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The Personal Investments Quarterly

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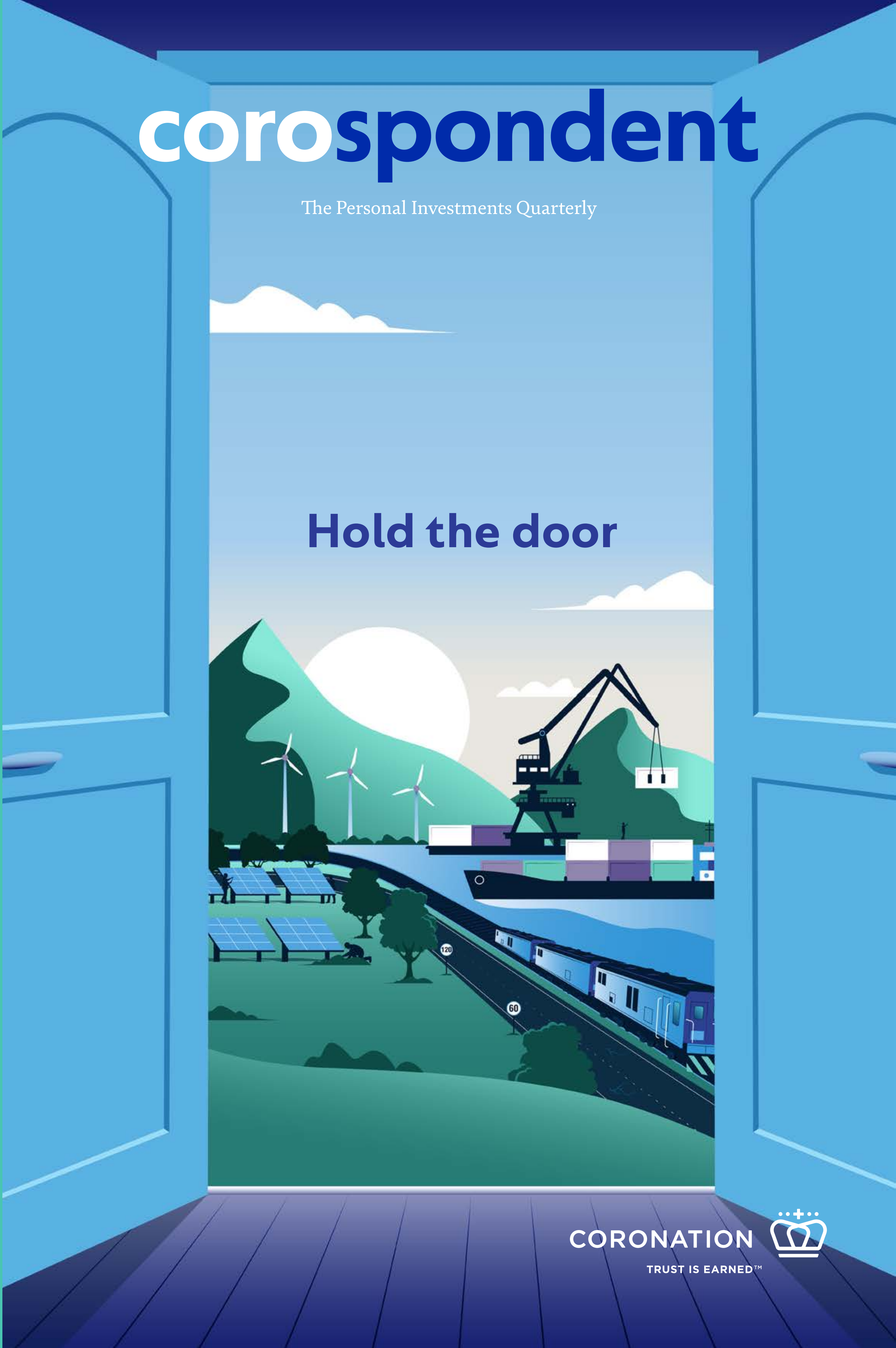

CORONATION

TRUST IS EARNED™

JULY 2021 WINTER EDITION

IN THIS ISSUE

CORONATION FUND UPDATES AND PERFORMANCE

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Notes from my inbox

"Give me accountability, I'll give you peace." – Abhijit Naskar, neuroscientist and author

By **PIETER KOEKEMOER**

Pieter is Head of Personal Investments

EVERY QUARTER WE put a lot of effort into producing *Corospondent*. Its most important purpose is to account to you, as the owners of the capital that you've tasked us with deploying on your behalf. It also documents recent events, our interpretation of these events and how they influence the decisions we make in constructing appropriate portfolios for our investors' diverse needs. If you want to revisit the quality of our current thinking a decade from now, the record is there for review.

When the editorial process for this quarter's edition started in earnest during June, things were looking up. The global economy is booming as lockdowns continue to ease, especially in developed markets, despite nagging concerns about Delta and other SARS-CoV-2 variants. South Africa enjoyed its best terms of trade since the 1980s, fuelled by a commodities boom. The pace of the vaccination rollout continued to increase, with all adults over 35 years of age now able to get their jabs.

As we show on the cover, progress was made on the economic policy front, with unexpected accommodative deregulation of independent power generation, the laying of the groundwork for greater efficiency in the management of our ports and some decisive steps in the fight against corruption. The positive momentum can be summarised by our quarter-end forecast for domestic economic growth in 2021 of 4.9%, as Marie Antelme reports on page 5.

Unfortunately, the storm clouds rolled in a few weeks later. Anarchy erupted in KwaZulu-Natal and parts of Gauteng, in what appears to have been an organised insurrection. The looting and mayhem >

were only brought under control by concerted action taken by local communities who rejected the actions of a few, and were eventually aided by the belated deployment of the defence force.

In the short term, markets have interpreted this as a one-off event that will quickly be brought (and kept) under control. Figure 1 shows selected market movements from 13 July (the worst day of looting) and at the time of writing on 19 July. Whether you look at the exchange rate, the equity market or the share prices of the retailers directly impacted by the events, it's clear that global risk appetite played a much larger role in setting market prices than local events did, however harrowing they were to live through.

Figure 1

MARKET IMPACT OF JULY UNREST

	Month to		Year to
	13 Jul	19 Jul	19 Jul
Rand: US dollar	(3.1%)	(2.0%)	0.8%
Brazilian real: US dollar	(3.8%)	(5.4%)	(1.1%)
South Korean won: US dollar	(1.7%)	(1.9%)	(5.4%)
FTSE/JSE All Share Index	1.3%	(2.1%)	10.8%
MSCI Global Emerging Markets Index	0.8%	(2.0%)	2.4%
Shoprite	(1.5%)	1.0%	12.1%
Dis-Chem	(1.9%)	(0.2%)	52.6%
Woolworths	(3.3%)	0.9%	35.1%

Sources: Bloomberg, IRESS

The long-term implications of these events are still unclear. It certainly dented confidence in government's ability to protect vital infrastructure and other assets, but it may also act as a catalyst for bolder economic reforms and more assertive action against the corrupt. The more government gets out of the way of its citizens and their businesses, the higher economic growth is likely to be. Higher growth is certainly what is needed to avoid the doors slamming shut on a more sustainable and prosperous future for all.

OPTIMUM GROWTH BALLOT SUCCESSFULLY CONCLUDED

To all the investors who participated in the recent ballot to convert the Coronation Optimum Growth Fund to a feeder fund into its new offshore sibling, the Coronation Global Optimum Growth Fund – thanks for the overwhelming support. The investor participation stage of the ballot has now successfully concluded, and the conversion process will be finalised during September, as previously communicated. Other than the change in the Fund's structure and name, all other aspects of its operation, including its investment strategy, the portfolio management team and its typical underlying holdings will remain unchanged.

FRAUD ALERT

We caution clients to be careful in responding to unsolicited invitations to invest with Coronation and other reputable investment companies. Scams spread via WhatsApp, Facebook and other social media channels are on the increase, with multiple fraudsters misrepresenting themselves as acting in the name of Coronation. We will never ask you to complete the investment process by depositing money into bank accounts shared via social media channels. Always remember that offers that sound too good to be true are most likely a scam. If in doubt about the veracity of an approach to you, reach out to our client service team via 0800-22-11-77 or clientservice@coronation.com.

I am also happy to announce that we successfully implemented a new digital verification system during July. This will simplify the new account opening process, as we will, in most cases, not require proof of address or a copy of a bank statement for 'know-your-client' purposes as a result.

ALSO IN THIS EDITION

Responsible stewardship and a sustainable investment approach are increasingly important to many investors. Neville Chester warns that this is a complex topic where a naive, overly simplified approach can have unintended consequences. Nicholas Hops writes about why, for the first time in many years, we are invested in locally listed gold miners, despite the gold price increasing by 50% over the last two years. We also include a synopsis of our research into US health insurers, Anthem and UnitedHealth, in Steven Barber's article. Finally, this issue includes a summary of the quarterly fund commentaries on our flagship funds, for your ease of reference.

As always, I invite you to let us know how we can improve if any aspect of our service to you is not to your satisfaction.

Take care

Pieter

SOUTH AFRICAN ECONOMIC COMMENT

South Africa

Passing breeze or real winds of change?

By **MARIE ANTELME**

THE QUICK TAKE

The global recovery has materially improved SA's near-term growth prospects through significant gains in terms of trade.

The enduring impact depends on how long the tailwinds last and how the reform agenda enables domestic investment.

Recent unrest is a setback. Lost activity, incomes and profitability may carry short- and long-term repercussions.

The fiscal position has improved relative to expectations, but we cannot afford to be careless; the SARB is likely to gradually normalise policy rates as the economy and inflation recover.

Marie is an economist with 21 years' experience as a market economist.

THE GLOBAL RECOVERY is providing a significant tailwind to South Africa's (SA's) growth recovery. Specifically, the rise in the commodity prices of key exports has boosted domestic terms of trade (the amount we earn on our exports relative to what we pay for imports). The way in which this windfall reverberates through the economy, and how durable these gains can become, will depend on the duration of the boost and the economy's ability to reinvest the gains. Once the terms of trade influences start to fade, it will be critical for the domestic reform agenda to have established an enabling environment for investment by easing regulatory constraints and boosting confidence.

The SA economy typically lags global cycles and usually needs a global trade tailwind to help kickstart a domestic recovery:

- An improvement in the terms of trade boosts domestic incomes through higher export earnings.
- The trade and current account improvement lifts growth and is usually accompanied by a stronger currency (and lower inflation).
- Higher nominal growth improves macro balances.
- The trade boost provides an opportunity to build on external momentum and reinforce domestic growth dynamics.
- Negatively, these dynamics tend to be temporary, and capacity constraints may limit the economy's ability to capitalise. Ultimately, as the domestic economy recovers, domestic import demand pushes the current account back into deficit.

We are already seeing aspects of this sequence emerging. The current terms of trade shock is the biggest we've seen in over 40 years. Measured by the >

South African Reserve Bank (SARB), Figure 1 shows SA's terms of trade index, including gold being up 10.4% over the past four quarters and 20% over the past two years. It is unlikely that such momentum will continue. Indeed, most forecasters expect commodity prices to retreat from here, but even accounting for the impact of the recent gain, we will see better economic outcomes.

First, the external balance has improved dramatically. In the first quarter (Q1-21), SA's trade balance reached 8.1% of GDP – the largest since 1988 – and the overall current account posted a surplus of 5.0%. Available trade data for the second quarter (Q2-21) has seen two consecutive monthly record surpluses in April and May, suggesting that the positive tailwinds should blow into the second half of this year. We expect the current account to hold a surplus of about 2% through 2021, and to register a small deficit in 2022, as domestic growth and demand for imports improve.

A closer look at the drivers of GDP shows that the trade influence on the supply side of the economy is also becoming clear. While most sectors saw growth ease a little compared to the fourth quarter of last year (Q4-20), it became better balanced – GDP growth slowed from 5.8% quarter on quarter (q/q), seasonally adjusted annualised (saa) to 4.6% q/q saa, but mining and quarrying output increased at a rate of 18.1% q/q saa in Q1-21 and contributed 1.2 percentage points (ppts) to headline GDP growth. Financial and business services benefited from the overall improvement in broader economic activity, and added 1.5ppts to growth. Transport, manufacturing and trade combined added the remaining 1.4ppts (see Figure 2 for more detail).

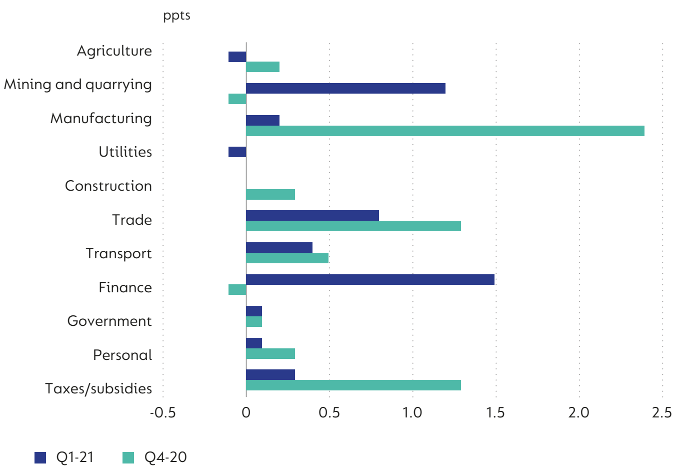
Figure 1

SA'S TERMS OF TRADE, INCLUDING GOLD

Source: South African Reserve Bank

Figure 2

SECTORAL CONTRIBUTIONS TO GDP, QUARTER ON QUARTER



Source: Statistics South Africa

In addition to the impact on GDP growth, improving terms of trade have helped support both compensation and gross operating surplus. While the impact across sectors is lumpy – with parts of the services economy still constrained by the pandemic – there is a modest aggregate recovery in both key metrics, which should gain momentum. Both are important drivers of consumer spending and investment in the longer term.

The impact of recent unrest will disrupt some of these gains. Concentrated in the populous economic heartlands of KwaZulu-Natal and Gauteng, trade lost to looting, the destruction of infrastructure and frozen supply chains will have an impact on incomes, consumption and profitability. At the time of writing, efforts are being made to restore supply and to assess the overall costs. It is unclear how long the disruptions will continue, but the longer it continues, the greater the cost will be.

CYCLICAL OR STRUCTURAL?

We do not expect commodity prices to gain from here, but we also don't expect a material rerating over the coming year or two. Global growth momentum is shifting from China and the US to Europe, and lagging emerging markets should see the recovery build over the next year as vaccine strategies mature. This means that terms of trade could remain elevated, presenting the opportunity for elements of this cyclical swing to become more permanent than transitory.

Importantly for GDP growth, we expect some recovery in household incomes, supported by normalising rates of compensation and boosted by non-salary and dividend contributions in the near term. Available data suggests >

a very uneven income recovery by income group, but initial gains should sustain households' ability to spend.

Secondly, we think investment may start to contribute positively to growth. It is fair to argue that the economy's ability to 'catch' the terms of trade tailwind is considerably less now than in the early 2000s, at the start of the last big commodity boom. At that time, SA's currency entered the period very undervalued after the 2001/2002 crisis, and the economy was coming out of recession with ample electricity to accelerate growth in productive capacity, as well as well-functioning port and rail infrastructure – none of which is present now.

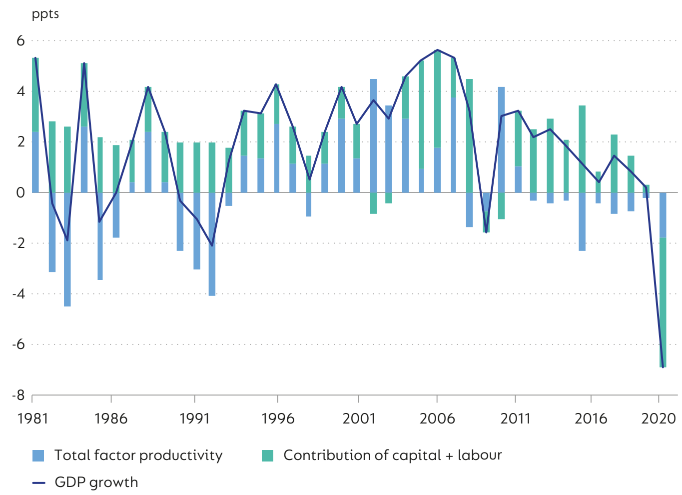
In contrast, we have suffered a prolonged period of weak growth, characterised by slowing investment, reluctant employers, depressed confidence and falling productivity. July's unrest may materially undermine investment in affected areas specifically, and more generally, as confidence in the State's ability to protect infrastructure and assets is shaken. Re-establishing authority to restore confidence is now even more critical.

History shows us that elevated terms of trade tend to have a lagged, but positive, impact on investment, which in turn has a positive impact on employment and productivity gains.

Figure 3 disaggregates GDP growth into the factors of production, namely labour accumulation relative to the inherent stock of labour, capital accumulation (investment) relative to existing capital stock and a residual, total factor productivity, which is the bit of GDP not explained by

Figure 3

FACTORS OF PRODUCTION, CONTRIBUTIONS TO GDP GROWTH



Sources: Coronation, UBS, IMF

these other two dynamics. This is 'magic sauce' that enables economies to grow in excess of their factor endowment. What is interesting and informative about this chart is that it shows that during the last commodity boom through the 2000s, the domestic economy enjoyed a protracted period of strong investment, job creation and a significant positive contribution to growth potential from associated productivity gains. It is also clear that in the intervening period, this has not been the case. For a range of reasons, as investment fell from 26.3% of GDP in 2008 to 15.0% in Q4-20, so too did employment and productivity.

Two critical issues in driving this deterioration were regulatory constraints on energy and other infrastructure, and the impact of politics and economics on business sentiment.

POLICY REFORM – ENERGISED AT LAST?

Reform progress is important and should still have a reinforcing impact on both. The most significant is the lifting of the embedded generation limit for private companies to 100 megawatts (MW), from 10MW. This limit adjustment well exceeded the 50MW hoped for, and has been greeted very positively by industry and business alike. The change is still subject to the Minister of Mineral Resources and Energy, Gwede Mantashe, actually amending the enabling regulation, and uncertainty about what it means for companies with geographically separated entities that will need to 'wheel' electricity across the Eskom grid from one place to another.

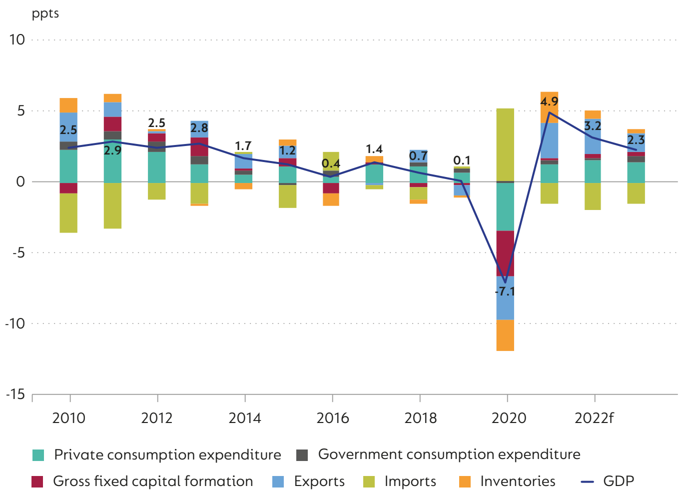
The long period of energy insecurity means many companies have already invested in power generation capacity, which can be expanded quickly. In the mining sector, incremental investment is expected over 12 to 18 months. The change will not materially reduce the risk of loadshedding for an economy still broadly reliant on Eskom and its dickey fleet, but it will increasingly secure energy to the industrial sector, boosting both output and investment.

The other recent change is the 'corporatisation' of the Transnet National Ports Authority (TNPA). While this isn't a new 'regulatory' change – it was embedded in the Ports Act in 2005 – the announcement that it is to be actioned is also significant. It will allow the TNPA to have its own independent board, and for the entity to better allocate revenue to capital expenditure in a way it has been unable to do to date because of complex cross-subsidising within the entity. This should vastly improve transparency and port and transport efficiency, and enhance the capacity to upgrade infrastructure. Taken together (but not limited to these two changes), actioning these reforms creates the capacity for the economy to again see an incremental increase in investment and, with it, employment and productivity gains.

We forecast GDP growth of 4.9% in 2021 and a solid 3.2% in 2022, but acknowledge that there is now some downside risk to these numbers. Nonetheless, we still think a larger contribution to growth from some areas of investment – albeit more a feature of next year's growth outlook and into 2023 – will help buoy real GDP and assist better productivity outcomes than has been the case in the recent past. Figure 4 shows a history and our forecast of GDP contributors out to 2022.

Figure 4

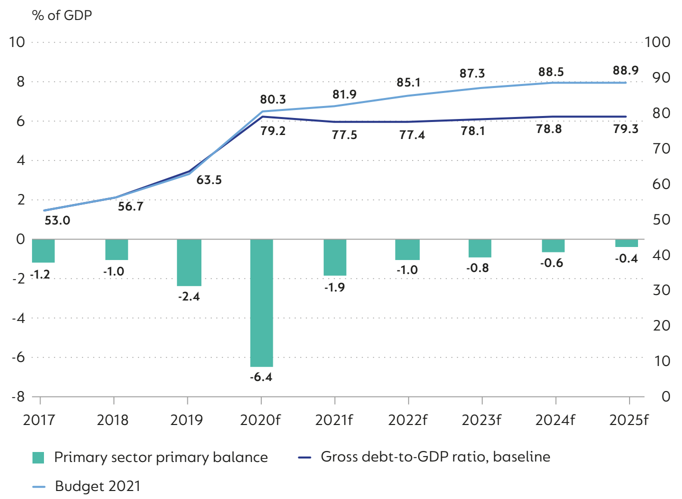
CONTRIBUTIONS TO REAL GDP



Sources: Coronation, Statistics South Africa

Figure 5

SA'S DEBT PROFILE



Sources: National Treasury, Coronation

NOMINAL MATTERS

Another important aspect of this recovery is what it means for nominal growth. Nominal growth is what drives revenues, and it has a meaningful impact on macro balances. The improved terms of trade and better growth prospects should see a material acceleration in nominal GDP growth, because changes in terms of trade reflect changes in the global prices for domestic goods, and they affect GDP inflation.

The first macro balance boost we have discussed already – the current account. However, SA's critical macroeconomic vulnerability lies in its fragile fiscal balance. Following a long period of low growth and expenditure expansion, persistent deficits have led to a massive accumulation of debt, even before the pandemic hit. The rise in nominal GDP, coupled with improved corporate profitability, notably, but not only, from mining, materially improves the revenue outlook. We estimate that relative to the Budget 2021 baseline, the tax windfall should help to raise tax revenue almost 20% year on year (y/y) and reduce the deficit from -11.1% of GDP in 2020/2021 to -6.9% in 2021/2022 (Budget estimate: -9.0%).

