JANUARY 2018 SUMMER EDITION

corospondent

The Personal Investments Quarterly

Enough already!

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

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Notes from my inbox

Enough already!

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By Pieter Koekemoer

2017 WAS NOT a year that ended with a whimper. The final quarter may go down in history as a period in which, to paraphrase then-UK prime minister Harold Macmillan's message to the apartheid government in SA in 1960, the winds of change again started blowing through our continent. The national discourse was enriched with the publication of a number of books, such as Adriaan Basson and Pieter du Toit's *Enemy of the People*, Crispian Olver's *How to Steal a City: The Battle for Nelson Mandela Bay* and Jacques Pauw's runaway bestseller *The President's Keepers*. These books, through brave and uncompromising reporting, gave further insight into how our public institutions have been hollowed out as a result of a misguided descent into cynical transactional politics.

In December, the ANC took the first tentative corrective steps by selecting Cyril Ramaphosa as leader, indicating some support for the anticorruption message that underpinned his campaign. At the time of writing, more green shoots are emerging, as news broke of potential prosecutorial action against the Gupta family.

In this issue we feature a guest column by independent political analyst Steven Friedman who gives insight into the changing

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

political landscape. On page 7, Marie Antelme, our economist, explains that the economic situation remains dire, with urgent need for sensible and confidence-restoring actions. We can unfortunately still expect a tough budget for taxpayers as a result of a highly constrained fiscal situation. Peter Leger, head of our Global Frontiers team, reminds us that political change in Angola and Zimbabwe also brings some hope of renewal elsewhere in our neighbourhood.

We dedicate this edition of *Corospondent* to those who have contributed to an environment where it again seems possible for our society to be run in the interest of the many rather than the few.

LESSONS LEARNED

The past quarter also brought some stark reminders of how a lack of commitment to the highest ethical standards can quickly lead private sector actors astray too. This was already evident with the number of global first-league businesses implicated in SA's state capture. However, the collapse in the value of Steinhoff in early December as a result of accounting irregularities and probable fraud was the most impactful example from the perspective of long-term investors. While the final chapters in this story are yet to be written, we include a detailed review of recent events at the company, as well as an explanation of why we decided in 2014 to invest in its shares. You can read more in CIO Karl Leinberger's article on page 12.

STRONG INVESTMENT RETURNS

The past year delivered a good performance for most of our investors despite all the noise dominating the headlines. Our local long-term growth funds all achieved double-digit returns, exceeding their long-run real return targets and outperforming most competitors. Our general equity funds have matched rather than exceeded benchmark returns. Nearly 40% of the FTSE/JSE All Share Index return was produced by Naspers, which now makes up an incredible one fifth of the market index. Even though we still see value in the share, it is just not prudent to accept the index level of concentration risk in one share in most of our funds. This 'forced underweight' effect was especially significant for investors in our more conservative funds (Balanced Defensive and Capital Plus) where we limit a single share's exposure to a maximum of around 3% of portfolio. While rand returns in our international funds were impacted by the currency strengthening by more than 10% in December, performance across the range was in line with or better than these funds' benchmarks. Dollar returns ranged between 7% for the conservative Global Capital Plus Fund and 39% for the specialist Global Emerging Markets Fund. You can read more about specific fund performance and positioning in the fact sheets and commentaries available on *www.coronation.com*.

As announced in last quarter's *Corospondent*, we recently introduced a new format for your investor statements, which now include additional useful information. It should also be easier to understand. If you have any feedback on how we can further improve the information we provide to you, please do not hesitate to get in touch with us via *clientservice@coronation.co.za*. In the coming weeks, we will also enhance our fact sheet disclosure by including the performance of the average fund in the respective peer groups, in addition to the funds' investable benchmarks. ✚

Pieter

MARKET MOVEMENTS

	4th quarter 2017	2017
All Share Index R	7.44%	20.95%
All Share Index $	17.61%	33.78%
All Bond R	2.22%	10.22%
All Bond $	11.89%	21.90%
Cash R	1.79%	7.53%
Resources Index R	4.86%	17.90%
Financial Index R	15.98%	20.61%
Industrial Index R	4.67%	22.50%
MSCI World $	5.51%	22.40%
MSCI ACWI $	5.73%	23.97%
MSCI EM $	7.44%	37.28%
S&P 500	6.64%	21.83%
Nasdaq $	7.26%	32.99%
MSCI Pacific $	8.02%	24.96%
Dow Jones EURO Stoxx 50 $	(0.77%)	24.27%

Sources: Bloomberg, IRESS

GUEST COLUMN

Divided we stand

Real change will depend on the will to fight

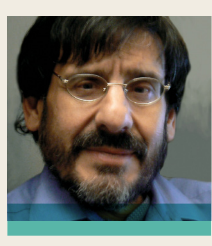
By *Steven Friedman*

THE ANC AFTER its December congress looks very much like it did before it – with only one change. But this change may make more of a difference than we are being told.

Last year, investors – and everyone else – were told repeatedly that the ANC conference would decide the direction of the governing party and the country. Either Nkosazana Dlamini-Zuma and the faction which supports president Jacob Zuma would win, turning government into a piggy bank for the connected, or Cyril Ramaphosa and the anti-Zuma faction would triumph, and quickly begin fixing corruption and state capture.

To anyone who knows the realities inside the ANC, this always seemed highly unlikely. It was very hard to see how a governing party increasingly unable to hold an internal election without the losers taking the winners to court could survive a hotly contested election in which one faction won everything and the other lost everything. It seemed inevitable that the losers would refuse to accept the result, creating a crisis for the ANC from which it might not recover. And so the only way out seemed to be some sort of

Steven is a political scientist and professor in the Humanities Faculty of the University of Johannesburg.
He writes a column in *Business Day* on current political and economic developments.



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a deal in which both factions received enough to persuade them to accept the result.

And so it proved. The ANC's top six leaders are split evenly between the two factions. Estimates of alignments on the national executive committee (NEC), which runs the ANC in the period between its five-yearly conferences, depend on your sources. But the safest method is to take the lists both sides circulated among their supporters and to check how many candidates from each were among the 80 members elected. If we do this, the NEC, like the 'Top Six', is divided down the middle.

So, either nearly 5 000 delegates voted spontaneously to produce the result needed to prevent the ANC from coming apart, or a deal was done to ensure this. What seems most likely is that neither faction would allow the other's candidate to become president by agreement and so there was an open contest for the presidency. Positions were then divided equally: faction leaders presumably told supporters to vote in ways which produced this result.

Whatever the method used, the result was the one the ANC needed to ensure that the election of a new leadership would stand. It achieved this by remaining divided – as it was before the conference. It again has a 'Top Six' split equally between the two factions and an NEC in which neither has a clear majority. This has produced a torrent of pessimism from commentators who were pinning their hopes on Ramaphosa winning in the 'winner takes all' result we were promised. The ANC's leader may have changed, they argue, but the ANC remains the same and so it will behave as it did before the conference.

This may seem logical but may be at most partially true. The result does show that the hope of many commentators and analysts that the Ramaphosa slate would win and then begin cleaning up the ANC and government without opposition was always a fantasy. The pro-Zuma faction was never about loyalty to one man. It is about using politics to acquire wealth which can be used partly to buy support. And it is a symptom of a reality which does not go away because one candidate wins an ANC presidential election: that many are still excluded from the marketplace, and that politics and government have become a way of creating opportunities which the market does not yet offer.

As long as that continues, there will be a strong faction in the ANC interested in access to public money, not boosting the economy. Ramaphosa and his supporters cannot simply impose solutions on the ANC and government. They will need strategy and staying power if they want change. But this does not mean that nothing in the ANC has changed. Something obvious has changed – the presidency. To know why that is important, we need only look back over the past few years when the ANC was split as it is now – but with Zuma as president.

Because he presided over a divided ANC, he could not get whatever he wanted: if he could, Des van Rooyen would have remained finance minister, probably keeping the seat warm for Brian Molefe. But he could get some of what he wanted because the president has the power to appoint. He could fire finance ministers and appoint heads of the SA Revenue Service and national prosecutors loyal to his faction. Ramaphosa will be able to do the same when, as seems likely, he becomes president of the country. This is not only a source of power in itself; it also sways politicians, and so the NEC may well turn out to be more solidly behind Ramaphosa than the numbers suggest.

SOME IN THE ZUMA FACTION MAY SHIFT PRIORITIES NOW THAT HE DOES NOT CONTROL THE PRESIDENCY: ZUMA HIMSELF MAY BE A CASUALTY SINCE BOTH FACTIONS MAY HAVE DECIDED THAT IT IS IN THE ANC'S INTEREST FOR HIM TO GO SOON.

Right now, calculating who will vote which way is complicated by the fact that some of the 80 elected in December were on both lists and some on neither. But Ramaphosa probably enjoys only a two-vote majority. The provinces and the ANC's leagues also sit on the NEC and here the split is 50-50.

But this may have changed already. Some members of the Zuma faction were supporting a sitting president and will switch to Ramaphosa. The provinces face a shake-up because of court actions and the movement of Zuma faction premiers into the national leadership. This may strengthen the Ramaphosa camp. He may well enjoy a working majority. Some in the Zuma faction may also shift priorities now that he does not control the presidency: Zuma himself may be a casualty since both factions may have decided that it is in the ANC's interest for him to go soon.

So, despite the deal and the apparent deadlock, we may well see significant changes in personnel: Zuma could go, and there may be a new Cabinet and new appointments in key posts. But changes to the underlying patterns which many want Ramaphosa to address will depend on how much stomach he has for a fight, and how he and his allies play their cards. +

The views and opinions expressed in this article are those of the author.

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SA ECONOMY

A new 1994?

Cyril Ramaphosa's ANC needs to save SA from economic déjà vu

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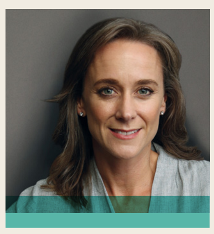
By Marie Antelme

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



IT HAS BEEN another brutal year. The economy has suffered the effects of political uncertainty which tightened its grip throughout the year and extended 2016's miserable performance. At a glance, it is hard not to notice that an alarming number of SA's economic metrics are back at levels that prevailed in 1994. Growth is set to average 1.4% over the last five years, assuming we manage even 1% in 2017, in a world which is growing at 3.6% (IMF estimate). This is below the 2.6% which prevailed from 1995 to 2000 (and that period included a series of emerging financial crises), although better than growth of 0.2% during the years before the first democratic election (1990 to 1995). It is well below the 'boom' years which preceded the financial crisis.

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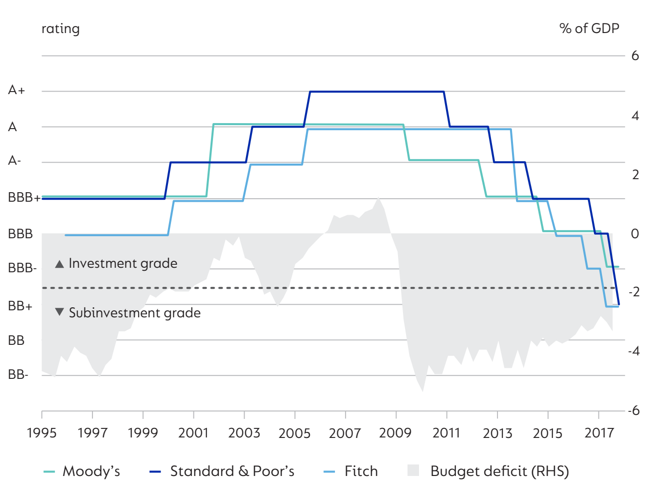
Critically, however, is that since 2015, on a per capita basis, real growth has been contracting – for the first time since the early 1990s. The fiscal position has deteriorated noticeably and the country's sovereign ratings have been downgraded five times since 2012, leaving SA with a subinvestment grade – back where we were in 1994.

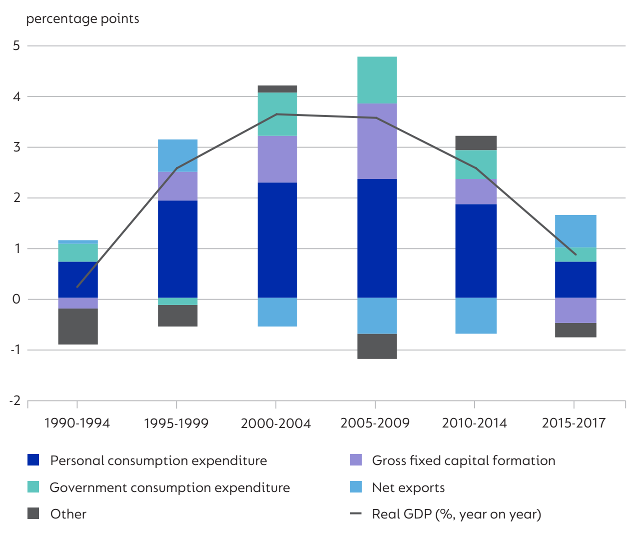
SA CREDIT RATINGS VS BUDGET DEFICIT



Source: HSBC

In 1990/1991 the country suffered a debilitating drought. Household spending was nonetheless the biggest source of demand, aided by government consumption. Investment was negative and the country maintained a (necessary) small trade surplus.

CONTRIBUTIONS TO SA ECONOMIC GROWTH



Sources: SA Reserve Bank, Statistics SA

HOW DID WE GET HERE?

It is 'easy' to say we lost our way, that the country was captured and that the global financial crisis derailed growth because commodity prices collapsed, which had a knock-on impact on the fiscal position and the economy more broadly. All of these reasons have some truth in them, but if we look very hard at the numbers, and our own history, we have to acknowledge that even without these developments, the economy would have faltered. An urgent remedy is required.

Much can be learned from looking at the composition of SA's growth in five-year(ish) clips from the period just before the democratic transition to where we are today. In this way we can see what drove output, and make an assessment of the conditions which influenced growth.

On many occassions, SA was affected by natural disasters or impacted by global events, ranging from the political and economic sanctions of the 1980s to the emerging market and financial market crises that ensued in the late 1990s, and the financial crisis of 2008/2009. But throughout, domestic economic and policy decisions have had a meaningful impact on growth.

If we start with the period 1990 to 1994, average growth was just 0.2% and per capita growth fell at an average rate of -2.2%. This dismal performance came at a time when the apartheid regime was failing and the economy was suffering the lingering effects of the economic sanctions imposed on SA since 1986. The economy operated under a massive balance of payments constraint because there was no foreign funding available, which meant the country had to run current account surpluses.

The post-1994 election period saw the economy liberalised and reintegrated into the global economy. Importantly, the trade boards were abolished, and regulations were relaxed and many discarded. The regulatory environment was simplified and access to global financial markets saw the balance of payments constraint ease.

Exposed to international markets, the domestic economy became more competitive and investment picked up. Government adopted the Reconstruction and Development Programme (RDP), with clear economic and social objectives, and began its implementation. Despite successive emerging market crises from late 1997 through 2000, average GDP was 2.6% and per capita growth turned positive, averaging 0.8% over this period.

The increase in investment and government spending through 2000 to 2004 saw the current account deficit widen, leaving net exports a detractor from growth and the country exposed to the vagaries of international capital. Government's economic policy through this time was determined by the Growth, Employment and Redistribution Strategy (GEAR), which broadly aligned policy to RDP objectives and was generally in line with Western liberal economic philosophy, advocating relatively tight monetary and fiscal policy objectives.

The independent SA Reserve Bank (SARB) adopted an official inflation target in 2000 and GDP growth accelerated to 3.6%. Social grant policy was implemented in 2004 and per capita income gains accelerated again to 2.4%. Over this period, inflation moderated from over 8% in the previous five years to 5.5%, and by 2004 debt to GDP was just 34.4%. Despite the improvement in growth and domestic fiscal position, there was much internal dissent about the effectiveness of GEAR to deliver the objectives of the RDP.

