobacco category. IQOS has been a phenomenal success in our view, ranging from truly extraordinary results in Japan to solid, steady progress across many European markets.

To date, c.11 million smokers have completely quit smoking combustible cigarettes and moved to IQOS. At the time of writing, the US Food and Drug Administration has just authorised IQOS to be sold in the US with a reduced risk exposure claim.

As IQOS grows, it is accretive to PMI's revenues and profits, and there is still a long runway of growth for IQOS globally. Despite the resilience of tobacco as a consumer category, PMI has not been immune to Covid-19 lockdowns. PMI has been negatively impacted by lost duty-free sales, lockdowns and temporarily slower IQOS user conversion.

We expect that over the medium term these lost sales should be recovered and that IQOS should fairly quickly resume its growth trajectory. PMI remains a top 10 holding.

THE WHEAT FROM THE CHAFF

Last quarter, we felt there were attractive opportunities for those investors with a long time horizon and the ability to filter companies whose prices had been dislocated with little impact to their sustainable earnings power. After a sharp rally, these opportunities are now harder to find.

In addition, the need to reassess the prospects of many businesses continues as investors assess fundamental virus-induced behavioural changes versus short-term noise. Fundamental changes, however, play to the strengths of fundamental investors, and we continue to find a select number of stocks with attractive long-term prospects that are reasonably priced, while appropriately managing exposures across a range of asset classes.

Thank you for your continued support and interest in the funds. ✚

Coronation Global Capital Plus: Highest annual return 17.1% (Jul 2010 - Jun 2011); Lowest annual return (7.4%) (Sep 2014 - Aug 2015)

Coronation Global Managed: Highest annual return 23.4% (Jan 2019 - Dec 2019); Lowest annual return (14.4%) (Mar 2015 - Feb 2016)

Coronation Global Equity Select: Highest annual return 37.1% (Jan 2019 – Dec 2019); Lowest annual return (20.4%) (Jan 2018 - Dec 2018)

FUND UPDATE

Coronation Optimum Growth and Global Emerging Markets Flexible funds

By **GAVIN JOUBERT, SUHAIL SULEMAN, MARC TALPERT** *and* **LISA HAAKMAN**

Head of Global Emerging Markets, Gavin has 21 years' experience as an investment analyst and portfolio manager.

Suhail is a global emerging markets portfolio manager with 18 years of investment experience.

Marc is a global emerging markets portfolio manager with six years of investment experience.

Lisa is a global emerging markets portfolio manager with 14 years of investment experience.

OPTIMUM GROWTH IS an unconstrained worldwide flexible fund, aiming to meaningfully grow wealth for long-term investors. The Fund appreciated by 13.4% in the second quarter of 2020 (Q2-20), bringing the year-to-date return to 18.7%, which is more than 10% ahead of benchmark. Over the past decade, the Fund returned 16.9% p.a. The Global Emerging Markets (GEM) Flexible Fund aims to give investors access to the best equity opportunities in emerging markets. The Fund returned 16.6% during Q2-20, which is 1.8% ahead of benchmark. Since inception 13 years ago, it outperformed the benchmark by 2% p.a.

GROWTH AND PROTECTION

Optimum Growth ended Q2-20 with 70% net equity exposure, similar to its position at the end of March, but with a higher weighting towards emerging markets, which have lagged the developed market equity rally. Approximately 51% of the equity exposure was invested in developed market equities (54% in Q1-20) and 49% in emerging market equities (46% in Q1-20). Our negative view on global bonds remains unchanged, as a large portion of developed market sovereign bonds offer negative yields to maturity, with the follow-on effect that most corporate bonds also offer yields that do not compensate for the risk undertaken. Only 1.2% of the Fund is invested in bonds. It also has c.3.5% invested in global property, largely Vonovia (German residential) and Unibail (European and US retail property). Lastly, the Fund has a physical gold position of 2.6%, along with a 0.8% holding in Barrick Gold Corporation, the largest gold miner globally, both of which have been reduced marginally during the quarter.

>

The balance is invested in cash, largely offshore. As has been the case for many years, the bulk of the Fund (over 90%) is invested offshore, with very little exposure to South Africa.

The largest positive contributors in Q2-20 were Spotify (+104%, 1.5% positive impact), Mercado Libre (+96%, 1.1% positive impact) and JD.com (+44%, 0.8% positive impact). The Fund's put-option positions, which provided valuable protection in Q1-20, detracted 1.8% from performance in Q2-20. These put options continue to provide protection should there be a market sell-off.

ENHANCING POSITIONS

We built new positions in the Optimum Growth portfolio in Linde PLC, Roche and Mercari.