Importantly for the debt dynamics, a combined improvement in nominal GDP growth relative to prevailing funding costs (the 'r-g' component of the debt equation), a reduction in the primary deficit from -6.4% of GDP to -2% in our forecast and the valuation effects of the stronger currency on foreign currency-denominated debt stock should help reduce the stock of debt from 79.2% in 2020/2021 to 77.5% in the current fiscal year. Thereafter, the moderation of these debt-stabilising factors in our baseline will see debt rise slowly towards 79.3% in 2025 (Figure 5).

While these fiscal improvements are welcome and, we believe, have aspects of permanence, it is critical to emphasise that they only make SA's fiscal position 'less weak' than expected. Civil unrest has highlighted yet again the desperate economic circumstances of many and the need for ongoing social support. It has also cast the weak position of State security structures into stark relief. Additional funding for both seems likely. The unrest will also have an ultimate impact on taxpayers. This will be a difficult balance for the National Treasury.

The stock of debt, and debt accumulation dynamics, remain precarious and there is limited room to ease the planned consolidation or allocate expenditure carelessly. We believe that government can do more to enforce this improving dynamic, but acknowledge significant political challenges to the implementation of ongoing expenditure cuts. We are also worried that State-owned enterprises and municipalities will need additional financial support in the near term, too. We have made some allocation to this end in the baseline (which is why the debt dynamics remain adverse in the forecast), but this could prove to be too small.

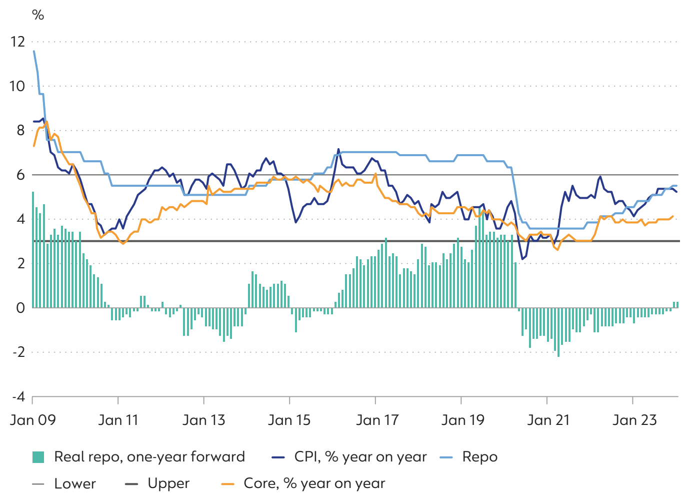
WHAT DOES THIS MEAN FOR INFLATION AND POLICY RATES?

Here, SA is in a relatively strong position. Inflation, which has ticked up mostly on normalising base effects, has not seen uncontained increases in core components or large currency-related price increases as seen elsewhere. Headline inflation accelerated to 5.2% y/y in May as the peak base effect from the collapse in fuel prices in 2020 normalised, and is expected to rise again to 5.4% in July, as Eskom's municipal tariff compounds a rise in food and fuel inflation. Excluding these components, core inflation remains well anchored at 3.1% – just above the bottom limit of the SARB's headline inflation target band.

The SARB has been able to monitor domestic inflation with little consideration for global factors for some years now, but this may not always be the case. A key risk remains rising commodity prices – notably food – where global increases are already putting some pressure on domestic prices. Transport costs, broader input price pressure in the supply chain and the risk that similar 'reopening' bottlenecks emerge in the price of various services are possible here too. Unrest-related price increases are also likely to emerge, even if temporarily, over time. Rentals are a large component of the basket, and remain low for now, but pressure is more likely to build with time than moderate. Positively, the terms of trade boost and a large trade surplus have not only helped strengthen the rand, but should help mitigate some of the currency risk of changing global rate expectations and investor sentiment. The strong rand will also help keep goods price inflation low.

Figure 6

INFLATION AND POLICY RATES



Sources: Statistics South Africa, Coronation

Figure 6 shows headline inflation's 'double peak' in 2021 as prices respond to last year's base and the implementation of fuel and electricity price hikes in July push inflation higher. Inflation cross-currents, in our view, will see inflation drift higher over the next two years, but we see few visible risks of a large or persistent threat to the target at this time. Wage and currency pressure are contained by labour market slack and the current account surplus for now, and we think the central bank will start to slowly normalise interest rates in line with the recovering economy, rather than hiking aggressively in response to rising inflation risk.

IN CONCLUSION

The global tailwinds still provide a welcome boost to the domestic cyclical recovery. To make the lift more durable, the present time also offers a unique opportunity in which to capitalise on these circumstances after a prolonged period of weak growth, deteriorating macro balances and depressed sentiment. The pandemic has materially weakened the base off which this recovery needs to build, and it was weak to start with. July's unrest undoubtedly holds short- and long-term challenges for the domestic recovery, and came at a time when much-needed momentum was just emerging. This means that policymakers need to act decisively and pragmatically so as not to waste the opportunity to help the economy grow and its people recover. ✚

INVESTMENT ANALYSIS

Gold

Cheap insurance at a time of heightened risk

By NICHOLAS HOPS

THE QUICK TAKE

We believe the monetary and fiscal policy responses to Covid-19 are supportive of the gold price

AngloGold and Gold Fields have vastly improved their businesses, yet can be bought at a discount

Historically, due to poor fundamentals, we have not held gold shares; this has changed

Nicholas is an investment analyst and portfolio manager with seven years' investment experience.

OVER THE LAST two years, the gold spot price has risen strongly, from $1 200 to $1 800, after peaking at $2 035 an ounce. The uncertainty brought about by the Covid-19 pandemic drove a flight to safety into the yellow metal in 2020, as record capital flowed into gold-backed exchange-traded funds (ETFs). In addition to the pandemic itself, the policy response from governments and central banks stands to support the gold price over the medium to long term. The global policy response has seen dramatic money printing, the expansion of central bank balance sheets and novel fiscal policies that put money directly into consumer pockets. Combined with a 13-year global equity bull market, we think that risks in the system are high. Gold is an inexpensive insurance against risk, and we believe that the gold equities currently provide historically cheap exposure to gold.

The gold price has performed well as a hedge over time, displaying a negative correlation to most financial assets. Unlike the rest of the commodity suite, the gold price does not have a strong relationship with typical supply/demand fundamentals or cost curve dynamics. In recent years, gold has exhibited a very strong relationship with real yields, which have become increasingly negative in developed markets, with gold rallying in this environment. Viewed as a risk-free/insurance asset, the zero yield on gold becomes more attractive as the real yield on other risk-free assets, such as government bonds, goes more negative. With the potential for higher inflation in the coming years and greater central bank tolerance of this, we believe the environment for the gold price is supportive.

Elevated gold prices and negative real interest rates are both indicative of a desire for risk protection. Before the advent of gold ETFs in the early 2000s, if investors wanted risk protection through gold, the only way to access this was to own gold equities. For this reason, the premium paid for risk protection was particularly high, with investors accustomed to paying multiples of net present value for the privilege of gold exposure. ETFs provided the opportunity for exposure to the gold price without the cost inflation, capital allocation missteps and operational risk that have been endemic to the miners over time. Poor capital allocation over time from the gold miners and an attractive alternative in the ETF market contributed to a meaningful de-rating within the

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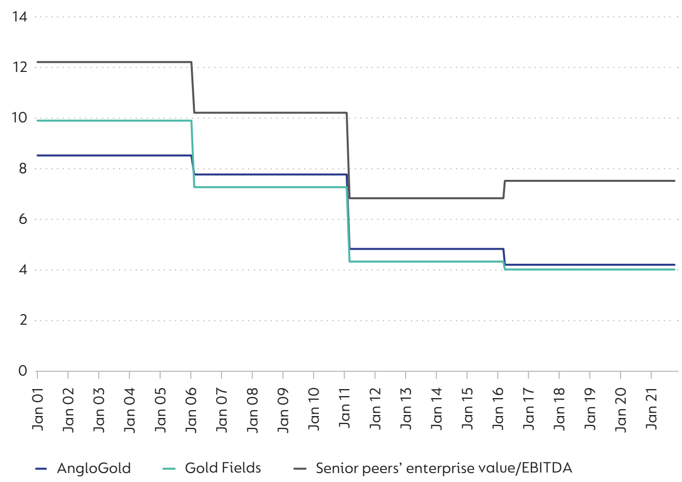
gold sector, with the South African (SA)-listed gold companies performing worse than their peers, and gold equities underperforming the gold price and the stock market over meaningful time periods. Multiples have come down dramatically over all time periods and the premiums investors used to pay have now turned into discounts (Figure 1). At the end of June 2021, the top eight gold miners in the world had a combined market capitalisation of $153 billion, lower than the $180 billion invested in ETFs.

Figure 1

FIVE-YEAR AVERAGE ENTERPRISE VALUE: EBITDA*

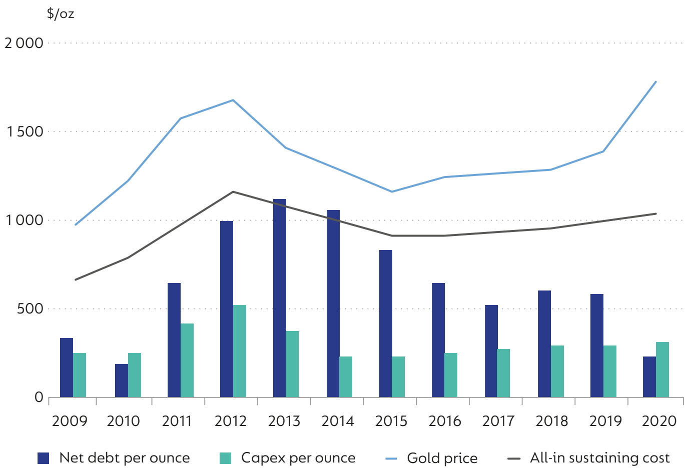


* Earnings before interest, tax, depreciation and amortisation

Source: Bloomberg

Figure 2

GLOBAL GOLD MINERS



Sources: Metals Focus, company reports

HISTORICALLY POOR ALLOCATORS OF CAPITAL

At the top of the last gold bull cycle in 2012, the gold sector, on average, continued to invest heavily in growth projects, and mergers and acquisitions. When the gold price began to decline, these capital commitments were met with debt as operating cash flows subsided. This left the entire industry needing to reduce costs, which had run up aggressively with the gold price, and reduce debt over a multi-year period. The gold sector's poor cost control, poor capital allocation and high valuations all contributed to Coronation not having had a meaningful position in gold equities for nearly two decades. We believe a lot has changed.

In recent years, the gold industry has displayed far better control over unit cost and capital expenditure, enabling companies and their shareholders to capture more of the rising gold price. Now that balance sheets are repaired and cost control has improved, the surplus free cash flow generated stands to be invested in smaller value-accretive growth projects and paid back to shareholders in the form of dividends. Several of the top global gold miners have increased their payouts to shareholders and we strongly believe there is further room for improvement.

Despite these improvements, investors are now able to buy the stocks at large discounts due to general disenchantment with the mining sector, and the gold miners in particular. While the gold sector is improving from a capital returns perspective, it lags the diversified mining sector and even the platinum sector. We believe that the gold sector overall has learnt valuable lessons from the last few cycles, much like we have seen in the diversified miners. Figure 2 shows this very nicely.

SA GOLD COMPANIES' IMPROVED RELATIVE POSITION

The SA-listed gold stocks have long traded at increasingly large discounts to their global peers, something they have largely deserved until now. We believe a discount is warranted due to shorter mine lives and higher costs, but nowhere near the c.50% discount they currently trade at. The relative discount stands at the widest it has ever been, at a point in time when we believe the relative differential is at its smallest. Our analysis shows that the primary drivers of rating differentials over time are production outlook and cost curve position. Over the next five years, the production and cost outlook for AngloGold and Gold Fields has not been this good for two decades, and they stand to dramatically improve their position versus their peers. This is not being reflected in valuations.

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Both AngloGold and Gold Fields have greenfield and brownfield projects available to them, with the potential to boost production by 31% and 25%, respectively, from 2021 to 2025 (Figure 3). This is in stark contrast to the last two decades and, importantly, from a shareholder perspective, the projects are high quality and low cost, all with the potential to bring down average group production costs. Delivery on these is critical, but in mining nothing is ever easy, as the recent fall of ground at AngloGold's Obuasi mine has highlighted. Over the next five years versus their major international peers, AngloGold and Gold Fields have the strongest volume outlook; delivering on this could go some way to narrowing the rating differential.

Figure 3

GROUP PRODUCTION (F2025)

*thousands of ounces

Sources: Company reports, Coronation forecasts

Figure 4

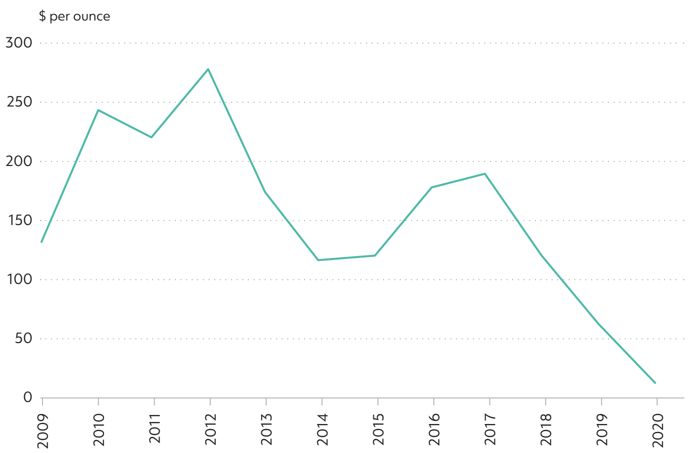
MOVING AWAY FROM SA

Production from SA	2000	2010	2020
AngloGold	75%	40%	0%
Gold Fields	87%	50%	10%

Source: Company reports

Figure 5

ALL-IN SUSTAINING COST GAP ANGLOGOLD/GOLD FIELDS VERSUS PEER GROUP



Sources: Metals Focus, company reports

Given that production from AngloGold and Gold Fields has declined so precipitously over the years, it is important to understand why. AngloGold has been the worst performer in this regard, and it is worth highlighting that the investment plan that Gold Fields has implemented over the last five-plus years has done good work to stabilise its portfolio and form a base from which to grow.

Over longer time periods, the overarching theme across the two businesses has been a move away from their SA assets towards a more international portfolio. SA gold mines are incredibly deep, risky to operate and largely high cost. Through a combination of asset sales, spinoffs and mine asset closures, both companies have reduced their share of production from SA materially (Figure 4). This has been the right strategy, albeit a painfully long one, given the original dominance of SA in their portfolios, and shareholders now stand to reap the rewards. Outside of Barrick Gold Corporation, both AngloGold and Gold Fields have seen the largest production declines of the majors over the long term. As shown in Figure 3, this is about to change.

AngloGold and Gold Fields are in the third quarter of the global cost curve, but, due to the flat nature of this curve, there is not too much separating them from their major global peers. The average All-in Sustaining Cost (AISC) of the top eight gold producers in the world for 2020 was $1 050, with both these counters within a percentage point of this average. Additionally, they have both shown better cost control than their peers over the last decade, leading to a narrowing of the cost gap between them. Figure 5 shows how dramatically the cost gap has improved for AngloGold and Gold Fields versus their peers over the last decade.

As previously mentioned, we expect the new projects and internal investment to enable both businesses to close this gap even further over the medium to long term. AngloGold, for example, is targeting a group AISC of $800 to $1 100 in 2025 versus the $1 059 it achieved in 2020. The company is investing heavily in the business in 2021 and 2022, which will see AISC temporarily rise before the investments bear fruit, leaving the business in >

better shape for the long term. Gold Fields is a few years ahead of AngloGold on the portfolio investment programme, with the results coming through in its operational performance. Both miners are investing in their existing assets to improve their life of mine. Adding reserves 'through the drill bit' is the cheapest way of bringing additional ounces into the business and responsible capital allocation.

CONCLUSION

Over the last decade, both AngloGold and Gold Fields have suffered from declining production, over-indebtedness and relatively high costs. As a result of recent and future investments, these drivers stand to reverse and improve dramatically going forward. Both companies have well-funded, high-quality growth projects that are coming online over the next five years, and improved balance sheets mean that surplus free cash flow stands to be returned to shareholders instead of debtholders in this period. Paradoxically, at the time where both of these businesses have the best forward-looking outlook that they have had in two decades, the multiples one is paying have never been lower and the margin of safety never higher.

Combining the pricing of the gold equities with our view on the potential for a strong gold price environment, we believe the protection one buys through exposure to the gold price has never been cheaper than it is today. +

RESPONSIBLE INVESTING

ESG: No easy solutions

But open minds and ability to shift positions are key

By NEVILLE CHESTER

THE QUICK TAKE

- Asset owners are placing increased pressure on how ESG factors are considered in portfolios
- ESG analysis cannot be reduced to numeric factors or single-score rankings
- There are negative multipliers involved in a naive approach to ESG integration
- ESG investing requires deep analysis and consideration of consequences across the board

Neville is a senior portfolio manager with 24 years of investment experience.

COVID-19 HAS UNDOUBTEDLY raised the profile and awareness of the importance of environmental, social and governance (ESG) factors in investing. The impact of a global pandemic on humanity has emphasised global challenges, such as pollution and climate change, and how they need to be dealt with by a global community. The impact of severe lockdowns and the divergent performance of companies and countries have also exacerbated inequality, underscoring many of the social challenges that the world is facing.

While only being part of the solution, it is expected that listed companies play their role in addressing these challenges. An assessment of how companies are applying ESG standards and changing their business models to deal with these challenges is an integral part of our analysis, understanding and valuation of a company. We are also seeing increased interest from the ultimate asset owners – the pension funds and unit trust investors – as to how their portfolios are being managed in line with ESG standards.

However, given how nascent the industry focus on ESG is, it remains fraught with risks, in particular, attempts to oversimplify what is a multi-faceted challenge and one that does not lend itself to quick fixes and short-term solutions.

The scale and scope of ESG analysis is sometimes so large that it is difficult to capture all the elements succinctly. It is important to understand the linkages between elements of ESG and that what might be positive for one element (e.g. reducing environmental impacts) might be negative for another element (e.g. the regional social impact of shutting down environmentally sensitive operations). Even within one element, you can end up with conflicts – for example, take the push by the UK and the EU to promote diesel vehicles because of their lower carbon dioxide emissions. In the UK, due to government incentives, the diesel market share went from 7.4% in 1994 to 39% in 2016. The flaw here is that by focusing primarily on carbon dioxide, they ignored the negative effect of diesel vehicles' particulate and nitrous oxide emissions, >

which result in more immediate health impacts. The US, which took a more holistic approach to assessing tailpipe emissions, did not adopt diesel incentives due to the negative externalities[1].

KEEPING SCORE CANNOT BE REDUCTIVE

The above example shows why it is so dangerous to attempt to 'score' companies or even portfolios with a simple metric. A single ESG score inevitably loses so much relevant information that it is at best worthless, or worse, results in negative outcomes. Members of the investment industry are typically numerate people, and we all have the desire to reduce complex problems to numbers, solvable in spreadsheets and quickly comparable in tables.

The reality is that ESG is not simply a numerical problem, but one that requires significant research, understanding and debate. The rise in passive funds has, unfortunately, placed further emphasis on the simple numerical solution, as passive managers by design do not have the backing of research teams that understand the nuances of every company that they own. It is preferable in their world to download a single-point score and rank the companies, as they are unable to differentiate on any other basis.

But how do you compare different ESG risks on a simple scorecard? Is a company that is reducing its emissions drastically, yet incurring a high number of workplace injuries and fatalities, better than a company that has a high regard for workplace safety but has been unable to reduce its emissions? How do you score lives versus emissions? Similarly, some of the most advanced technology companies in the world today, while delivering huge value and life-changing solutions, often have very poor human capital ratings (consider the so-called 'Gig Economy' workers) and typically have founders that are entrenched through high-voting share schemes. Given their high ranking in ESG tables and their prevalence in ESG funds, these are clearly issues that do not score badly on current ESG assessments, but is this correct?

THE NATURE OF POWER

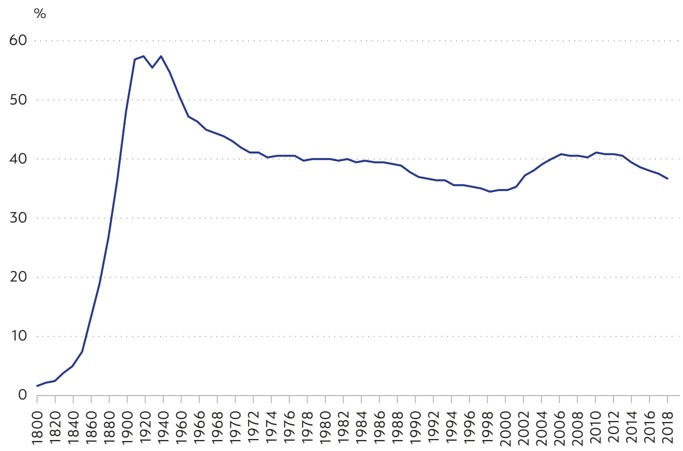
There is no greater example of unintended consequences, in our opinion, than the current global stance on divesting from fossil fuel companies. While there are myriad issues facing the world under the banner of ESG, the easy win for investors to be seen to be doing something has been their stance on thermal coal companies. The policy of divestment has been used as a blunt tool to force investment funds out of companies that have operations providing thermal coal to the world's power plants.

For perspective, it is important to understand that coal has been a prevalent fuel for the past century and a half, and was undoubtedly the driver that elevated the human race from an agrarian society to where we are today; principally, through the provision of electrical power.

While coal peaked in 1920 on the back of industrialisation, Figure 1 shows that, following a steady decline, coal's share of power generation began to increase in 2000 as nuclear power fell out of favour (nuclear is greenhouse gas free but has other issues, such as safe waste disposal). This saw millions of Asians lifted out of poverty as Asia (mainly China) industrialised. Consider that the World Bank states that China has lifted 800 million people out of extreme poverty since 1970 – truly a staggering achievement. Coal usage peaked in 2013 and has been on a steady decline since then.