Amidst much opposition, including from politically powerful unions, GEAR was never fully implemented, and commitment waned.

Domestic economic policy floundered from about 2005 to 2009, but growth was buoyed by the enormous uplift in global economic momentum, domestic credit growth and financial deepening, and crucially, the commodity boom. Consumer spending surged, the domestic housing market took off and capital expenditure boomed as government and the private sector began to prepare for the 2010 Soccer World Cup.

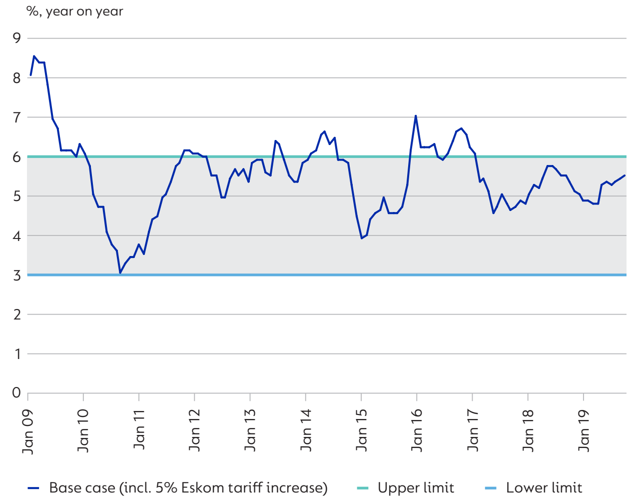
In 2007, Jacob Zuma was elected as the ANC president and became national president in 2009. By this time, GEAR had been abandoned and the fledgling Accelerated and Shared Growth Initiative never really saw daylight. Under president Zuma, the broad growth strategy fell under the National Development Plan, but economic vision became more diluted as the newly created department of economic development, the department of trade and industry, and the National Treasury all operated within different philosophical and capacity constraints. Despite this, SA's commitment to conservative economic policies, and the strength and resilience of its political and economic institutions saw rating agencies hold SA at high investment grade ratings through this period.

The period following the financial crisis (2010 to 2014) saw all GDP components deliver smaller contributions to output. In part this reflected the weak global environment and commodity price collapse, which had a material impact on mining and manufacturing as well as on government revenues. Through this period, government embarked on a counter-cyclical fiscal policy – expenditure increased to 31% of GDP, driving a more developmental agenda which manifested in a massive swelling of government payroll. GDP growth averaged 2.6%, but after a relatively long period of sustained growth in per capita GDP, this now started to stall.

In addition, political events from around mid-2012 started dragging on economic growth, which averaged at just 0.9% since 2014. Per capita GDP was falling for the first time since the early 1990s. There were three main reasons: global growth tailwinds had faded, commodity prices had been depressed, and lastly, extractive political policies undermined both confidence and the ability of economic institutions to provide an environment in which private sector investment could thrive. Consumer and business confidence plummeted and with it, investment and consumption. Household spending – still the largest driver of growth but to a much smaller extent – was squeezed by depressed profitability, lower income growth, (at times) higher inflation and higher taxes.

Growth in the year ahead will probably be a bit better than over the past three years, provided the global backdrop remains as supportive as it has been last year. It seems reasonable that political uncertainty may moderate, and a few interventions to restore confidence will go a long way to easing some of the constraint on both investment and consumption. At this stage, inflation looks set to remain comfortably within target, especially following the Eskom tariff ruling awarding the state electricity provider an increase of just 5.2% in 2018. We see some room for the SARB to lower rates early in the year.

SA CPI FORECAST



Source: Coronation forecast

MUCH HINGES ON DOMESTIC POLITICS

Newly elected ANC president Cyril Ramaphosa campaigned on a mandate of a New Deal for the country and the economy. In an op-ed in the *Business Day* on the eve of the ANC's December elective conference, Mr Ramaphosa put forth a number of practical proposals to improve confidence, boost growth and address endemic corruption.

Whether he can deliver on these remains to be seen, but he is certainly in a very powerful position as both president of the ANC and deputy president of the country, despite uncertain internal political constraints. And he has great experience and success as a skilled negotiator, so it seems reasonable to hope that with some capable, principled people backing him, he will be able to address some of the institutional challenges which inhibit growth to facilitate meaningful, pragmatic discussion between business, labour and the government, and possibly appoint capable people to key institutional positions and allow them to do their jobs. In many cases, institutions of good quality are still there, awaiting new leadership.

The biggest challenge to political and economic stability is SA's very high level of income and wealth inequality, and falling per capita GDP severely aggravates this situation. As we have seen in other countries, this outcome foments at the heart of populist politics, and SA now has significantly fewer resources with which to meet this challenge.

To manage a very long road to ensure future economic stability, SA needs an economic vision which recognises honestly its failures, accepts fairly that both the public and the private sector are accountable, and acknowledges the available resources which we have to work with. We have indeed been here before – the democratic transition came with hope, and a broken economy. +

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FRONTIERS

Making Africa great again

What now that the kings are gone?

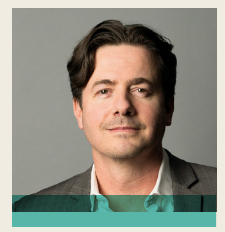
By Peter Leger

"WE ARE GOING to die, and that makes us the lucky ones. Most people are never going to die because they are never going to be born. The potential people who could have been here in my place but who will in fact never see the light of day outnumber the sand grains of Arabia."

So starts Richard Dawkins's *Unweaving the Rainbow*, which studies the relationship between science and the arts from his perspective as a biologist with a naturalistic world view. Dawkins explores the idea that science does not destroy, but rather discovers poetry in the patterns of nature. He concludes that human beings are the only animal with a sense of purpose in life. In his view, that purpose should be to construct a comprehensive model of how the universe works.

I have always thought of politics as the realm where a sense of purpose should collide with action. And the pinnacle of this realm would be the installed leader. 'Make America Great Again' must be right up there when talking sense of purpose. But so strong is this sense of purpose that a number of leaders seem keen on the idea of extending their stay in power. Indefinitely.

Peter is head of Global Frontiers and manages all strategies within the global frontiers offering. He joined Coronation in 2005 and has 20 years' experience in the financial markets in Africa as both a portfolio manager and research analyst.



Africa has had its fair share of leaders who have overstayed their welcome. Opposition has been aggressively managed. Leaders have ignored election results with little fear of consequence. And the sense of purpose is only curtailed by Dawkins's opening truism, where dying is the only limitation to a president for life. Uganda, for example, has recently scrapped the age limit of 75 years to allow President Yoweri Museveni to extend his 'brief' three-decade stay in power indefinitely. This is a very bad thing.

Where there is no challenge and no change, there is no accountability. A long-serving dictatorship wears down the division between political and commercial power. Leadership cannot tell the difference and government becomes a service for the elite, resulting in countries that have great wealth making only a few wealthy. So when this changes, it is a very big deal.

Why was the December election of the new ANC leader in SA so closely followed? It was arguably the most important vote since free elections in 1994, as many saw this as a moment when SA would either continue down the road of the state being used for personal gain, or a return of accountability to SA politics. Ten years ago the National Prosecuting Authority brought 783 counts of corruption, fraud, racketeering and money laundering charges against president Jacob Zuma. And 10 years ago he became president of the ANC. That he has managed to avoid having these charges heard in court is a direct result of the position of power he has held. Imagine an SA where no term limit existed for our president or for the ANC, and where accountability could be delayed indefinitely. A chilling thought. How the transition of power plays out in 2018 will be market defining for SA.

To our north, José Eduardo dos Santos was president of Angola for 38 years, and Robert Gabriel Mugabe president of Zimbabwe for 37 years. Both left office within two months of each other towards the end of 2017. Isabelle (44), dos Santos's daughter, is Africa's richest woman today. Her business interests stretch the gamut of the Angolan economy. Doing business in Angola requires doing business with the family, suggesting that her wealth comes almost entirely from her family's power and connections. The new president came into office in September 2017. Since then he has set about dismantling the dos Santos hold and tearing down the original compromise government that was negotiated. Angola's state oil company has announced an investigation into "possible misappropriation" of funds. The former first family is no longer protected. The president has also issued an ultimatum for the return of foreign-held funds – a figure of $30 billion. And the currency peg is to be ditched. He has to do this if any form of relationship is to be built with global financial institutions and foreign governments. These are very good things.

While this has been happening, and just a little bit east of Angola, president Mugabe resigned under huge military pressure, leaving a chronically failed state. In return, he is rumoured to have received a $10 million bonus and a bevy of benefits. His final months in office made a mockery of Zimbabwe and its government. The economy was starved of physical cash while Grace, Mugabe's wife, and his sons were making headlines for behaving badly and consuming conspicuously – an extreme case of government serving the elite.

Zimbabwe now has a new ruler: president Emmerson Mnangagwa. Much has been written about him and what might be. In fairness, he needs to do very little to make a big change. Yes, the country is in a shambles. It does not have a functioning currency and the US dollars that it uses are in short supply. A revaluation of 'zollars' (the nickname for Zimbabwe's electronic dollars) to dollars seems inevitable. But when you are heading at full tilt towards the edge of the cliff, just tapping the brakes and turning the wheel a little starts to look like skilful driving to your panicked passengers.

Instated in November, Mnangagwa's new cabinet consists mostly of Zanu-PF and military loyalists. Yet the crucial positions of finance and mining have both been filled by technocrats. The president, joined by his deputy, has visited the main opposition leader at his home; not to discuss a coalition government, but as a symbolic gesture of acknowledgement. The president has embarked on a major corruption crackdown, warning offenders to come clean and surrender ill-gotten gains. Grace Mugabe and her sons are being probed by the anti-graft agency over dodgy land deals and mineral trading. The family protection does not extend beyond the former president. Former ministers are facing corruption charges. Bids are being sought for state-owned enterprises which gorge on the little tax revenue available. And a moratorium on prosecution for repatriating ill-gotten offshore funds was announced. It is rather surprising how similar the Zimbabwean and Angolan hymn books are.

While our funds do not have any Angolan allocations, we hold a material level of exposure to Zimbabwean equities on behalf of our clients. These businesses have endured 'Dante's inferno' and still continue to be profitable today. We think there is a reasonable chance of a decent recovery in Zimbabwe. With some of the highest literacy rates in Africa, many of Zimbabwe's three million diaspora would like to return home. The country has rich institutional memory and structures. There is reasonable international goodwill, with the African Export-Import Bank, an international financial institution, having extended funding of $1.5 billion and the UK stating that it would like to assist in the recovery. The country needs a lot more. Exiled white farmers have been invited to return, with one farmer arriving at his grabbed farm under military escort to the sound of ululating workers. Even the black market 'zollar' rate has strengthened significantly from its lows. This could all just be hope, and stark realities remain to be addressed. Elections are planned for this year, which will provide more guidance on the road ahead.

WE THINK THERE IS A REASONABLE CHANCE OF A DECENT RECOVERY IN ZIMBABWE. WITH SOME OF THE HIGHEST LITERACY RATES IN AFRICA, MANY OF ZIMBABWE'S THREE MILLION DIASPORA WOULD LIKE TO RETURN HOME.

While we are all to die, a lengthy status quo can beguile us into expecting more of the same. Three seismic leadership changes occurred in the last quarter of 2017, setting the scene for significant changes in 2018. We do not expect more of the same and are feeling very optimistic for what may come, both at home and north of our borders. The countries are now more aligned than ever to make the region great again. ✚

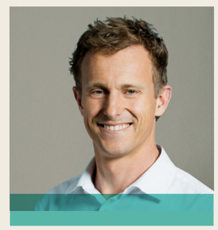
RETAIL

Steinhoff

Sometimes the truth is stranger than fiction

By Karl Leinberger

Karl was appointed CIO in 2008. He joined Coronation in 2000 as an equity analyst and was made head of research in 2005. He manages the Coronation Houseview portfolios.



STEINHOFF, THE GLOBAL discount retailer with more than 11 000 stores in over 30 countries, suffered a spectacular share price collapse during December 2017. The company was one of the largest listed on the JSE. Our equity and multi-asset class funds were invested in Steinhoff equity to varying degrees, depending on the mandate of the fund.

WHAT HAPPENED?

A concise chronology of events is as follows:

In the period leading up to the release of Steinhoff's full-year results, several public allegations of impropriety at the company were made. The first came in an article published by the German *Manager Magazin* on 24 August 2017. Most of the issues in this article had been previously disclosed by Steinhoff, or were known by the investment community. These included a history of numerous acquisitions, an ongoing legal dispute between Steinhoff and Andreas Seifert (the owner of its former joint venture partner XXXLutz) over the ownership of certain of its European retail operations, and the allegation that losses were being incurred in off-balance sheet entities. Steinhoff responded immediately by refuting the allegations on the JSE news service, SENS.

On 18 September 2017, Steinhoff released an announcement stating that Seifert had asked a Dutch court to review Steinhoff's financial statements. It was challenging the appropriateness of consolidating the aforementioned retail business that Seifert believed he still partly owned. This announcement was no major surprise, given that the legal battle between the two parties had already been disclosed. Steinhoff management was adamant that the counterparty had a weak case. In addition, Steinhoff had already raised a provision in its accounts to cover the cash amount required to settle the case should the company be wrong in its assessment of the likely outcome. In the announcement, Steinhoff reminded stakeholders that its financial accounts had received an unqualified audit opinion from Deloitte and that the company remained confident that the case would be dismissed.

A second news article, this time on Reuters, appeared on 8 November 2017 – two days after the company had entered into a closed period ahead of the release of its financial results due early in December. This article raised some new allegations, one of which was serious: that Steinhoff held an undisclosed interest in a company called GT Branding Holding – a company whose 100%-owned subsidiary (GT Global Trademarks) had previously purchased certain Steinhoff brands. Since Steinhoff was in a closed period, it was constrained in its ability to respond to the article. Its only response therefore was a communication on SENS in which it vigorously defended the independent nature of the parties with whom it had transacted and its accounting treatment of the relevant transactions.

On 4 December 2017, with stakeholders expecting the release of Steinhoff's financial results and clarity over the allegations, the company surprised the market by announcing that the results scheduled for release would be unaudited. Two days later, the resignation of CEO Markus Jooste was announced. This confirmed the market's biggest fears and sparked a collapse in Steinhoff's share price (amounting to a breathtaking 89% decline in that week).

The almost complete absence of any useful information from the company at a time when confidence in its financial position and creditworthiness hung in the balance, spoke volumes.

WHERE DO WE STAND NOW?

At the time of writing, stakeholders find themselves in an information vacuum. Possible outcomes range from the best-case scenario of tax evasion and inadequate disclosure of related-party transactions to that of sophisticated fraud orchestrated by the CEO. The former would result in a material, albeit manageable, reduction in Steinhoff's intrinsic value. The latter holds much more serious implications for the long-term future of the company.

Until we have a better understanding of the nature and scale of these improprieties, we simply cannot speculate further. Without such information, and an understanding of how the banks are responding to the crisis, it is just not possible to value the company with any conviction. The stock could just as easily be worth more than the current market price as it could be less. At current prices, we are therefore likely to retain our equity holding in the company until more information has been made available publicly. At this stage, we are expecting that to be by the end of this month (31 January).

There is no doubt that many parties will litigate against Steinhoff and its auditors. Until the full nature of what occurred is known we cannot commit to our actions in this regard; however, we will be sure to act in our clients' best interests.

Finally, it is important to highlight that none of our portfolios have exposure to any debt or convertible instruments issued by Steinhoff.

WHY DID SO MANY OUTSIDERS MISS THIS?