Linde PLC

Linde PLC is the largest industrial gas business in the world (20% market share), with extensive geographic and industry diversification. The business owns hard-to-replicate assets given their geographic location, which is key when selling a commodity that can be prohibitively expensive to transport. The company's revenue is generated via sales to large customers, often with a long-term contract; medium-sized captive customers with associated offtake agreements; and smaller customers that have cylinders associated to the sale which are rented, providing an incentive for repeat usage and refill.

Ultimately, this creates a business with a large portion of annuity revenue that we believe can steadily grow and compound over time. The business is a function of the merger of Linde and Praxair in 2017/2018, with expected post-merger synergies resulting in free cash flow increasing by a third. The CEO of the combined entity has an exceptional track record of running Praxair for 12 years prior to the merger; this provides further credibility to the synergy numbers.

Roche

Roche is a global innovative pharmaceutical company with a dominant position in a strongly growing oncology market. The company has a promising pipeline of drugs in addition to its current offering, which should protect it from generic price erosion. Roche has an extreme focus on research and development, and consistently outspends its peers in this regard, which has supported consistent innovative drug discovery.

The business trades on 16 times forward earnings, which should be resilient in the current environment; a starting dividend yield of just under 3%; and an expected mid-single-digit earnings growth profile that should result in a low double-digit total shareholder return.

RISING SUN

Founded in 2013, Mercari is a Japanese business which has a dominant online used goods consumer-to-consumer (C2C) marketplace and a growing payment business. The company also has a fast-growing US online C2C marketplace business. The Japanese C2C business has nearly 17 million monthly active users, up from 13 million a year ago, and is still rapidly growing, as used goods commerce continues to gain traction in Japan.

The payment business operates in a highly competitive but lucrative market, as Japan currently significantly lags the developed world in cashless penetration (currently just over 20% versus its developed market peers well north of 50%, depending on the market). Management has laid important strategic building blocks via alliances to improve the competitive positioning of the payment business. Its most notable alliance here is with NTT DoCoMo, the biggest mobile operator in Japan, with a 40% market share.

The used-goods C2C business is well understood, but very little credit is being given to the potential success of the payment business. We think the Japanese C2C business can continue to grow its revenue in excess of 20% over the next few years, with margins continually increasing due to the high incremental margins associated with a marketplace business. This should lead to both earnings and free cash flow growth in excess of this revenue growth rate. Outside of this, we believe that both the Japanese payment business and the US used-goods marketplace should reduce losses significantly as they move from investment phase into monetisation phase.

We are now just over seven months into the Covid-19 pandemic, yet there still remain many unknowns as to its ultimate duration, how governments will respond and what permanent consumer behaviours will manifest post the pandemic. However, against this backdrop, we feel that the Optimum Growth Fund has been built bottom-up and we have ensured adequate diversification without taking a strong thematic portfolio view on hard-to-predict future trends.

LOOK TO THE EAST

The largest contributors to the GEM Flexible Fund's return in Q2-20 were Chinese premium baijiu company, Wuliangye Yibin, Latin American e-commerce and payments company, Mercado Libre, the number two e-commerce retailer in

China, JD.com, the second-largest food retailer in Russia, Magnit, and the top search-engine operator in Russia, Yandex. Philip Morris was the largest detractor. We sold small positions in KB Financial (Korean bank) and Hero MotoCorp (Indian motorbike manufacturer), and reduced the position in 58.com materially (leading online classified business in China). We introduced a small position in Hong Kong Exchanges & Clearing (HKEx), which is the monopoly stock exchange operator in Hong Kong.

The HKEx is effectively a gateway to China, as 70% of the Hong Kong market is made up of Chinese businesses. Stock exchanges are generally very good businesses in our view, and the HKEx is right up there among the best, as its monopoly gives it pricing power and resultant high margins (earnings before interest and tax margins are around 67%, which are among the highest margins for an exchange globally). The HKEx trades on a c.3.5% 2021 free cash flow yield, which we think is attractive, given the quality of this asset and the expected free cash flow growth of c.15% p.a. over the next few years.

Coronavirus has naturally had an impact on all businesses globally. In some cases, this is likely to only be a short- to medium-term impact, but in other cases a long-term impact will be felt as well. For most businesses, the impact has been/ will be negative, to varying degrees. One clear exception to this is e-commerce, where there has been a positive impact, largely as a result of increased use of e-commerce by consumers (for obvious reasons), resulting in an acceleration of e-commerce penetration.