Figure 1

COAL'S SHARE IN ELECTRICITY



Sources: Bernstein, World in Data

THE SHADOW IMPACT

What this reality means is that there are still significant coal-fired generation facilities in existence and that there are still coal mines operating to supply their fuel source. Selling a coal mine from one's portfolio doesn't stop it from existing. All that this achieves is an equivalent to the tragedy of the commons, where what might be good for the individual is not good for the community. This divestment stance has seen many listed companies attempt to exit their coal mine holdings as fast as possible. The net result is that instead of sitting

[1] https://theconversation.com/fact-check-are-diesel-cars-really-more-polluting-than-petrol-cars-76241)

observable in a listed entity that is governed by global governance and environmental standards, they are leaking into separate listings, private investors and State-owned entities – none of which are better than the existing situation, and in many cases, are much worse.

Take the new listing of Thungela, where Anglo American, a large and well-resourced global miner, under pressure from investors, spun off its South African (SA) thermal coal assets into a separate vehicle. While part of a major miner with many revenue streams, these assets could have been run down in a responsible manner, under the watchful eye of society.

As a large mining group, there would have been the potential for employees to be moved to different operations as the mines ran down. The diversity of minerals would ensure that the company's success or failure would not be linked to the performance of just one commodity. One cannot blame Anglo American's management for doing this, as they were just responding to the incentive system that investors were imposing (i.e. sell your coal assets or else we won't invest in you).

In 2019, Coronation specifically wrote letters to the boards of BHP Billiton and Anglo American asking them not to unbundle or sell their coal assets, but rather to hold them and run them down in a socially responsible manner. Unfortunately, we have lost this battle. Today, of all the thermal coal being mined in SA, only 41% is being done by publicly listed entities. When companies are unlisted, it becomes far more difficult to engage with these businesses and it is much more difficult to track key metrics such as:

- their emissions intensity;
- their rehabilitation funds – are they being provided, or are existing funds being stripped?;
- capital allocation into new mines or life extensions;
- mineworker safety; and
- investment in surrounding communities.

In analysing the voting on the unbundling of Thungela, it is apparent that the only major fund manager to vote against the unbundling was Coronation. Now listed on its own, Thungela is completely exposed to the risks associated with the movement of a single commodity price – that of thermal coal. Given the exact same pressures that Anglo American was under, a 100% thermal coal operation is unlikely to find a home in many portfolios, which means that capital markets are, for all intents and purposes, closed.

Banks are under pressure not to lend to coal mines, which means that Thungela will struggle to fund itself through a cyclical downturn, increasing its solvency risk. Reinsurers are under pressure not to underwrite coal assets, which means that they are unlikely to be able to insure themselves against catastrophic risks, exposing workers and nearby communities to the risk that they would not receive any compensation should one of these eventuate.

The CEO, who has now been put in charge of this new listed company and has a fiduciary responsibility to his employees and shareholders, has come out in support of his business and was quoted as follows, "Anglo was not going to invest in the future of these mines necessarily … We are now independent, where it makes sense we will absolutely invest in these mines". So, in fact, the policy of divestment is now directly responsible for reinvestment in coal mines, which is the exact opposite of the intended end goal.

The same stance held towards coal companies is increasingly being applied to oil companies. The net result is that, because the continued demand and requirement for oil are likely to extend for many years as we transition responsibly to more sustainable power sources, the oil we need is increasingly going to be supplied by privately held companies and nation states. The downside here is that many of these entities do not comply with the most basic of environmental or governance standards.

SUBSTANCE OVER FORM

The above is an example of just some of the nuances of a particular industry dealing with a specific subset of the ESG continuum. A portfolio of shares operating across multiple industries will introduce tens and hundreds of further ESG-related issues, none of which can be reduced to simple numbers. They all require the application of thought and careful consideration with regard to what the intended outcomes are and the consequences of those decisions on all stakeholders.

Undoubtedly, mistakes will be made, but these need to be recognised and positions changed as evidence comes to the fore, showing that what was previously seen as the appropriate stance no longer applies. One needs to be open to new ideas and be prepared to stand for what is right rather than expedient. Already the industry abounds with claims of 'greenwashing', and it is incumbent on us as long-term managers to ensure that we can show a track record of having made meaningful change for the benefit of all, rather than just sweeping difficult problems out the door. ✚

INSIGHTS

Three needs, two decades of outperformance

Celebrating the anniversaries of three of our multi-asset funds

THE QUICK TAKE

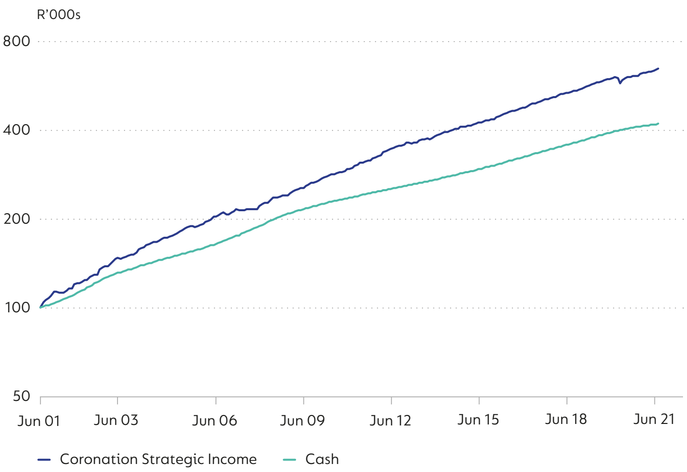
- Multi-asset class funds can be structured to meet a variety of investor needs
- The pandemic highlighted that emergency savings are essential; invest to beat cash
- Retired investors need to beat inflation while protecting against capital loss
- Non-retirement funding investments can access the full global opportunity set

TWENTY YEARS AGO, we launched three funds as part of our local unit trust fund range, the Coronation Strategic Income, Coronation Capital Plus and Coronation Market Plus funds. While each fund set out to meet a very different investor need, they all shared the common goal of not only meeting, but exceeding, the expectations of their investors through active multi-asset class investing. Below, we briefly look at how each of these funds has managed to do just that over this two-decade-long period.

Figure 1

BETTER THAN CASH

Value of R100 000 invested 20 years ago as at 30 June 2021 (after fees)



Source: Morningstar as at end-June 2021

CORONATION STRATEGIC INCOME

Most investors need to keep a portion of their savings liquid for different reasons. And, if the past 18 months have taught investors anything, it is the importance of having an emergency fund to tap into as part of your investment portfolio. The natural assumption would be to keep such monies in cash, but if this is a permanent component of your investment strategy, it may be more efficient to consider a conservative fund with the ability to do better than cash (i.e. one that is likely to deliver a better return than that of a cash deposit at the bank).

Delivering a return that is higher than that of a traditional money market or pure income fund (i.e. cash equivalents) is exactly what we set out to do with the launch of Coronation Strategic Income back in July 2001. Over the subsequent 20-year period to end-June 2021, the Fund has outperformed cash by 2.4% p.a. with an annualised net return of 9.8% (Figure 1). Over this period, the Fund also managed to outperform cash over any rolling 12-month period 80% of the time.

CORONATION CAPITAL PLUS FUND

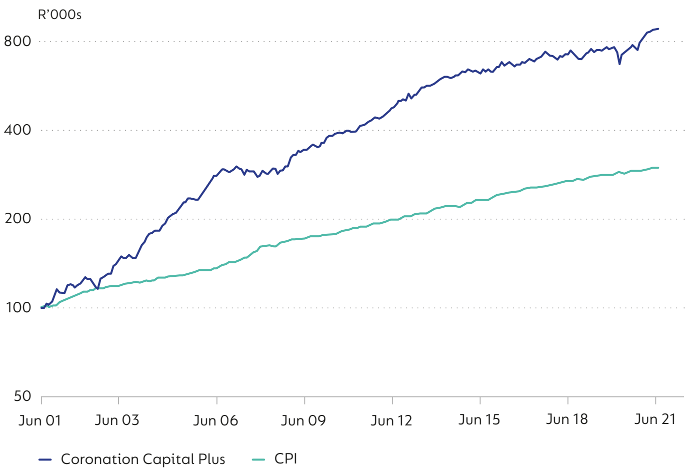
What retired investors need from their investment is to achieve two outcomes simultaneously – growth and protection against downside risk. This means that they are seeking inflation-beating returns that are delivered in a manner that doesn't expose their capital to the full impact of severe market corrections (which occur periodically, as has been the case in the early stages of the Covid-19- induced market selloff).

Inflation-beating returns are crucial, as your accumulated retirement savings may need to last over multiple decades should you live longer than the average life expectancy.

Figure 2

MORE THAN DOUBLE INFLATION

Value of R100 000 invested 20 years ago as at 30 June 2021 (after fees)

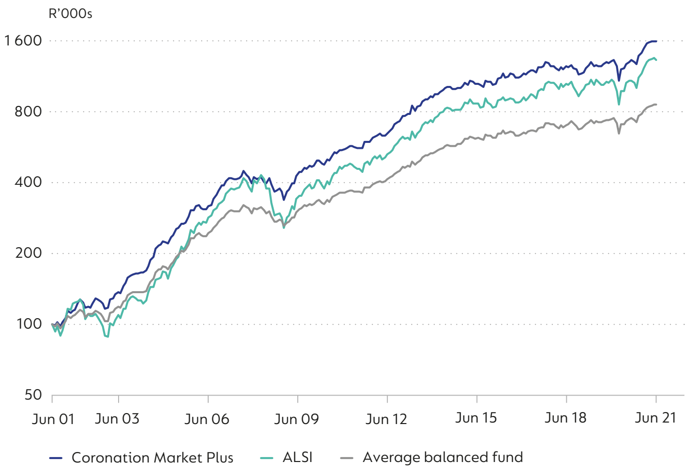


Source: Morningstar as at end-June 2021

Figure 3

BETTER THAN THE AVERAGE BALANCED FUND AND THE MARKET

Value of R100 000 invested 20 years ago as at 30 June 2021 (after fees)



Source: Morningstar as at end-June 2021

Managing downside risk is equally important, given that when you withdraw a regular income from your capital, your investment returns need to be less volatile.

For the past two decades, the Coronation Capital Plus Fund has delivered on this dual need by producing returns that are well ahead of its inflation +4% benchmark. In fact, an investment at launch would have resulted in more than double that of inflation over the 20-year period, while at the same time being consciously managed to minimise downside risk (Figure 2).

As a practical example, an investor who started off with an income drawdown of 5% per year (in line with industry guidelines for those aged 65) at the Fund's inception in July 2001, saw a more than tripling of their nominal capital over the last two decades, while drawing more than 2.3 times their initial capital as income over that period. Put simply, for every R1 million invested in Coronation Capital Plus 20 years ago, you would have R3.34 million today, after withdrawing R2.33 million in income[1].

CORONATION MARKET PLUS

Individuals with the ability to invest beyond what they are saving for their retirement (discretionary investors) may want a fund that can express views beyond the constraints of Regulation 28 of the Pension Funds Act – and rightly expect such a solution to outperform a traditional balanced fund. If managed well, this multi-asset class fund can even provide a return that is close to, or in line with, the market, but without the associated volatility of a pure equity fund. Enter Coronation Market Plus.

Since its inception in 2001, the Fund has met the needs of aggressive investors aiming to build long-term capital outside of their retirement portfolio. With the ability to invest more than 75% in equities and 30% offshore (as mandated by Regulation 28), the Fund has delivered an annualised return of 14.9% compared to the quantitative benchmark return of 13.2% and the median balanced fund return of 11.3%. What is particularly pleasing is that, over this period, despite never being fully invested in equities, the Fund has also managed to outperform the JSE All Share Index's performance of 13.8%. With an objective to grow real capital over time, the Fund delivered an annualised real return of 9.4% p.a. (Figure 3).

[1] The value of R1 million invested in Coronation Capital Plus at inception through to 30 June 2021. It assumes an initial drawdown rate of 5% per year set at inception and income calculated on each anniversary.

TWO DECADES OF ADDING VALUE TO OUR CLIENTS

It is rewarding to look back and see how we have added value to our clients over time. Through active asset management, within three multi-asset mandates, their track records celebrate the delivery of competitive long-term returns to our clients for more than two decades (Figure 4).✚

Figure 4

FUND SNAPSHOTS

Fund name	Coronation Strategic Income Fund	Coronation Capital Plus	Coronation Market Plus
Fund highlights over the past 20 years	Outperformed cash by 2.4% per annum, and 80% of the time when measured over any rolling 12-month period.	Delivered more than double inflation while actively managing downside risk.	Delivered a real return of 9.3% p.a., ahead of the average balanced fund as well as the local market.
Suitable for	Investors with a time horizon of 12 to 36 months who want to achieve a better return in rands than cash or bank deposits.	Investors in the early stages of their retirement investing for both income and growth.	Discretionary investors who want to grow their capital over the long term.

Source: Coronation

For highest and lowest returns for these funds, please refer to pages 32 and 53.

GLOBAL ECONOMIC COMMENT

Half-year stocktake

Shifting growth dynamics and inflation uncertainty

By **MARIE ANTELME**

THE QUICK TAKE

- Economic recovery varies per region, shaped by vaccine strategies and policy support
- The Delta variant of coronavirus is a potential threat, but not yet enough to offset strong recovery tailwinds
- Inflation risk is broadening, but markets are not yet convinced of its persistence
- Stability will be threatened should inflation continue to surprise expectations

Marie is an economist with 21 years' experience as a market economist.

VACCINE STRATEGIES HAVE dictated regional growth recoveries. Mid-year stocktaking reveals that the world is recovering fast from the pandemic, but the recovery is starkly uneven, and the dynamics are shifting. Growth leadership passed from China to the US, and more recently from the US to the UK and Europe, as staggered vaccine strategies and degrees of policy support have dictated the pace of each region's economic reopening. In countries where vaccinations lagged – initially in Europe and now visibly in emerging markets – so has growth, although this should start to converge in the second half of this year (H2-21). The emergence of the Delta variant is an unknown headwind to the recovery, but not yet enough to derail it, as a combination of broadening vaccinations and policy support remains a considerable tailwind.

Accompanying this uneven recovery has been a broad-based surge in inflation in both developed and many emerging economies, where data has surprised to the upside. While rising inflation has generally reflected base-related price normalisation, the surprises were not limited to a strong recovery in affected components. Reopening has seen pent-up demand for both goods and services collide with constrained supply lines that have led to bottlenecks and soaring prices for select goods and services. Also, the extension of income support in some countries has fuelled labour shortages, pushing up wages in some sectors. Base effects and bottlenecks should moderate, but booming asset prices and wage pressures could be more durable, which raise the risk that inflation may be elevated for some time.

While regional variances are stark, the broader shape of the recovery is becoming clearer. Economies with headroom to provide ongoing fiscal and monetary support, accompanied by well-executed vaccine strategies, have recovered first, fast. Those that have not managed to provide either the additional support or that have lagged in vaccine rollouts are still struggling to fully reopen – although many have still benefited from rising global trade volumes and commodity prices. These laggards should move forward in the growth pack as more people are vaccinated, while the leaders are increasingly likely to have inflation and policy uncertainty to manage.

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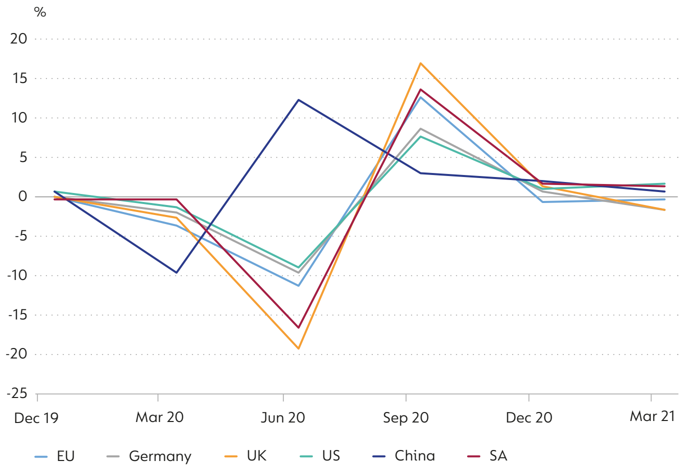
GROWTH OUTLOOK: LAGGARDS TO LEADERS?

GDP data at mid-year shows that China's economy peaked in late-2020, and growth is now slowing sequentially. Overall, GDP growth looks set to continue ahead of the pre-pandemic rate, but consumer spending has slowed in line with tighter policy settings and a falling credit impulse. Using JPMorgan forecasts, growth is expected to moderate from 5.3% quarter on quarter (q/q), seasonally adjusted annualised (saa) in the second quarter of 2021 (Q2-21), and from 8.8% in 2021 to 5.5% in 2022, as government refocuses policy from support to deleveraging and de-risking China's highly leveraged economy.

Figure 1 shows China's early exit from recession, but fading growth momentum as stimulus fades. Growth has been supported in the US, while the UK and EU suffer a weaker recovery on extended Q1-21 lockdowns.

Figure 1

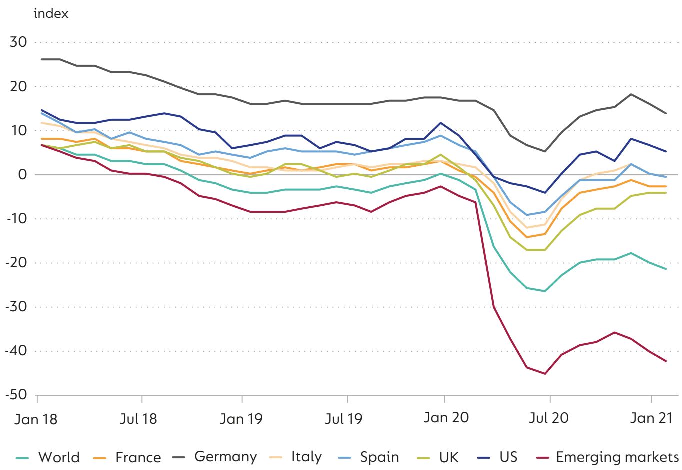
SEQUENTIAL REAL GDP, Q/Q SEASONALLY ADJUSTED



Source: Haver

Figure 2

TRACKING INDEXES FOR THE GLOBAL ECONOMIC RECOVERY (TIGER INDEX)



Sources: Haver, Brookings Institution

In the US, growth surged 1.6% q/q in Q1-21, on a recovery that is fueled by full-bodied monetary and fiscal support, and an aggressive vaccine rollout. Specifically, the newly elected Biden-Harris Administration extended income support through both the Coronavirus Aid, Relief, and Economic Security Act and the Emergency Covid Relief Act (passed in December 2020), and then the broader fiscal stimulus package, the American Relief Plan of $1.9 trillion, passed in March 2021. Following an aggressive vaccination programme, the economy has opened, and a large, accumulated cushion of savings has helped to boost spending and employment. The pending passage of the Infrastructure Bill should also give the recovery longevity, as growth moves from consumption to investment.

A similar pattern has played out in Europe. With a hard Wave 2 lockdown in many core countries, and patchy vaccine strategies, the growth recovery in Europe lagged that of the US. However, with initial vaccinations now nearing completion and an accelerated easing in mobility restrictions since June, and opening to tourism from late-July, European GDP growth is expected to accelerate into Q3-21, reaching 5.4% for the year as a whole, before slowing a little in 2022 to 5%.

Importantly, this plan allocates €2 trillion from the EU Budget to member countries, mostly earmarked for spending on green technologies and digitisation, and should boost EU GDP by more than one percentage point through 2022. The relaxation of fiscal rules in Europe as economies recover from the pandemic should also provide additional fiscal headroom and help leveraged economies, like Italy and Spain, avoid a sudden stop in fiscal support and a sudden moderation in growth.

In the UK, an aggressive vaccination drive has been somewhat hobbled by a slightly less smooth reopening strategy. Nonetheless, GDP growth, after contracting again in Q1-21, is set to rebound strongly in Q2-21, as monthly tracking data points to an increasingly strong rebound.

Elsewhere – and most notably in emerging markets – vaccine strategies have lagged, and so has growth. This is in part a function of local logistics, and in part the inability to secure enough stock of vaccines (not to mention individual supply issues), as developed market strategies took precedence. While the evolution of variants is likely to be more damaging in countries where there have been limited vaccinations, emerging market vaccinations are now gathering momentum. Notably, vaccinations in Brazil, Turkey and India have picked up visibly in past weeks, supporting a stronger growth outlook in H2-21 (Figure 2).

As these economies are able to open, so too should the recovery in previously constrained services sectors begin. Global growth is set to converge in H2-21 and into 2022. JPMorgan forecasts global growth of 6.4% in 2021 and 4.5% in 2022.

VACCINATIONS AND VARIANTS

The evolving virus remains a persistent threat. Available information shows that the newly emerged Delta variant of the coronavirus is significantly more transmissible than its predecessors, but it is not yet clear whether, outside of the higher infection rate, it is more deadly. Also, people who have been vaccinated seem to suffer fewer extreme symptoms and do not require hospitalisation. That said, the higher transmissibility means that for countries where vaccination rates are low, the risk of hospitals being overwhelmed and associated deaths rising meaningfully is much higher. Emerging markets are very vulnerable, and there remains considerable risk that low vaccination rates will further delay recoveries and impose longer-term scarring on weakened underlying economies.

There is not a lot of reliable information about the threat posed by the Delta variant in Africa, where vaccinations have been the lowest and where testing rates are, perhaps, not as good as elsewhere in the emerging market universe. As the situation develops, it highlights the need for more aggressive and committed vaccine strategies in countries where these have, so far, been poor.

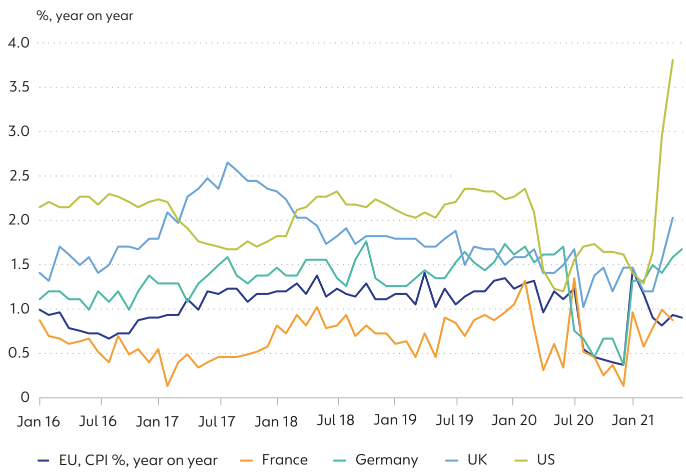
INFLATION RISK REMAINS ELEVATED

The economic reopening has been accompanied by a broad-based surge in inflation. The initial increase was widely forecast and well anticipated by markets as base- and fuel-price-related adjustments emerged visibly from April and May. Prices that were depressed by the pandemic, such as in the tourism and other services sectors, are now normalising, but many have some way to go, given the growth dynamics outlined above.

