corospondent

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TRUST IS EARNED™

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IN THIS ISSUE

CORONATION FUND UPDATES AND PERFORMANCE

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Notes from my inbox

"In the midst of chaos, there is also opportunity." – Sun Tzu

By **PIETER KOEKEMOER**

Pieter is Head of Personal Investments.

THE LATE 2021 'WORRY LIST'

'CLIMBING THE WALL of worry' is a market cliché acknowledging the fact that despite numerous potential problems appearing on the horizon, enough optimism may persist for asset prices to continue to rise. We all know that long-term investing is a future-facing endeavour, meaning that investors should expect to be continuously challenged by uncertainty. It's useful to remember that this is a feature of the system, not a bug. If you cannot find a way to embrace uncertainty, you are highly unlikely to be an efficient investor; in this case, your investments often won't bring you much joy, to paraphrase tidying and organising guru Marie Kondo.

A related observation is that, due to the human brain's bandwidth limitations, the collective narrative typically only has capacity to worry about a few things at a time. In financial markets, it's rare for more than two or three main story arcs to dominate the headlines in any given quarter. This narrow focus creates opportunities for investors who are prepared to do the hard work of conducting their own independent and proprietary research.

Not only is the real world infinitely more complex and interconnected than what can be accommodated in the news cycle, but the fact that nearly everyone is busy parsing information about the same risks often leads to the market overestimating the actual downside caused by the unfolding events, especially when measured over longer time horizons.

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The topics that are currently driving market sentiment and on which we provide our views in this *Corospondent* include:

- The health of the global economy, which is slowing down after the rapid post-lockdown recovery period, while governments and central bankers grapple with setting the appropriate pace of withdrawing the extraordinary fiscal and monetary support unleashed since the pandemic started.
- Increasing concern about the potential for a lengthy period of stubbornly high inflation, which becomes more likely the longer current inflation rates remain elevated.
- The prospects for investors in China, who were recently buffeted by a leftwards shift in government policy, a tighter regulatory environment and growing concerns about the health of the property market.

The above are unpacked in detail by Marie Antelme, Suhail Suleman and Nishan Maharaj in their respective articles.

NASPERS/PROSUS AND THE LOCAL EQUITY MARKET

Over the past 20 years, an investment in the FTSE/JSE All Share Index performed very well, increasing capital invested in September 2001 by a factor of nearly 15. Over the same period, JSE heavyweight Naspers outperformed the Index by an order of magnitude, growing by 186 times. Astounding wealth has been created for investors and the company is arguably the defining South African public investment market success story of the democratic era.

However, more recent outcomes were not as rosy. In response to the Chinese authorities' assertive policy and regulatory actions referred to above, Naspers declined by c.15% year to date (at the nadir, it was down 25%, but the share price staged a strong recovery in recent weeks). The sheer size of Naspers and related company Prosus makes the outlook for these shares hugely significant to most investors. The good news is that we still have high conviction in this investment case, as Marc Talpert explains on page 13.

RETURN EXPECTATIONS

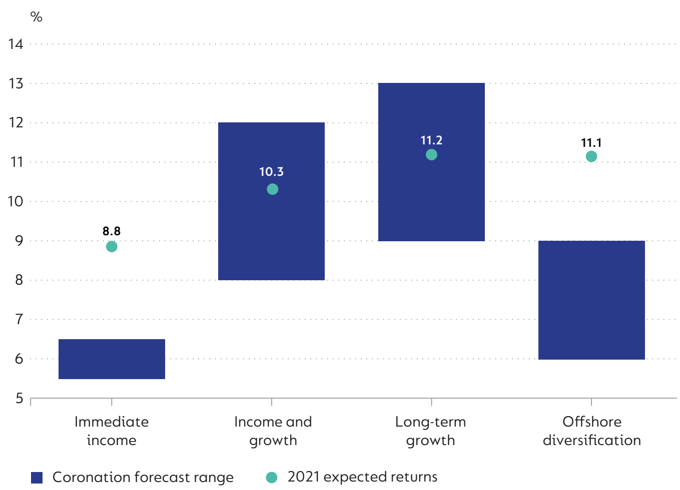
We would like to thank the many thousands of clients who participated in our annual client survey during July. While the primary purpose of the exercise is to get your input on the areas where our service to you can be improved, we also ask a few investment-related questions. The most important of these is about better understanding your long-term return expectations. It helps us to calibrate your expectations (the wisdom of the crowd) with the output of our research effort, which we express in a forecast return range over the next decade for the various key investor needs.