Many observers are asking why such a long list of outsiders (equity and debt investors, banks, auditors and rating agencies) would be taken in by Steinhoff. In the dramatic and emotive events of December, it is easy to forget that indications of impropriety only surfaced in the very recent past. This is a company that thrived for almost two decades, notwithstanding the stress test of the global financial crisis (which did put pressure on the company, given its numerous European operations and its significant debt issuance to European investors) and the increased scrutiny that came from pursuing, and then achieving, a primary listing in Europe (which requires such steps as producing a listing prospectus). From its humble beginnings as a midsized manufacturer of furniture, it grew to become the second largest household goods retailer in Europe – a company with 130 000 employees, €13 billion in turnover and more than 11 000 stores.

At this stage, with the nature and scale of the improprieties still unknown, the question is of course impossible to answer. However, when the information is finally disclosed, we believe that one should consider it in the following context:

1. *If this is a case of serious fraud, it would have been highly sophisticated and well concealed*. It is highly likely that the audited financial results misrepresented the facts. Somehow Deloitte, which is a top-four audit firm with access to all the internal information it needed to perform those audits, did not pick this up. Even an independent review by a second audit firm that, we understand, was commissioned by the Board to investigate the allegations, came out clean. Finally, David Young, a professor of accounting and control at graduate business school INSEAD who analysed Steinhoff's financial statements post the events of December, concluded that these off-balance sheet structures could not have been uncovered using the group's annual financial statements or other publicly available information.

2. *A vast number of insiders, who by definition had better information than outsiders, were heavily invested in the company and blindsided by recent events*. This was an owner-managed company that had an unusually large number of its executives heavily invested in the company and fully aligned with shareholders' interests. We rank the company as high as second on the JSE in terms of breadth and depth of share ownership among its executives. Not only were its executives heavily invested; many kept buying Steinhoff shares right up until its collapse in December (the chief financial officer, who subsequently resigned in early January 2018, bought R4 million worth of shares as late as early November). Even more unusual is the fact that very few executives ever sold shares. This is very rare for a listed company: staff who receive shares as part of share schemes usually sell their stakes pretty quickly. Many of these Steinhoff insiders have now been wiped out financially.

3. *Over time, the CEO surrounded himself with more and more highly respected businesspeople*. Most were astute and experienced individuals, many of whom had no history with the company. Most of them stayed with the company right up until the events of December. Examples include:

   i. Sean Summers, a former Pick n Pay CEO, who managed some of the group's UK and Australian retail businesses.
   ii. Andy Bond, previously the CEO of Asda (the third largest grocer in the UK). He is personally invested in Poundland and currently manages the European general merchandise segment (Poundland and Pep Europe).
   iii. Christo Wiese, who has a formidable, multidecade track record in business. He chose to sell Pepkor into Steinhoff and then invested most of the capital he had accumulated over his decades in business into the Steinhoff group.
   iv. Jannie Mouton, who is the founder of PSG and one of SA's most respected businessmen. He joined the board in October 2002 before retiring as a director in May 2016. Steinhoff subsequently remained a material shareholder in PSG.
   v. Louis van der Watt, a cofounder of the Atterbury group and one of the best property developers in SA. He has been a key development partner of Steinhoff in the purchase and development of a number of its European properties.
   vi. Jo Grove, who was the CEO of supply chain company Unitrans when it was acquired by Steinhoff and subsequently remained in the group in various managerial roles.
   vii. Thierry Guibert, who was the CEO of Conforama when it was acquired by Steinhoff and who is now a non-executive director. He is currently the CEO of global fashion label Lacoste.

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viii. David Sussman, who was CEO of the JD Group for many years before it was acquired by Steinhoff. He also stayed with the company for some time after the acquisition.
ix. Eugene Beneke, who was the CEO of Iliad Africa when it was acquired by Steinhoff. He subsequently remained with Steinhoff Africa to run its domestic building materials business.

4. *This was a company with a strong and independent board that appeared to take its fiduciary responsibilities very seriously.* Contrary to what some may argue, we believe that Steinhoff has one of the stronger boards on the JSE. It has many astute and genuinely independent directors – most of whom have decades of relevant business or accounting experience. Attendance records at board meetings, as well as the composition and attendance of audit committee meetings, were best in class. Board members who increased our confidence in the company include:

    i. Dr Johan van Zyl, the previous CEO of Sanlam.
    ii. Dr Steve Booysen, who is a chartered accountant (CA) and the previous CEO of Absa.
    iii. Christo Wiese, who has an exceptional, multidecade track record of directorships of many JSE-listed companies (Shoprite, Invicta, Tradehold and Brait).
    iv. Dr Theunie Lategan, who is a CA and was previously the CEO of FNB Corporate & Commercial Banking, and FirstRand Africa and Emerging Markets. He currently serves as vice-chairman for Absa Corporate.
    v. Thierry Guibert, a former KPMG auditor and, as previously noted, CEO of Conforama prior to it being acquired by Steinhoff. (Guibert was therefore very familiar with a material part of the European retail operations.)
    vi. Dr. Len Konar, who has held numerous directorships of listed companies, was previously the head of accounting at the University of Durban-Westville, is a member of the King Committee on Corporate Governance and a past chairman of the External Audit Committee of the IMF.

WHAT WAS OUR INVESTMENT CASE?

For the first decade of Steinhoff's listing, we were very sceptical of the company, its numerous acquisitions and the quality of its earnings. However, over time, we gained comfort for the following reasons:

1. Over almost two decades the company steadily built a very impressive global business from modest beginnings:

    - It made many astute acquisitions (Unitrans, the UK furniture retailer Homestyle, and Conforama) that delivered handsomely, despite our scepticism at the time.

    - The operational delivery throughout the company's history was stellar – whether one looked at Unitrans, industrial group KAP, the UK retail assets or the European retail assets.

    - This operational delivery was not due to a single individual. Steinhoff runs a very decentralised model; such delivery had therefore been realised by numerous high-calibre managers, many of whom were respected independent managers who had established track records outside of the group.

2. The defining event that changed our view of the company was its purchase of the Pepkor group in 2014. We were shareholders in Pepkor at the time of its listing on the JSE in the early 2000s. It is a formidable company, with one of the best track records in SA. It generates lots of free cash and continues to grow strongly despite a demanding base. We were very optimistic about the company's growth prospects in both SA and Eastern Europe, where the apparel market is large but the opportunity significant for a well-managed value/discount retailer. We believed that Steinhoff had bought Pepkor at a good price and that it had fundamentally changed the quality and prospects of Steinhoff.

3. We performed extensive due diligence that extended far beyond analysis of the company's financial statements. Over the last 15 years, four different Coronation analysts, all of whom are CAs, covered the company. We constantly challenged quality of earnings, cross-checking margins against competitors for reasonability and cross-referencing management's assertions with more junior employees of the company, nonexecutive board members and outsiders (typically competitors and suppliers). Although we cannot, for confidentiality reasons, disclose the names of those people, we can confirm that we spoke to at least 82 individuals during that research process (51 of those being outsiders).

4. Due diligence work on management always reached the same conclusion – that although this was an aggressive and entrepreneurial team, it was one that was ethical and respectful of the law. There were many sources for these reference checks, but the most compelling were always those individuals who had joined through businesses bought by Steinhoff.

5. The company significantly improved its board composition through the calibre and independence of its directors. The same is true of its audit and risk committee (which had three independent directors, one of whom, Steve Booysen, was chairman).

6. Finally, after extensive due diligence over the years we also gained comfort around the company's quality of earnings. A key reason for this was its conversion of earnings to cash flow, which is always the acid test of earnings quality and which had improved dramatically over time.

After gaining comfort on Steinhoff's investability we built our investment case, which was premised on the following points:

1. An extremely undemanding valuation that we felt significantly undervalued the underlying businesses.

2. Although we are highly sceptical about the prospects of most bricks-and-mortar retailers in a digital world, we believe that certain segments will be resilient to this threat. We believe that discount retail (Steinhoff's overwhelming retail format) is such an example and were of the view that the market was being too penal in its harsh rating of the company, tarring it

with the same broad brush as all other conventional retailers. (We should note here that this leg of the case seems to be vindicated with indications of strong recent trading from many of Steinhoff's retail operations).

3. Finally, we believed that with a heavily invested and entrepreneurial team of managers (not just the CEO, as previously outlined), Steinhoff would continue to grow the business in a fragmented market as it had throughout its 20-year history.

DID WE GIVE DUE CONSIDERATION TO THE RISKS?

As with all investments, we were cognisant of the risks inherent in the investment case, and duly accounted for them, as follows:

Low tax rate: Steinhoff's low tax rate has consistently been a concern. We took this issue seriously and questioned management in detail on the matter. Ultimately we gained comfort from the fact that Steinhoff did not use tax havens, that they had legitimate operations in certain low tax jurisdictions (such as the UK and Switzerland) and that they benefited from manufacturing tax incentives in Eastern Europe. One should also remember that many global multinationals achieve low tax rates (e.g. Steinhoff's largest competitor Ikea, as well as Richemont, Pfizer, Johnson & Johnson, Google and Apple). After recent revelations, we now think it likely that some of Steinhoff's structures crossed the line between tax evasion and tax avoidance.

Numerous acquisitions: Although many case studies of corporate failure include highly acquisitive companies, we would caution against sweeping generalisations that all acquisitive companies fail. Many successful SA companies have been built through acquisitions – examples include SA Breweries, Bidvest and Bidcorp. Steinhoff had also increasingly demonstrated capital discipline – by walking away from the Darty and Home Retail Group (Argos) bids when pricing reached unattractive levels.

Accounting complexity: We do not believe that companies with complex financial accounts are uninvestible. It is the job of a professional investor to sift through the detail and intricacies in the task of unearthing value. Many of our greatest successes over the years have come from complex businesses with complex financial accounts.

Off-balance sheet transactions: This was a matter we took very seriously. We spent a great deal of time investigating the issue. At the time, we concluded that the motivation was tax structuring and we took account of the risk by assuming higher tax rates in the future and in our valuation of the company.

OUR ACTIONS IN THE LAST FEW MONTHS OF 2017

As soon as the allegations were made in *Manager Magazin* (24 August), we made contact with the magazine's editor to request the contact details of Steinhoff's former joint venture partner so that we could call him in our capacity as a shareholder of Steinhoff. The editor contacted him on our behalf, but unfortunately advised that the individual would not speak to us. We assumed this was because the matter was sub judice.

The Reuters article (8 November) contained allegations around Steinhoff's ownership in GT Branding Holding (and that it was part of the Campion Capital Group). This ownership stake had never been disclosed by the company (as it should have been). This was our biggest concern, because it alleged that the Campion group had also bought JD Financial Services' lending book from Steinhoff 18 months earlier. At the time we had questioned the sale with management, and the risk of an undisclosed related-party transaction, only to be given the plausible explanation that no related parties were involved and that the book had been sold to a European private equity firm with other sub-Saharan lending businesses.

The Reuters allegation was made only a few weeks before the group's financial results were due for release and the company emphatically rejected the accusation via SENS. We were unable to speak to the company (because they were in a closed period), but arranged to discuss the issue with them as soon as results were in the public domain. We took comfort from the fact that Steinhoff had a strong and independent board, one that would be closely monitoring all company announcements. In addition, both the CFO and chairman of the supervisory board (Christo Wiese) bought material tranches of shares in early November. Ultimately, we elected not to be rash and sell when we felt that the stock more than priced in many of these concerns, and especially because our base case was very much that the motivation for the structuring was tax related (and not fraud, as has become more likely with developments since then).

CONCLUSION

It is often said that you learn something new every day in financial markets. The current Steinhoff crisis was a learning that we would have hoped to avoid, having had a healthy level of scepticism throughout and having conducted an enormous amount of independent due diligence.

Despite this, in the end, we still got it wrong. Although errors are part of the investment process, this one is hard to stomach. The failure of the board and the company's independent auditors to identify what is at least two years of misstated financial statements is frustrating. It is mystifying that so many smart insiders, who, by definition, had better information than outsiders, were so heavily invested in the company and so blindsided by recent events.

When more information comes to light we will be able to undertake a more comprehensive study of what went wrong and update our clients accordingly.

Finally, as much as the loss on Steinhoff is disappointing, we do take comfort from the fact that ultimately we produce portfolios, as opposed to single-stock views, for our clients, and that our funds proved resilient in their performance, both through that first week of December and for 2017 as a whole. ✚

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GLOBAL

Alphabet

The next generation of big bets

• • •

By Humaira Surve

Humaira is an analyst within the global developed markets investment unit. She joined Coronation in 2012 after working for Accenture. She holds an MBA from INSEAD.

MUCH HAS BEEN written about Google's dominance in search. In this article we explore the culture of the business and some of the hidden yet very valuable other assets of its parent company, Alphabet.

In his 2015 shareholder letter, Alphabet's CEO Larry Page wrote that "incrementalism leads to irrelevance over time, especially in technology, because change tends to be revolutionary, not evolutionary".

Alphabet is the holding company of Google. From its founding in 1998, Alphabet has worked to avoid the tendency of companies to become less innovative and more bureaucratic as they grow, allowing it to escape the fate of many prior tech titans like Nokia and Kodak. The company's continuous investment and innovation, driven by its ambitious goals, are likely to bear fruit over the short-, medium- and long-term time horizons. Besides the Google search engine, Alphabet has many 'hidden' assets. Seven of its products, many of which are in the early stages of monetisation, have over one billion users: Google Search, YouTube, Google Maps, Google Play, Android, Google Chrome and Gmail.

YouTube is now the most watched TV network globally, with over one billion hours watched per day. Google Maps has arguably the most comprehensive building and location information of any map provider. (Justin O'Beirne, a leading US cartographer and software engineer, estimates that Google Maps has a lead equal to six years on Apple Maps.) The Android mobile device operating system, with its Google Play app store, is accessed by two billion people every month. The Chrome browser is estimated to have a 55%, and growing, market share.

Longer term, seemingly the most successful 'moonshot' (or highly ambitious) project is Alphabet's self-driving car business, which has logged 30 times the autonomous miles in California of its peers, combined. Many of Google's platforms benefit from a first-mover advantage and network effects which create a moat that new entrants will struggle to overcome.

CULTURE

Warren Buffett talks about the "institutional imperative" – the tendency of an institution to resist change to its current direction and to mindlessly follow company leaders or competitors. He tries to invest in companies that are alert to the problem.

Alphabet is such a company. This is evident in Larry Page's emphasis on first-principles thinking and "being unencumbered by the traditional way of doing things". As a manifestation of this, Google ran a revolutionary auction-based initial public offering in 2004, which upended the opaque practice of allowing a bank to allocate shares to chosen investors at a recommended price. Another example was how YouTube CEO Susan Wojcicki changed the way the company thought about its budget. Typically, companies allocate their budget according to the size of existing business segments. Her view was that the amount allocated should instead be related to the investments required to achieve the potential of the business. Luckily she did not give in to the institutional imperative; YouTube may otherwise not be Alphabet's next leg of growth today.

At Alphabet, people think about '10X goals', or building products and services that one day can be 10 times the size they are today. They believe that "if you hire the right people and set big enough dreams, you'll usually get there".[1]

Alphabet management also emphasises the importance of small, entrepreneurial teams. Today, developing the best products is key, as customers have more information about products than ever before, distribution is practically free due to mobile devices being ubiquitous, and the cost of developing products is very low due to public cloud infrastructure. Small entrepreneurial teams allow Alphabet to iterate fast in order to make better products than competitors.[2]

YOUTUBE

YouTube is the 'hidden asset' likely to make the biggest impact in the medium term. YouTube reportedly has 1.5 billion logged-in users who view videos every month. It is accessible across multiple devices and has a massive content library. Much of the content, often created by independent content creators, appeals to niche groups. Ever heard of PewDiePie, a Swedish gaming enthusiast with 56 million subscribers, or Smosh, a sketch comedy channel with 22 million subscribers? Traditional broadcast television is technically unsuited to deliver customised content to smaller groups at different times, giving YouTube a clear advantage.