However, increases have not been limited to base effects. Bottlenecks have emerged where pent-up demand has created shortages for inputs and final goods alike, exacerbated by rising commodity prices. Policy-driven income support has seen labour shortages emerge, mostly in hospitality, but wage growth is also becoming more evident across other sectors, mostly in the US. Developed market business surveys are now, almost uniformly, highlighting price pressures, while housing markets are also heating up and rentals are starting to rise in key economies. This means that it's not just relative prices that are rising, but the broader base, extending to housing and wages (most visible in the US), which suggests a more durable upside risk to inflation (Figure 3). This risk is potentially compounded by a seeming tolerance of key central banks – notably the Federal Reserve Board (the Fed) and the European Central Bank (ECB) – of higher inflation.

Figure 3

NOT ALL ABOUT THE BASE – CORE INFLATION IS RISING, NOTABLY IN THE US AND UK



Source: Haver

The slower growth recoveries in emerging markets have not immunised them to rising price pressures. Inflation surprises in Turkey, Mexico, Brazil and Russia have already prompted their central banks to start raising policy rates.

It is possible that a shift in price pressure from goods to services will see inflation peak and then slow, as bottlenecks unravel and labour shortages ease, but the broadening growth dynamics materially increase the risk of inflation persistence. Labour market dynamics in developed economies will play an important role in determining the duration of price pressures, but most visibly and critically in the US and to a lesser degree, the UK. By September, most furlough schemes will end, schools will be reopening, and vaccinations should be well advanced in most economies. If this prompts stronger labour participation and eases pressure on wages, markets will reprice inflation and policy uncertainty.

THE DRIVER IS POLICY

Policy settings have also reached a sort of 'half-time' review, and decisions over their direction will further shape the recovery. In developed markets, fiscal support has broadly been extended into 2022 and, in some cases, beyond. There is some lingering uncertainty as to the US proposal of additional fiscal packages of $4 trillion over 10 years, but the

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EU has acted firmly, with the urgent deployment of the Next Generation EU recovery plan. This leaves the weight of policy adjustment to monetary policy, and, here too, the outlook is increasingly uncertain. The Fed's new 'flexible average inflation target' implies tolerance for inflation to overshoot the target for limited periods, while the ECB is currently reviewing its mandate. But, when the Fed met in June and delivered a more hawkish statement in the face of strongly higher inflation, the Bank of England and the ECB, no doubt, took note. Markets made a sharp adjustment to policy rate expectations at the time, but have since shifted gear again, apparently again less concerned about inflation risk. But more persistent upside surprises in inflation, driven by wage pressure, most at risk in the US and UK, could severely challenge this stability in coming months. +

STOCK ANALYSIS

US health insurers

Finding value in complexity

By STEVEN BARBER

THE QUICK TAKE

- Coronation's proprietary analysis has delivered value for our investors
- Management changes can drive improved corporate performance and deliver value for shareholders
- Health insurers have a role to play in driving better outcomes in the US healthcare system
- The scourge of Covid-19 called for a demonstration of good corporate citizenship

Steven is an investment analyst with 11 years of investment experience.

THE US HEALTHCARE system is somewhat dysfunctional. Despite the boldness of the claim, this view is not that controversial. Humana, one of the largest US health insurers, suggested at its recent investor day that "the health system is costly, complex, and poorly positioned to meet customer needs".

The US spends a far higher percentage of GDP on healthcare than other developed nations, yet generates worse outcomes[1]. At Coronation, as investors with opportunities to invest globally, it would be easy to dismiss US healthcare as simply unsustainable and look for ideas elsewhere. However, by embracing this complexity and endeavouring to understand it, we have generated attractive returns for our clients.

Coronation's global equity portfolios have held Anthem and UnitedHealth, the two largest US health insurers by enrolment, since 2017 and 2019, respectively. Both have contributed favourably to the portfolios' returns.

STRONG TRACK RECORD

Both Anthem and UnitedHealth have generated strong financial results and demonstrated resilient business models that have weathered different economic cycles and political regimes. The businesses have grown revenues consistently in a range between 7.5% to 10.5% p.a. over the last three, five and 10 years. Figures 1 and 2 overleaf show historical earnings growth together with our forecasts[2]. We expect earnings-per-share (EPS) growth of 13% to 14% for both companies over the next five years.

[1] As measured by life expectancy or other measures of chronic disease burden.

[2] Revenue growth includes acquisitions for both companies and the benefit of an accounting change for Anthem. EPS in recent years was flattered by the benefits of lower tax rates as a result of US tax reform. We don't expect this benefit to repeat; in fact, it is more likely that tax rates will increase over our investment time horizon.

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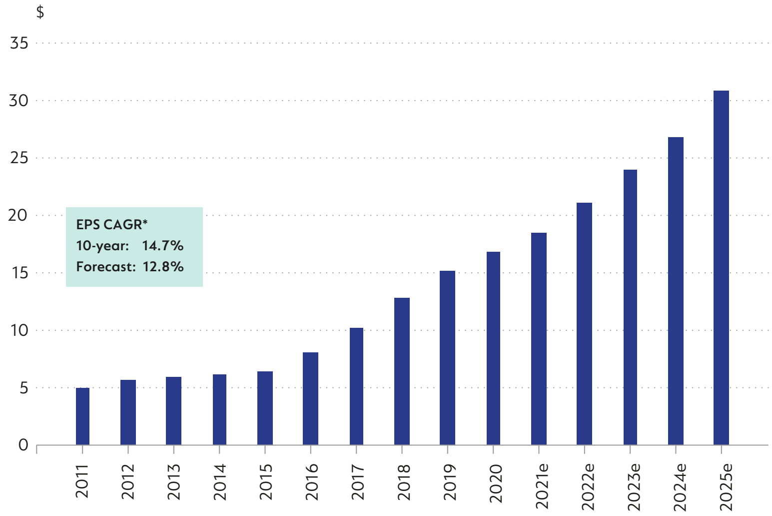
Figure 1

UNITEDHEALTH EARNINGS PER SHARE

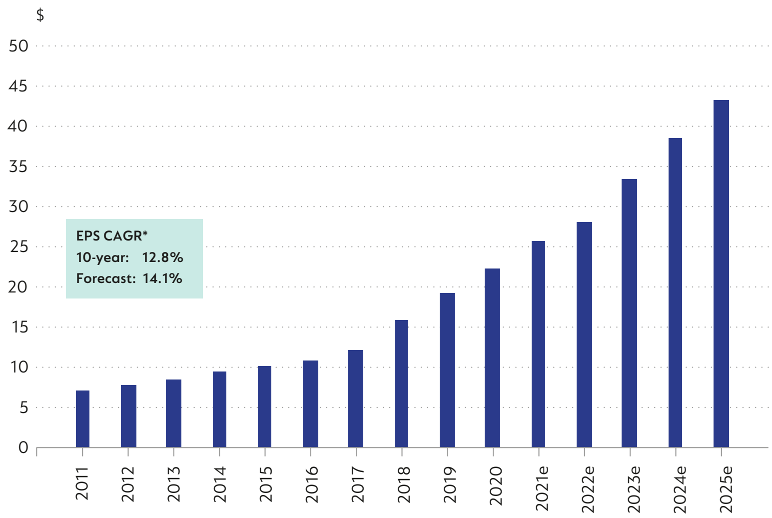


*Compound annual growth rate

Sources: Company reports, Coronation

Figure 2

ANTHEM EARNINGS PER SHARE



*Compound annual growth rate

Sources: Company reports, Coronation

ANTHEM: A SLEEPING GIANT REAWAKENING

Anthem has its roots in two mutual insurance companies founded in Indianapolis in the 1940s to provide health insurance under the Blue Shield and Blue Cross trademarks. The resultant Blue Cross Blue Shield (BCBS) mutual company ultimately merged with or acquired 13 other single-state BCBS plans in the 1990s and early 2000s.

In 2001, the resultant entity demutualised and listed on the New York Stock Exchange. With its cultural roots as an agglomeration of former mutuals, Anthem was, in our view, undermanaged for a long time. At one point, the company operated up to 30 separate medical claims systems, which is just one tangible example of this chronic undermanagement. Under the leadership of CEO Gail Boudreaux since late 2017, the company has refocused its strategy and improved execution.

The new management team has driven strong results and we believe that there are still further benefits to come from improved execution of the new strategy. To continue the example, the company currently operates on three claims processing systems, with plans to reduce this to the end state of two by next year[3].

PART OF THE SOLUTION RATHER THAN PART OF THE PROBLEM: A SHIFT TO VALUE

The US healthcare market is undergoing a seismic shift from paying for individual care encounters under fee-for-service arrangements, to one in which healthcare providers are increasingly incentivised to take broader ownership of patient outcomes and bear increasing levels of risk for medical costs under value-based care (VBC) payment models. Initially, VBC can involve bundled payments for an episode of care (e.g. a hospital admission for a hip replacement), or up- and downside risk-sharing in cost savings or overruns on medical expenses versus a predetermined baseline.

The ultimate endpoint of VBC is full capitation, in which healthcare providers receive a fixed fee per member every month from the health insurers and are accountable for all of a member's healthcare expenses, regardless of how much or how little they utilise the healthcare system.

While there are periodic calls from liberal quarters for the US to shift to a single-payer healthcare system, the shift to VBC is akin to a market-based solution to the problems of high costs and fragmented, episodic care. A provider operating under full capitation has a very different set of incentives than one who is billing per unit of care.

While the shift to value is reactive to the current dysfunction and will take decades to play out, we believe that the health insurers have a key role to play in this transition by facilitating and motivating providers to adopt new payment models that encourage them to take a more holistic view of the care they offer. Change will not come quickly, but change is indeed afoot.

[3] One for the government programmes business and the other for commercial/employer-focused business, which typically run on separate systems.

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THE VALUE OF GOOD RELATIONSHIPS

UnitedHealth in particular, with its Optum Care business, is well positioned to not only facilitate, but also profit from this shift. Optum Care, which has been building a footprint of physician[4] practices in the US for over a decade, now employs or is affiliated to 56 000 physicians in the US, serving 20 million patients in total. A patient's relationship with their primary care doctor is one of the most important in healthcare and, under more intensive value-based treatment regimes[5], allows for early intervention and greater practice of preventative medicine.

Today, only four million of Optum Care's 20 million patients are cared for under some form of risk-bearing value-based arrangement, and only two million under full capitation. Growing value-based relationships has been partly responsible for a doubling in the revenue per consumer served over the last four years for the broader OptumHealth business, of which Optum Care is a part, with a further 32% increase in the first quarter of 2021.

There is a decade of strong growth ahead for Optum Care, as consumers are increasingly treated under value-based arrangements, delivering better outcomes for patients and strong growth and profitability for UnitedHealth from the increased scope that VBC enables.

The recent flurry of listings of value-based healthcare companies like Oak Street Health has shone a spotlight on the value inherent in UnitedHealth's Optum Care business. Despite the re-rating in UnitedHealth stock, we expect Optum Care to contribute towards strong ongoing growth in both revenues and earnings, and solid returns for our clients over our investment horizon.

COVID-19 RESPONSE: DOING THE RIGHT THING

Covid-19 resulted in significant deferral of medical care throughout 2020, as patients avoided unnecessary visits to hospitals and other medical settings. This initially resulted in a significant windfall for the health insurers who continued to collect monthly premiums but were faced with significantly lower medical expenses.

Collectively, the health insurers did the right thing and returned significant value to commercial clients and the government, while hospitals and other medical providers came under significant financial pressure because of lower levels of medical utilisation. For companies that touch tens of millions of lives and all of the US healthcare system, it was good corporate citizenship to do the right thing.

VALUATIONS

Trading on approximately 14 times forward earnings expectations (which is a substantial discount to the market), we find that Anthem offers attractive value. UnitedHealth, on 20 times forward earnings expectations, trades broadly in line with the market. Despite UnitedHealth's higher rating, we still expect the stock to deliver strong compounding returns in the years ahead, driven by continued strong earnings growth. Both stocks remain core holdings in our global equity portfolios. ✚

[4] The terms 'physician' and 'doctor' are used interchangeably. The US practice is to refer to doctors as physicians.

[5] The doctor is incentivised to see a patient more frequently and spend more time with them, especially sicker patients, as the doctor is at risk for the costs of treating that patient.

BOND OUTLOOK

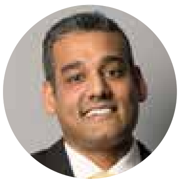
Global growth boom spells higher inflation and monetary policy normalisation

But strong local bond performance continues

By NISHAN MAHARAJ

THE QUICK TAKE

- SA's economic and asset price recovery is due to both global developments and local reform progress; recent unrest is likely to soften, but not derail, the recovery
- The current global growth and commodity boom raises the risks of higher and more persistent inflation
- Interest rate normalisation will be felt in SAGBs through rising global bond yields and a rising repo rate
- The risk premium embedded in SA bonds should absorb a significant amount of the widening in global bond yields and higher local policy rates



Nishan is Head of Fixed Interest and has 18 years of investment experience.

THE WORLD IS poised to experience growth exceeding 6% this year, as many developed market economies make breathtaking recoveries to pre-pandemic levels of output. Emerging economies will lag this growth boom due to less fiscal cushioning during the Covid-19-induced crisis and slower vaccination rollouts, leading to a more gradual economic reopening. The recent rise in commodity prices, spurred by increased demand from China, a pivot towards greener technology and a focus on infrastructure development, has offered salvation to emerging market commodity producers. This growth and commodity boom does, however, raise the risks of higher and more persistent inflation.

South Africa's (SA) recovery has been elevated by the current global environment, which has translated into strong asset price performance. The rand is up c.3% against the US dollar this year, with most of that performance coming through in the second quarter of the year (Q2-21). This is pretty much in line with its emerging market peer group (except Brazil, which has enjoyed a more significant recovery in its currency following the commencement of its preemptive rate hiking cycle), but what has set SA apart is the performance of its local bonds. Despite the yield on the 10-year bond being 30 to 40 basis points (bps) higher since the beginning of the year, the FTSE/JSE All Bond Index (ALBI) has returned 5% this year (6.9% over Q2-21). This has been led by the strong performance of bonds with a maturity of >12 years, as the yield curve has continued to flatten. Inflation-linked bonds (ILBs) had a poorer quarter, returning c.3%, but remain ahead of ALBI returns, year to date (7.7%). Both ALBI and ILB returns remain well ahead of cash for the quarter (0.88%) and the year (1.73%).

POSITIVE DEVELOPMENTS DRIVING LOCAL RECOVERY

SA's economic and asset price recovery has not been solely due to global factors. Local developments, including the lifting of the minimum threshold for energy generation licensing to 100 megawatts; the sale of a majority stake in South African Airways to a local consortium;

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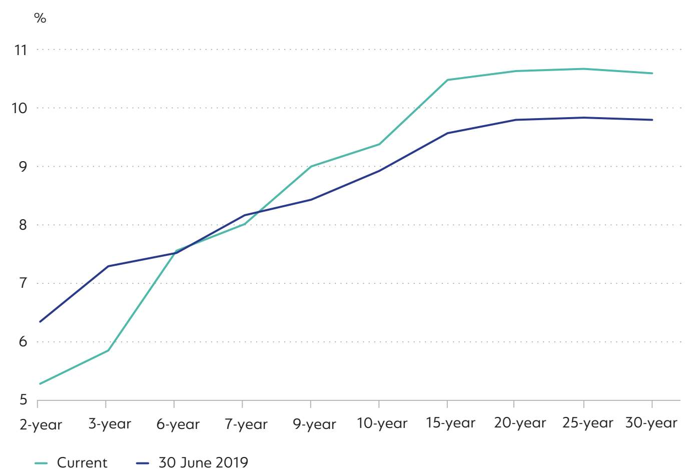
the sidelining of suspended ANC Secretary General, Ace Magashule, following his arrest by the National Prosecuting Authority; and the sentencing of former President Jacob Zuma to 15 months in prison for not testifying at the Zondo Commission, have also helped to improve investor belief in SA's reform agenda. Inflation has continued to remain well under control, and, although it will hover around 5% for the next 18 months, we do not see a sustained move through the top end of the inflation band (6%).

The recovery in growth this year is supported by the low base in 2020, the bounce in commodity prices, the rebuilding of inventories and a slightly more optimistic consumer. Growth this year will be more than 4% and just above 2% in 2022. As a result, one can expect the next move in interest rates to be higher, although this would most likely only take place at the end of 2021 or in the first quarter of 2022. Higher growth and higher commodity prices imply stronger tax revenue, which provides more breathing space for the fiscus. In addition to this, government has continued to hold the line on the government employee wage freeze, which keeps SA on the path of fiscal consolidation.

Figure 1

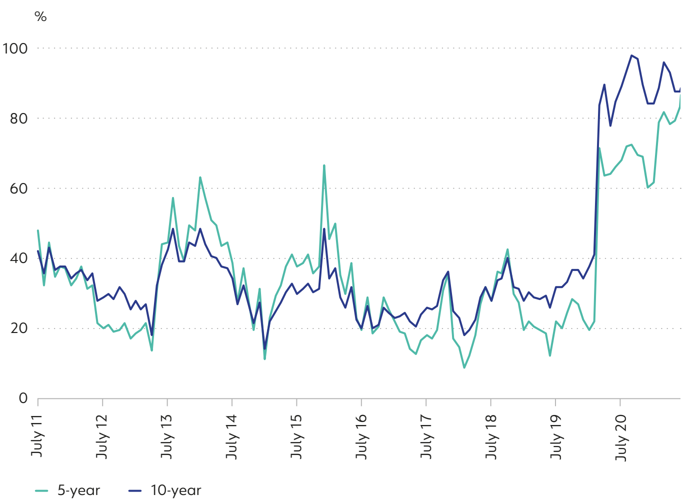
SA BOND CURVE (CURRENT VERSUS JUNE 2019)



Sources: Coronation, Bloomberg

Figure 2

SA 5-YEAR AND 10-YEAR BOND BREAKEVEN TO CASH



Sources: Coronation, Bloomberg

Despite the recent recovery in local bond yields and the flattening of the yield curve, SA bond yields remain elevated, and the curve remains steep. In Figure 1, we show the current SA bond curve relative to pre-Covid-19 (June 2019) levels.

Two things are immediately observable. First, the shape of the curve remains incredibly steep. Arguably, the fiscal metrics in 2019 were better, but expectations were for significant deterioration. Currently, fiscal metrics are at their worst since the Global Financial Crisis, but will improve over the next two years, which suggests the curve should be flatter. Secondly, bonds yields are very elevated compared to cash rates. This is illustrated in the bond breakeven rate relative to cash, which measures how much bond yields can sell off before their return equals cash. Not only are the breakeven rates elevated, but the five- and 10-year bonds have very similar breakevens, suggesting the overall level of bond yields remains very elevated relative to cash and price in a significant risk premium (Figure 2). This suggests that, overall, there is still significant room for bond yields across the curve to compress (reduce) and the spread between longer-dated bonds and shorter-dated bonds to narrow (a flatter yield curve).

THE EFFECT OF INCREASED RATES

Over the last six months, concerns around rising inflation and excess liquidity in global markets have heightened expectations for interest rate normalisation, both in developed and emerging market economies. The impact of this will be felt in SA government bonds (SAGBs) through rising global bond yields and a rising repo rate.

The current steepness of the bond curve and high bond breakevens relative to cash suggest a limited pass-through of rising short rates (the repo rate) into local bond yields. However, this is not a certainty. All previous episodes of rate hiking in SA have had a knock-on to higher bond yields. The current landscape might just mean that the pass-through is reduced. In a rate hiking cycle, shorter-dated bond yields are generally more sensitive to a change in cash (repo) rates, while longer-dated bond yields have a much lower sensitivity.

In Figure 3, we show the total return of each of the government bonds given a move up in yields over the next two years – e.g. if the R186 yield moves up 2% in the next two years, its total return will be 4.99%. The area shaded in green is where a bond's performance exceeds the performance of the R186 (five-year) and R2030 (nine-year). The five- and nine-year bonds will generally be more sensitive to movements in the repo rate and will experience a much more significant move higher in yield than the rest of the curve. Only in the case where all bond yields move up by 2% do the 12- and 15-year bonds underperform the five- and nine-year bonds. This reinforces the case for holding bonds in the 12- to 15-year area of the bond curve, as it offers the most attractive return prospects in the event that the repo rate is normalised over the next two years.

Figure 3

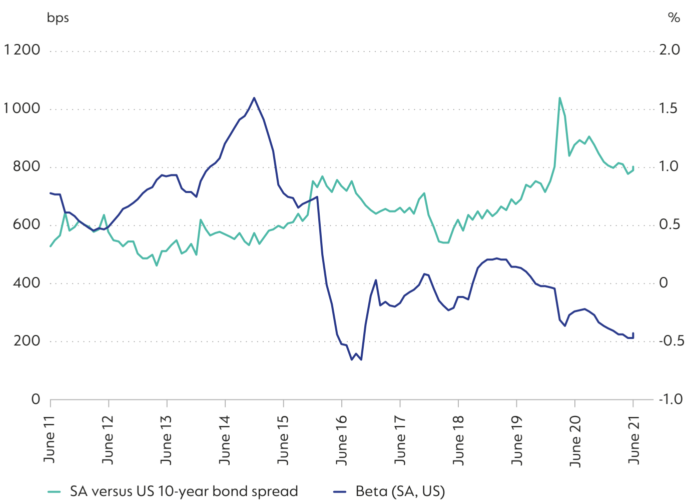
YIELD INCREASE

Bond	Maturity	Move up in yield			
		200.00	150.00	100.00	50.00
R186	21 December 2026	4.99%	5.65%	6.32%	7.00%
R2030	31 January 2030	4.55%	5.65%	6.77%	7.93%
R2032	31 March 2032	4.38%	5.68%	7.03%	8.43%
R2035	28 February 2035	4.23%	5.67%	7.17%	8.75%
R2037	31 January 2037	4.00%	5.52%	7.11%	8.79%
R2040	31 March 2040	3.85%	5.42%	7.08%	8.85%
R2044	31 March 2044	3.51%	5.14%	6.89%	8.76%
R2048	28 February 2048	3.18%	4.86%	6.68%	8.63%

Sources: Coronation, Bloomberg

Figure 4

BETA OF SA/US RATES VERSUS SA/US 10-YEAR BOND SPREAD



Sources: Coronation, Bloomberg

Global monetary policy normalisation will take the form of the tapering of bond asset purchase programmes, followed by a rise in policy rates. This will result in global bond yields moving higher over the next few years. Historically, the pace and magnitude of the rise in global bond yields have had significant repercussions for the local bond market. More specifically, the more sudden and sizeable the selloff in global bond yields, the larger the rise in local bond yields. Currently the US 10-year Treasury Bond (a proxy for global bond yields) is at 1.5%, and pricing in the forward market puts expectations for this rate to be at 2% to 2.25% over the next two to three years. The magnitude of the move is not large by historical standards, although the pace of the repricing will remain unpredictable.