The good news from this year's survey is that your and our expectations for returns from domestic general equity and multi-asset class funds are aligned. Our detailed research confirms that valuation levels in the domestic market are still relatively undemanding, meaning that a return expectation of inflation plus 4% to 7% p.a. from multi-asset class funds such as Balanced Defensive, Capital Plus and Balanced Plus is achievable over the next decade.

Of some concern is that your collective expectations are around 2% p.a. higher than ours for immediate income (from funds such as Coronation Strategic Income) and from international funds (such as Coronation Global Optimum Growth or Global Managed). For these fund categories, client expectations are closely aligned to the outcomes produced by these strategies over the past decade. However, when we take into account elevated developed market valuation levels (especially in the US) and the likelihood of lower-for-longer short-term interest rates, we reach somewhat less optimistic conclusions for these two investor needs.

Figure 1

WHAT IS A PRUDENT RATE OF RETURN ASSUMPTION OVER THE NEXT DECADE?



Source: Coronation

Client expectations compared to Coronation forecast range, as at 30 June 2021.

RECOGNITION

At the recent European Pensions Awards held in London, Coronation received the European Pensions Emerging Markets Award, recognising our industry-leading performance and world-class client experience in this strategy. We launched our global emerging markets (GEM) equity strategy in 2008, which represents our view of the best investment opportunities available in this market segment. In 2020, the strategy ranked eighth out of 104 GEM all-cap strategies, and first out of 21 GEM all-cap core strategies, according to the investment platform eVestment.

NEW ONLINE INVESTOR SERVICE LAUNCHING IN NOVEMBER

I'm also excited to share that we will be introducing a refreshed online investor service during November. Our aim is to make your client experience more pleasant, getting more things done more quickly and from more places. We will communicate the details to you in the coming weeks.

Thanks again for your ongoing support.

As always, I invite you to get in touch via clientservice@coronation.com if there is any aspect of our service to you that requires attention.

Pieter

GLOBAL ECONOMIC COMMENT

No antidote for the uncertainty

"We demand rigidly defined areas of doubt and uncertainty!"
– Douglas Adams, *The Hitchhiker's Guide to the Galaxy*

By MARIE ANTELME

THE QUICK TAKE

- An increasingly complex and uneven economic landscape is emerging from the recovery
- New variants, variable policy extension and withdrawal, rising inflation and a looming energy crisis challenge policy settings and market pricing
- Wide-ranging political uncertainty has increased and may have long-term economic implications

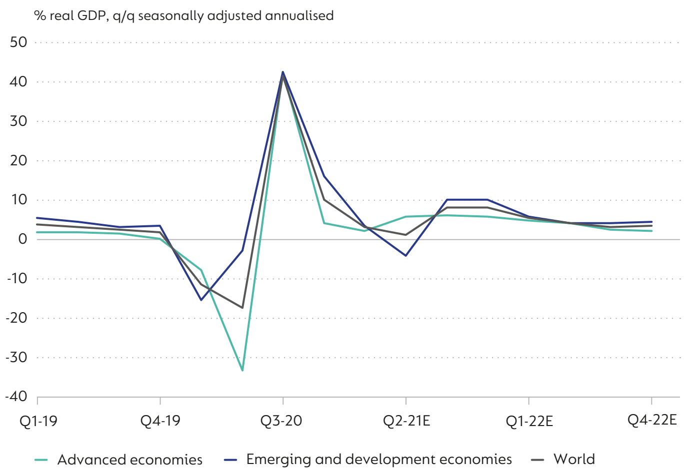
Marie is an economist with 21 years' experience as a market economist.