YouTube had an early-mover advantage and now benefits from network effects, making it difficult for new entrants to disrupt its position. It was one of the first online video platforms and Alphabet invested heavily in its infrastructure, incurring losses for years. It built up a lead as a result of its ever-growing audience, which resulted in more content creators being attracted to the platform. Content creators are attracted by their ability to earn a commission of about 45% of advertising revenue generated from advertisements shown with their content. In turn, audiences are attracted to YouTube because it has the most content creators.

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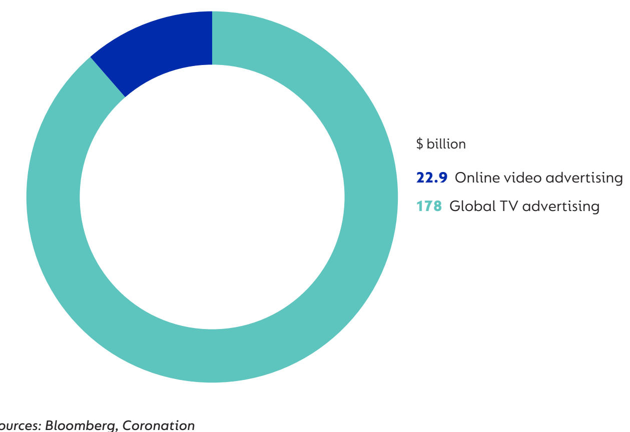
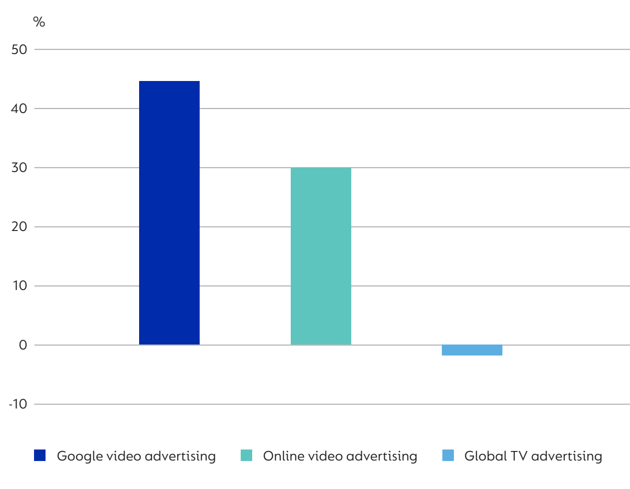
ESTIMATED GLOBAL TV ADVERTISING REVENUE IN 2017



Sources: Bloomberg, Coronation

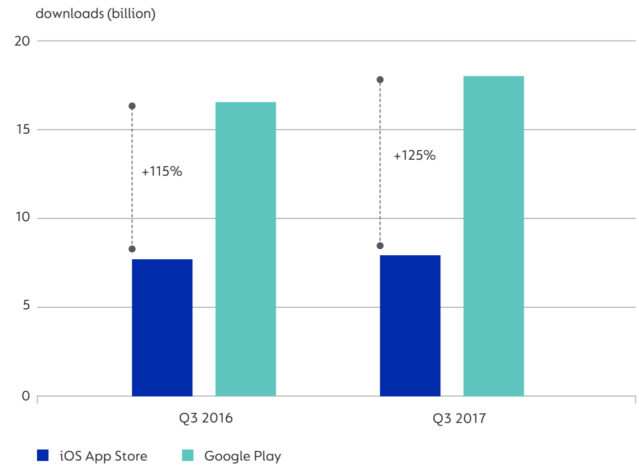
[1] *How Google Works*, by Eric Schmidt and Jonathan Rosenberg
[2] *Ibid*

ESTIMATED 2017 GROWTH



Sources: Bloomberg, Coronation

WORLDWIDE APP DOWNLOADS BY STORE



Source: App Annie

Traditional TV advertising captures about 35% of the total advertising market globally (down from 40% in 2014), amounting to a potential income opportunity of about $178 billion currently. Global online video advertising is still a fraction of this at c. 13% of total TV advertising spend – but it is growing rapidly.

Google, with a market share of more than 50% of the online video ad market, stands to take advantage of the shift towards online video advertising – and to take even more market share. Interestingly, reaching one billion hours of video viewing in 2017 was the achievement of a '10X goal' set in 2012 when viewers watched 100 million hours a day.

GOOGLE PLAY

A second underearning asset is Google Play, Google's app store. It generates revenue through mobile app sales and is a wonderful tollgate on digital consumption. Google takes a 30% commission of the revenue generated from app downloads and pays the remaining 70% to the app's creator.

Google Play has always been distributed together with Google's open-source Android operating system (which is now used by 87% of smartphones sold), affording it a massive advantage in building its user base. This early lead kick-started a network effect between app users and developers. The Google brand provides some level of comfort that payments will be managed properly, and app rankings give customers confidence in app quality. Together these features create a powerful moat which makes it difficult for competitors to displace Google Play and which could lead to search-like margins over time.

Android has an installed base of two billion users and Android smartphones outsells Apple by about six to one.

Apple recently stated a goal of driving $50 billion of software and service sales by 2020. Stripping out non-app revenue from this, Apple could conceivably generate $30 billion in app store revenue by 2021.

Even if it only achieves average revenue per user of 40% of that of Apple, the Google Play store has the opportunity to reach a similar size, given its massive and rapidly growing installed base in emerging markets.

MOONSHOTS

Alphabet's 'moonshot' projects are the epitome of the think-big culture of the firm. The seeds planted today will likely see the company well positioned 10 years from now.

Waymo, Alphabet's self-driving car project seems to be furthest along among Alphabet's 'moonshots'. Many are aware of Tesla's autopilot function and Uber's self-driving plans, but Waymo is improving rapidly, below the radar.

Between December 2015 and November 2016, Waymo drove 635 868 autonomous miles on public Californian roads. That is equivalent to driving from Cape Town to Johannesburg 732 times. When a Waymo car struggles with a decision, it disengages, allowing the driver to take over. Waymo disengaged only 0.2 times per 1 000 miles driven (equal to about once in five trips from Cape Town to Johannesburg). According to a recent report, this was four times better than the year before. This is phenomenal, considering the many complex scenarios and events that the car must consider.

The California Department of Motor Vehicles also recorded the autonomous miles driven by the 11 other firms registered to test cars in California. Together, they travelled just 20 000 miles, or 3% of Waymo's distance.

The above is an illustration of the big ambition and relentless pursuit of goals that have served Google so well over the years.

VALUATION

Alphabet's significant investment spending has resulted in near-term margins being depressed. Its overall operating margins are

estimated to be 27% for 2017, compared to its search business margins of c. 50%. (Margins of similar businesses like Facebook are around 45%.) Clearly, many of Alphabet's younger businesses are immature and not yet operating at normalised margins. It is not inconceivable that YouTube could generate margins of 25% in time, or that Google Play could achieve search-like margins given the moats described earlier.

Last quarter, Alphabet reported net cash just shy of $100 billion (13% of its market cap). Its impressive chief financial officer, Ruth Porat, previously from Morgan Stanley, instituted the first share repurchase when she joined Alphabet in 2015. It looks increasingly likely that US tax reform could result in a tax holiday for repatriated cash, which could mean that more cash will be returned to Alphabet shareholders. Alphabet converts much more of its net income to free cash flow than the average business (about 106% compared to under 80% for the average company). Accordingly, a price/free cash flow multiple offers a better yardstick than a price/earnings ratio.

Stripping out net cash, Alphabet trades at 20.6 times its one-year forward free cash flow. This is less than the MSCI World Index's average multiple of 20.9 times (remember, the index constituents convert less of their earnings to cash). We believe this is good value for a business with leading market shares in attractive sectors that will drive growth at two to three times the market for many years. +

LISTED PROPERTY

Hammerson

Well positioned in an evolving environment

By Anton de Goede

IT HAS ONLY been 12 months since you last read about the UK-based retail landlord Hammerson in *Corospondent*, but what a year it has been for retail-focused property stocks around the world.

Amid continued growth in online retailing, a sharp increase in retailer bankruptcies in the US triggered feverish media coverage that predicted the demise of physical stores. Led by a sell-off in US retail-focused property stocks, companies in Europe and the UK also saw losses of up to 30% from the start of 2017. Shares were trading at discounts to their underlying net asset value of between 20% and 50%. This disconnect between the actual value of underlying properties and the value implied by the share prices offered the appropriate time for a myriad of consolidation opportunities across these regions, including cross-Atlantic portfolio mergers. Some publicly listed companies were also taken private. Towards the end of the year, share prices recovered by 10% to 30% as these boardroom discussions were announced.

One of the transactions announced in recent weeks was Hammerson's intended takeover of Intu Properties. Previously known as Liberty International or Capital Shopping Centres, Intu is a retail landlord with a large UK national footprint. It owns nine of the UK's top 20 shopping centres and has recently also gained exposure to the resurgent Spanish retail property market.

On behalf of our clients, we have been a long-standing shareholder of Intu, recognising the value of this footprint and dominance in the UK retail landscape. We believe the tie-up between Hammerson and Intu is important for both sets of shareholders.

As a reminder, 60% of Hammerson's portfolio is exposed to the UK, split between shopping centres, retail parks and outlet centres, with the remaining 40% providing exposure to mainly French and Irish shopping centres and a selection of outlet centres in major European cities.

Anton is a property specialist with specific responsibility for listed property-related research across the Coronation investment team. He joined Coronation in 2008.

The investment case for Hammerson, which we presented 12 months ago, still stands. In this article, we focus on two important considerations relating to its prospects after the proposed transaction has been implemented.

PORTFOLIO DOMINANCE

An enlarged Hammerson portfolio will have an estimated value of £21 billion, making it one of the three biggest European retail property groups, with 18 centres above 90 000m² in size. This enlarged portfolio will introduce two major differences.

First, its exposure to UK shopping centres will increase from 36% to 64%. This should have a growing positive impact on the company, as Hammerson has proven that it can manage shopping centres through different cycles; over the last nine years, which included extremely tough years for retail landlords, it experienced only one year of negative like-for-like net rental income growth in its UK shopping centre portfolio.

Hammerson is well positioned to weather the uncertainty of the current consumer environment and could even benefit from it as retailers gravitate towards proven retail locations and landlords. With exposure to 17 of the top 25 UK shopping centres, Hammerson enjoys a very enviable position for any landlord. Retailers have embraced the concept of flagship units – they spend more money on these units in strong locations, using them as key points of engagement with customers.

The importance of a flagship retail unit cannot be overemphasised. It is now estimated that a retailer can achieve a national footprint in the UK with as few as 25 to 50 stores, compared to 100 to 200 stores in the past. This is all due to the increase in online retail. In addition, in a world where retailers have no choice but to embrace e-commerce,

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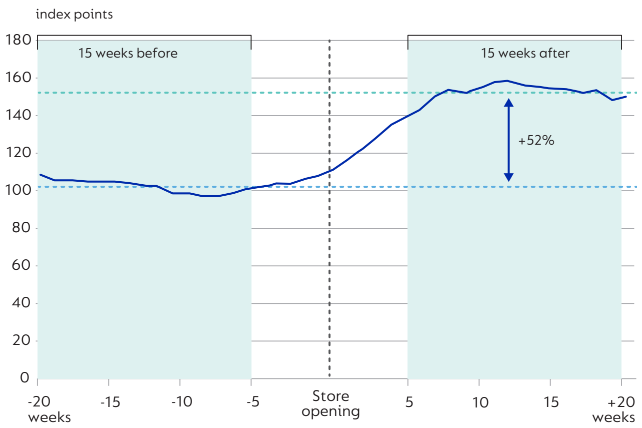
maintaining omnichannel customer interaction becomes important. (Omnichannel refers to using various channels of seamless client interaction, from a physical store to pure online shopping.)

The interplay between a physical presence and a retailer's online strategy is very important in the current retail environment, which is dominated by the omnichannel approach. A study conducted by Hammerson peer British Land and Connexity Hitwise found that when a new store opens, the traffic to such a retailer's website from that location increases by 52% from the 15 weeks prior to opening to the 15 weeks post opening. This increase is even more pronounced when a retailer has a footprint of fewer than 30 stores.

UK department store John Lewis has been a pioneer in embracing omnichannel retailing and is reaping the rewards; an omnichannel customer spends on average much more compared to either a pure physical store or online customer. UK retailers have been much earlier adopters of omnichannel retailing: the e-tailing shake-up currently witnessed in the US has been raging on for the past five to ten years in the UK due to its high internet retailing penetration.

PHYSICAL STORES BOOST ONLINE INTEREST



Sources: British Land, Connexity Hitwise

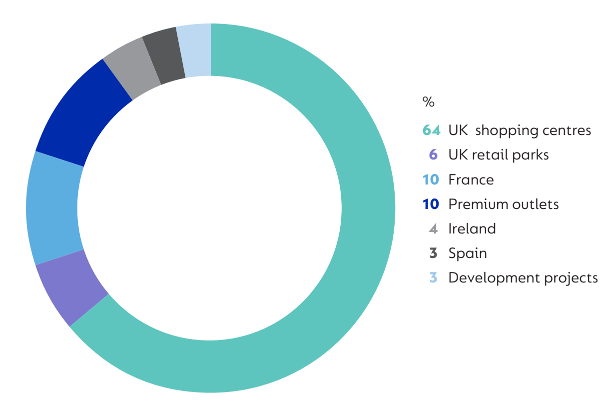
PORTFOLIO DIVERSIFICATION

The second major difference between the current and the enlarged Hammerson portfolio is the decrease in non-UK European exposure, from 40% to 27%. The enlarged portfolio presents a healthy balance between the benefit of a stronger, more defensive portfolio in the UK and still being sufficiently diversified into Europe. We anticipate that the portfolio will regain a higher exposure to Europe over the medium term, and management has confirmed that this is part of its strategy.

Hammerson's European exposure, especially its premium outlet centre segment, has been driving earnings over the last few years. Although the Intu takeover initially decreases the exposure to this growth segment, the larger prospective balance sheet provides an opportunity to speed up gaining further exposure to these segments in the medium term.

As part of the integration of the two portfolios, management anticipates that at least £2 billion of UK assets will be sold. Not only will this result in a natural portfolio reweighting towards Europe, it will also create balance sheet capacity for development projects in the pipeline which are earmarked for higher-growth regions, including Ireland and Spain. The money may also be used to buy (or extend) potential premium outlets.

HAMMERSON'S PORTFOLIO SPLIT



Source: Company reports

STRATEGIC MANAGEMENT

The benefits of portfolio dominance and diversification can only be reaped if management can extract this value, both strategically and operationally. The anticipated deal should drive operating cost synergies and result in potential lower debt refinancing, which is where the calibre of Hammerson's management team should shine through.

Since Hammerson's move to focus only on retail assets, the company has consistently delivered a better operational performance than Intu. Its UK shopping centre portfolio achieved on average a 3.5% outperformance in like-for-like net rental income per annum since 2009 against the Intu portfolio. In the more recent past, it also consistently outperformed Intu on leasing versus estimated market rental levels, by 5% to 6% on average per annum. We believe the Intu portfolio offers latent rental growth prospects; by combining the portfolios under Hammerson's management, this should be unlocked at a faster pace.

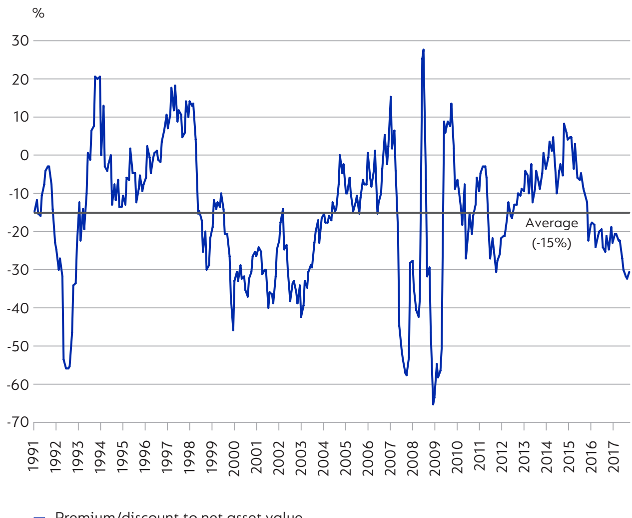
Strategically, Hammerson has proven itself a good allocator of capital, often confounding initial market skepticism relating to acquisitions or disposals.