Local bonds have generally had a high beta (the relative measure of volatility between two assets) with US 10-year bonds. However, the spread between SA bonds and US bonds is at historically wide levels, primarily due to the deterioration in SA's fiscal metrics. It is plausible that with SA's fiscal metrics recovering, this spread is too wide and should narrow, implying that even if US bonds were to sell off, the equivalent selloff in SA bonds should not be severe. In Figure 4, we look at the rolling two-year beta of SA 10-year bonds to US 10-year bonds, versus the spread between the two bonds. It is quite evident that, as the spread has widened, the beta between the two has decreased; i.e., the influence of US rates on SA rates has diminished. This further suggests that the risk premium embedded in SA bonds should absorb a significant amount of the widening in global bond yields.

INFLATION PROTECTION A NECESSARY INSURANCE

The rise of inflation has become a hotly debated topic. The surge in demand that we are seeing in developed economies as they open, the supply bottlenecks and elevated commodity prices are all stoking concerns that inflation will exceed current lofty expectations and remain high for an extended period. Our base-case view is that most of these factors are transitory, and that the feed-through to SA will be muted and offset by softer demand conditions locally.

However, in constructing robust portfolios, we must look for assets that provide us with some protection in the event that the tail risk becomes a reality. ILBs provide portfolios with protection in the event that inflation materialises higher than expectations. Currently, the real yields on offer are higher than longer-term averages, and the actual inflation average required to provide a better return than nominal bonds is quite low in certain

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areas of the curve. Figure 5 shows the various ILBs on offer and the inflation average required over the maturity of the bond to perform in line with its nominal bond equivalent. The longer the maturity of the bond, the larger the payoff symmetry; i.e., if you are certain inflation will average above the minimum required level, it pays more to own the longer maturity. Our current expectations are for inflation to hover around 5% for the next 12 to 15 months, which makes ILBs out to 2029 quite attractive. Longer-dated ILBs will have a better return profile, but the hurdle for them to outperform nominal bonds is significantly higher, making them less attractive.

Figure 5

IMPACT OF INFLATION ON INFLATION-LINKED BONDS

Bond	Maturity	Current real yield	Inflation required to beat nominal bond	Current nominal bond equivalent
R197	7 December 2023	1.3300	4.36	5.75
I2025	31 January 2025	2.2100	4.13	6.43
I2029	31 March 2029	3.1300	5.27	8.56
I2033	28 February 2033	4.0200	5.56	9.81
I2038	31 January 2038	4.2400	5.94	10.43
I2046	31 March 2046	4.2700	6.03	10.55
I2050	31 December 2050	4.2400	5.98	10.47

Sources: Coronation, Bloomberg

TO CONCLUDE

The prospects for the local economy have improved as reform progress has gathered momentum and global developments have provided tailwinds to the local recovery. Inflation is moving higher, but should remain under control despite uneasiness around global inflation. The recovery in growth should gain more traction and spill into next year, which will provide more breathing space for the fiscus. SAGBs, despite their recovery in the last quarter, still embed a significant risk premium relative to cash. The steepness of the yield curve makes the 12- to 15-year area attractive, even in the event that the local rate hiking cycle starts sooner than expected. For bond portfolios, we continue to advocate overweight positions to SAGBs focused in the 12- to 15-year area of the curve and allocations to ILBs with a maturity of less than eight years. +

MARKET REVIEW

Improving local economic outlook

FOR THE SECOND quarter of 2021 (Q2-21), the JSE All Share Index was flat (0.0%) in rands. The FTSE/JSE Capped Shareholder Weighted All Share Index returned 0.6% over the last three months and the one-year return is still a very healthy 27.6%, coming off the low base of a year ago. The domestic-focused financial sector delivered strong returns (8.2%), relative to a flat return from industrials (0.8%) and weaker performance from resources.

The stronger-than-expected domestic economy and, especially, the profitability of the mining sector will boost tax revenues for government, bringing some welcome relief to the precarious fiscal situation. This improved outlook was reflected in declining yields on government bonds, leading to a strong 6.9% performance for the All Bond Index over the quarter and 13.7% over the past year. The rand strengthened by 3.5% against the US dollar.

Good returns from global equity markets continued with the MSCI All Country World Index up by 7.4% for Q2-21, resulting in a 12-month return of 39.3%. This brings the recovery from the Covid-19 lows in March last year to approximately 90%. Developed market equities (MSCI World Index +7.7%) outperformed emerging markets (MSCI Emerging Markets +5.0%), as the benefits of more rapid vaccine rollouts allowed for a faster re-opening of economic activity.

Notable emerging market underperformers included Chile and Peru, where markets reacted to an expected shift to the left in economic policy. Vaccine rollout in these markets has generally lagged developed market peers. The emergence of the Delta variant in India highlighted the vaccine gap. Widespread vaccination is critical in slowing the spread of the virus and reducing the threat of further mutations. In South Africa, too, vaccination has been off to a slow start. To date, c. four million South Africans have been vaccinated, which was insufficient to avoid the current third wave and another round of restrictions being placed on the economy.

For Q2-21, the Barclays Global Aggregate Bond Index rose 1.3%, recovering some of its first-quarter selloff.

All local returns are quoted in rands and all international returns are quoted in US dollars.

Key performance indicators and fund performance

AS AT 30 JUNE 2021

		QTD	YTD	1 YEAR	3 YEARS	5 YEARS	10 YEARS	15 YEARS	20 YEARS
INTERNATIONAL INDICES [USD]									
Global Equity	MSCI ACWI	7.4%	12.3%	39.3%	14.6%	14.6%	9.9%	7.6%	7.3%
	MSCI WORLD	7.7%	13.0%	39.0%	15.0%	14.8%	10.7%	7.8%	7.3%
	MSCI GEM	5.0%	7.4%	40.9%	11.3%	13.0%	4.3%	6.6%	10.1%
	S&P 500	8.5%	15.3%	40.8%	18.7%	17.6%	14.8%	10.7%	8.6%
Global Property	Global Property (FTSE EPRA/NAREIT Developed Index)	9.4%	16.1%	34.8%	7.4%	6.0%	7.3%	5.3%	8.8%
Global Bonds	Barclays Global Bond Aggregate	1.3%	(3.2%)	2.6%	4.2%	2.3%	2.1%	3.7%	4.7%
US Cash	3 Month Libor	0.0%	0.1%	0.2%	1.5%	1.4%	0.9%	1.4%	1.7%
SPOT RATES AND COMMODITY PRICES									
Exchange Rates	Rand Dollar exchange rate	14.8	14.7	17.4	13.7	14.7	6.8	7.2	8.1
	Rand Dollar % change	3.5%	2.9%	21.6%	(1.3%)	0.6%	(7.2%)	(4.5%)	(2.8%)
	Rand Euro exchange rate	17.3	18.0	19.5	16.0	16.3	9.8	9.1	6.8
	Rand Pound exchange rate	20.4	20.1	21.5	18.1	19.6	10.8	13.2	11.3
Select Commodities	Gold price (USD)	1 691.1	1 891.1	1 768.1	1 250.5	1 320.8	1 505.5	613.5	270.6
	Oil price (USD barrel)	62.7	51.8	41.3	79.2	49.7	112.5	73.5	26.1
SOUTH AFRICAN INDICES [ZAR]									
SA Equity	ALSI (J203T)	0.0%	13.2%	25.1%	8.1%	8.1%	10.9%	11.1%	13.8%
	CAPI (J303T)	1.6%	14.6%	28.6%	8.3%	7.8%	10.9%	11.3%	-
	Capped SWIX (J433)	0.6%	13.3%	27.6%	4.8%	4.3%	9.8%	-	-
	Resources Index (J258)	(5.0%)	12.8%	29.6%	20.9%	20.6%	5.7%	6.3%	11.2%
	Industrial Index (J257)	0.8%	13.8%	19.4%	6.2%	5.5%	13.5%	14.9%	15.8%
	Financials Index ex property	7.5%	11.7%	31.3%	(3.1%)	0.6%	9.1%	8.7%	10.8%
SA Property	Africa All Property Index (J803T)	11.1%	20.1%	25.6%	(10.7%)	(8.3%)	4.2%	-	-
SA Bonds	BEASSA (TR) All Bond Index	6.9%	5.0%	13.7%	9.2%	9.2%	8.5%	8.6%	9.4%
SA Cash	Short Term Fixed Interest 3 Month Cash Rate	0.9%	1.7%	3.5%	5.6%	6.2%	5.9%	6.8%	7.5%
SA Inflation	Inflation	1.1%	2.8%	4.9%	3.9%	4.2%	5.0%	5.6%	5.6%

	QTD	YTD	1 YEAR	3 YEARS	5 YEAR S	10 YEARS	15 YEARS	20 YEARS	SINCE LAUNCH
DOMESTIC FUNDS (PERFORMANCE IN ZAR)									
Coronation Top 20 Fund	(1.7%)	12.4%	28.6%	9.0%	8.6%	10.8%	12.7%	16.0%	16.9%
ASISA Mean of South African Equity General	0.7%	13.1%	25.3%	5.7%	5.0%	8.6%	9.3%	13.1%	13.4%
Coronation Market Plus Fund**	1.7%	11.6%	26.0%	8.7%	7.5%	10.9%	11.6%	14.9%	14.9%
ASISA Mean of South African Multi-Asset Flexible	2.0%	10.5%	20.5%	5.9%	5.2%	9.6%	9.5%	-	11.0%
Coronation Balanced Plus Fund	1.5%	10.6%	23.8%	8.2%	7.3%	10.5%	11.1%	13.4%	14.0%
ASISA Mean of South African Multi-Asset High Equity	1.9%	9.3%	17.2%	6.7%	5.8%	8.6%	8.7%	12.0%	12.1%
Coronation Capital Plus Fund	2.1%	8.2%	17.7%	6.6%	5.8%	8.3%	9.2%	11.4%	11.4%
ASISA Mean of South African Multi-Asset Medium Equity	2.1%	7.7%	13.8%	6.6%	5.8%	8.1%	7.9%	-	10.8%
Coronation Balanced Defensive Fund	1.7%	6.4%	13.4%	7.0%	6.6%	9.1%	-	-	9.2%
ASISA Mean of South African Multi-Asset Low Equity	2.4%	6.0%	10.8%	6.4%	5.9%	7.9%	-	-	7.5%
Coronation Strategic Income Fund	2.6%	3.3%	6.8%	6.6%	7.3%	8.1%	8.6%	9.8%	9.8%
ASISA Mean of South African Multi-Asset Income	2.2%	3.2%	7.4%	7.1%	7.4%	7.0%	7.7%	-	8.8%
INTERNATIONAL FUNDS (PERFORMANCE IN USD)									
Coronation Global Equity Select Fund	5.6%	12.1%	39.6%	15.0%	14.6%	-	-	-	9.4%
Coronation Optimum Growth Fund	3.1%	1.9%	23.3%	11.7%	11.9%	7.5%	6.7%	10.2%	9.9%
Coronation Global Managed Fund	4.3%	7.2%	24.9%	9.3%	9.2%	6.7%	-	-	7.1%
Coronation Global Capital Plus Fund	3.0%	4.3%	12.0%	5.5%	5.1%	3.6%	-	-	4.4%
Coronation Global Strategic Income Fund	0.7%	1.1%	3.2%	2.3%	2.0%	-	-	-	2.4%

* 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).

Meaningful periods

Not listed here. but included in the following commentaries – Coronation Equity Fund: highest annual return: 62.5% (Aug 2004 - Jul 2005); lowest annual return -28.7% (Mar 2008 - Feb 2009) and Global Emerging Markets Fund: highest annual return 106.2% (Mar 2009 - Feb 2010); lowest annual return -33.6% (Sep 2014 - Aug 2015).

Rest of funds' details available on pages 53 and 55.

Figures as at 30 June 2021; for detailed fund performance. refer to pages 53 - 56.

FUND UPDATE

Coronation Balanced Plus and Coronation Equity funds

By **KARL LEINBERGER** *and* **SARAH-JANE ALEXANDER**

Karl is CIO and manager of Coronation's Houseview strategies.

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

BALANCED PLUS RETURNED 1.5% for the second quarter of 2021 (Q2-21), resulting in a return of 23.8% over the last year. Coronation Equity returned -0.4% for the quarter and 30.2% over the last year. Performance benefited from recovering markets, asset allocation decisions, and alpha in the domestic and global equity building blocks. The funds have performed well against their respective peer groups over all meaningful time periods.

Given this considerable strength, Balanced Plus has reduced its holding in global equities to a neutral level, although we see opportunities for stock-picking. High levels of sovereign indebtedness and low yields keep us cautious on global bonds. There is a rising risk of inflation, as economic restrictions ease amidst tight labour markets.

The Equity Fund's allocation to global equities has benefited the portfolio over time, bolstering returns and improving risk management. The Fund has built a position in AUTO1 Group, which owns the largest consumer-to-business car-buying platform in Europe (the equivalent of South Africa's [SA] WeBuyCars). The European used car markets are ripe for disruption, given the vast but fragmented market and generally poor customer experiences. AUTO1's competitive advantage lies in its cost-efficient sourcing of vehicles direct from the consumer, and superior transactional data and pricing, as well as a growing retail business. The business has a long growth runway ahead. The Fund's exposure to Chinese technology businesses, including Tencent Music Entertainment and JD.com, detracted from performance during the quarter, as these businesses sold off on fears of increasing regulation. Actions by the regulators have focused on anticompetitive practices and data security. We believe these actions are consistent with regulators in many parts of the world where technology companies are having increased social and economic impacts on everyday life, and in many parts are largely unregulated. Having run through a range of regulatory outcomes, we believe share prices are discounting extreme outcomes and believe there is upside at these valuation levels.

In SA, a more resilient domestic economy continued to exceed expectations. Reported first-quarter GDP was up 4.6% quarter on quarter, seasonally adjusted annualised. Constrained power and the poor condition of State-owned enterprises are major headwinds to growth and fiscal sustainability. We note the positive announcements in this regard made during the quarter, enabling greater private power generation and the sale of government's majority stake in South African Airways.

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These factors are driving increased confidence in the domestic outlook. Local interest rates are expected to remain lower for longer, as inflation remains relatively contained. Balanced Plus added to its position in SA government bonds, given this improving backdrop and the attractive real yields on offer. The buying was funded from cash, taking the Fund to a neutral position.

Having increased exposure to SA equities during 2020, we remain overweight in the asset class, given the breadth of value on offer in resources, domestically listed global stocks and domestic shares. Within SA equities, selective buying of domestic shares further narrowed the domestic underweight. Domestic companies continued to report results ahead of our expectations, due to more resilient economic activity and stringent cost-cutting. This has resulted in strong free cash flow generation.

The portfolios remain overweight resource shares given their attractive valuations. Our investment case is not premised on higher commodity prices (we expect most to trend downwards), but rather on the undemanding multiples and generous free cash flow yields, even after adjusting commodity prices lower. In addition, decarbonisation should support sustained demand for metals. Major diversified holdings continue to include Anglo American, Glencore and Exxaro.

We have built a position in the gold equities, which offer upside and reasonably priced protection. Given the increased risk from stretched sovereign balance sheets and high global market levels, the local gold counters offer a well-priced, diversified investment opportunity. Coronation has not owned gold equities for nearly two decades as they traded at extended valuations, suffering from rapidly rising costs and declining production profiles, and offered poor returns to shareholders. For the two former 'SA' gold producers, AngloGold and Gold Fields, the risks have meaningfully changed. Today, these businesses have greater geographical diversification, reduced exposure to SA's deep, complex gold mines, better cost control, healthier production profiles and restored balance sheets. At spot gold prices, we see a margin of safety in valuations and expect better returns to shareholders going forward. You can read a more detailed analysis on page 10 of this *Corospondent*. These positions were funded from selling down platinum group metals shares (currently underweight), which have performed strongly.

The portfolio continues to have considerable exposure to several of the global businesses listed domestically. These are attractive for a variety of stock-specific reasons. Major holdings include Naspers (-15.1% for Q2-21), British American Tobacco (-1.3%), Quilter (-7.0%), Bidcorp (+8.3%), Textainer (+14.8%) and Aspen (+12.3%). The Naspers share price decline reflected underlying price pressure on Tencent as the regulatory environment for technology companies in China intensified, as previously mentioned. Current areas of Chinese regulatory focus include anticompetitive practices and data security.

The Tencent ecosystem is extensive, but we believe this powerful platform is leveraged to the economic benefit of both Tencent and its partners. As a Chinese company, Tencent's data is retained within China. While we acknowledge the increased regulatory scrutiny, Naspers and Prosus continue to offer exposure to an exciting growth asset in Tencent, which is meaningfully underpriced. The Naspers/Prosus management teams are focused on this discount and aligned with shareholders through their remuneration. The announced share swap deal between Prosus and Naspers is unlikely to be sufficient to unwind the discount, but it is the first step.

Distell rose strongly during the quarter (+43.1%) on the news of a potential offer from Heineken. We have long been admirers of Distell's quality portfolio of branded beverages and its long runway for growth as it expands on the African continent. As such, we believe a sizeable premium for the business can be justified.

Within the financial sector, banks (9.6%) and property (12.1%) outperformed the life sector (5.8%). The banks raised significant provisions related to Covid-19 during 2020. Actual defaults are proving to be lower than expected, supporting a faster recovery in earnings for the sector. Further, a resumption in dividend payments by the banks improves returns to shareholders. We increased the domestic banks' exposure during the quarter. Life companies continue to face headwinds, both from lower new business volumes and higher mortality risks related to Covid-19 infections. The funds' major exposure is through Momentum Metropolitan, where the balance sheet is sufficiently strong to withstand these shorter-term headwinds, and the company has highlighted the potential for additional shareholder returns.

Transaction Capital is a new holding in the funds. This entrepreneurially run business recently acquired a controlling stake in WeBuyCars, at what we believe to be a very attractive price. Transaction Capital has demonstrated a strong track record of delivery in its traditional businesses. The addition of WeBuyCars introduces an exciting >

growth vector going forward. WeBuyCars brings convenience, trust, competitive vehicle pricing (backed by proprietary market transactional data) and scale to a fragmented secondhand car market. This superior offer has enabled WeBuyCars to grow its share of the secondhand vehicle market to 10%. We are excited about the prospects of the business over the long term and expect it to make a meaningful contribution to Transaction Capital.

The domestic property sector remains challenged as reduced demand for both retail and office space threatens future rental tension. This, combined with escalating costs (rates, electricity and water), provides ongoing headwinds. However, a more resilient domestic economy should aid faster deleveraging than our initial expectations, reducing the size of the capital raises required. Exposure in Balanced Plus remains small and is predominantly through the more defensive 'A' shares.

While the past 18 months have seen a huge amount of volatility and fluctuating outlooks, our focus remains on seeking out opportunities where the longer-term prospects of assets are mispriced by the market. We continue to believe that this patience will be rewarded. +

FUND UPDATE

Coronation Capital Plus and Balanced Defensive funds

By CHARLES DE KOCK, PALLAVI AMBEKAR *and* NEILL YOUNG

Charles is a senior portfolio manager with 34 years of investment experience.

Pallavi is a portfolio manager with 18 years of investment experience.

Neill is a portfolio manager with 23 years of investment experience.

DESPITE SETBACKS ASSOCIATED with the spread of the Covid-19 virus's new Delta variant, the global economic recovery remains on track. Vaccinations in developed nations have progressed well in most countries and the route to a more normal world is looking increasingly likely. The rollout of vaccines in the emerging world, including South Africa (SA), has been far slower, and the normalisation of these societies and economies will consequently take longer.

The strong performance of commodities and the positive impact on SA's terms of trade have kept the current account in a substantial surplus and has supported the rand. Measured against the US dollar or the euro, the rand is now back to levels last seen five years ago in 2016. The firmer rand has also had a beneficial effect on expected inflation, giving the South African Reserve Bank enough room to keep interest rates at the current low levels for longer.

The past quarter was also marked by a number of positive political developments. The sale of the majority stake in South African Airways, the commitment to give independent private producers the right to generate power of up to 100 megawatts and the cancellation of the Turkish powerships on environmental grounds are signs that practical measures rather than ideology are winning these battles. The fight against corruption has also moved forward with several bold steps, including the suspension of ANC Secretary General, Ace Magashule, the placement on special leave of Health Minister, Zweli Mkhize and, finally, the jail sentence handed down to former President Jacob Zuma by the country's highest court. These significant steps bode well for the future of a cleaner government.

Balanced Defensive posted a return of 1.7% over the second quarter of 2021 (Q2-21) and 13.4% over the past year, while Capital Plus returned 2.1% for the quarter and 17.7% over the past year, both well ahead of their respective inflation plus 3% and 4% targets. Real returns over longer periods are ahead of inflation over most periods. Since inception, Capital Plus and Balanced Defensive achieved very pleasing real returns of 5.8% and 3.6%, respectively.

We often write about the importance of long-term investing and measuring success or failure over long periods of time. In July, Capital Plus celebrates its 20-year anniversary, a period during which its investors have seen bull and bear markets, crashes and booms, currency collapses, the Global Financial Crisis and, more recently, the Covid-19 pandemic. Throughout it all, the investment team at Coronation has tried to navigate these turbulent times by investing in such a way as to grow the portfolios at a rate in excess of >

its targeted real return of inflation +4% while preserving capital as well. It is indeed pleasing to look back at the 20-year history and to be able to report that the Fund has delivered a real return of 5.8% p.a., net of fees.

From an asset allocation perspective, we added exposure to equities after the big pandemic-induced selloff in early 2020. The higher equity exposure and consequent strong price recovery contributed the most to the funds' one-year performance. Within equities, Anglo American, Altron, Northam Platinum, Impala Platinum and FirstRand were the biggest contributors to Fund returns, while British American Tobacco, gold shares and Naspers detracted marginally.

Over the past year, we were very active in Richemont, the luxury goods company and owner of jewellery brands such as Cartier and Van Cleef & Arpels. The funds sold their entire holding in early 2020 on the view that the pandemic-induced travel restrictions affecting China, in particular, would be very negative for the sale of luxury goods. However, towards the end of Q3-20, we took the view that the pandemic will most likely be controlled through global vaccinations, leading to a strong rebound in the sale of luxury goods. We therefore re-established a sizeable position in Richemont. The share price has since recovered well. Although quite highly rated now, its prospects for when global travel resumes, and its exceptionally strong balance sheet are valid reasons to maintain it as one of the funds' top 10 holdings.