AN UNCERTAIN AFTERMATH

Global growth has peaked (see Figure 1). This is not unexpected after the initial strong recovery from China late last year, followed by developed economies with superior vaccination strategies. After China, the US saw growth accelerate to 1.5% quarter on quarter (q/q) in the first quarter of 2021 (Q1-21) and 1.6% in the second quarter (Q2-21), then the UK staggered open and output surged 5.5% in Q2-21, after a lockdown-induced contraction in Q1-21. A laggard, Europe opened steadily from Q2-21, and growth momentum has gathered. Yet, into year-end, activity data has slowed, and the growth outlook has become uneven and increasingly complex. Different strategies related to Covid-19 variant emergence are in part to blame, but the uncertain withdrawal of policy support and related risks to inflation are now growing headwinds.

Figure 1

GLOBAL SEQUENTIAL GROWTH SLOWING



Source: UBS

In the emerging markets, growth recoveries have been more mixed. These countries were slower to reopen because vaccine strategies were more challenging, and generally their policy support was more limited. Here too, though, recent data (excluding China) has seen sequential growth that was stronger than expected, implying upside risk to current expectations for 2021, and possibly 2022, but that overall momentum is also likely to slow.

THE SLOWDOWN WAS INEVITABLE

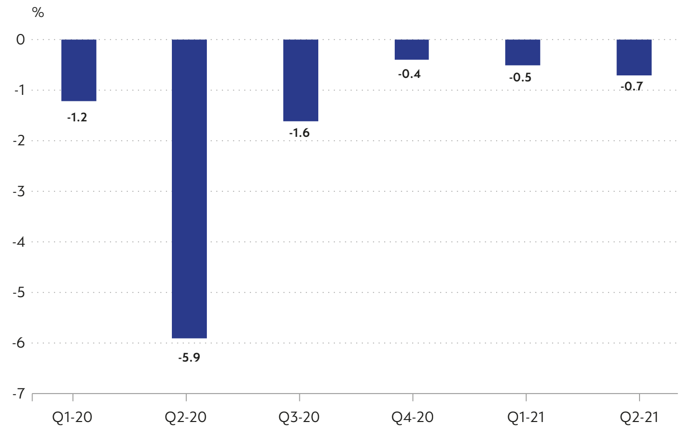
In contrast to the protracted and weak recovery that followed the Global Financial Crisis (GFC), by nature, the pandemic was a different kind of crisis.

Not only is the 'V'-shaped recovery testament to the impact of the large, coordinated monetary and fiscal support, which protected economies from more enduring economic damage; what also helped was a much stronger starting position. Balance sheets were healthy, private sector leverage was much lower and the world had enjoyed a long period of growth. Importantly, financial systems are solid, much better provisioned and protected by policy interventions.

Despite this, the recovery has been accompanied by shortages, bottlenecks and a sharp rise in inflation. With the withdrawal of policy support moving closer, the question has shifted from what the recovery will look like, to how smooth the slowdown can be.

Figure 2

DIMINISHING IMPACT OF GLOBAL MOBILITY RESTRICTIONS ON GDP

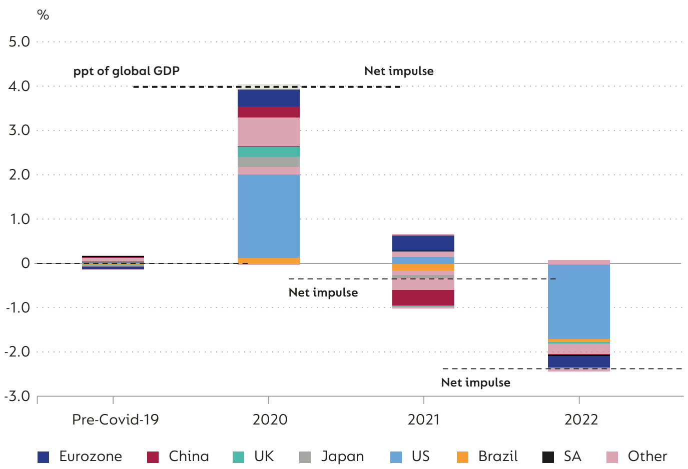


Source: UBS

Regressing the impact on GDP of an aggregated index of mobility restrictions suggests periods of tightening have had a diminishing impact on growth.

Figure 3

FISCAL IMPULSE AND GDP



Source: UBS

Fiscal stimulus was overwhelmingly provided in the US. Withdrawal will be a drag on growth, but likely less than initially feared.