This acceleration has resulted in higher earnings and free cash flow generation in the nearer term which, in turn, will result in higher fair values for these businesses due to the time value of money (near-term free cash flow is worth more than free cash flow further out).

The GEM Flexible Fund has a number of investments in emerging market e-commerce assets, including 4.4% in Alibaba and 3.9% in JD.com (the no. 1 and no. 2 e-commerce businesses in China, respectively), and a smaller 1.4% position in Mercado Libre (effectively the Amazon of Latin America).

POSITIVE ON CHINA

While the fall in markets globally in March was very quick and severe, so too has been the rebound over the past few months. The world, and emerging markets, are by no means out of the woods, even if global equity markets seem to be behaving as such. We expect difficult times ahead in a number of emerging markets, particularly those with poor country balance sheets and weak economies, such as South Africa and Brazil, and we have been very selective with stock selection in these countries.

China is emerging as one of the better-off countries – partly because it was 'first-in' with Covid-19, partly because the country locked down hard and early, and partly because the underlying economy was reasonably strong pre-coronavirus and has attractive fundamentals. 34% of GEM Flexible is invested in China (39% if one includes Naspers, whose largest asset [c.80% of our Naspers valuation] is its stake in Tencent). A large part of the Chinese exposure is in internet businesses that have structural growth drivers and which have continued to grow, even through the coronavirus-affected period (Tencent [through Naspers and Prosus], Alibaba, JD.com, NetEase and Tencent Music Entertainment), as well as in selected assets in other attractive industries where penetration rates are low, including premium branded spirits (Wuliangye Yibin), insurance (Ping An) and education (New Oriental Education).

ONLINE IS KING

India is the second-largest country exposure (9.7% of GEM Flexible), with 6% of this being invested in financials (Housing Development Finance Corporation [HDFC] and HDFC Bank). While India is suffering economically because of the country's hard lockdown, we believe that both HDFC and HDFC Bank, while also clearly being impacted, will take market share from weaker players and emerge even stronger at the other end. 1.9% of the Fund is invested in two Indian IT services companies (Tata Consultancy and Infosys). Russia is the third-largest exposure by country (10%), with four investments – no. 1 and no. 2 food retailers, X5 Retail and Magnit (a combined 5% position), Yandex (first in search, with various other assets, including taxi-ride hailing, food delivery, e-commerce and online classified advertising; a 2.8% position), and Sberbank (1.8%). ✚

Coronation Optimum Growth: Highest annual return 51.1% (Jan 2013 - Dec 2013); Lowest annual return (31.5%) (Mar 2008 - Feb 2009)

Coronation Global Emerging Markets Flexible: Highest annual return 49.7% (Mar 2009 - Feb 2010); Lowest annual return (37.5%) (Mar 2008 - Feb 2009)

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	96.6% 3.4%	57.4% 42.6%	47.2% 52.8%	28.3% 71.7%	0.2% 99.8%
LAUNCH DATE	Jul 2001	Feb 2007	Jul 2001	Apr 1996	Oct 2000
ANNUAL RETURN[2] (Since launch)	10.0% 7.7%†	8.9% 5.7%†	11.1% 5.7%†	13.6% 12.7%†	16.4% 12.7%†
QUARTILE RANK (Since launch)	1st	1st	1st	1st	1st
ANNUAL RETURN (Last 10 years)	8.4% 6.2%†	9.0% 5.0%†	7.9% 5.0%†	9.9% 11.4%†	10.7% 10.6%†
STANDARD DEVIATION (Last 10 years)	2.1% 0.2%†	5.4% 1.3%†	6.8% 1.3%†	9.2% 8.7%†	14.0% 13.8%†
FUND HIGHLIGHTS	The fund remains the top performing fund in its category since launch in 2001 and outperformed cash by 2.3% over this period.	Outperformed inflation by 3.2% p.a. (after fees) since launch, while producing positive returns over 12 months more than 99% of the time.	The fund remains the top performing fund in its category since launch in 2001 and outperformed inflation by 5.4% p.a. (after fees) over this period.	No. 1 balanced fund in South Africa since launch in 1996, outperforming its average competitor by 1.8% p.a. Outperformed inflation by on average 7.5% 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 R100 000 invested in Top 20 at launch in Oct 2000 grew to more than R1.9 million by end-June 2020. The fund is a top quartile performer since launch.