At the time of writing, SA is in the midst of the third wave of the Covid-19 pandemic and the vaccine rollout has been far too slow. One can easily succumb to emotions of despair or anger when confronted by this pandemic, but when making investment decisions, one should try to put these emotions aside in order to remain measured, analytical and objective. Our analysis continues to show very good value in many JSE-listed stocks.

Our investment approach of looking through the cycle and focusing on normal earnings leads us to remain fully invested in equities at this time. Subsequent to the selloff of early 2020, we added to our equity exposure and, whereas we have trimmed our global equities somewhat on valuation concerns, we maintain our higher SA-listed stock exposure where we see good value across many sectors and companies.

It is in the global investment universe where we have more concerns. Global government bonds offer very poor value, in our view, and the valuation of equities does not leave much room for disappointment either. The funds are, consequently, not at their full offshore weighting.

We do believe returns in excess of our inflation plus 3% and 4% targets for Balanced Defensive and Capital Plus, respectively, are achievable with the combination of assets currently held within the funds. +

FUND UPDATE

Coronation Top 20 and Market Plus funds

By **NEVILLE CHESTER, NICHOLAS STEIN** *and* **NICHOLAS HOPS**

Neville is a senior portfolio manager with 24 years of investment experience.

Nicholas is an equity analyst with 12 years of investment experience.

Nicholas is an investment analyst and portfolio manager with seven years of investment experience.

MARKET PLUS RETURNED 1.7% for the second quarter of 2021 (Q2-21), resulting in a return of 26% over the last year. Top 20 returned -1.7% for Q2-21 and 28.6% over the last year. For the quarter, the funds benefited from being overweight certain South Africa (SA) Inc. holdings, such as Nedbank and Momentum Metropolitan. At a portfolio level, being underweight SA Inc. detracted. Naspers also detracted from performance. We always strive to manage the funds with a long-term time horizon in mind. For Top 20, alpha since inception has been 3.6% p.a., net of fees.

The end of June 2021 marked the 20th anniversary of the launch of the Coronation Market Plus Fund. It was conceived as a balanced fund unconstrained by Regulation 28 of the Pension Funds Act, allowing it greater freedom around equity holdings and more flexibility on offshore allocation. The idea was that this would allow the Fund to outperform a traditional balanced fund and achieve meaningful real growth over time.

It is therefore pleasing to report that, over the past 20 years, Market Plus did achieve these objectives through what has been a tumultuous time. Over the past two decades, the Fund has delivered an annualised return of 14.9% compared to the quantitative benchmark return of 13.2% and the median balanced fund return of 11.3%. What is particularly pleasing is that over this period, despite never being fully invested in equities, the Fund has also managed to outperform the JSE All Share Index's (ALSI) performance of 13.8% p.a., net of fees. The objective was also to grow real capital over time, which the Fund achieved, having delivered an annualised real return of 9.4% p.a.

Over the past 20 years, investors have suffered some tumultuous moves. Shortly after the launch of Market Plus, SA experienced a massive selloff post the 9/11 attacks, where the rand and local markets were punished. It's unbelievable to think of it now, but the rand moved from just over R8 to the dollar to peak at R13.50 (which is where it was recently trading, 20 years later), only to retrace all those losses and more over the following years.

Shortly thereafter, the Dot.com bubble burst, with the S&P 500 Index collapsing 37% from its highs (the losses for SA investors were much higher, given that the rand strengthened significantly over this period, with peak-to-trough losses of 58% for those who rushed offshore at the height of the 2001 panic).

Then, after a few years of relative stability and a strong upward trend in resource prices, the local market and the world were impacted by the near collapse of the US banking system, which was >

quickly named the Global Financial Crisis as the linkages from the US housing market permeated into global developed financial institutions. The S&P 500 fell by 57% peak to trough, the rand to dollar once again blew out from levels around R6.50 to R11.40, and the resource-dominant JSE ALSI fell 47% from peak to trough.

The recovery that followed was quick and fast as global central banks introduced a term that we would all come to know as QE (quantitative easing). Equity and bond markets around the world responded well to this. But, in SA, it wasn't plain sailing as the Zuma decade started, and we experienced bouts of volatility, none more so than the firing of the Finance Minister in 2015, where the rand moved from R13 levels to R17, exacerbating a market already struggling under the weight of a commodity bear market. Global markets also had periods of volatility with the first 'taper tantrum', various forecasts of the EU collapsing, Brexit and Donald Trump.

And then finally, the recent Covid-19 disaster, where, once again, volatility records were broken, with the S&P 500 Index falling 37% and recovering it all within six months! The rand, again a casualty of global risk appetite, moved from R14 to over R19 to the dollar, and the ALSI fell by over 23%. As global central banks worldwide printed money and cut interest rates on a scale not seen outside of world wars, markets have recovered strongly, and the rand is back at around the R14 level.

What can one learn from this journey? It has certainly highlighted that investing should always be done with a long-term time horizon! Short-term reactions to market moves can often end up damaging long-term returns. As much as we bemoan the fluctuations of the rand, the fact that it floats freely often protects us from the extremes of market moves and changes in risk appetite and, typically, over time, we never see the extreme moves continue but generally retrace as terms of trade adjust to the changed rand levels. It has also shown that, despite all the volatility and complete left-field events, black swans and 100-year events (which seem to happen every seven years), a well-managed multi-asset fund can deliver solid, consistent market- and inflation-beating returns.

What do the next 20 years hold? After living through these past two decades, it would be foolish to hazard a guess, given the surprises and shocks that we have experienced. But undoubtedly, the defining factor for the period ahead is the vast amount of debt issued by (mainly) the developed world and the record level of monetary easing implemented by central banks to deal with the impacts of the Covid-19 lockdowns. It is impossible to believe that there won't be serious repercussions; from inflation, already very evident in asset prices, higher taxes and, ultimately, higher interest rates. The pandemic has also given massive impetus to the push towards a more sustainable world, and this has very meaningful effects on the demand for the 'green' commodities that will be required for this transition.

Market Plus is positioned to deal with these two megatrends. First, regarding inflation, the best asset class remains equities, in particular those with pricing power. The Fund is still holding a relatively high weighting to equities despite the market moves, because they should still deliver real growth in an era of rising inflation. We have avoided owning global bonds. Interest rates are all still trading at artificially low levels, impacted by global central bank buying. And, with inflation spiking, with most regions above the top end of their inflation ranges, these bonds are all yielding negative real returns. The only exception to this is SA.

In SA, our yields are still stubbornly high, with real yields of over 6% in the longer-dated bonds. This is because the South African Reserve Bank is one of the few independent central banks left and has refused to manipulate the yield curve. While concerns around our debt position remain relevant, this is more than reflected in the price. Renewed fiscal discipline from the National Treasury, as evidenced through its approach to wage negotiations, as well as some unexpected windfall tax gains from the commodity sector, should be able to move us back to a sustainable debt reduction path. It remains relevant to consider that SA's total outstanding debt is lower than most developed nations; it is the cost of funding that debt that is the biggest problem. Should that cost come down, the recovery path becomes much more obvious, and bonds will continue to re-rate. Buying the R214, which matures in 2041, you are locking in a return of 10.5% p.a. for the next 20 years – a compelling investment opportunity.

On the trend towards a greener future, the funds have a significant exposure to global miners with meaningful copper production. Anglo American is the only diversified miner to have initiated the development of a new copper mine in the past few years. This production should be coming to the market in 2023, well timed for a huge increase in demand for this metal. Glencore is the diversified miner with the largest percentage of its revenue coming from copper; it also has exposure >

to battery metals, such as cobalt and nickel. To drive renewable electricity production as well as the rollout of electric vehicles, copper demand will increase dramatically. With a combined allocation of around 20% of Top 20 and Market Plus's SA equity exposure to these two companies, the funds are well positioned to benefit from this trend.

On the commodity front, recent newsflow has been dominated by the Chinese government's attempts to cool commodity prices. High iron ore, steel and coal prices benefit producers of those minerals, but lead to inflation and other imbalances that China is attempting to manage. The two main levers they have used is to a) talk down commodity prices by cracking down on 'excessive' financial speculation in commodity markets, and b) sell strategic stockpiles of certain metals. The prices of most metals and minerals have corrected over the quarter, suggesting they have had some success. On point a), our views are that the financial speculation introduces price noise, with prices overshooting and undershooting 'the real price', i.e. the one set by underlying supply and demand factors. To this end, demand has remained robust (if slowing a bit off a strong base) and supply discipline remains intact. As such, we expect China's attempts to show only moderate and short-term success. To truly cool prices, China would need to demand fewer metals and minerals. This requires lower growth, with growth being sacrosanct to the Chinese government. On point b), stockpile sales have been small. Ultimately, they would need to be replaced in future, resulting in 'excess' demand.

Despite the fact that we view commodity prices as high, we don't view the share prices as high. The market has taken quite a sceptical approach to this cycle, with share prices lagging commodity prices, resulting in shares trading on undemanding multiples. Put differently, the share prices are discounting commodity prices well below spot (and in many cases below our base case for where they settle). Supply discipline and generous free cash flow yields add to the appeal of the investment cases.

We were net buyers of SA Inc. shares over the quarter, increasing our exposure to Sanlam and the banks. On the back of the strong turnaround in the banking sector's operating performances and, yet, the poor performance by their share prices, we increased our exposure to the sector. Given our meaningful positions in Nedbank and Standard Bank, we chose to increase the exposure through a new position in FirstRand. As always, we seek to build portfolios that can withstand a range of outcomes. Our SA Inc. holdings sit alongside great global businesses, growing strongly at attractive valuations, as well as mining shares, which also have attractive valuations and material free cash flow yields.

We are still not overweight SA, as we do see the need to temper some of the SA Inc. enthusiasm. The slow pace of our vaccine rollout puts us at a disadvantage compared to other nations, which are seeing returns to normalisation and a more meaningful economic rebound. SA has large tourism, leisure and hospitality sectors, which employ many workers. These sectors remain depressed, with a long, drawn-out recovery ahead.

We continued adding to our gold position. We view gold as cheap insurance at a time of heightened risk and find valuations compelling. We have long seen gold equities trade at multiples of net present value. We now see them at discounts using spot prices and see upside risks to the gold price.

Naspers declined 15.1% over the last quarter. This decline followed a strong run in Q1-21, which left Naspers flat for the first six months of the year. Two factors have been the dominant contributors to this underperformance. The first is the Naspers/Prosus share swap announced in May and the second is that the Chinese authorities have placed tighter controls on technology firms when it comes to deemed monopolistic behaviour and data security. There is a concern in the market that the Naspers/Prosus share swap creates added complexity and may orphan the Naspers asset. We believe that it will not be the final iteration and that, down the line, more steps will be taken specifically to unlock the discount at the Naspers level, should it persist.

While there has been no direct action by the Chinese regulators on Tencent, some subsidiary companies have been reviewed, and the risk remains that, at some point, Tencent receives similar attention. We do not dismiss this risk but believe that the impact on Tencent's three key business verticals is unlikely to materially reduce the asset's long-term value, especially when bought at a large discount through Naspers/Prosus. In the gaming business, the Chinese government has already tightened regulations, and Tencent is compliant; the company also has a strong international component to this business. Stringent consumer data protection within Weixin and the open nature of this platform reduce the likelihood that its advertising business will be targeted. We see the risk of regulatory intervention as highest in the fintech business. Here, we gain comfort that payments, which carry a lower regulatory risk than other financial products, make up 70% of the business and that the non-payments business

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is in line with new regulations. There is a lot of uncertainty, but our analysis leads us to believe that Tencent is on the right side of the regulatory bodies.

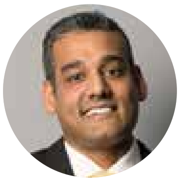
An asset class with a very uncertain future is property. The slow shift from physical retail to online was given a huge boost during the lockdowns, resulting in certain retail properties no longer generating rentals. Over and above this, working from home became a reality through lockdown as technologies enabled this. Certain industries are now contemplating this being the future, even in a more normal environment. This has impacted rental tension on these two major property segments, making it difficult to forecast what yields and values these assets will trade at in future. It's too soon to tell. As society reverts to normal, we see that the desire to socialise is as strong as ever, meaning that certain venues will continue to attract footfall. The challenges of maintaining corporate culture and teamwork in a distributed environment will also become more evident as time goes on. As a result, Market Plus has not invested heavily into the property sector, locally or globally, but maintained a small exposure to high-quality, low-geared names. Top 20 has no property exposure.

One of Coronation's core tenets is that without clients, we have no business. Indeed, without the loyal support of the investors in our funds, none of our achievements would have been possible. We never take our responsibility to grow our clients' capital lightly. It is a privilege we are conscious of, and we strive to maintain and improve our performance every day. +

FUND UPDATE

Coronation Strategic Income Fund

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



Nishan is Head of Fixed Interest and has 18 years of investment experience.

Mauro is Head of Fixed Interest Research and a portfolio manager, and has 10 years of investment experience.

THE FUND RETURNED 2.6% for the second quarter of 2021 (Q2-21), bringing its total return to 6.8% for the 12-month period. This return is ahead of cash (3.5%) and its benchmark (3.9%). Celebrating its 20-year anniversary in July, the Fund's annualised and cumulative returns ahead of its benchmark since inception are 1.6% and 163.1%, respectively.

South Africa's (SA) recovery has been elevated by the current global environment, translating into strong asset price performance. The rand is up c.3% against the US dollar this year, with most of that performance coming through in Q2-21. This is pretty much in line with its emerging market peer group (except Brazil, which has enjoyed a more significant recovery in its currency following the commencement of its pre-emptive rate hiking cycle), but what has set SA apart is the performance of its local bonds. Despite the yield on the 10-year bond being 30 to 40 basis points higher since the beginning of the year, the FTSE/JSE All Bond Index (ALBI) has returned 5.0% this year (6.9% over Q2-21). This has been led by the strong performance of bonds with a maturity of >12 years, as the yield curve has continued to flatten. Inflation-linked bonds (ILBs) had a poorer quarter, returning c.3%, but remain ahead of ALBI returns year to date (7.7%). Both ALBI and ILB returns remain well ahead of cash for the quarter (0.9%) and the year (1.7 %).

June saw developed market central banks maintaining monetary policy rates and revising growth expectations upwards, following increased economic activity and success in rolling out the vaccine programme. In emerging markets, a few central banks surprised the market with rate hikes as inflation pressure continues to rise.

In the US, the Federal Reserve Board (the Fed) left policy rates unchanged at 0.00% to 0.25%, and maintained the size of the asset purchasing programme, as expected by the market. The post-meeting communication highlighted growth risks to the upside as economic data has positively surprised expectations. Importantly, though, the Fed turned more cautious on inflation, revising its 2020 forecast up to 3.4% from 2.4% at the previous meeting – although the gains are still deemed likely to be temporary. Headline inflation accelerated to 5% year on year (y/y) in May from 4.2% y/y in April. The uptick was the result of a combination of factors, including low base effects, increased energy prices and an extension of high used vehicle prices. Core inflation rose to 3.8% y/y in May from 3% y/y in April.

In emerging markets, China's headline inflation increased to 1.3% y/y in May from 0.9% y/y in April. The upward pressure came from a mix of factors, including increases in the cost of non-food goods,

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transportation, communication, clothing and education. Core inflation increased to 0.9% y/y in May versus 0.7% y/y in April. Elsewhere in emerging markets, central banks in Brazil, Mexico, Russia and Hungary hiked policy rates as inflation concerns mount. Inflation pressures are seen to be on the upside, owing to base effects, increasing demand and rising commodity prices.

The rand was stronger over the quarter but weaker over June, in line with the performance of high-yielding emerging market assets. This was further buoyed by positive developments on the growth and political front in SA, which helped the rand end the quarter at $1/R14.28. The Fund maintains its healthy exposure to offshore assets. When valuations are stretched, it 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 Q1-21, SA's GDP was stronger than expected at 4.6% quarter on quarter (q/q), seasonally adjusted annualised (saa), compared to a revised growth of 5.8% q/q saa in Q4-20. Positive contributions came from financial and business services, mining, manufacturing, transport and trade sectors. From the demand side, household and government spending slowed down but remained positive contributors to GDP, while inventories provided a strong boost, as these were drawn down at a slower pace than before. The new restrictions could dampen third-quarter GDP this year, despite efforts made to limit the impact on the broader economy.

Headline inflation accelerated to 5.2% y/y in May from 4.4% y/y in April. Core inflation was stable at 3.1% y/y in May versus 3.0% y/y in April. The inflation uptick largely reflects base effects related to fuel and somewhat higher food and apparel prices. The South African Reserve Bank left rates unchanged in May, but more recent comments from Monetary Policy Committee members suggest some growing caution about the outlook for inflation.

At the end of June, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 6.07% (three-year) and 7.14% (five-year), significantly higher than the close at the end of the previous month. This was largely driven by expectations for higher inflation, reduced stimulus and quicker rate normalisation speeds across global emerging and developed markets. However, SA's more moderate inflation expectations suggest that the 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 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) and we will remain cautious and selective when increasing exposure.

Global monetary policy normalisation will take the form of the tapering of bond asset purchase programmes, followed by a rise in policy rates. This will result in global bond yields moving higher over the next few years. Historically, the pace and magnitude of the rise in global bond yields have had significant repercussions for the local bond market. More specifically, the more sudden and sizeable the selloff in global bond yields, the larger the rise in local bond yields. Currently, the US 10-year Treasury Bill (a proxy for global bond yields) is at 1.50%, and pricing in the forward market puts expectations for this rate to be at 2% to 2.25% over the next two to three years.

The magnitude of the move is not large by historical standards, although the pace of the repricing will remain unpredictable. Local bonds have generally had a high beta (a relative measure of volatility between two assets) with US 10-year bonds. However, the spread between SA bonds and US bonds is at historically wide levels, primarily due to the deterioration in SA's fiscal metrics. It is plausible that with SA's fiscal metrics recovering, this spread is too wide and should narrow, implying that even if US bonds were to selloff, the equivalent selloff in SA bonds should not be severe. As the spread has widened, the beta between the two assets has decreased; that is, the influence of US rates on SA rates has diminished. This suggests that the risk premium embedded in SA bonds should absorb a significant amount of the widening in global bond yields.

The prospects for the local economy have improved as reform progress has gathered momentum and global developments have provided tailwinds to the local recovery. Inflation is moving higher but should remain under control despite uneasiness around global inflation. The recovery in growth should gain more traction and spill into next year, which will provide more breathing space for the fiscus. SA government bonds (SAGBs), despite their recovery in Q1-21, still embed a significant risk premium relative to cash. The steepness of the yield curve makes the 12- to 15-year area attractive, even if the local rate hiking cycle starts sooner than expected. We continue to favour positions to SAGBs focused in the 12- to 15-year area of the curve and allocations to ILBs with a maturity of less than eight years.

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The local listed property sector was down 3% over June, bringing its 12-month return to 25.6%, and has been the largest drag on the Fund's performance. The balance sheet concerns coming out of the Covid-19 crisis have subsided somewhat as companies have managed to introduce dividend payout ratios (with some withholding dividends entirely) and sell assets. 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 down 4.2% over the month, bringing its 12-month return to 14.8%. 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, limiting availability. In addition, most of the bank-related preference shares trade at a discount, which enhances their attractiveness for holders from a total return perspective and increases the likelihood of bank buybacks. Despite attractive valuations, this asset class will continue to dissipate, given the lack of new issuance and because its associated risks are classified as eligible loss-absorbing capital (only senior to equity). The Fund maintains select exposure to certain high-quality corporate preference shares but will not actively look to increase its holdings.

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 6.35% 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. +

FUND UPDATE

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

By **NEIL PADOA, HUMAIRA SURVÉ** *and* **LOUIS STASSEN**

Neil is Head of Global Developed Markets and has 13 years of investment experience.

Humaira is a portfolio manager with nine years of investment experience.

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

GLOBAL EQUITY SELECT returned 5.6% for the quarter under review (Q2-21) and 14.6% p.a. over five years. Global Managed returned 4.3% for Q2-21, 24.9% over one year (with the strong market recovery evident) and 9.2% p.a. over five years. Global Capital Plus returned 3% for Q2-21, 12% over one year and 5.2% p.a. over five years.

Equifax, one of the three largest US credit bureaus, is a more recent addition to the portfolios and has contributed to performance from the get-go. Credit bureaus effectively collect information on all credit-active individuals and sell this data and associated analytics to banks and other credit providers, who use it to gauge the riskiness of a loan. These are advantaged businesses – high barriers to entry, pricing power and operating leverage translate into highly recurring, highly profitable revenue streams. At the time of our purchase, we did not think the market fully appreciated an inflection in Equifax's growth.

Equifax had lagged the rest of the sector since it fell victim to a large-scale data breach in 2017, when the personal information of 148 million individuals was compromised. This event spurred significant changes in its business. Under a new management team, it has spent $1.25 billion on a new IT platform, moving all its data and applications to the public cloud. While this has been a painful process, it has allowed the company to reduce costs and materially accelerate the pace of new product development. We saw concrete evidence of this towards the end of 2020 and further momentum early in 2021.

Equifax's biggest differentiator, though, in our view, is its Workforce Solutions business (EWS). Painstakingly built over a number of years by building relationships with employers and payroll service providers, it has the largest national employment and income verification database. During the past year, it surpassed a key level of having more than half of the non-farm US payroll in its database. In our view, this business has reached a tipping point, where the penetration is sufficiently high for clients to embed EWS in their workflow, resulting in more frequent usage and sticky relationships. Despite its dominance (no competitor comes close), there is still a long runway for growth for EWS, as it expands the dataset and launches new product applications.

Finally, Equifax is heavily exposed to the mortgage market. With interest rates remaining low, a wave of mortgage refinancing over the past year has increased demand for credit reports and employment verification. It has benefited disproportionately from this growth in the mortgage market and there is some justified concern that revenue growth could stall when the mortgage market cools. We claim no special

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insight in guessing when that may be, but believe the long-term penetration growth in EWS, as well as a cyclical recovery in non-mortgage-related lending, should provide sufficient offset. With the price up over 40% since March, we think many of these favourable characteristics are now closer to being priced in.

In contrast, JD.com is a long-standing position, owned since May 2014 when the company listed. JD.com is the second-largest e-commerce retailer in China, with 500 million customers reported at the end of March, compared to 387 million in the comparable period a year ago, with management aiming to gain a further 100 million in the year ahead. Customer growth has been driven by a greater assortment and improvements in fulfilment. The company's incredible logistics arm employs 200 000 people and has more than 1 000 warehouses, giving it almost complete geographical coverage of this massive country – all within its own control. More than 90% of orders are delivered either on the same day or the next day. Customer loyalty is most evident when looking at purchase frequency and spend, which have increased four-fold and five-fold, respectively, since 2015.