Its recent entry into Ireland is a prime example where growth earned from its exposure more than compensated for initial concerns over the entry price into the country. Gaining exposure to the high-growth premium outlet business proved to be a stroke of genius. Hammerson read the evolving consumer shopping patterns correctly. Its management will be able to strategically tap into that which is best in class in the Intu portfolio, enhance it and apply it across the enlarged portfolio.

CONCLUSION

Independent from the takeover offer for Intu, Hammerson continues to focus on its core portfolio. Capital from smaller mature assets is recycled for investments into growth assets and regions. Through these sales, the company is strengthening its balance sheet, and positioning itself to placate investors who continue to be concerned about the large capital requirements of its development pipeline. The retail market is polarising, and retailers who benefit from either dominance or convenience are proving to be the winners. Hammerson is now in an even better position to benefit from this trend. The enlarged portfolio is a clear market leader in the UK, and the accompanying benefits of this position should surely allay the fears of investors who are concerned about the potential negative impact of Brexit on property values. Although there are signs of a marginal repricing in shopping centres due to this uncertainty, the discount to net asset value at which Hammerson trades remains unjustified, especially since the proposed takeover of Intu should enhance both earnings and net asset value. We therefore believe that Hammerson remains a sound investment opportunity, which is being mispriced by the market. ✚

HAMMERSON'S PREMIUM/DISCOUNT TO NET ASSET VALUE



Sources: Reuters, Coronation

BOND OUTLOOK

An important year for SA

Renewed optimism and contained inflation could benefit government bonds

By Nishan Maharaj

THE END OF 2017 marks almost a decade since the global financial crisis. Over this period, financial markets have become accustomed to historically low policy rates, super-low long bond rates and a seemingly unending supply of 'free money' from central banks in developed countries, keeping asset prices, from bonds to equities, very well supported. The local bond market benefited from this relatively benign global environment over the last decade, returning 8.6% in rands versus cash delivering 6.9%. However, these headline numbers hide the SA market's rollercoaster ride since 2015 and more especially over the course of last year.

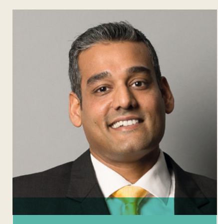
2017 was a difficult year for every South African, with the economy basically grinding to a halt as policy inaction and political uncertainty sapped confidence in the prospects of the local economy. In thinking about SA, an age-old story comes to mind. One day a farmer's dog fell down into a well. The farmer was at a loss as the animal cried piteously for hours. Finally, he decided the animal was old, that the well needed to be covered anyway and that it was just not worth retrieving the dog. He grabbed a shovel and began to shovel dirt into the well. The dog realised what was happening and yelped horribly. Then, to the farmer's surprise, he quietened down. A few shovel loads later, the farmer finally looked down the well and was astonished at what he saw. With every shovel of dirt that hit his back, the dog would shake it off and take a step up. As the farmer continued to shovel dirt on top of the animal, he would shake it off and climb a little bit higher. Soon, to his amazement, the dog stepped up over the edge of the well and trotted off. Could this be SA in 2018?

The last quarter of 2017 was particularly eventful in the local bond market. Following the poor Medium Term Budget Policy Statement in October, when SA's fiscal deterioration became a reality, the local 10-year bond sold off aggressively from 8.6% to a high of just above 9.5%. As previously highlighted, these higher levels were a better reflection of underlying risks in the local economy given the policy and political backdrop.

Up to the ANC elective conference in December, SA bonds spent most of the quarter at levels of around 9.25% to 9.5%. As Cyril Ramaphosa emerged as the new president of the ANC (and possibly the country), the local bond market rallied to close the year at levels of 8.59%. Before December, there were expectations that bonds would underperform cash for the year, but the All Bond Index (ALBI) ended 2017 up 10.2% (gaining 5.66% in December alone). This is significantly above the performance of cash and inflation-linked bonds, which returned 7.1% and 2.8% respectively. The bulk of the ALBI's performance came from the three- to seven-year and the seven- to twelve-year buckets, which both returned just over 11%, driven primarily by the falling repo rate over the course of the year.

2018 will be a very important year for SA, and the performance of the local bond market will anchor three key outcomes. The first outcome is the ability of government to push through reforms that support a recovery in growth, which is directly tied to Mr Ramaphosa being able to exert his influence as the new leader of the ruling party on policy direction. The second outcome is the trajectory of inflation over the course of the next two years and its implication for the path of the SA repo rates. Finally, the evolution of the global monetary policy environment and its impact

Nishan is head of Fixed Interest and responsible for the investment process and performance across all portfolios within the fixed interest offering. He has 15 years' investment experience.



on emerging markets will have a large bearing on the direction of international and hence local bond yields.

The issue of policy inaction has led to a steady deterioration in SA's credit fundamentals, as illustrated by the constant downgrades of SA's credit rating over the last two years. SA is now rated below investment grade by all but one of the rating agencies, Moody's (which has SA one notch above subinvestment grade, but intends to pronounce judgement before the end of February). Moody's will be looking for some evidence that government is trying to halt the current path and trajectory of fiscal deterioration, as well as for indications of pro-growth reforms. For SA to avert a downgrade to below investment grade and consequently an exit from the Citigroup World Government Bond Index (WGBI), we would have to see corrective actions implemented at many of the large state-owned enterprises to alleviate concerns around financial stability and more importantly, governance. This would imply the need for new or revamped boards and management teams that could restore confidence in these institutions. In addition, one would have to see a more fruitful partnership between government and the private sector to kick-start growth.

Whether Mr Ramaphosa can implement such changes, despite an already divided ruling party, is a question that is unfortunately beyond the scope of this report. However, given that Mr Ramaphosa is seen by the market as a reformist and corporate SA has not spent any money over the last year, we could see a boost to economic growth from 'relief spend' over the first two quarters of 2018, taking growth to above 1.5% for the year. Whether this growth is sustainable would rely on how quickly reforms are implemented. Moody's will more likely than not be willing to give SA a stay of execution if there is evidence that the country is turning a corner. Even if the downgrade does come, the global backdrop and the trajectory of the SA economy will play a much more vital role in determining where the local bond market settles.

Two key developments should support a lower (or at least a more stable) inflation profile over the next year. First, the rand has rallied 11% this year, which will continue to subdue the rand price of oil and overall import inflation. Second, the recent decision to only award Eskom a 5% tariff increase, while a problem for Eskom's liquidity, is good news for inflation. The combined effect is that, at the bare minimum, we should see inflation average 5% to 5.5% over the next two years, implying the real policy rate will average 1.75% to 1.25%. This should allow the SA Reserve Bank (SARB), at worst, to keep the repo rate stable over the next two years and probably bias the next move to the downside.

Globally, the path and pace of the increase in US interest rates will remain a key driver for global bond yields. Current market pricing suggests that the federal funds rate will move up to 2% by the end of 2019, slightly below the Federal Reserve's (Fed) own projection of 2.25%. Even if the current term premium (the difference between the US 10-year bond and the federal funds target rate) of 100 basis points (bps) is maintained and the Fed moves its target rate to 2% to 2.25%, this implies that the US 10-year bond should be in the 3% to 3.25% range, as opposed to the current level of 2.4%. Given the current US administration's embrace of pro-growth policies, risks to US inflation will remain tilted to the upside, suggesting the US 10-year bond might overshoot the 3% to 3.25% target. More importantly, however, as history has shown us, is the pace at which global bond yields move higher. If they continue to move higher at a gradual and measured pace, this would maintain a supportive environment for emerging markets. An abrupt change in the direction of monetary policy in the US or the EU, with both aggressively removing monetary policy accommodation, would have a more disruptive impact on emerging markets.

In the table below, we bring together the various elements of our fair value model and then incorporate some of the main points from our discussion in this article. The key takeaway is that at current levels, the SA 10-year bond is fairly valued. Under an adverse outcome (scenario B), we could see a 50 bps move higher in yields, while under a favourable outcome (scenario A), we could see a 58 bps compression in yields. Under scenario A, we assume that the market is correct and the Fed only hikes interest rates twice this year, that SA inflation averages 5% over the next year and that the country adopts a reform agenda as is currently expected. With scenario B, we assume that the Fed hikes four times, SA inflation averages at the top end of expectations (5.5%), US inflation averages 2.25% (resulting in the aforementioned four hikes) and that SA's reform agenda takes longer to implement, resulting in a wider credit spread.

Although the risks to the implementation of policy adjustments by Mr Ramaphosa remain high, the fact that he has been appointed the leader of the ruling party and has acknowledged the need for government to clean up its act does leave the risks biased towards further compression in bond yields to the levels suggested by scenario A.

SA BONDS: FAIR VALUE MODEL

	Market level	Scenario A	Scenario B
US 10-year bond	2.40%	3.0%	3.5%
Plus the market-implied 10-year average inflation expectation for SA	6.09%	5.0%	5.5%
Minus the market-implied 10-year average inflation expectation for US	1.98%	2.00%	2.25%
Plus the SA sovereign risk spread	2.2%	2.2%	2.5%
Equals the implied fair value of SA	8.71%	8.2%	9.25%
Current SA 10-year bond	8.78%	8.78%	8.78%
Cheap/(expensive)	7 bps	58 bps	(47 bps)

Source: Coronation

An event that could prove problematic is if Moody's chooses to downgrade SA to subinvestment grade, resulting in an exit from the Citigroup WGBI. The magnitude of the associated outflow could be anywhere between $5 billion to $9 billion, which is quite sizeable. However, much depends on the global environment and the trajectory of the local economy. If we are still loosely following the conditions suggested in scenario A, the outflows could be easily digested. This will have very little sustained impact on bond >

levels, as market participants will use the flow to allocate more to SA government bonds. However, if fiscal consolidation and the reform agenda continue to be pushed out, it is likely that the SA 10-year bond will settle at levels of 9.25% to 9.5%.

Despite our expectation for a recovery in the SA economy over 2018, given the symmetric nature of the yield moves, we choose to maintain a neutral outlook on SA government bonds. To build an overweight position, we require better levels to provide a more adequate margin of safety.

Inflation-linked bonds (ILBs) had a tumultuous year, underperforming bonds and cash considerably. Given the current implied market breakeven inflation levels, we still see little value in ILBs with a maturity of greater than seven years. The market expects inflation to average above 6% (close to 7% in the longer-dated bonds), which, given our inflation expectations (5.5%), remains too rich (see the graph below).

Our preference is to hold longer-end nominal bonds instead of ILBs. The shorter end of the ILB curve remains an area of interest.

Average inflation breakeven levels sit between 5.25% and 5.5%, which is more in line with our forecast and provides one with protection against inflation moving above 5.25% to 5.5%.

In addition, with the SARB's real policy rate target being closer to 1.5%, these shorter-end real yields will remain well anchored, increasing their attractiveness.

The SA economy could be at a key turning point if the newly elected ruling party leadership is able to push through much-needed growth reforms, stabilise ailing parastatals and restore confidence in the SA economy. SA's growth could receive a short-term boost from inventory renewal as SA corporates start to spend again after a year-long hiatus. Inflation will remain well behaved, with chances of further downside surprises adding to the case for a lower repo rate.

SA government bonds should benefit from this renewed optimism and contained inflation. However, at current levels they are only at fair value, and with exclusion from the Citigroup WGBI still a possibility, we remain cautious. ✚

NOMINAL BONDS VS INFLATION-LINKED BONDS

Source: Coronation

SA FLAGSHIP FUND UPDATE

Performance and positioning

2017 proved to be a strong year for most asset classes and our portfolios performed well over the period

INVESTOR NEED: LONG-TERM GROWTH

Domestic general equity funds

PERFORMANCE FOR VARIOUS PERIODS

	Launch date	2017	5 years	10 years	Since inception
Top 20	Oct 00	18.1%	11.5%	13.0%	19.2%
Average competitor		12.7%	9.1%	8.3%	14.8%
Equity	Apr 96	17.1%	12.5%	12.0%	16.5%
Average competitor		12.7%	9.1%	8.3%	13.9%

Annualised. Average competitor performance is defined as the mean return of the SA General Equity category excluding Coronation funds as measured by Morningstar and is shown since the inception date of the Coronation Top 20 Fund.

Sources: Coronation, IRESS

Domestic equity markets delivered good returns in 2017, reversing the lacklustre performance of the past few years. The FTSE/JSE Capped All Share Index returned 18.1% for the year and 6.5% in the fourth quarter, compared to an annualised 8.9% over three years. The return in US dollar terms was 30.6% over the year as the rand strengthened, reflecting a positive shift in sentiment on the back of the ANC elective conference outcome.

In addition to the positive currency response, domestic shares rallied strongly as short positions were closed and investors tried to hurriedly gain exposure. This was very positive for our holdings in financial stocks such as Nedbank and Standard Bank, and the retail exposures held via Woolworths and Spar. We took this opportunity to lighten some of our pure domestic exposure. While we agree that the outcome of the elective conference was net positive for SA, structurally the economy faces major challenges which are likely to keep a dampener on growth. As a result, we believe that many domestic shares now look quite expensive relative to their growth prospects.

In particular, the past quarter's rally in domestic banks (+28%) is cause for review, with higher earnings expectations being priced in. While slow advances in growth over the last few years may accelerate, a benign credit cycle leaves little room for credit loss improvements. We have adjusted position sizes to reflect a reduced margin of safety.

A detractor to performance was Frankfurt- and JSE-listed discount retailer Steinhoff, which announced that its CEO would be stepping down and that its financial statements could not be released due to what appears to have been a number of years of misstatement of its audited accounts. For a detailed analysis of our position, please refer to page 12.

Over the past year, the Coronation Equity fund benefited from holdings in global businesses including JD.com, 58.com and Porsche. 58.com is a Chinese online classifieds player operating in a growing marketplace as the business drives penetration into lower-tier Chinese cities, expands advertising services to merchants and gains traction in used goods markets. Growing scale and dominance should support margin expansion. JD.com is a Chinese online retailer similarly benefiting from rapidly growing demand as it expands product ranges and invests in its infrastructure and fulfilment services. The vast domestic market with its large number of high-density cities creates longer-term potential for a very profitable business and the company continues to gain scale and market share.

Calendar 2017 was a relatively robust year for commodity prices, with most strengthening as Chinese demand remained resilient. Supply remained constrained as miners persisted with disciplined allocation of capital and Chinese environmental regulation capped domestic supply. While higher commodity prices have reduced the margin of safety in resource valuations, we maintained a reasonable exposure and have seen contributions to full-year performance from a number of holdings.

We enter 2018 with a number of compelling holdings in the portfolios that we believe will continue to deliver strong results in the years ahead and support investor returns over the medium to long term.

Multi-asset class funds

PERFORMANCE FOR VARIOUS PERIODS

	Launch date	2017	5 years	10 years	Since inception
Balanced Plus	Apr 96	12.7%	11.3%	11.0%	15.2%
Average competitor		10.0%	9.2%	8.3%	12.8%
Market Plus	Jul 01	10.4%	11.3%	11.4%	16.5%
Average competitor		7.8%	12.4%	8.8%	11.5%

Annualised. Average competitor performance is defined as the mean return of the SA Multi-asset High Equity category excluding Coronation funds as measured by Morningstar and is shown since the inception date of the Coronation Balanced Plus Fund.

Sources: Coronation, IRESS

Over the longer term, significant offshore exposure remains a meaningful contributor to the funds' performance.