[1] *Income versus growth assets as at 30 June 2020. Growth assets defined as equities, listed property and commodities (excluding gold).*

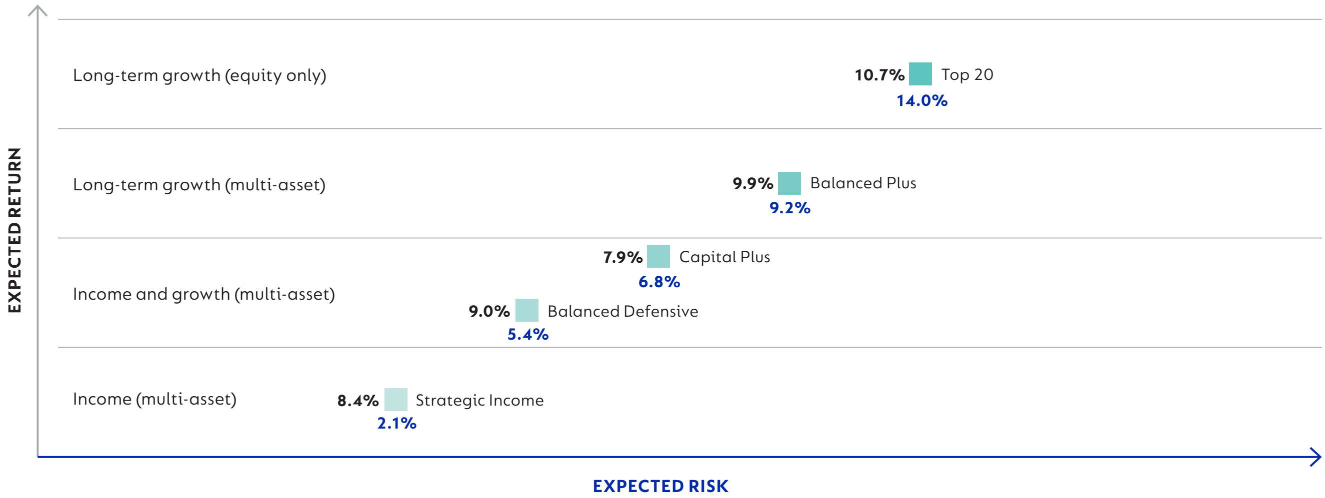
[2] *Highest annual return*
Balanced Defensive: 21.2% (Jun 2012 - May 2013); Balanced Plus: 49.3% (Aug 2004 - Jul 2005); Capital Plus: 33.8% (Aug 2004 - Jul 2005); Strategic Income: 18.7% (Nov 2002 - Oct 2003); Top 20: 68.9% (May 2005 - Apr 2006)

Lowest annual return
Balanced Defensive: -5.8% (Apr 2019 - Mar 2020) ; Balanced Plus: -17.4% (Sep 1997 - Aug 1998); Capital Plus: - 9.3% (Apr 2019 - Mar 2020); Strategic Income: 2% (Apr 2019 - Mar 2020); Top 20: -31.7% (May 2002 - Apr 2003)

Figures are quoted from Morningstar as at 30 June 2020 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

RISK VERSUS RETURN

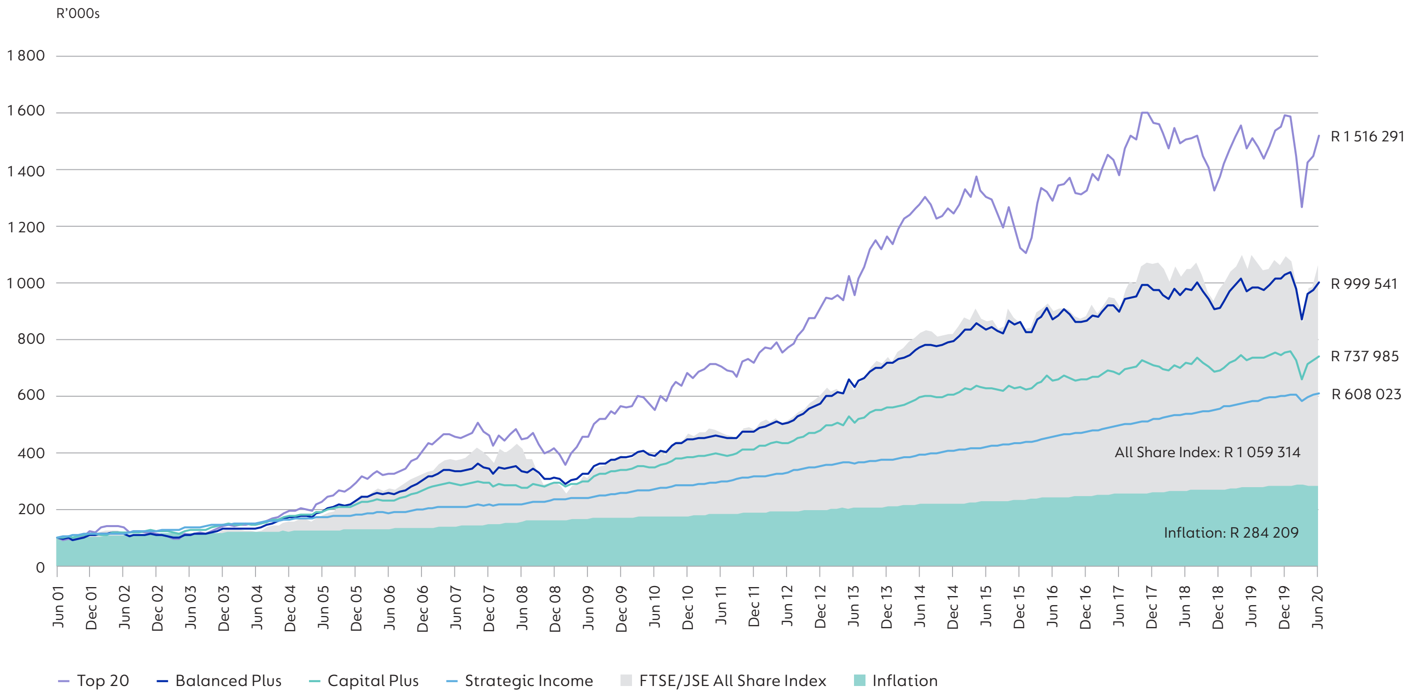
10-year annualised return and risk (standard deviation) quoted as at 30 June 2020.
Figures quoted in ZAR after all income reinvested and all costs deducted.