JD.com has been effective in incubating new business units, with the most notable being JD Logistics (described above) and JD Health (an online health platform). Both have been separately listed successfully, with the holding company retaining 64% ownership in JD Logistics and 69% ownership in JD Health. This dynamic is important to consider when thinking about the implied valuation for the core retail business. The entire group has a market value of $118 billion, but the market value of its listed stakes ($50 billion), together with the most recently reported net cash ($19 billion), means the market values the retail arm at around only $50 billion. The core retail business should generate $135 billion in revenue this year at a 4% earnings before interest and taxes (EBIT) margin. We believe this margin is well below normal, which could potentially be high single digits. If you apply a conservative 6% EBIT margin and the statutory 25% tax rate, the core retail business trades on less than nine times earnings for this year. Even at the current 4% margin, the multiple is only 12 times earnings for a company growing topline at 20% p.a.

This analysis ignores other balance sheet investments that the group has, namely, JD Technology (fintech and cloud) and JD Property, which is increasingly housing the business's physical logistics assets off-balance sheet by bringing in capital partners.

A final point worth considering is that the increased scrutiny of the technology sector in China could potentially benefit JD.com's retail business. It has historically been hurt by 'pick-one' tactics, whereby a brand that sells on multiple platforms is penalised on Alibaba's platforms. These tactics have resulted in JD.com offering an inferior assortment for some key categories, such as fashion and beauty products. With the banning of these tactics by the regulators, merchants have been free to sell all products on all platforms, which should further improve the customer value proposition. The share is down around 25% from its peak in mid-February this year and offers around 100% upside to fair value, in our view. This is extremely attractive in both absolute and relative terms, and JD.com is thus a 3.5% position in Global Equity Select, a 2.1% position in Global Managed and a 0.8% position in Global Capital Plus.

At quarter-end, Global Managed was positioned with 75% in growth, or risk, assets comprising the following:

- 59% effective equity
- 4% in property
- 5% in infrastructure
- 1.5% in convertible instruments
- 5% in high-yield credit

The remaining 25% of Global Managed is invested in either more stable assets or diversifying assets, which we think are attractive in their own right and have a lower correlation to equities:

- 7% in commodities
- 1.5% in inflation-linked bonds
- 6% in absolute return/hedged equity positions
- 10% in investment-grade fixed income

As highlighted in prior commentaries, we continue to feel that the fundamental diversification evident in this portfolio construction is both more appropriate and more robust than that of Global Managed's benchmark, which includes a 40% weighting to the Bloomberg Barclays Global Aggregate Bond Index. As a reminder, the Index as a whole offers a low nominal expected return and a negative real return. Setting this meagre return against the risks, which we feel are significant, including huge budget deficits and elevated debt levels, suggests to us that this offers a poor risk-reward trade-off and that investors will do well to avoid these instruments. In our view, they will be better served over the long term by holding a blend of fundamentally attractive growth assets and more stable diversifying assets, as outlined above.

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At quarter-end, Global Capital Plus was positioned with 48% in growth, or risk, assets comprising the following:

- 28% effective equity
- 5% in property
- 4.5% in infrastructure
- 2% in convertible instruments
- 8.7% in high-yield credit

The remaining 52% of Global Capital Plus is invested in either more stable assets or diversifying assets, which we think have a lower correlation to equities:

- 8% in commodities
- 2% in inflation-linked bonds
- 7% in absolute return/hedged equity positions
- 35% in investment-grade fixed income (primarily 14% in short-dated Treasury bills and 19% in investment-grade corporate credit)

As highlighted in prior commentaries, we continue to feel that the fundamental diversification evident in our portfolio construction, with the duration of the fixed-income holdings kept very short, is both more appropriate and more robust than Global Capital Plus's cash benchmark or a significant position in developed market bonds.

Markets are at record highs, and, considering the context of historically solid returns coupled with near-term multiples on the high side, it would seem reasonable for investors to temper future return expectations. But as a reminder, we don't own the market. In fact, the funds' concentrated equity holdings look quite different to the market, and, in our view, are qualitatively more durable and higher quality, and are well placed to deliver attractive returns over the long term.

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

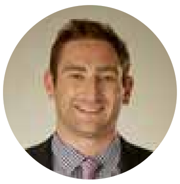
FUND UPDATE

Coronation Optimum Growth and Global Emerging Markets funds

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

Gavin is Head of Global Emerging Markets and has 22 years of investment experience.

Suhail is a global emerging markets portfolio manager with 19 years of investment experience.



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

OPTIMUM GROWTH

Measured in rands, the Fund declined 0.4% in the second quarter of 2021 (Q2-21), compared with a benchmark return of 2.7%, which resulted in 3.1% underperformance for the period. This underperformance is disappointing, yet we believe that the collection of assets held by the Fund offers compelling long-term, risk-adjusted returns with which to deliver on its goal of compounding capital well ahead of inflation.

While we are by no means happy with the short-term underperformance of the Fund over the past year, something to bear in mind is that c.90% of the Fund's investments are offshore, and the rand's 17% appreciation over this period has been a headwind. It should be further acknowledged that the past year has particularly benefited economically sensitive businesses, as actual macroeconomic numbers have materially outperformed expectations within the depths of despair last year. With this, economically sensitive businesses' actual earnings performance has also been significantly ahead of expectations, driving the sharp outperformance of these types of stocks.

The Fund has, and continues to own, far less of these sorts of businesses, which are often lower quality as well. Macro is inherently difficult to predict, as the last 12 months have shown. Thus, we prefer to invest in businesses that benefit from structural tailwinds, led by excellent management teams who ultimately determine these businesses' long-term success, as opposed to hard-to-predict macroeconomic factors that businesses cannot control. Valuation, however, has always been our guiding principle in determining whether to deploy your Fund's capital into these sorts of businesses.

We remain confident that the Fund is well positioned to achieve outperformance over the long term with these key principles in mind. Over the past five years, the Fund has generated a rand return of 11.3% p.a., over 10 years a return of 15.9% p.a. and, since inception over 20 years ago, 14.1% p.a. (2.6% annualised net-of-fees outperformance).

It appears that our expectation of a disjointed normalisation experience is playing out across different geographies as varying degrees of vaccine coverage are achieved, which continues to create complexity for many businesses that operate across geographies. Emerging variants of Covid-19 are also contributing to increasing uncertainty, and short-term visibility remains low. During the quarter, the largest positive contributors were Alphabet (+13.3%, 0.3% positive impact), Facebook (+14.0%, 0.3% positive impact), Heineken (+14.1%, 0.3% positive impact) and Mercari (+13.1%, 0.2% positive impact). The largest negative contributors were New Oriental Education (-45.3%, 0.7% negative impact), Naspers (-15.0%, 0.7% negative impact) and Tencent Music Entertainment (-27.6%, 0.5% negative impact).

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New Oriental Education is a business focused on after-school tutoring (AST) of Chinese students. The share came under considerable pressure due to potential regulations that could impact the AST industry. These regulations could come in the form of restrictions as to when AST is allowed, which, if implemented, would materially impact the future growth of New Oriental. Against this backdrop, we conducted extensive expert calls to obtain insight into the potential regulations. From this work, we are more comfortable that even though new regulations will be instituted, they will most likely be less draconian than feared. Thus, the negative share price movement appears to be overdone. However, we are cognisant of the risk inherent in this view, and therefore the position has been sized accordingly, at 1.2% of the Fund, notwithstanding the significant potential upside on offer.

The Fund ended the quarter with 79.4% net equity exposure, roughly 2% higher than at the end of March 2021, as we found compelling equity opportunities.

Our negative view on global bonds remained 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. We did, however, buy South African (SA) bonds in the quarter, which now represent 1.6% of the Fund. Our view on the SA fiscal situation has improved somewhat due to record current account surpluses, driven by buoyant commodity markets, a commitment to structural reform as evidenced by the change in regulations toward private power generation, and the acceptance of a private partner for South African Airways, coupled with a commitment towards austerity regarding the public sector wage bill. Considering this backdrop, we feel the current yields on offer for SA government bonds are compelling enough to have exposure.

The Fund also has c.2.2% invested in global property, largely Vonovia (German residential). Lastly, the Fund has a physical gold position of 3.2%, a 0.82% holding in AngloGold Ashanti and a 0.74% holding in Barrick Gold Corp, the largest gold miner globally. The gold price is down approximately 9% in US dollars year to date, but we continue to hold the position for its diversifying properties in what we characterise as a low-visibility world with inflation risks. The balance of the Fund 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 SA.

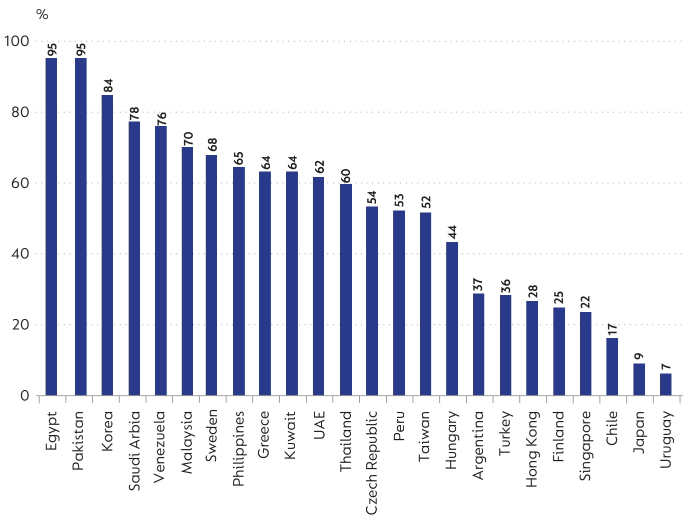
As the outlook for the future remains uncertain and hard to predict, we take comfort in the fact that the Fund holds a collection of businesses that we feel are attractively priced and can operate in what we deem a highly complex and fast-changing environment. Also, because the Fund is a multi-asset flexible fund, we have access to additional tools to take advantage of dislocations in the market, with the continued increased equity exposure being an example.

Notable buys/increases in position sizes during the quarter were Delivery Hero and AUTO1.

Delivery Hero is an online food delivery business with a leading market share position in markets that account for more than 95% of its gross transaction value, which makes it extremely well placed in a winner-takes-most or, at least, oligopolistic industry (Figure 1). 67% of its current gross transaction value comes from Asia, with Korea contributing 53% to the group's gross transaction value. The Middle East and North Africa region then makes up 20%, with Saudi Arabia the key market. We feel there are material, secular tailwinds for food delivery, with the current penetration of home delivery of takeaway food in Delivery Hero's markets only amounting to 32%, which should materially increase due to the consumer value proposition of home-delivered food. Notwithstanding the business being loss-making at a group level, we're encouraged by the positive economics of the company's more mature regions, which provide a pathway to future overall

Figure 1

DELIVERY HERO HAS >50% MARKET SHARE IN MAJORITY OF ITS MARKET (2021)



Source: Bernstein and Apptopia analysis profitability. The business is attractive based on our long-term assessment of business value.

AUTO1 is the leading online used car platform in Europe, providing a significantly better consumer experience for buying and selling used cars. It also acts as a key destination for a fragmented European dealer base from which to buy or sell cars. At 1%, online penetration of used car transactions is extremely low across Europe, but it is set to rise as an increasing number of consumers become accustomed and willing to purchase a used car online due to the materially improved experience offered by AUTO1 (45% of European consumers are willing to buy a used car online). The company is a first mover, has pan-European exposure (important for vehicle sourcing) and is founder-led (the founders continue to own 25% of the business). The economics of the business have been improving and the company is already close to breakeven, notwithstanding heavy investments for growth. We are confident that the long-term economics of the business will be attractive, along with the immense future growth prospects.

Vaccines have continued to roll out across the world, and this should continue in the months ahead, with the hope that we are close to the end of the pandemic and its devasting effects. However, further uncertainty has been brought about due to emerging virus variants. Against this backdrop, we remain positive on the outlook for the Fund, which has been built bottom-up, with a collection of attractively priced assets to provide diversification and achieve the best risk-adjusted returns going forward.

GLOBAL EMERGING MARKETS

Measured in US dollars, the Fund returned 0.4% in Q2-21, lagging the 5.1% return of the benchmark MSCI Emerging Markets (Net) Total Return Index by 4.6%. This underperformance has reversed the positive start to the year, and the Fund now lags the benchmark over the last year by just over 4%. Although this short-term underperformance is disappointing, we believe some drivers are shorter term in nature and driven by stock-specific moves, which are discussed below. Over more meaningful long-term periods, the Fund is still well ahead of its benchmark, by 2.3% p.a. over three years, 0.8% p.a. over 10 years and by 2.0% p.a. since inception, just shy of 13 years ago.

The biggest positive contributor to relative performance (alpha) in the quarter was Sendas Distribuidora SA. We spoke about Sendas in our last quarterly commentary, when it had been freshly spun out of its previous holding company, CBD, with shareholders receiving an equal number of Sendas shares to their CBD shareholding. This was done to better realise value by separating the cash-and-carry operation of CBD (which became Sendas) from the supermarket, hypermarket and convenience store formats, which remain part of CBD. The cash-and-carry business was run separately from the other formats, so there were no real gains from having everything under the same roof other than saving a few central costs, which were dwarfed by the poor rating applied to the company as a whole.

This transaction has proven to be a spectacular success, with the individual shares of Sendas and CBD now (as at 30 June) trading at a combined share price of R$124, compared to a share price for CBD of R$71 at the beginning of the year and R$79 just before the spinoff at the beginning of March. The biggest pickup was in the much-maligned CBD, which has almost doubled in value since the separation (in local currency terms). As a result, we sold out of CBD completely, as it reached our assessment of fair value. The Sendas position we retained returned 31.9% in the quarter, contributing 54 basis points to relative performance.

There were a few other material positive contributors during the quarter. First of these was Momo.com, the leading Taiwanese e-commerce retailer, which almost doubled and contributed 0.4% to alpha. Additionally, the 18% return from global brewer Heineken contributed 0.3% to alpha, while the 40% return from Brazilian education stock YDUQS contributed 0.2% to alpha.

The largest negative impact on relative performance came from the decline in the combined Naspers/Prosus position. We hold these stocks in preference to holding Chinese internet firm Tencent, as they trade at a significant discount to their look-through value. The Fund holds a large (average 9.0% position in the quarter) position in Naspers and Prosus, and the 12.3% aggregate negative return from these positions had a 1.5% negative impact on relative performance. This was partially offset by not owning Tencent directly, as it is the second-largest stock in the benchmark (over 5% weight at quarter-end).

With Tencent returning -3.9% in the quarter, this zero Tencent weight contributed a positive 0.5% to relative performance. The correct way to look at the overall impact is to combine the two, and in this case, the combined impact was therefore -1%. This was a direct reversal of the situation that occurred in the first quarter and was caused by the discount to which Naspers and Prosus trade relative to Tencent widening once more. Prosus, which was originally spun out of Naspers to narrow >

the discount, has announced a scheme to purchase Naspers shares by means of a tender offer. This tender offer is aimed at addressing the discount. Coronation is currently engaged in discussions with Naspers and Prosus in this regard.

The second-largest detractor was the Chinese AST provider New Oriental Education. We added to the existing New Oriental position late in the last quarter after a 25% share price decline so that it had reached a 2.5% position by March quarter-end. Unfortunately, the regulatory news that led to the original share price decline continued to develop negatively, and the share declined substantially further during the latest quarter, costing the Fund 1.4%. New Oriental is now 55% below the levels it traded at in mid- March.

What initially started as a crackdown on payment practices and lax business registration, which we expected to benefit New Oriental at the expense of less scrupulous operators, morphed into a full-blown review of the tuition industry. There has been much speculation in the press on what this will look like, with the country's President opining that schools should shoulder the majority of the burden in educating children, rather than children relying on AST.

There has also been an indication that younger children (K-9 years) should not experience so much pressure so early in their school career, as there is already enough pressure later on when the school-leaving *gaokao* exam is taken. The range of outcomes for AST providers is being speculated to include total bans for younger students, a ban on the marketing of AST services and restrictions on offering classes during weekends and/or school holidays.

With this range of outcomes, it is not surprising that the share prices of New Oriental and other players have reacted so negatively. It is impossible to know the final outcome with any degree of certainty; however, we have spent a lot of time talking to industry experts, ultimately assessing what each potential regulatory change could do to the earnings power of the listed players and comparing this to their current share prices. Each business is slightly different. Some are more online-focused (rather than offline/face-to-face tutoring), and some are more exposed to K-9 versus years 10 through to 12. Each also has a different cost structure, and the flexibility to adjust this cost structure varies between them.

Overall, we believe that New Oriental's share price already reflects a fairly dire outcome. The risk/reward is attractive in our view and thus we have kept the position around 2.3% of the Fund. However, we are cognisant of the overall exposure to the sector, given the wide range of potential outcomes, and we therefore sold out completely from TAL, one of New Oriental's competitors. TAL, which has higher K-9 exposure, was trading at a higher starting rating, with a lower upside to fair value, and therefore we believed it had more potential to derate significantly in a worst-case outcome.

The next most significant negative contributor was Tencent Music Entertainment. This was also a stock that declined late in the previous quarter and returned a further -24.5% in the latest quarter. This position cost -0.9% of relative performance. Operationally, Tencent is doing well, despite a challenging base in the first quarter of 2020 when China was mostly locked down, which was good for its business. Revenue in Q1-21 was up 24% year on year, with operating profit up 12% and accompanied by great cash generation. The company even bought back roughly $200 million of stock, a rarity among Chinese businesses.

The reason for the share price decline is anti-trust-related. Like most dominant firms in China, Tencent has attracted attention from Chinese regulators. The first issue relates to exclusive content, which in our view is manageable as only a small part of Tencent's business today is exclusive. The second is speculation that two previous acquisitions (Kuwo and Kugou) may not have been properly approved by the authorities prior to being effected. The potential remedies ranged from a fine to a forced unwind of these deals. Our research suggests that the 'nuclear' option of a forced unwind has roughly been reflected in the halving of the share price since it peaked in March. The forced sale of Kuwo and/or Kugou would, of course, result in corresponding proceeds to Tencent and would still leave QQ Music (the original music app before the acquisitions) having around 35% market share, which is the approximate market share held by Spotify (the Global No. 1 and No. 1 in most countries) in most of its markets.

The last material detractor was JD.com, which returned -5.5% in the quarter and cost the Strategy -0.5% alpha. JD is the second-largest e-commerce retailer in China, with 500 million customers reported at the end of March compared to 387 million in the comparable period a year ago, with management aiming to gain a further 100 million in the year ahead. Customer growth has been driven by greater product variety and improvements in fulfilment. JD.com's incredible logistics arm employs 200 000 people and has more than 1 000 warehouses, giving it almost >

complete geographical coverage of this massive country – all within its own control. More than 90% of orders are delivered either the same day or the next day. Customer loyalty is most evident when looking at purchase frequency and spend, which have increased four-fold and five-fold, respectively, since 2015.

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A final point worth considering is that the increased scrutiny of the technology sector in China could potentially benefit JD.com's retail business. It has historically been hurt by 'pick-one' tactics, whereby a brand that sells on multiple platforms is penalised on Alibaba's platforms. These tactics have resulted in JD.com having an inferior assortment for some key categories, such as fashion and beauty products.

With the banning of these tactics by the regulators, merchants have been free to sell all products on all platforms, which should further improve the customer value proposition. The share is down around 25% from its peak in mid-February this year and offers around 100% upside to fair value, in our view. This is extremely attractive in both absolute and relative terms, and JD.com is thus a 7.1% position in the Fund.

There were two new buys in the quarter, Delivery Hero (1.5% of the Fund) and Anglo American (1.0% of the Fund). Anglo American was purchased for both valuation and diversification reasons. The Fund has little commodity exposure at a time where demand is generally more than supply and prices are rising as a result of this mismatch. Unlike the 2007 period, where miners were trading at high ratings (multiples) on unsustainably high earnings, ratings today are generally quite reasonable, even if spot commodity prices are at the higher end of their normal range.

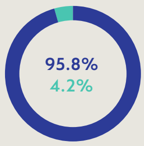
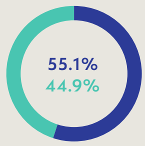
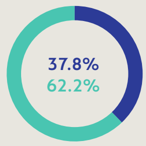
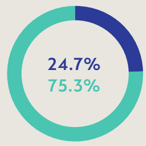
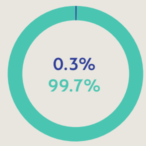
In the case of Anglo American, the company trades at around 6.5 times 12-month forward earnings and offers a 7% dividend yield. Importantly, it trades at less than 11 times earnings if its key commodities were to return to our assessment of normal prices. In previous commodity booms (most notoriously in the run-up to 2007), miners blew all their profits on massive expansion projects that ultimately caused prices to tank, or they bought one another out at astronomical valuations, only to see share prices fall later in tandem with commodity prices. This time around, behaviour has been more disciplined, so it is less likely that this mistake will be repeated. From an environmental, social and governance perspective, Anglo American has no direct oil exposure and have spun out its coal assets to shareholders, leaving shareholders with platinum group metals, iron ore, diamonds and copper making up more than 90% of profits.

The other new buy, food delivery business, Delivery Hero, is covered in detail on page 49. +

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 C-SWIX†
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	 95.8% 4.2%	 55.1% 44.9%	 37.8% 62.2%	 24.7% 75.3%	 0.3% 99.7%
LAUNCH DATE	Jul 2001	Feb 2007	Jul 2001	Apr 1996	Oct 2000
ANNUAL RETURN[2] (Since launch)	9.8% 7.5%†	9.2% 5.7%†	11.4% 5.6%†	14.0% 13.0%†	16.9% 13.4%†
QUARTILE RANK (Since launch)	1st	1st	1st	1st	1st
ANNUAL RETURN (Last 10 years)	8.1% 5.9%†	9.1% 5.0%†	8.3% 5.0%†	10.5% 11.4%†	10.8% 10.7%†
STANDARD DEVIATION (Last 10 years)	2.2% 0.3%†	5.6% 1.3%†	7.1% 1.3%†	9.6% 8.7%†	14.2% 13.9%†
FUND HIGHLIGHTS	The Fund remains the top-performing fund in its category since launch in 2001 and outperformed cash by 2.4% over this period.	Outperformed inflation by 3.6% 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 5.8% p.a. (after fees) over this period.	No. 1 balanced fund in South Africa (SA) since launch in 1996, outperforming its average competitor by 2.0% p.a. Outperformed inflation by on average 8.0% p.a. since launch and outperformed the ALSI on average by 1.0% p.a. (since launch).	The Fund added 3.5% p.a. to the return of the market. This means that R100 000 invested in Top 20 at launch in October 2000 grew to R2 570 751 by end-June 2021. The Fund is a top quartile performer since launch.