The strong run in global equity markets continued into the quarter, with a quarterly US dollar return of 5.7% (MSCI All Country World Index) supporting the 12-month number at 24.0%. Major markets were broadly strong across the developed and emerging world, with both the US and eurozone reporting healthy growth. This was achieved despite political tensions continuing to boil under the surface – North Korea's ongoing development of its nuclear agenda, alleged Russian interference in US politics and a tumultuous Middle East.

As the economic outlook for most markets remains good, with Europe, Asia and the US still showing very positive underlying growth metrics, we do not believe we should be underweight equities, but given high valuation levels it is no longer prudent to maintain a big overweight position. Given the strong run in global markets and continued political uncertainty, we have deemed it prudent to trim back these holdings.

Rand strength and a rally in domestic assets meant the large offshore holdings and limited exposure to government bonds detracted from performance in the quarter.

Within the domestic portion of our equity allocation, the majority of our exposure remained to companies with significant operations offshore. The main driver behind this remains the outlook for tepid growth locally and the expensive ratings of many domestic stocks. The strong rally in domestic stocks after the outcome of the ANC elective conference was not unexpected, but we remain firm in our belief that it is unwarranted, given the massive challenges the local economy faces. The fiscal position is dire and the low productivity of the workforce is unlikely to change given poor educational outcomes. We have taken advantage of the recent run in domestic stocks to lighten our exposure to these equities at what we think are optimistic price levels.

A position in Steinhoff was also a detractor from our performance in the last quarter, as was our very low exposure to government bonds, which saw a very strong rally at the end of the year. The rally presented an opportunity to further reduce our exposure as the domestic bond market faces a number of challenges in the year ahead. SA's dire fiscal position will require much greater funding, especially as the parlous position of state-owned enterprises' finances becomes more evident. With debt to GDP spiralling ever higher, worsened by the prospect of free tertiary education, we do not believe current bond yields are sufficient to reward investors. As our debt rating moves to junk status across all rating agencies, we do not see the potential pool of investors getting any bigger. Instead, it will shrink. Importantly, this is happening in an environment where we see government bond yields in developed countries starting to rise, which will put further pressure on domestic bond yields.

Offsetting our low domestic bond position has been our high weighting in domestic property. While domestic property performed better in the last quarter, it has not yet responded to the election of Cyril Ramaphosa as ANC president to the same extent as the bond market. Yields on domestic property stocks remain very attractive, with many in double digits, with the prospect of further earnings growth. We remain overweight this particular asset class, with expectations of decent returns before any capital growth.

Within the offshore component outside of equities, we are also very underweight bonds, with the exception of a few high-yield opportunities where we believe the credit spreads will more than compensate for adverse yield movements. We have increased exposure to property, adding to European retail landlords and, more recently, to a number of large US retail property owners where yields are looking very attractive and the underlying properties are high quality and defensive.

Given the current structure and fund holdings of the funds, we believe we are well positioned to continue to deliver benchmark- and inflation-beating returns in the future, in line with our long-term track record.

INVESTOR NEED: INCOME AND GROWTH

Multi-asset class funds

PERFORMANCE FOR VARIOUS PERIODS

	Launch date	2017	3 years	5 years	Since inception
Capital Plus	Jul 01	6.9%	5.2%	8.0%	12.6%
Average competitor		9.2%	6.0%	8.5%	11.2%
Balanced Defensive	Feb 07	7.8%	6.6%	8.8%	10.0%
Average competitor		8.4%	6.5%	8.0%	8.0%
Inflation (CPI)		4.7%	5.6%	5.5%	6.2%

Annualised. Average competitor performance is defined as the mean return of the SA Multi-asset Medium Equity and the SA Multi-asset Low Equity categories excluding Coronation funds as measured by Morningstar and is shown since the inception date of the Coronation Balanced Defensive Fund.

Sources: Coronation, IRESS

Over the course of the year, the biggest contributors to the portfolios' performance were Naspers, Standard Bank, Anglo American and global equities. However, the strength in the rand towards year-end had a negative effect on performance, as it impacted the value of the funds' offshore holdings totalling 25% of portfolio. Another detractor was Steinhoff, although the impact of its collapse was not crippling.

Listed property company Intu is a stock we have held for many years in the belief that the value of its underlying portfolio of high-quality shopping centres far exceeded its market capitalisation. Our view was supported by rival property company Hammerson's offer to buy Intu at a large premium to its then-current price. The combined portfolio of Hammerson and Intu will make it the largest holder of prime retail shopping centres in the UK. We further believe the Hammerson management team can unlock significantly more value for shareholders over time. As such, we support the buyout enthusiastically.

We were very active in the bond market over the quarter, using the market's disappointment in the Medium Term Budget Policy Statement to add to government bonds at very attractive yields, and therefore enjoyed the sharp improvement in yields subsequent to the ANC's elective conference.

Looking forward to 2018, the market will be focused on how Mr Ramaphosa will lead the ANC and, in particular, for how long Jacob Zuma will remain president of the country and therefore in control of key cabinet appointments and government policy. In our view, the deeply divided top six officials of the ruling party and its national executive committee will make it difficult for the new president to act decisively. We think the markets have been too euphoric in its assessment of recent events and expect some retreat in those market sectors that were so buoyant in December.

INVESTOR NEED: IMMEDIATE INCOME

Income fund

PERFORMANCE FOR VARIOUS PERIODS

	Launch date	1 year	3 years	Since inception
Strategic Income	Jul 01	9.3%	8.4%	10.5%
Average competitor		7.8%	7.5%	9.1%
Cash (STeFI3M)		7.1%	6.7%	7.8%

Annualised. Average competitor performance is defined as the mean return of the SA Multi-asset Income category excluding Coronation funds as measured by Morningstar and is shown since the inception date of the Coronation Strategic Income Fund.

Sources: Coronation, IRESS

The last quarter of 2017 was particularly eventful in the local bond market. Following the poor Medium Term Budget Policy Statement in October, when SA's fiscal deterioration became a reality, the local 10-year bond sold off aggressively, from 8.6% to a high of just above 9.5%. As we have been highlighting for some time, these higher levels better reflect the underlying risks in the local economy, given the policy and political backdrop. Up to the ANC elective conference in December, SA bonds spent most of the quarter at levels of around 9.25% to 9.5%. With Mr Ramaphosa emerging as the new president of the ANC (and possibly the country), the local bond market rallied down to close the year at levels of 8.59%.

Before December, there were expectations that bonds would underperform cash for the year, but the All Bond Index ended 2017 up 10.2% (gaining 5.66% in December alone). This is significantly above the performance of cash and inflation-linked bonds, which returned 7.5% and 2.8%, respectively. The fund has continuously used any spike in yields as an opportunity to add selective exposure to the longer area of the bond curve (more than 12 years) at levels of around 10.25% to 10.50%, given its attractive return prospects relative to cash over the longer term.

The SA economy could be at a key turning point if the newly elected ruling party leadership is able to push through much-needed growth reforms, stabilise ailing parastatals and restore confidence in the economy. SA's growth could receive a short-term boost from inventory renewal as corporate SA starts to spend again after a year-long hiatus. Inflation will remain well behaved, with a chance of further downside surprises adding to the case for a lower repo rate. SA government bonds should benefit from this renewed optimism and contained inflation. However, at current levels, they are only at fair value, and with exclusion from the Citigroup World Government Bond Index still a possibility, we choose to be neutral on SA government bonds, looking instead for more attractive levels to extend duration further.

The SA listed-property sector gained 4.21% in December, bringing its return for the year to 17.86%. From our recent interactions with many of the listed property companies, it is clear that poor economic conditions have started to affect the local property market. Still, we remain confident that the sector offers selective value. The changes in the property sector over the last decade (including the increased ability to hedge borrowings and large offshore exposures) have rendered the yield gap between the property index and the current 10-year government bond a poor measure of value. On the surface, it appears quite stretched. However, if one excludes the offshore exposure, the property sector's yield rises to approximately 8.3%, which compares very favourably to the benchmark bond. The fund maintains holdings in counters that offer strong distribution and income growth, with upside to their net asset value valuations. In the event of a moderation in listed property valuations (which may be triggered by further risk asset or bond market weakness), we will look to increase the fund's exposure to this sector at more attractive levels.

We remain vigilant of risks emanating from the dislocation between stretched valuations and the underlying fundamentals of the SA economy. However, we believe that the fund's current positioning correctly reflects appropriate levels of caution. The fund's yield of 8.98% 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. +

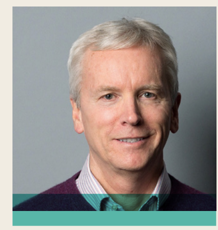
INTERNATIONAL OUTLOOK

Navigating in unchartered waters

Valuations are high and uncertainty is increasing

By Tony Gibson

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



THE MSCI ALL Country World Index posted a positive total return of 24% in US dollars during 2017. Global equity markets have continued to benefit from a combination of broad-based economic growth, low inflation, tax changes in the US and supportive central bank policies. Over the course of the year, emerging market equities have outpaced developed market equities by more than 13%, with an impressive US dollar return of 37%.

BROAD-BASED GROWTH

Global economic growth continues to impress, with JP Morgan estimating that global real GDP has expanded at a solid 3.7% annual rate during the second half of the year. That said, there is some evidence that growth by that measure has cooled to an estimated 3.0% pace in the fourth quarter. This is due to two near-term drags – the 30% rise in energy prices in the second half of the year and the impact of China's credit tightening on credit-intensive sectors like housing and infrastructure. But the global expansion is now so broad based that there are likely to be positive feedback effects, supporting financial conditions as well as business and consumer sentiment. Indeed, JP Morgan's measure of global consumer confidence has reached its highest level in over a decade, suggesting that any impact on purchasing power from higher oil prices is likely to be modest.

Following the 0.25% rate hike by the Federal Reserve (Fed) during December, some observers are concerned that the associated flattening of the US yield curve is pointing to a significant slowdown ahead for its economy. But arguing against that view is the growing likelihood of US fiscal stimulus associated with the recently approved tax cut package that became the Republican Party's number one objective.

Additionally, the fact that overall financial conditions remain buoyant, as reflected in high stock prices, tight credit spreads and the very high level of Bloomberg's Financial Conditions Indexes argue against an imminent slowdown. Although Fed funds futures are pricing in two further rate hikes in 2018, projections by Fed officials are pointing to the need for twice that amount of tightening. The Fed's view will have been reinforced by the passage of the tax cut package, which is widely expected to add more than $1 trillion to US debt over the next decade.

In contrast to the Fed, interest rate normalisation by the European Central Bank (ECB) and the Bank of Japan is expected to proceed much more slowly, with core inflation in the euro area having stalled at 0.9% in November, while core inflation in Japan remains zero on a year-on-year basis. That said, the euro area economy continues to power ahead, with economic sentiment in December at a 17-year high. Growth has been strong of late and appears to be broadening, with deflationary risks having all but disappeared. Politics suggest that fiscal spending could increase in some countries, including Germany. Inflation could tick higher and force the ECB to start talking about rate rises. ECB president Mario Draghi could of course find some way to extend quantitative easing well past September 2018 in a difficult balancing act that increases the risk of a policy error. Japan's economy also remains on a solid footing, as reflected in a very strong Purchasing Managers' Index reading for November and a government survey showing stronger capital spending growth in the most recent quarter.

The focus on China is less on interest rate policy, which remains neutral for now, and more on credit policy. New regulatory efforts were announced to reign in excess credit growth and reduce the implicit guarantees embedded in continuing risky, off-balance sheet lending. This has created uncertainty in China's financial markets, triggering rising bond yields and volatility in domestic equities.

With the government aiming for a soft landing, the most likely scenario for 2018 seems to be further deceleration in credit-intensive sectors like housing and infrastructure, offset by a stronger contribution from export sectors that benefit from improved global growth and the decline of nearly 10% in the trade-weighted currency since early 2016.

THE RISKS OF COMPLACENCY

Looking ahead to 2018, conditions for global equity markets continue to look reasonably good in the context of a broad-based global expansion and generally accommodative monetary policy. But valuations are a concern, particularly in the US, where the Shiller cyclically adjusted price earnings ratio is at the 95th percentile of its historic range since 1926.

Valuations outside of the US are generally less elevated, and on conventional metrics, the MSCI Europe, Australasia and Far East, and the MSCI Emerging Markets indices trade at 14.9 and 12.3 times estimated earnings respectively, compared to the MSCI USA Index at 18.7 times. Against the backdrop of still-low global bond yields, this suggests that global equities remain attractive relative to fixed income, albeit somewhat less so than was the case over the past few years.

Global markets saw some geopolitical-related wobbles, specifically around Brexit and US politics, but even the German, Dutch and French elections caused only very minor disturbances. But overall, the market trajectory over the last 12 months, if not 23 months, has been almost unique in history – leading to an increasing number of commentators making a fundamental case that equity and credit markets are at bubble valuations. They point to charts supporting their thesis that the market is technically overbought and sentiment is at extremely positive levels, which could potentially trigger a correction. Meanwhile, the momentum in markets remains upwards, with bearish sentiments having to be tempered at the moment. Despite warnings, the majority of investors simply appear to have adopted a momentum and yield strategy; that is, they will remain invested in risk assets until the market turns.

DESPITE WARNINGS, THE MAJORITY OF INVESTORS SIMPLY APPEAR TO HAVE ADOPTED A MOMENTUM AND YIELD STRATEGY; THAT IS, THEY WILL REMAIN INVESTED IN RISK ASSETS UNTIL THE MARKET TURNS.

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Given that we are at the start of a new calendar year, some perspective is called for. As outlined, the market environment for equity and credit markets has been quite extraordinary in 2017. It is worth noting that, historically, US equities perform best in the second half of an American presidential term. However, this pattern has been distorted over the past decade by the bounce-back from the deep recession of 2008 into 2009, followed by the flood of central bank liquidity injections – and related suppression of yields which in turn fed a global rotation toward momentum-driven equities, dividend-yielding equities and corporate debt.

That said, it must be pointed out that the suppression of yields by central banks over the last five years is really only a tailwind to a decline in yields that has been in progress since the early 1980s. While there is little doubt that, as quantitative easing programmes around the world are slowly shut down, yields will rise, the strategic outlook will also depend on background forces that have contributed to lower yields for a long time. This global excess of mobile liquidity should continue to buoy equities into 2018. Responding to a modest but synchronised upturn in the global economy, pragmatic investors continue to direct mobile capital toward equity risk. Investors reason (or rationalise) that with no viable alternatives, this will remain the most prudent allocation of client assets. Worryingly, complacency hides risks posed by the eventual end of central bank bond buying and overdependence on index funds, especially those that are leveraged. The key point is that asset price appreciation in equities, credit, sovereign bonds and other asset classes has been strong throughout the careers of the majority of people currently employed in finance – but logic suggests that this dynamic seems likely to come to an end.

IN THE SHORT TERM, REASONABLE GROWTH, EXCESS LIQUIDITY AND NEGATIVE REAL INTEREST RATES WILL CONTINUE TO SUPPORT THE ROTATION TOWARD ECONOMIC AND EQUITY RISK. BUT LATER THIS YEAR AND INTO 2019, EVENTS WILL MOST LIKELY TRIGGER AN ABRUPT REPRICING OF RISK.

STRUCTURAL PROBLEMS ALLEVIATED BUT NOT SOLVED

Risks are mounting. These include the unravelling of western geopolitical alliances, the drift toward military miscalculation in Northeast Asia, and slow but relentless economic transformations within countries and economic regions. Although many individual investors worry that equities are overvalued, they continue to rotate their capital (and hope) towards, for example, momentum-driven cryptocurrencies or cash-burning shares such as Tesla. As highlighted, in the short term, reasonable growth, excess liquidity and negative real interest rates will continue to support the rotation toward economic and equity risk. But later this year and into 2019, events will most likely trigger an abrupt repricing of risk. The knock-on effect of this will, if current trends are any guide, further inflame populist antipathy toward ruling elites and the status quo around the world.