Source: Morningstar

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

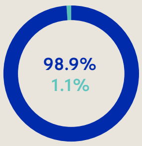
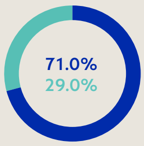
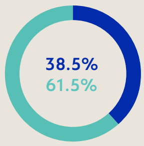
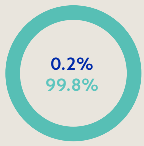
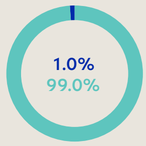
Value of R100 000 invested in Coronation's domestic flagship funds since inception of Capital Plus on 2 July 2001 as at 30 June 2020. All income reinvested for funds; FTSE/JSE All Share Index is on a total return basis. Balanced Defensive is excluded as it was only launched on 1 February 2007.



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					
LAUNCH DATE OF OLDEST FUND	Dec 2011	Nov 2008	Oct 2009	Aug 1997	Dec 2007
ANNUAL RETURN[3] (Since launch)	2.3% 1.0%†	4.7% 0.9%†	5.7% 6.5%†	6.0% 5.8%†	2.7% 0.8%†
QUARTILE RANK (Since launch)	–	1st	2nd	–	1st
ANNUAL RETURN[3] (Last 5 years)	1.5% 1.5%	2.4% 1.5%	2.7% 5.9%	2.0% 6.7%	3.7% 2.9%
ANNUAL RETURN[3] (Last 10 years)	–	3.7% 0.9%	6.4% 7.3%	6.7% 10.2%	4.4% 3.5%
QUARTILE RANK (Last 5 years)	–	1st	2nd	–	2nd
FUND HIGHLIGHTS	Outperformed US dollar cash by 1.3% p.a (after fees) since launch in December 2011.	The fund has outperformed US dollar cash by 3.8% p.a. (after fees) since launch in 2008.	No. 1 global multi-asset high-equity fund in South Africa since launch in October 2009.	The fund seeks to give investors access to some of the best fund managers across the globe.	Both the rand and dollar versions of the fund have outperformed the MSCI Emerging Markets Index by more than 2.0% 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 30 June 2020 (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); Global Equity Select: 37.1% (Jan 2019 - Dec 2019)

Lowest annual return
Global Strategic USD Income: -2.0% (Apr 2019 -Mar 2020); 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); Global Equity Select: -20.4% (Jan 2018 - Dec 2018)

Figures are quoted from Morningstar as at 30 June 2020 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