[1] *Income versus growth assets as at 30 June 2021. Growth assets defined as equities, listed property and commodities (excluding gold).*

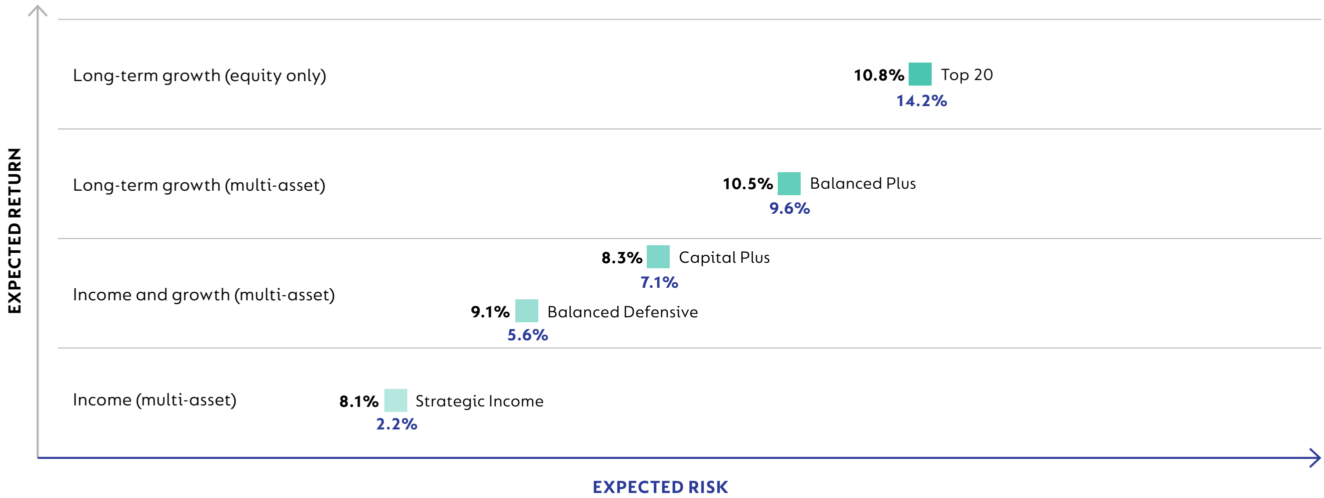
[2] *Highest annual return*
Balanced Defensive: 23.1% (Apr 2020 - Mar 2021); Balanced Plus: 49.3% (Aug 2004 - Jul 2005); Capital Plus: 33.8% (Aug 2004 - Jul 2005); Strategic Income: 18.7% (Nov 2002 - Oct 2003); Top 20: 68.9% (May 2005 - Apr 2006)

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 2021 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

RISK VERSUS RETURN

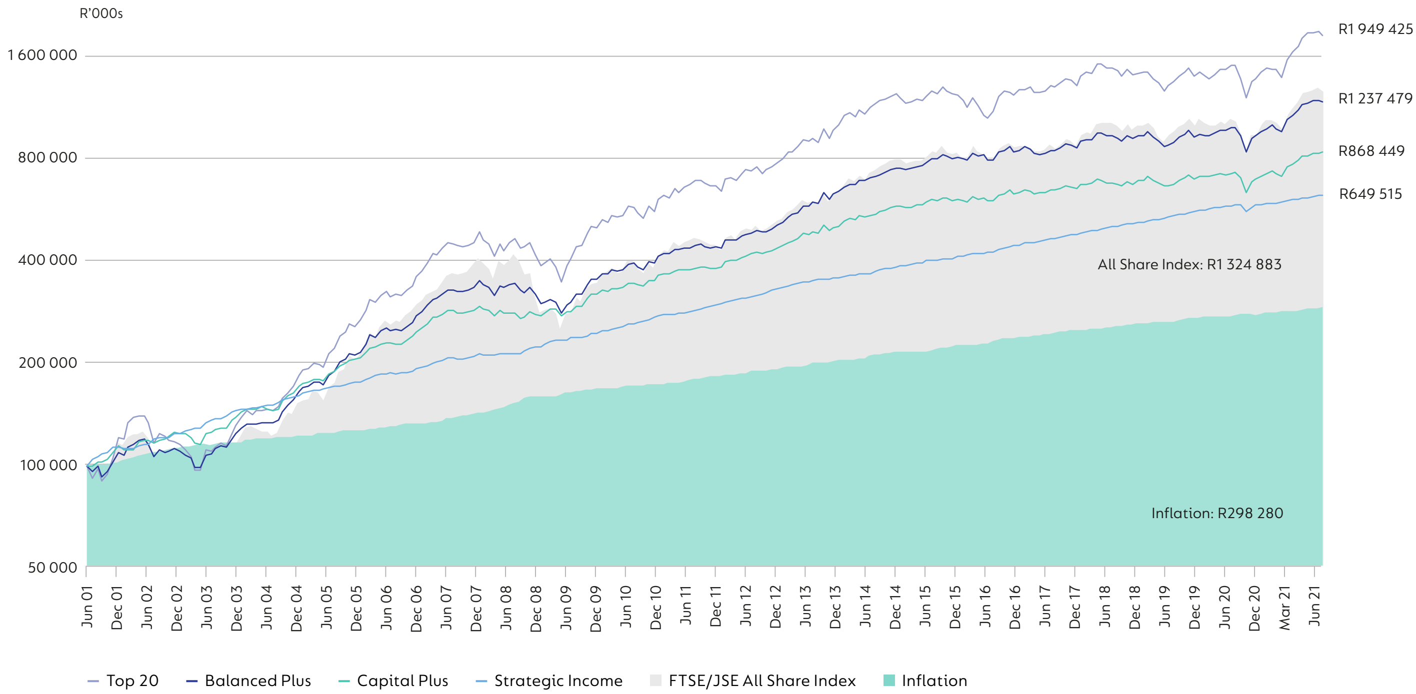
10-year annualised return and risk (standard deviation) quoted as at 30 June 2021.
Figures quoted in ZAR after all income reinvested and all costs deducted.



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 2021. 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

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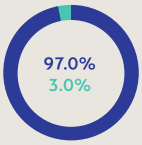
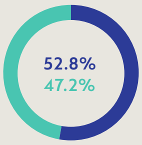
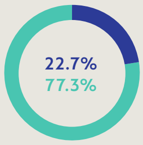
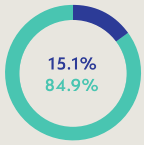
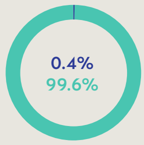
International flagship fund range

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)†	**OPTIMUM GROWTH** Composite: 35% JSE CAPI, 15% ALBI, 35% MSCI ACWI, 15% BGBA	**GLOBAL EQUITY SELECT** MSCI All Country World 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.	The aim of the Fund is to maximise long-term investment growth by investing in a range of opportunities available in public asset markets from both SA and around the world. Our intent is to provide competitive after-inflation returns measured in rand over all five-year periods.	The Fund aims to give investors access to the best opportunities in global equity markets. The Fund is biased to developed markets and actively seeks out attractively valued shares to maximise long-term growth. Our intent is to outperform the global equity benchmark over all periods of five years and longer.
INCOME VS GROWTH ASSETS[2] ● INCOME ● GROWTH	 97.0% 3.0%	 52.8% 47.2%	 22.7% 77.3%	 15.1% 84.9%	 0.4% 99.6%
LAUNCH DATE OF OLDEST FUND	Dec 2011	Nov 2008	Oct 2009	Mar 1999	Jan 2015
ANNUAL RETURN[3] (Since launch)	2.4% 0.9%†	5.3% 0.8%†	7.3% 7.8%†	9.9% 7.5%	8.0% 10.6%
QUARTILE RANK (Since launch)	–	1st	1st	1st	2nd
ANNUAL RETURN[3] (Last 5 years)	2.0% 1.4%	5.1% 1.4%	9.3% 9.9%	11.9% 10.5%	14.5% 14.6%
ANNUAL RETURN[3] (Last 10 years)	–	3.4% 0.9%	6.6% 7.3%	7.5% 5.4%	- -
QUARTILE RANK (Last 5 years)	–	2nd	1st	1st	1st
FUND HIGHLIGHTS	Outperformed US dollar cash by 1.5% p.a. (after fees) since launch in December 2011.	The Fund has outperformed US dollar cash by 4.4% p.a. (after fees) since launch in 2008.	No. 1 global multi-asset high-equity fund in SA since launch in October 2009.	The Fund has out-performed the composite benchmark since launch and was a top quartile performer in the Worldwide MA Flexible category since launch in 1999.	The Fund continues to seek attractively valued shares to maximise long-term growth.

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 2021 (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: 34.8% (Apr 2020 - Mar 2021); Global Equity Select: 56.6% (Apr 2020 - Mar 2021); Optimum Growth [ZAR]: 72.8% (Mar 2009 - Feb 2010)

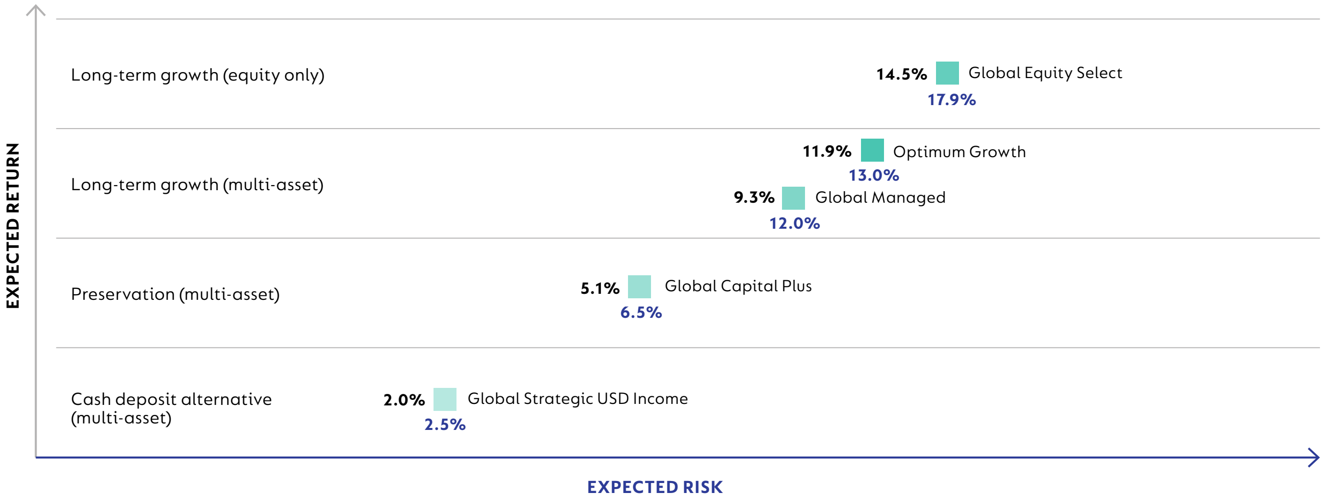
Lowest annual return
Global Strategic USD Income: -2.0% (Apr 2019 - Mar 2020); Global Capital Plus [ZAR] Feeder: -7.0% (Mar 2015 - Feb 2016); Global Managed [ZAR] Feeder: -14.9% (Mar 2015 - Feb 2016); Global Equity Select: -21.9 % (Mar 2015 - Feb 2016); Optimum Growth [ZAR]: -49.2% (Dec 2007 - Nov 2008)

Figures are quoted from Morningstar as at 30 June 2021 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

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

RISK VERSUS RETURN

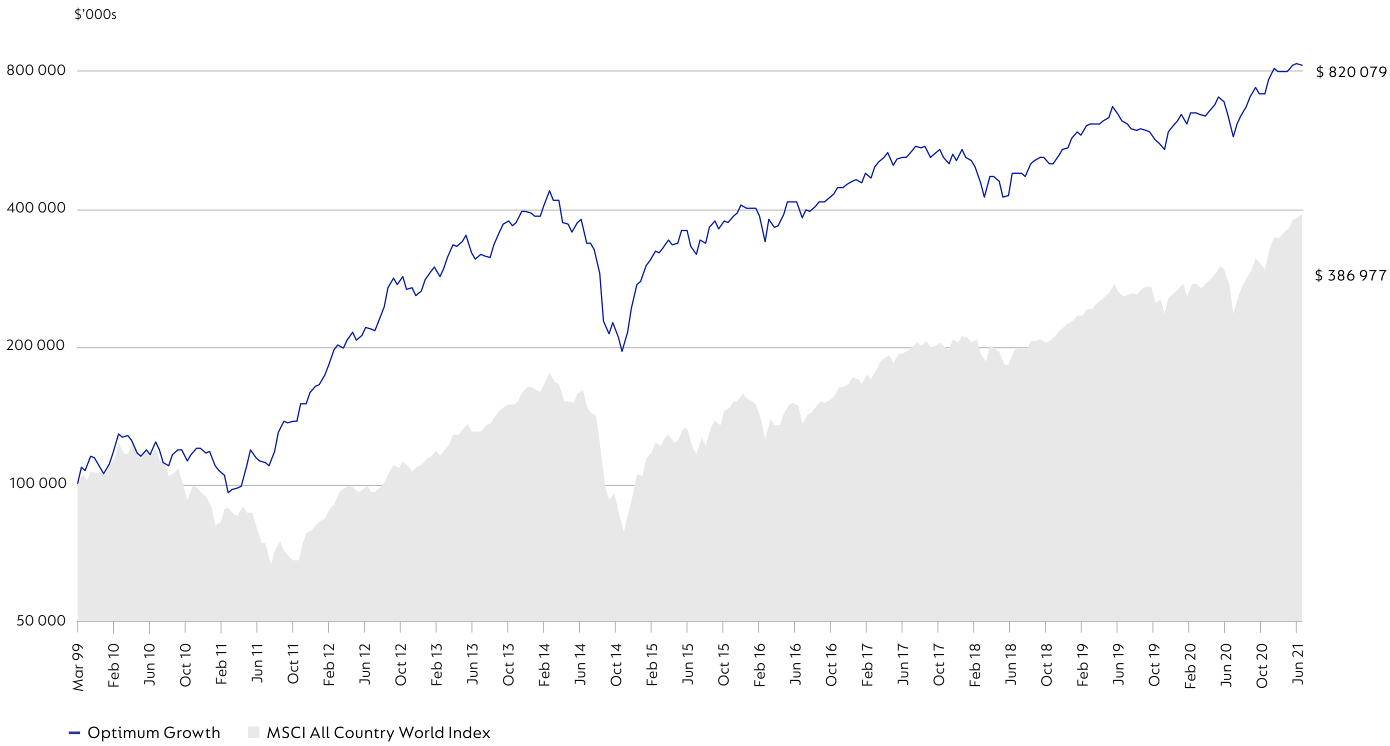
5-year annualised return and risk (standard deviation) quoted as at 30 June 2021. Figures quoted in USD (for the oldest fund) after all income reinvested and all costs deducted.



Source: Morningstar

GROWTH OF $100 000 INVESTED IN OPTIMUM GROWTH FUND SINCE INCEPTION

Value of $100 000 invested in Optimum Growth Fund [ZAR] on 15 March 1999. All income reinvested for funds. MSCI All Country World Index is on a total return basis. All returns converted to USD.



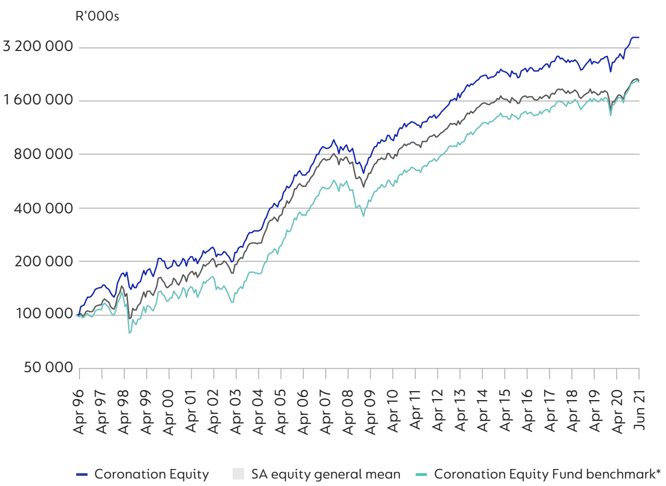
Source: Morningstar

Long-term investment track record

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

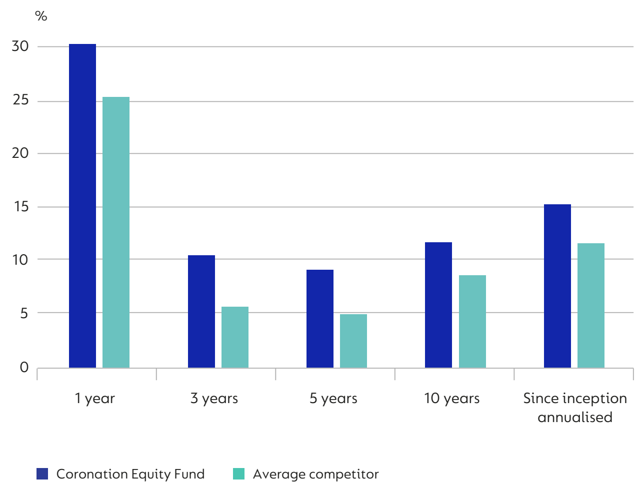
10-YEAR ANNUALISED RETURNS	CORONATION EQUITY	AVERAGE COMPETITOR	OUTPERFORMANCE OF AVERAGE COMPETITOR
2006	19.38%	17.09%	2.30%
2007	21.45%	19.23%	2.22%
2008	17.62%	18.47%	(0.84%)
2009	16.53%	16.68%	(0.15%)
2010	19.59%	19.14%	0.45%
2011	18.03%	16.98%	1.05%
2012	21.12%	18.94%	2.19%
2013	21.60%	18.68%	2.92%
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%
2020	10.48%	7.10%	3.38%
9 years 6 months to June 2021	12.35%	8.84%	3.52%
ANNUALISED TO 30 JUNE 2021	**CORONATION EQUITY**	**AVERAGE COMPETITOR**	**OUTPERFORMANCE**
1 year	30.24%	25.28%	4.96%
3 years	10.47%	5.70%	4.77%
5 years	9.10%	4.98%	4.12%
10 years	11.72%	8.57%	3.15%
Since inception in April 1996 annualised	15.27%	11.65%	3.62%
Average outperformance per 10-year return			1.98%
Number of 10-year periods outperformed			14.00
Number of 10-year periods underperformed			2.00

CUMULATIVE PERFORMANCE



Source: Morningstar

ANNUALISED RETURNS TO 30 JUNE 2021



Source: Morningstar

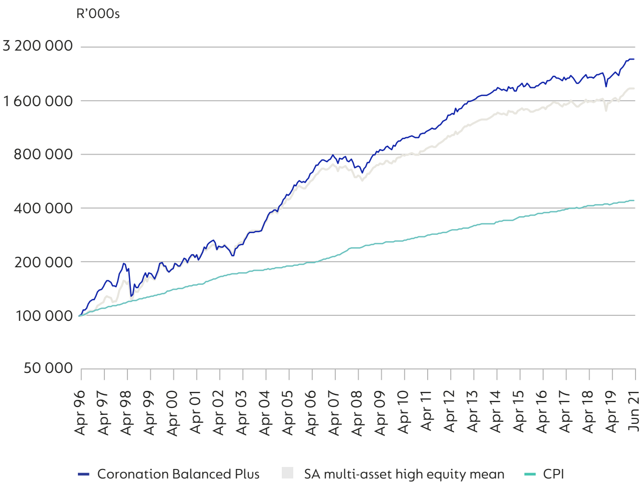
An investment of R100 000 in Coronation Equity on 15 April 1996 would have grown to **R3 574 954** by 30 June 2021. By comparison, the returns generated by the Fund's benchmark over the same period would have grown a similar investment to **R2 020 088**, while the SA equity general sector would have grown a similar investment to **R2 072 262**.

[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 SA – Equity – General category, ex-Coronation Funds

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

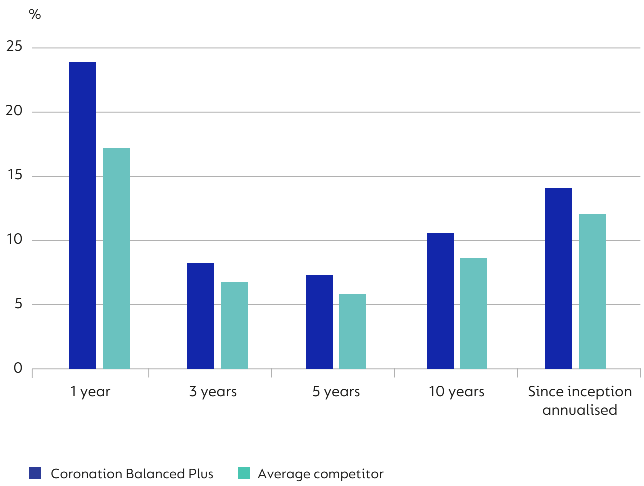
10-YEAR ANNUALISED RETURNS	CORONATION BALANCED PLUS	INFLATION	REAL RETURN
2006	18.33%	6.47%	11.86%
2007	17.81%	6.59%	11.22%
2008	16.96%	6.87%	10.09%
2009	15.69%	6.75%	8.94%
2010	17.20%	6.28%	10.93%
2011	15.78%	6.24%	9.54%
2012	17.85%	5.76%	12.09%
2013	18.63%	5.90%	12.73%
2014	16.58%	6.00%	10.57%
2015	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%	5.11%	5.19%
2020	9.66%	5.07%	4.58%
9 years 6 months to June 2021	10.76%	5.01%	5.75%
ANNUALISED TO 30 JUNE 2021	**CORONATION BALANCED PLUS**	**AVERAGE COMPETITOR**	**OUTPERFORMANCE**
1 year	23.80%	17.15%	6.65%
3 years	8.24%	6.70%	1.54%
5 years	7.30%	5.82%	1.49%
10 years	10.52%	8.64%	1.89%
Since inception in April 1996 annualised	14.02%	12.05%	1.97%
Average 10-year real return			8.57%
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%			7.00
Number of 10-year periods where the real return is 0% - 5%			2.00

CUMULATIVE PERFORMANCE



Source: Morningstar

ANNUALISED RETURNS TO 30 JUNE 2021



Source: Morningstar

An investment of R100 000 in Coronation Balanced Plus on 15 April 1996 would have grown to **R2 717 665** by 30 June 2021. By comparison, the SA multi-asset high-equity sector over the same period would have grown a similar investment to **R1 869 923**.

[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.