The causes of the political uncertainty in western industrialised nations are not hard to find. A sharp decline in economic prospects, stagnating real wages, job insecurity, pension systems under threat and growing inequality have combined to create a sense of discontent. These are largely the result of long-term structural problems. The recent global cyclical upswing will alleviate some of these in the short term, but it will not solve them. And although the global economies are growing and unemployment has fallen, wages remain stubbornly low.

Statistics from the IMF show that while unemployment has fallen to below 6% across advanced economies, annual wage growth has barely moved above 2%. We may be experiencing an upturn but for many, little has changed or improved. Against this backdrop, the impending end to central banks' expansive monetary policy, or quantitative easing, of the past decade is another source of uncertainty. The tricky part is that normalising monetary policy means undoing 10 years of monetary stimulus. This is something that, in our opinion, investment markets are too complacent about and unprepared for. Central bank balance sheets have never been so large and are in unprecedented territory. Simply put, interest rates are extremely low and global debt is extremely high.

WHAT CAN GO WRONG?

While the current benign inflation environment has dampened investor fears, more forward-thinking commentators recognise that we are in unchartered waters. Today's low financial market volatilities are deceptive and underestimate the underlying risks and uncertainties – the point is that the long-term effects of quantitative easing are not fully understood and that the impact of reversing this process therefore remains unknown. Uncertainty of this type should be reflected in increased risk and therefore the pricing of risk. This leaves investors with a conundrum: how to explain the discrepancy of high levels of uncertainty coexisting with financial market complacency.

The implicit message at present therefore seems to be that, due to the high levels of uncertainty, risk cannot be accurately priced. Equity markets are very clearly ignoring the uncertainty at present. This will, as is always the case, change at some point. In the mean time, both investors and policymakers will enjoy the upswing while it lasts, knowing that it will not last indefinitely. Investors should therefore prepare for a return of volatility. In a period of uncertainty, portfolio diversification is becoming increasingly vital.

Concerns as to where inflation is headed leaves investors with continued uncertainty as to where interest rates will wind up. But it would be reasonable to conclude that a significant inflation shock would be a major negative force affecting today's investment portfolios. Despite deflation being the dominant fear since the 2008 financial crisis, it seems likely that a meaningful increase in inflation from here would trigger larger portfolio losses than a depression. While depressions are bad for risk assets and good for quality bonds, inflation is very bad for bonds and mildly bad for stocks.

As things stand now, bonds would do particularly badly given their very low real yields. However, shares could get more severely hit

given their extremely high valuations. Although we do not know if an inflation surge is inevitable, it is something that investors should have in the forefront of their minds when they think about what could go wrong for their portfolios.

This does not mean we need to prepare for an abrupt multi-asset sell-off, but it is likely to mean a strategic change in the asset return environment that investors will not be used to. This will also have profound implications for the structure of the finance industry and the question of active versus passive stock selection. An unanticipated low return outlook will challenge the methodology and even the goal of investments, all of which have been predicated on the belief that returns from asset markets are higher than the return demanded to fund the savings needs of society. ✚

Domestic flagship fund range

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

INVESTOR NEED

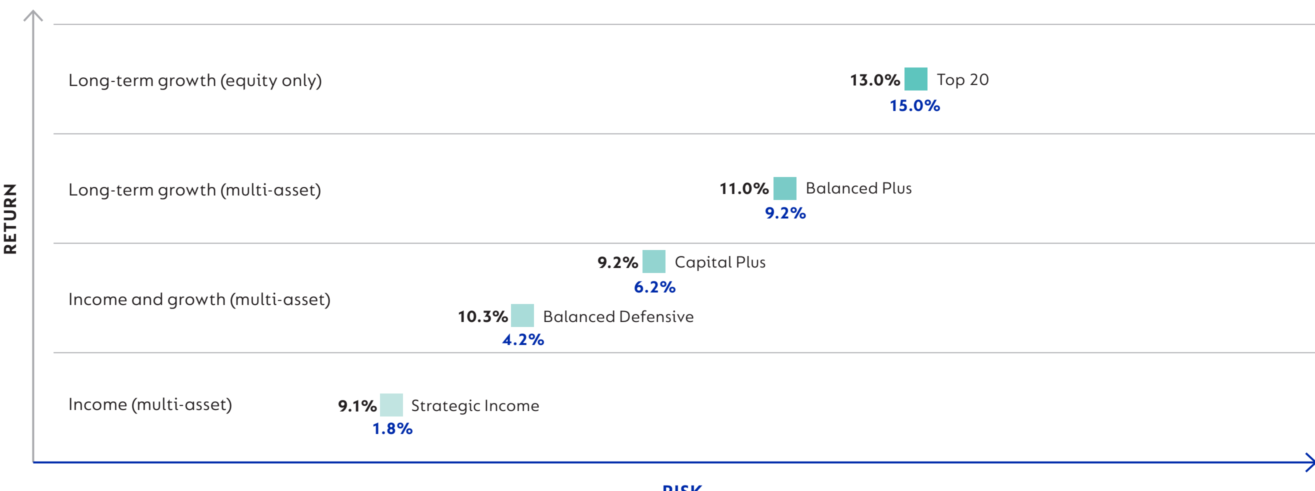
	INCOME ONLY	INCOME AND GROWTH		LONG-TERM CAPITAL GROWTH	
FUND	**STRATEGIC INCOME** Cash†	**BALANCED DEFENSIVE** Inflation†	**CAPITAL PLUS** Inflation†	**BALANCED PLUS** Composite benchmark† (equities, bonds and cash)	**TOP 20** FTSE/JSE CAPI†
FUND DESCRIPTION	Conservative asset allocation across the yielding asset classes. Ideal for investors looking for an intelligent alternative to cash or bank deposits over periods from 12 to 36 months.	A lower risk alternative to Capital Plus for investors requiring a growing regular income. The fund holds fewer growth assets and more income assets than Capital Plus and has a risk budget that is in line with the typical income-and-growth portfolio.	Focused on providing a growing regular income. The fund has a higher risk budget than the typical income-and-growth fund, making it ideal for investors in retirement seeking to draw an income from their capital over an extended period of time.	Best investment view across all asset classes. Ideal for pre-retirement savers as it is managed in line with the investment restrictions that apply to pension funds. If you are not saving within a retirement vehicle, consider Market Plus, the unconstrained version of this mandate.	A concentrated portfolio of 15-20 shares selected from the entire JSE, compared to the average equity fund holding 40-60 shares. The fund requires a longer investment time horizon and is an ideal building block for investors who wish to blend their equity exposure across a number of funds. Investors who prefer to own just one equity fund may consider the more broadly diversified Coronation Equity Fund.
INCOME VS GROWTH ASSETS[1] ● INCOME ● GROWTH	91.3% 8.7%	59.0% 41.0%	40.3% 59.7%	18.7% 81.3%	1.1% 98.9%
LAUNCH DATE	Jul 2001	Mar 2007	Jul 2001	Apr 1996	Oct 2000
ANNUAL RETURN (Since launch)	10.5% 7.8%†	10.0% 6.2%†	12.6% 5.9%†	15.2% 13.6%†	19.2% 14.9%†
QUARTILE RANK (Since launch)	1st	1st	1st	1st	1st
ANNUAL RETURN (Last 10 years)	9.1% 6.8%†	10.3% 5.9%†	9.2% 5.9%†	11.0% 10.7%†	13.0% 10.3%†
STANDARD DEVIATION (Last 10 years)	1.8% 0.5%†	4.2% 1.6%†	6.2% 1.6%†	9.2% 9.6%†	15.0% 16.1%†
BEST-PERFORMING 12 MONTHS	18.7% Nov 2002 - Oct 2003	21.2% Jun 2012 - May 2013	33.8% Aug 2004 - Jul 2005	49.3% Aug 2004 - Jul 2005	68.9% May 2005 - Apr 2006
WORST-PERFORMING 12 MONTHS	2.6% Jun 2007 - May 2008	2.0% Mar 2008 - Feb 2009	(6.2%) Nov 2007 - Oct 2008	(17.4%) Sep 1997 - Aug 1998	(31.7%) May 2002 - Apr 2003
FUND HIGHLIGHTS	Outperformed cash by 1.8% p.a. over the past 5 years and 2.7% p.a. since launch in 2001.	Outperformed inflation by 3.8% p.a. (after fees) since launch, while producing positive returns over all 12-month periods. A top-performing conservative fund in SA over 5 years.	Outperformed inflation by 6.6% p.a. (after fees) since launch, while producing positive returns over 24 months more than 99% of the time.	No. 1 balanced fund in SA since launch in 1996, outperforming its average competitor by 2.4% p.a. Outperformed inflation by on average 8.8% p.a. since launch and outperformed the ALSI on average by 1.1% p.a.	The fund added 4.3% p.a. to the return of the market. This means R100 000 invested in Top 20 at launch in October 2000 grew to more than R2.0 million by end-December 2017 – nearly double the value of its current benchmark. The fund is a top quartile performer since launch.

[1] Income versus growth assets as at 31 December 2017. Growth assets defined as equities, listed property and commodities (excluding gold).

Figures are quoted from Morningstar as at 31 December 2017 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

RISK VERSUS RETURN

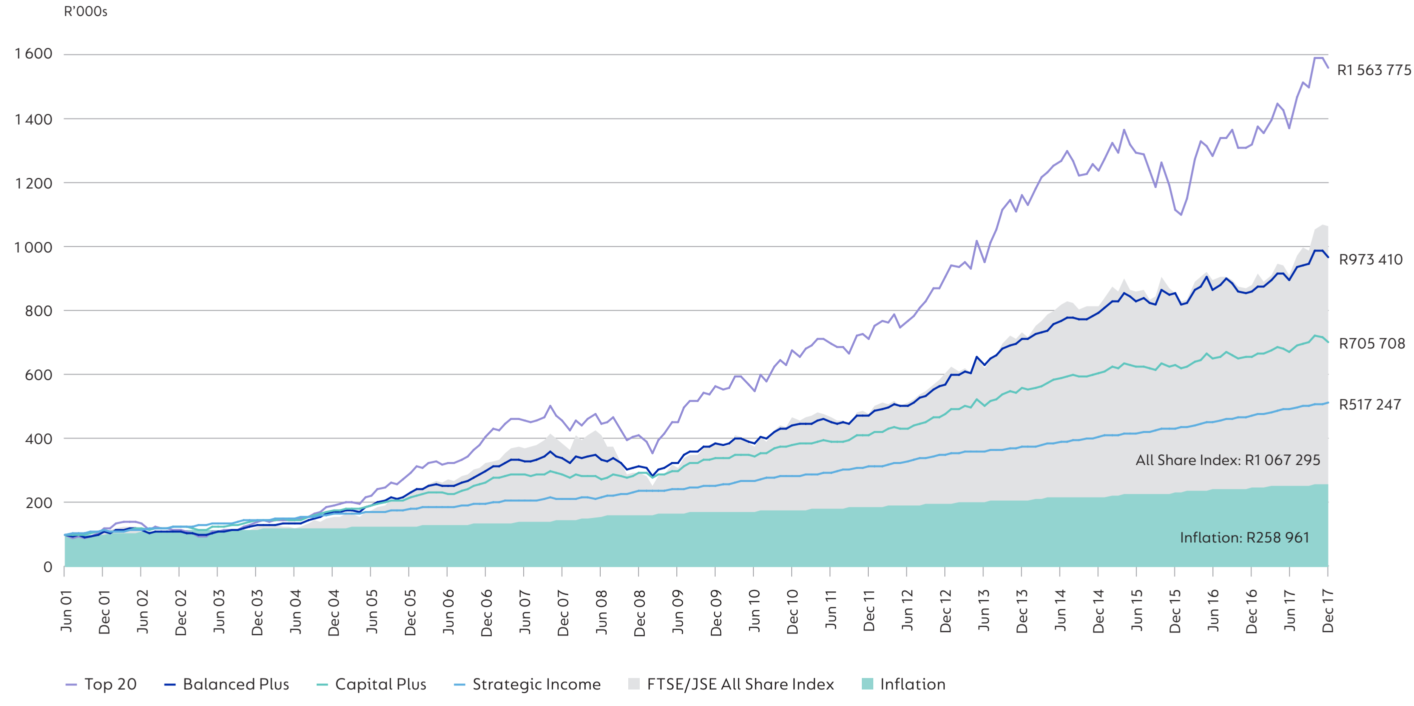
10-year annualised return and risk (standard deviation) quoted as at 31 December 2017.
Figures quoted in ZAR after all income reinvested and all costs deducted.



Source: Morningstar

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

Value of R100 000 invested in Coronation's domestic flagship funds since inception of Capital Plus on 1 July 2001 as at 31 December 2017. All income reinvested for funds; FTSE/JSE All Share Index is on a total return basis. Balanced Defensive is excluded as it was only launched on 2 February 2007.



Source: Morningstar

International flagship fund range

INVESTOR NEED

	DEPOSIT ALTERNATIVE	CAPITAL PRESERVATION	LONG-TERM CAPITAL GROWTH (MULTI-ASSET)	LONG-TERM CAPITAL GROWTH (EQUITY ONLY)	
FUND[1]	**GLOBAL STRATEGIC USD INCOME [ZAR] FEEDER** **GLOBAL STRATEGIC USD INCOME** US dollar cash (3 Month Libor)†	**GLOBAL CAPITAL PLUS [ZAR] FEEDER** **GLOBAL CAPITAL PLUS [FOREIGN CURRENCY]**[4] US dollar cash (3 Month Libor)*	**GLOBAL MANAGED [ZAR] FEEDER** **GLOBAL MANAGED [USD]** Composite (equities and bonds)†	**GLOBAL OPPORTUNITIES EQUITY [ZAR] FEEDER** **GLOBAL OPPORTUNITIES EQUITY [USD]** MSCI ACWI†	**GLOBAL EMERGING MARKETS FLEXIBLE [ZAR]** **GLOBAL EMERGING MARKETS [USD]** MSCI Emerging Markets Index†
FUND DESCRIPTION	An intelligent alternative to dollar-denominated bank deposits over periods of 12 months or longer.	A low-risk global balanced fund reflecting our best long-term global investment view moderated for investors with smaller risk budgets. We offer both hedged and houseview currency classes of this fund. In the case of the former, the fund aims to preserve capital in the class currency over any 12-month period.	A global balanced fund reflecting our best long-term global investment view for investors seeking to evaluate outcomes in hard currency terms. Will invest in different asset classes and geographies, with a bias towards growth assets in general and equities in particular.	A diversified portfolio of the best global equity managers (typically 6-10) who share our investment philosophy. An ideal fund for investors who prefer to own just one global equity fund. Investors who want to blend their international equity exposure may consider Coronation Global Equity Select, which has more concentrated exposure to our best global investment views.	Our top stock picks from companies providing exposure to emerging markets. The US dollar fund remains fully invested in equities at all times, while the rand fund will reduce equity exposure when we struggle to find value.
INCOME VS GROWTH ASSETS[2] ● INCOME ● GROWTH	96.0% 4.0%	59.3% 41.0%	32.5% 67.5%	0.7% 99.3%	4.4% 95.6%
LAUNCH DATE	Aug 2013 Dec 2011	Nov 2008 Sep 2009	Oct 2009 March 2010	Aug 1997 May 2008	Dec 2007 July 2008
ANNUAL RETURN[3] (Since launch)	2.7% 0.6%†	5.7% 0.6%†	7.7% 7.3%†	7.1% 6.2%†	4.1% 1.9%†
QUARTILE RANK (Since launch)	1st	1st	1st	1st	1st
ANNUAL RETURN (Last 5 years)	1.8% 0.6%	2.7% 0.6%	7.1% 7.4%	10.1% 12.2%	4.5% 4.6%
ANNUAL RETURN (Last 10 years)				4.9% 5.6%	4.1% 1.9%
QUARTILE RANK (Last 5 years)	–	2nd	1st	1st	2nd
BEST-PERFORMING 12 MONTHS[5]	7.1% Jan 2012 - Dec 2012	17.1% Jul 2010 - Jun 2011	22.7% Jul 2010 - Jun 2011	50.0% Apr 2009 - Mar 2010	106.2% Mar 2009 - Feb 2010
WORST-PERFORMING 12 MONTHS[5]	(1.0%) Mar 2015 - Feb 2016	(7.4%) Sep 2014 - Aug 2015	(14.4%) Mar 2015 - Feb 2016	(23.5%) Jun 2008 - May 2009	(33.6%) Sep 2014 - Aug 2015
FUND HIGHLIGHTS	Outperformed US dollar cash by 2.2% p.a (after fees) since launch in December 2011.	Outperformed US dollar cash by 5.1% p.a. (after fees) since launch in 2008.	No. 1 global multi-asset high equity fund in SA since launch in October 2009.	Both the rand and US dollar versions of the fund have outperformed the global equity market with less risk since their respective launch dates.	Both the rand and US dollar versions of the fund outperformed the MSCI Emerging Markets Index by more than 2% p.a. since their respective launch dates.