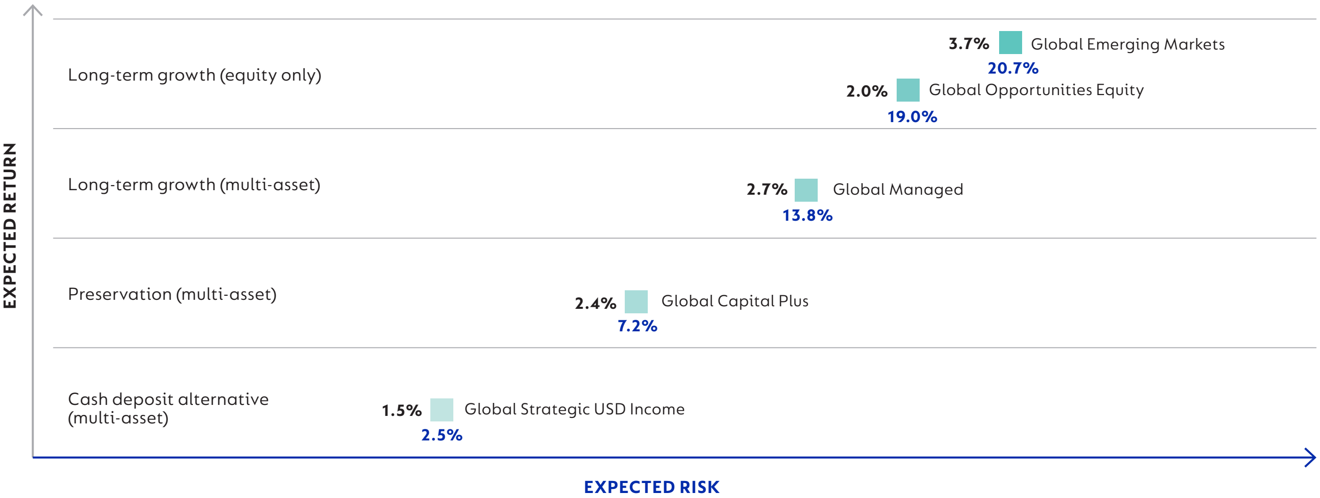
HAVE YOU CONSIDERED EXTERNALISING RANDS? IT IS EASIER THAN YOU MIGHT THINK.

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

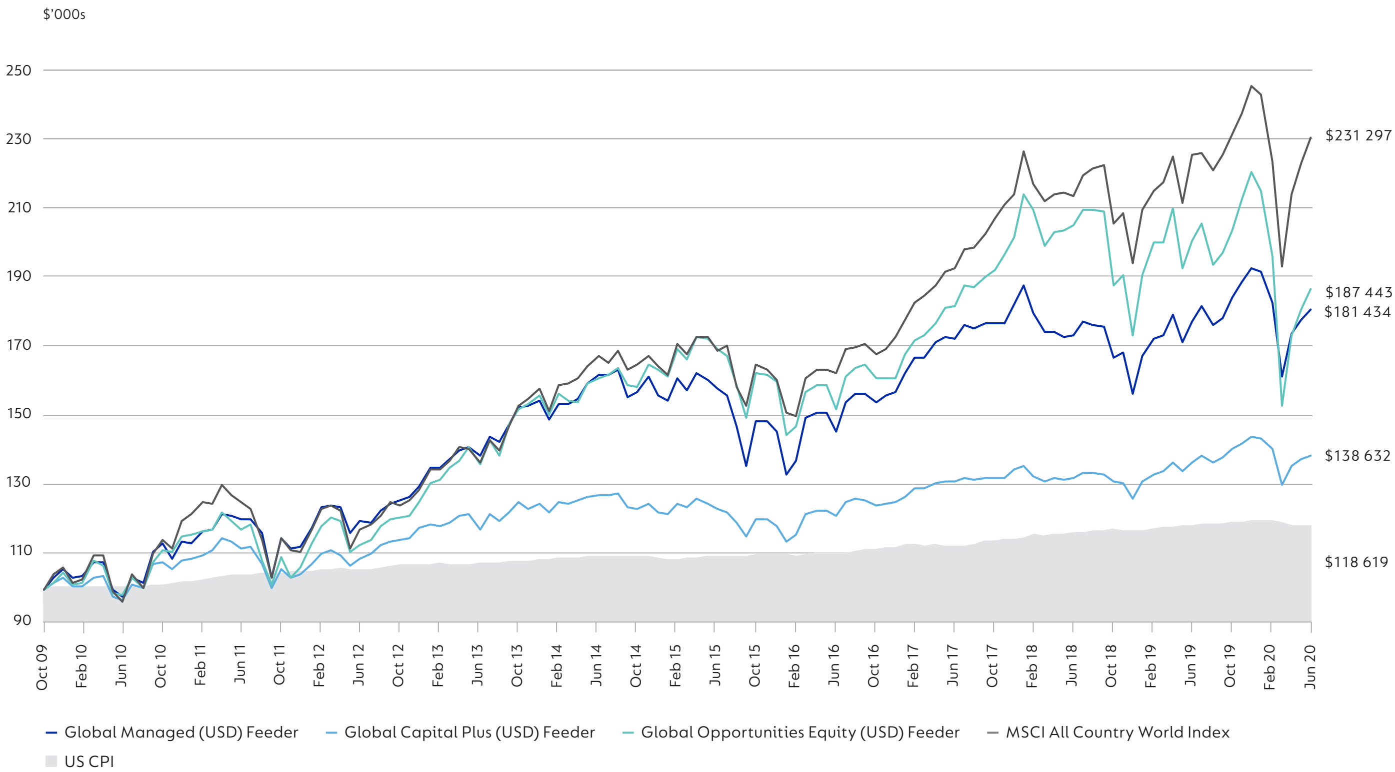
5-year annualised return and risk (standard deviation) quoted as at 30 June 2020. Figures quoted in USD (for the oldest fund) after all income reinvested and all costs deducted.



