FUND UPDATE

Coronation Strategic Income Fund

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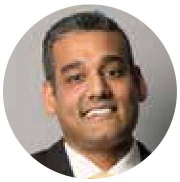

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THE FUND RETURNED 0.20% in March, bringing its 12-month total return to 6.29%. This return is ahead of cash (3.64%) and that of its benchmark (4.01%).

The first quarter of 2022 (Q1-22) saw a significant increase in financial market volatility. Global inflation expectations for this year have more than doubled from a year ago (5.1% currently from 2.1% previously), while expectations for growth have moderated (4% current from 4.6% previously). US monetary policy is now expected to move into restrictive territory, with the Federal Reserve Board (the Fed) funds rate anticipated to end 2022 at 3.1%. Looking ahead, the Fed is expected to hike in increments of 0.5% (previously 0.25%) for at least the next two meetings of this year. Russia's invasion of Ukraine has placed risk on tenterhooks, while fanning concerns about global stagflation on the back of the resultant surging oil and other commodity prices. The hangover from Covid-19 and its many variants had already rendered economic outcomes relatively uncertain, and current geopolitical dynamics have only served to further muddy the outlook and perplex investors.

South Africa (SA) has proved to be the prettiest among its ugly siblings. In Q1-22, the rand has appreciated 9.15% against the US dollar (only outdone by the Brazilian real), ending the quarter at R14.61/$1. The terms of trade boost (higher export prices relative to import prices) on the back of higher commodity prices has been the primary driver of the rand's outperformance. SA government bonds (SAGBs) returned 1.86% over the quarter (as measured by the FTSE/JSE All Bond Index), ahead of cash (0.93%) and inflation-linked bonds (0.31%). Over the last 12 months, SAGBs have returned an impressive, 12.37%, well ahead of cash (3.64%) and inflation-linked bonds (10.76%). This outperformance has been driven by a flattening of the yield curve, that saw bonds with a maturity of 12 years returning 17.77% over the last year. The combination of rand appreciation and bond returns has made SAGBs the best performer in the global bond universe, well ahead of global bond indices, which have been dragged into negative territory due to the sell-off in US bond yields.

March was dominated by central bank meetings, with the majority hiking policy rates in response to high inflation. The impact of the recent spike in energy prices is yet to be seen in the coming months' inflation readings and many central banks have indicated to be ready to intervene, where appropriate, to help stabilise inflation.

In the US, the Fed hiked the target range for the federal funds rate by 25 basis points (bps); moving the range to 0.25% - 0.5% at the last monetary policy committee (MPC) meeting. The Fed commented that it is aware of the heightened inflationary pressure and stands to intervene, where appropriate, and even alluded to implementing a 50bps rate hike should the need arise. The Fed assesses the US economy to be in a strong position and well placed to handle tighter monetary policy.

US headline inflation rose to 7.9% year on year (y/y) in February versus 7.5% y/y in January. Core inflation increased to 6.4% y/y in February from 6.0% y/y in January. Rising energy prices continue being the main contributor to the inflation uptick. Food and vehicle prices also increased over the month of February. Prices were already on an upward trend but the recent developments relating to the Russia-Ukraine war, coupled with ongoing supply constraints, strong demand and labour shortages, will likely lead to inflation being elevated in the medium term.

In terms of emerging markets, countries across the globe continue to impose sanctions on Russia, with energy sector sanctions implemented by the US, while Europe has signalled the possibility of implementing sanctions on this sector. While Russia and Ukraine have engaged in talks that could lead to the end of the war, the situation remains fluid and its impact on the global economy is yet to be assessed.

The rand ended the month at R14.61/US$1. The cyclical tailwinds from strong commodity prices and a turn in risk sentiment, helped the local currency outperform most of its emerging market peers. Since the beginning of the year, the rand has appreciated 9.15% versus the US dollar, making it slightly overvalued relative to long-term metrics. Recent geopolitical tensions and global monetary policy normalisation will continue to weigh on risk appetite as global liquidity reduces in the face of elevated inflation. When valuations are stretched, the Fund will hedge/unhedge portions of its exposure back into rands/dollars by selling/buying JSE-traded currency futures (US dollars, UK pounds and euros). These instruments are used to adjust the Fund's exposure synthetically, allowing it to maintain its core holdings in offshore assets.

In SA, headline inflation slowed temporarily to 5.7% y/y in January from 5.9% y/y in December. Core inflation increased to 3.5% y/y in January from 3.4% y/y in December. The moderation in inflation came from falling fuel prices, but the sharp reversal since then is likely to push headline inflation materially higher, with a breach of the target for several months now likely.