[1] *Rand- and US dollar-denominated fund names are included for reference.*

[2] *Income versus growth assets as at 31 December 2017 (for US dollar funds). Growth assets defined as equities, listed property and commodities (excluding gold).*

[3] *Returns quoted in US dollar for the oldest fund.*

[4] *Available in US dollar Hedged, GBP Hedged, EUR Hedged or Houseview currency classes.*

[5] *Returns are quoted in USD for the US dollar-denominated funds.*

Figures are quoted from Morningstar as at 31 December 2017 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

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

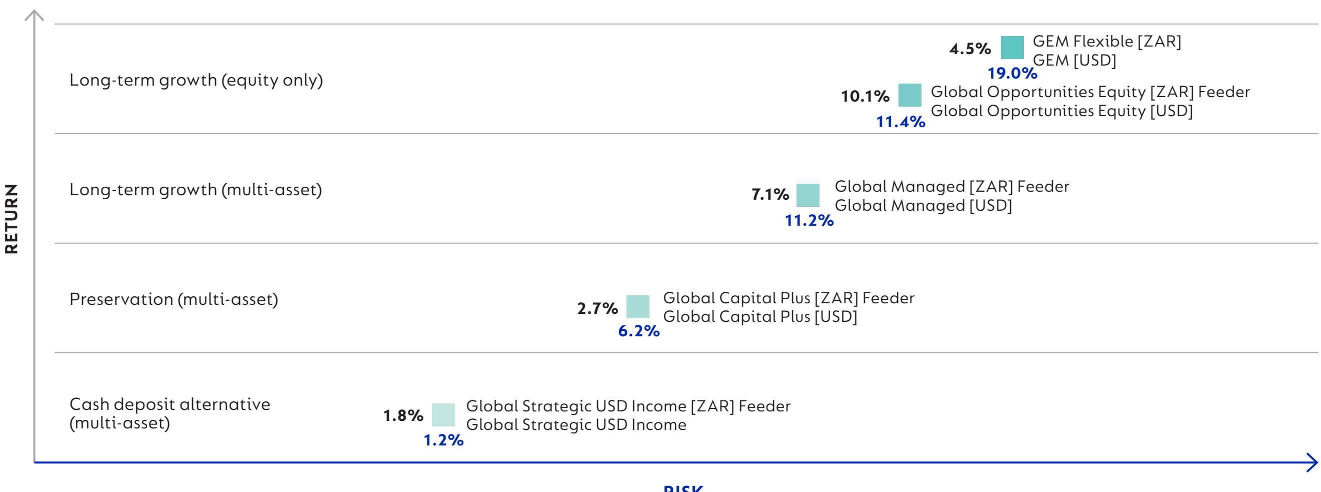
HAVE YOU CONSIDERED EXTERNALISING RANDS? IT IS EASIER THAN YOU MIGHT THINK.

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

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

RISK VERSUS RETURN

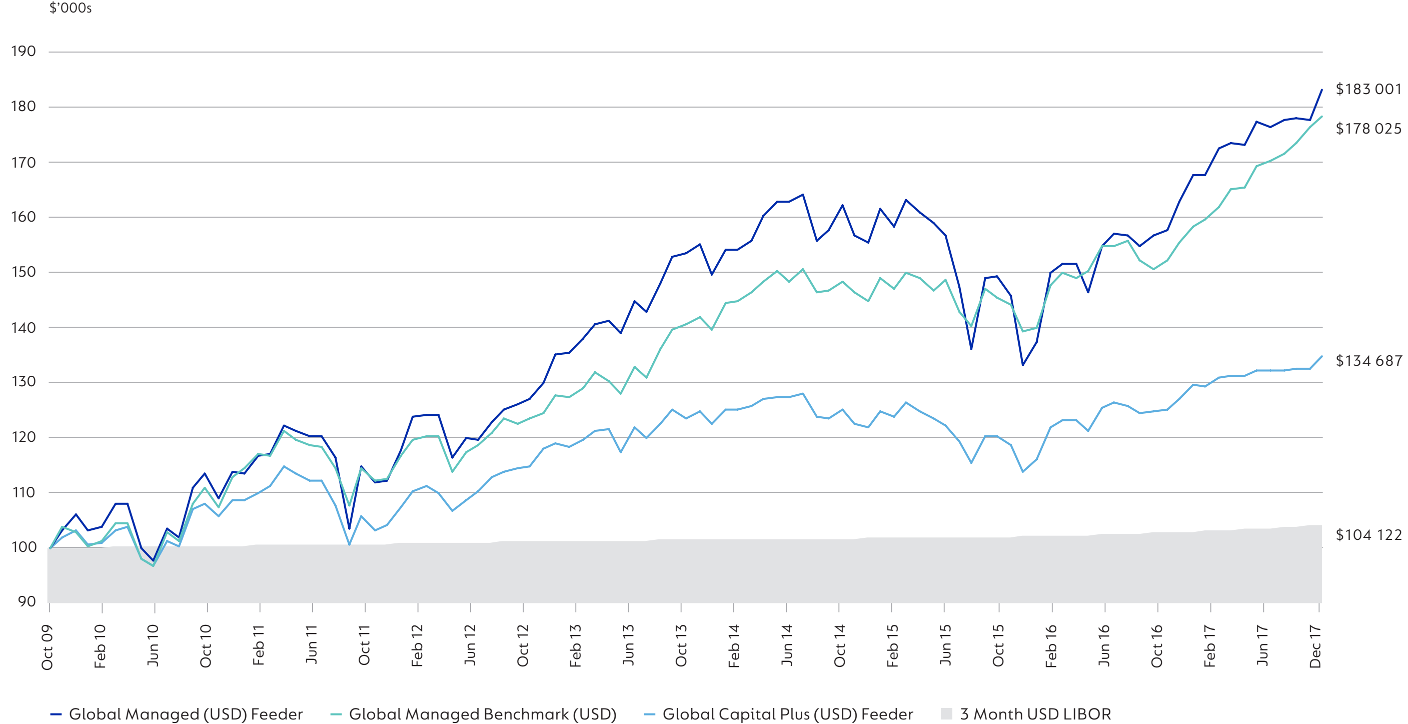
5-year annualised return and risk (standard deviation) quoted as at 31 December 2017. Figures quoted in USD (for the oldest fund) after all income reinvested and all costs deducted.



Source: Morningstar

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

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

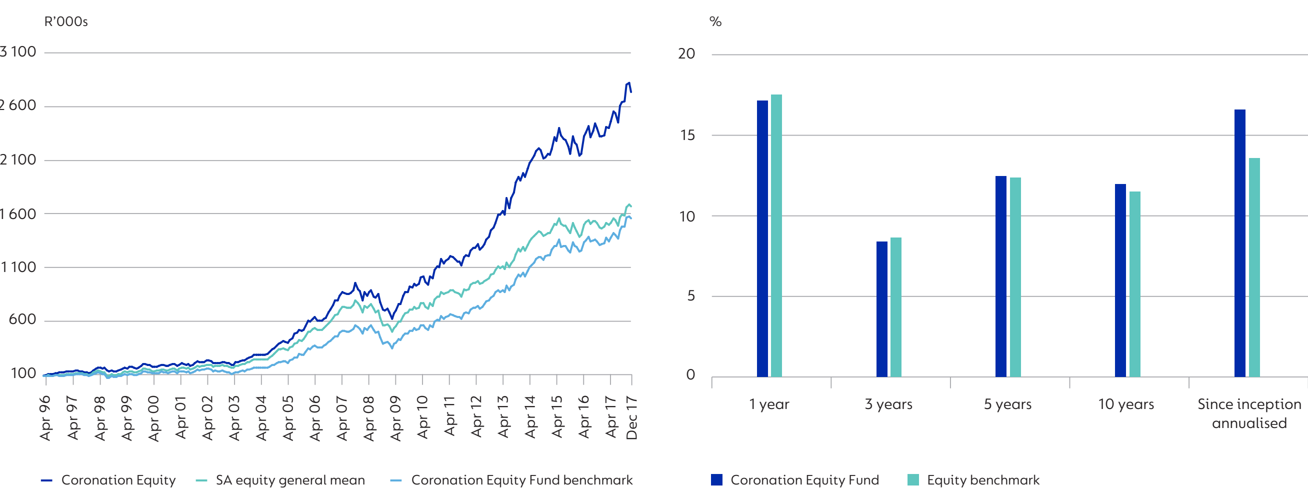


Source: Morningstar

Long-term investment track record

CORONATION EQUITY RETURNS VS EQUITY BENCHMARK

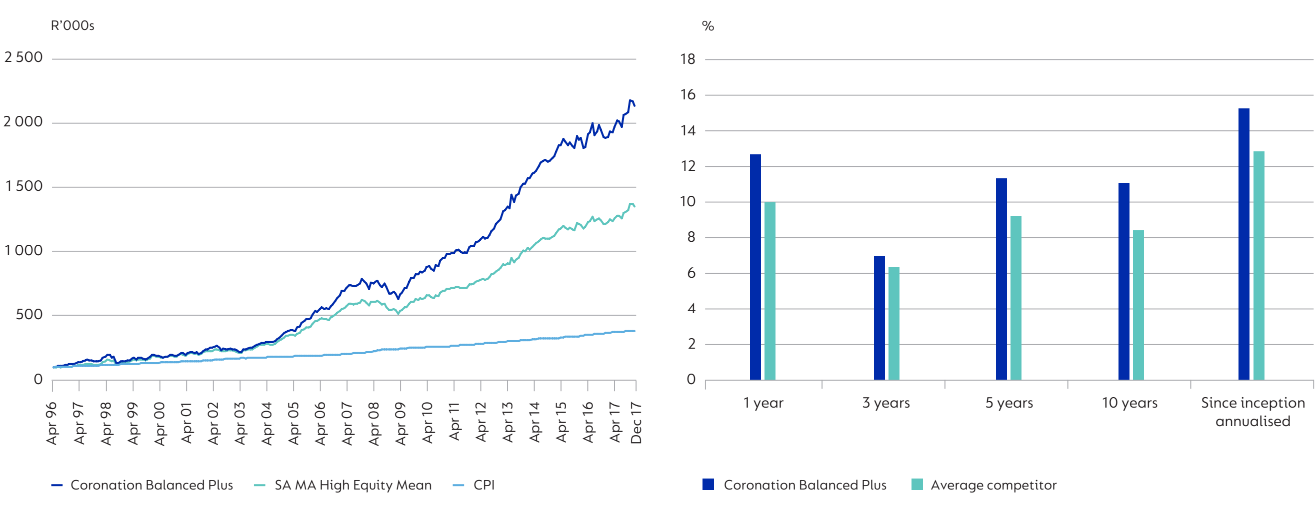
5-YEAR ANNUALISED RETURNS	CORONATION EQUITY	EQUITY BENCHMARK	ALPHA
2000	15.66%	6.17%	9.49%
2001	12.37%	9.38%	2.99%
2002	12.15%	7.14%	5.01%
2003	14.63%	13.49%	1.14%
2004	13.82%	10.46%	3.36%
2005	23.32%	19.44%	3.88%
2006	26.84%	23.91%	2.93%
2007	31.53%	30.40%	1.12%
2008	20.70%	20.09%	0.60%
2009	19.31%	19.37%	(0.06%)
2010	15.97%	15.12%	0.85%
2011	9.83%	8.65%	1.18%
2012	11.54%	10.60%	0.94%
2013	22.51%	20.60%	1.91%
2014	17.58%	17.78%	(0.20%)
2015	13.76%	14.72%	(0.96%)
2016	14.11%	14.44%	(0.33%)
2017	12.45%	12.29%	0.16%
ANNUALISED TO 31 DECEMBER 2017			
1 year	17.08%	17.42%	(0.35%)
3 years	8.37%	8.62%	(0.25%)
5 years	12.45%	12.29%	0.16%
10 years	11.99%	11.45%	0.55%
Since inception in October 1993 annualised	16.49%	13.53%	2.97%
Average outperformance per 5-year return			1.89%
Number of 5-year periods outperformed			14.00
Number of 5-year periods underperformed			4.00



An investment of R100 000 in Coronation Equity on 15 April 1996 would have grown to **R2 732 277** by 31 December 2017. By comparison, the returns generated by the fund's benchmark over the same period would have grown a similar investment to **R1 562 121**, while the average competitor would have grown a similar investment to **R1 671 294**.

CORONATION BALANCED PLUS FUND VS INFLATION AND AVERAGE COMPETITOR*

5-YEAR ANNUALISED RETURNS	CORONATION BALANCED PLUS	INFLATION	REAL RETURN
2000	16.00%	7.90%	8.10%
2001	14.38%	7.41%	6.97%
2002	10.73%	8.04%	2.69%
2003	14.68%	7.33%	7.35%
2004	13.82%	6.68%	7.14%
2005	20.53%	5.85%	14.68%
2006	22.43%	5.54%	16.89%
2007	25.35%	5.17%	20.18%
2008	19.28%	6.41%	12.87%
2009	17.60%	6.82%	10.77%
2010	13.97%	6.71%	7.26%
2011	9.49%	6.94%	2.55%
2012	10.81%	6.36%	4.45%
2013	17.98%	5.39%	12.58%
2014	15.57%	5.19%	10.38%
2015	14.05%	5.54%	8.51%
2016	12.69%	5.67%	7.02%
2017	11.27%	5.47%	5.80%
ANNUALISED TO 31 DECEMBER 2017	**CORONATION BALANCED PLUS**	**AVERAGE COMPETITOR**	**ALPHA**
1 year	12.68%	9.96%	2.72%
3 years	6.97%	6.25%	0.73%
5 years	11.27%	9.16%	2.11%
10 years	11.04%	8.34%	2.70%
Since inception in April 1996 annualised	15.18%	12.77%	2.42%
Average 5-year real return			9.23%
Number of 5-year periods where the real return is >10%			7.00
Number of 5-year periods where the real return is 5% - 10%			8.00
Number of 5-year periods where the real return is 0% - 5%			3.00



An investment of R100 000 in Coronation Balanced Plus on 15 April 1996 would have grown to **R2 137 737** by 31 December 2017. By comparison, the SA multi-asset high-equity sector over the same period would have grown a similar investment to **R1 350 597**.

* *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.*

Every day is a good day to earn your trust.

It was before our first democratic elections. Before fears of Y2K rippled through the business world. Before the market crash and recession. Before the biggest sports event in the world came to South Africa. And before we carried our lives in our phones.

It was before all this that we made it our purpose to grow the long-term wealth of all South Africans. We'll never know what the future holds, but just as we've done over the past 25 years, we'll keep on seeing every day as an opportunity to earn your trust.

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CORONATION

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