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.



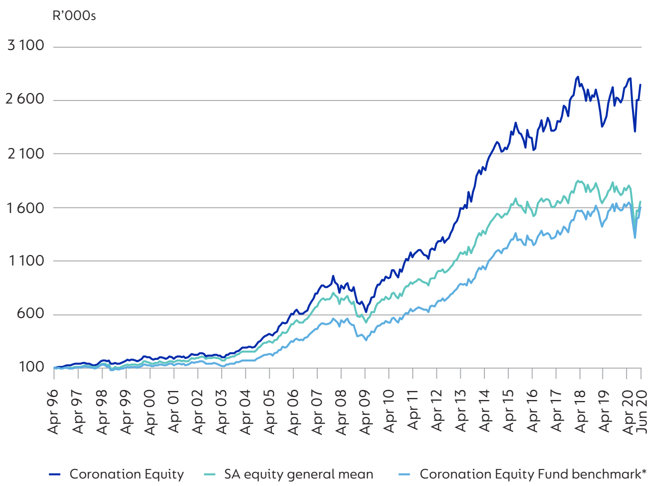
Source: Morningstar

Long-term investment track record

CORONATION EQUITY RETURNS[1] VS AVERAGE COMPETITOR[2]

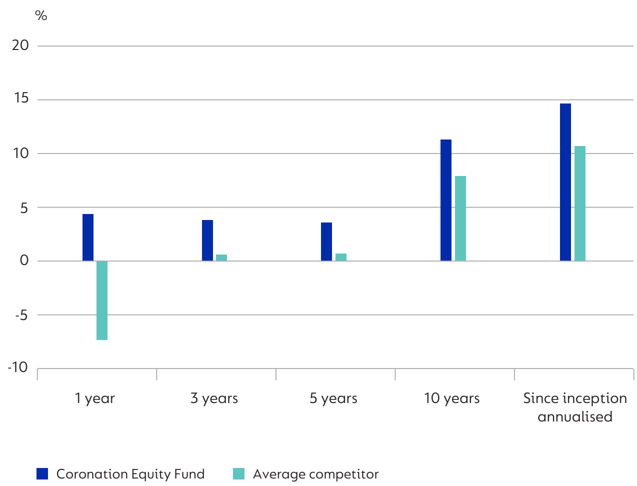
10-YEAR ANNUALISED RETURNS	CORONATION EQUITY	AVERAGE COMPETITOR	OUTPERFORMANCE OF AVERAGE COMPETITOR
2006	19.38%	17.09%	2.30%
2007	21.45%	19.23%	2.22%
2008	17.62%	18.47%	(0.84%)
2009	16.53%	16.68%	(0.15%)
2010	19.59%	19.14%	0.45%
2011	18.03%	16.98%	1.05%
2012	21.12%	18.94%	2.19%
2013	21.60%	18.68%	2.92%
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%
2019	11.35%	8.71%	2.63%
9 Years 6 Months to June 2020	9.30%	6.31%	2.99%
ANNUALISED TO 30 JUNE 2020	**CORONATION EQUITY**	**AVERAGE COMPETITOR**	**ALPHA**
1 year	4.38%	(7.32%)	11.70%
3 years	3.85%	0.62%	3.23%
5 years	3.63%	0.65%	2.98%
10 years	11.27%	7.91%	3.36%
Since inception in April 1996 annualised	14.69%	10.70%	3.99%
Average outperformance per 10-year return			1.86%
Number of 10-year periods outperformed			13.00
Number of 10-year periods underperformed			2.00