The domestic economy grew by 1.2% quarter on quarter (q/q) in the fourth quarter of 2021 (Q4-21) from a revised contraction of 1.7% q/q in the third quarter of 2021. Overall, the economy grew by 4.9% in 2021 from a contraction of 6.4% in 2020. Household expenditure contributed the most to Q4-21 GDP growth due to an improvement in household income growth and easing of lockdown restrictions towards the end of 2021. Other growth contributions came from an increase in gross fixed capital formation, while government expenditure remained muted and net exports were negative. Looking ahead, the heightened global uncertainty will affect domestic growth; however, the impact may be nuanced – the rising price of commodity prices, especially food and fuel will undermine real incomes and put pressure on consumer spending. We also expect the South African Reserve Bank (SARB) to continue steadily raising interest rates in response to higher inflation and for electricity availability to remain a constraint to growth and confidence.

The SARB increased the repo rate by 25bps to 4.25% at the March MPC meeting. The vote was mixed, with three committee members voting for a 25bps hike and two members voting for a 50bps hike. The move to increase rates reflects concerns about the upside risk to the local inflation outlook, rising global inflation exacerbated by the war in Ukraine, and the increase in less accommodative monetary policy settings globally. The SARB also revised its inflation forecast upward to reflect the short-term upward price pressure associated with rising fuel prices, increasing food inflation and global price pressures. Average inflation is now expected to rise to 5.1% in 2022 from a previous forecast of 4.8%.

Headline inflation for February was unchanged from 5.7% y/y reported in January. Core inflation also remained unchanged at 3.5% y/y. The moderation in inflation over the month came from softer price increases for transport, food and household utilities.

At the end of March, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 7.51% (three-year) and 8.21% (five-year), significantly higher than the close at the end of the previous month. The recent move higher was in sympathy with bond yields, expectations for higher inflation given the move higher in global commodity prices and more aggressive SARB interest rate tightening. Our inflation expectations suggest that current pricing of these instruments remains attractive due to their lower modified duration and, hence, high breakeven relative to cash. In addition, NCDs have the added benefit

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of being liquid, thus aligning the Fund's liquidity with the needs of its investors. The Fund continues to hold decent exposure to these instruments (fewer floating than fixed), but we will remain cautious and selective when increasing exposure.

Geopolitical tensions have increased the risk of higher global inflation and a faster normalisation in global monetary policy. SA has benefited from a significant terms of trade boost that provides more breathing room for the fiscus but will place pressure on the SARB to normalise rates at a pace similar to that of global central banks. SAGBs still trade at historically high yields and are elevated compared to their emerging market counterparts. The current market pricing of interest rate normalisation in SA also suggests that the embedded inflation premium in bond yields remain excessive and yields have a significant risk buffer to absorb higher local inflation and higher US bond yields. We continue to advocate long duration positions that are focused in the 10-year area of the yield curve.

The local listed property sector was up 4.40% over the month, bringing its 12-month return to 26.25%. The balance sheet concerns in the sector have subsided, as companies have managed to introduce dividend payout ratios (with some withholding dividends entirely) and selling off assets in order to recapitalise themselves. Going forward, operational performance will remain in the spotlight as an indicator of the pace and depth of the sector's recovery. We believe that one must remain cautious, given the high levels of uncertainty around the strength and durability of the local recovery. However, certain counters are showing value, given their unique capital structures and earnings potential. These counters remain a core holding within the Fund.

The FTSE/JSE Preference Share Index was up 7.25% over the month, bringing its 12-month return to 53.33%. The most recent performance has been bolstered by the banks announcing their intent to repurchase a significant portion of their outstanding preference shares. Preference shares offer a steady dividend yield linked to the prime rate and, depending on the risk profile of the issuer, currently yield between 8% and 10% (subject to a 20% Dividends Tax, depending on the investor entity). The change in capital structure requirements mandated by Basel III will discourage banks from issuing preference shares, which will limit availability. Due to the reduced liquidity in this asset class and other instruments, at the same point in the capital structure, trading at more attractive valuations, the Fund will not look to increase its holdings and will maintain its current small exposure to specific corporate preference shares.

We remain vigilant of the risks emanating from the dislocations between stretched valuations and the local economy's underlying fundamentals. However, we believe that the Fund's current positioning correctly reflects appropriate levels of caution. The Fund's yield of 7.36% 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.

As is evident, we remain cautious in our management of the Fund. 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. +