CUMULATIVE PERFORMANCE



Source: Morningstar

ANNUALISED RETURNS TO 30 JUNE 2020



Source: Morningstar

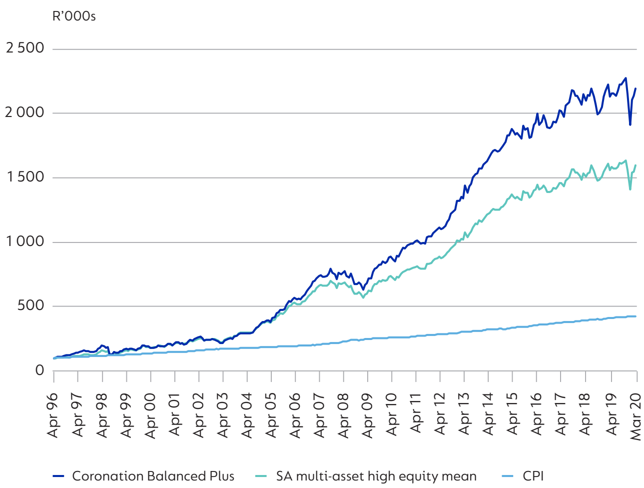
An investment of R100 000 in Coronation Equity on 15 April 1996 would have grown to **R2 744 975** by 30 June 2020. By comparison, the returns generated by the fund's benchmark over the same period would have grown a similar investment to **R1 604 644**, while the South African equity general sector would have grown a similar investment to **R1 658 555**.

[1] Highest annual return 62.5% Aug 2004 - Jul 2005; Lowest annual return (28.7%) Mar 2008 - Feb 2009
[2] Average of performance of the South African - Equity - General category, ex-Coronation Funds

CORONATION BALANCED PLUS FUND VS INFLATION AND AVERAGE COMPETITOR[1]

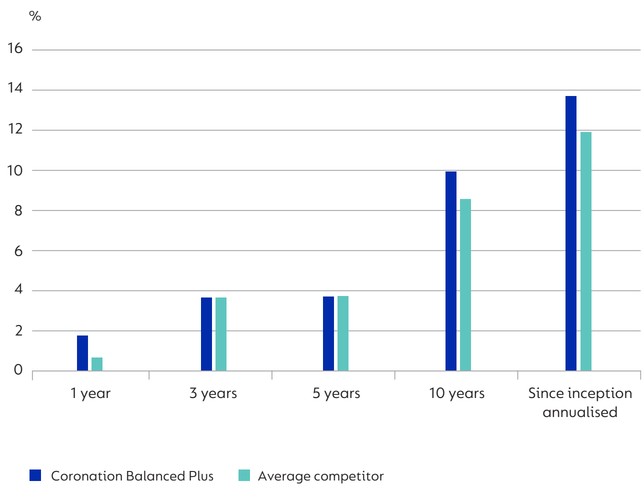
10-YEAR ANNUALISED RETURNS	CORONATION BALANCED PLUS	INFLATION	REAL RETURN
2006	18.33%	6.47%	11.86%
2007	17.81%	6.59%	11.22%
2008	16.96%	6.87%	10.09%
2009	15.69%	6.75%	8.94%
2010	17.20%	6.28%	10.93%
2011	15.78%	6.24%	9.54%
2012	17.85%	5.76%	12.09%
2013	18.63%	5.90%	12.73%
2014	16.58%	6.00%	10.57%
2015	14.01%	6.12%	7.89%
2016	11.08%	6.30%	4.77%
2017	11.04%	5.92%	5.12%
2018	11.26%	5.34%	5.92%
2019	10.30%	5.12%	5.18%
9 Years 6 Months to June 2020	8.88%	5.11%	3.77%
ANNUALISED TO 30 JUNE 2020	**CORONATION BALANCED PLUS**	**AVERAGE COMPETITOR**	**ALPHA**
1 year	1.74%	0.61%	1.13%
3 years	3.61%	3.60%	0.01%
5 years	3.68%	3.71%	(0.04%)
10 years	9.91%	8.54%	1.37%
Since inception in April 1996 annualised	13.63%	11.86%	1.77%
Average 10-year real return			8.71%
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%			6.00
Number of 10-year periods where the real return is 0% - 5%			2.00

CUMULATIVE PERFORMANCE



Source: Morningstar

ANNUALISED RETURNS TO 30 JUNE 2020



Source: Morningstar

An investment of R100 000 in Coronation Balanced Plus on 15 April 1996 would have grown to **R2 195 122** by 30 June 2020. By comparison, the South African multi-asset high-equity sector over the same period would have grown a similar investment to **R1 595 274**.

[1] *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.*


Unity.
Humanity.
Determination.
Resilience.