IMPACT OF INCREASED COMPLEXITY ON GROWTH PROSPECTS

The first, of course, is that the scourge of the novel coronavirus is still with us. New variants may again derail the recovery, although the news here seems encouraging. The Delta variant now accounts for more than 90% of the new cases in most countries but, on aggregate, mobility restrictions continue to ease. There are, of course, still regional differences, notably in Asia where governments still have a zero-tolerance approach to new infections, but much of the West, and many emerging markets, have continued to open their economies. Regression analysis shows that the successive impact of lockdown since early 2020 on GDP has diminished as workplaces and productivity have adjusted (Figure 2). Death rates are also, mercifully, well below previous peaks. As vaccinations continue, the associated economic risk should continue to diminish.

In many countries, the critical fiscal support extended during the crisis is now rolling off. Some countries/regions – such as the US and Europe – have passed long-term stimulus plans, but the recovery risk of a 'global' fiscal cliff as emergency policies are taken away is a key uncertainty.

The IMF estimates that pandemic fiscal support amounted to about 5% of global GDP. Withdrawal will inevitably create a drag. But about 70% of this came from the US – which makes this predominantly a US story – and, at the time of writing, the possibility of a government shutdown in the US cannot be discounted and markets have become more jittery (Figure 3). It's worth noting, though, that even in the US, the issue is a near-term one. Under current policy configuration, fiscal support will moderate from 7% of GDP in 2020 to 3% in 2023, with the bulk of the negative impulse happening now and into early 2022. As growth continues to recover, the drag should fade. While a clear and present risk, this should still be a meaningful underpin to the global recovery.

RISE IN INFLATION

The rise in inflation that has accompanied the recovery is potentially a more enduring problem. Not only has the rise in prices been much stronger than expected, but it's also been broader (Figure 4 overleaf). A close look at US inflation data shows that the big surprises have come from 'tail' items affected either by lockdown or reopening, like cars, but increasingly, prices of non-core items such as housing and other domestic services are starting to rise. Bottlenecks have also lasted longer than expected, extending high goods prices. Some price drivers – namely shutdowns,

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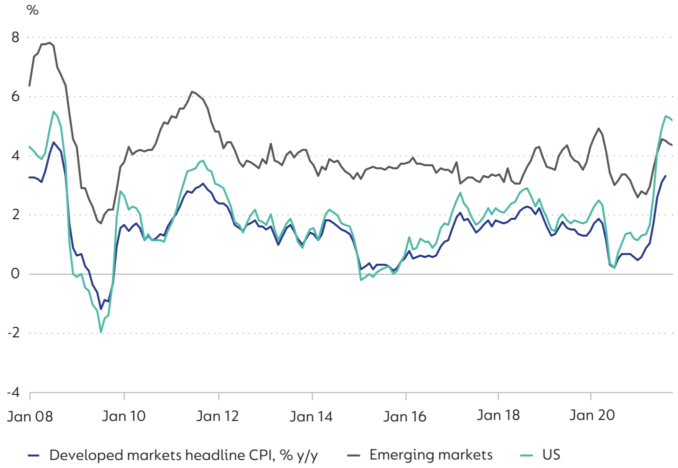
Figure 4

HEADLINE CPI – MORE OF AN ISSUE IN DEVELOPED MARKETS THAN EMERGING MARKETS, ESPECIALLY THE US



Source: Haver

The inflation surge in the developed markets, especially in the US, has been stronger than in emerging markets. The longer prices remain high, the more reinforcing the inflation risk becomes.

bottlenecks, shortages and, more recently, the rise in house prices and the emerging energy crisis – may become reinforcing as they drive expectations and wage demands higher.

Central banks are still broadly of the view that the rise in inflation will be 'transitory', but the longer temporary pressures persist, the more enduring the effects may become – and this is becoming a clear concern. The likely policy response to higher inflation is also not straightforward. Central banks are wary of tightening too fast and choking growth, and both the Federal Reserve Board (the Fed) and the European Central Bank (ECB) have mandates that now emphasise growth considerations.

In countries where government debt is very high and debt costs are anchored to very low rates, fiscal and financial stability constraints hamper the implementation of rate hiking cycles. For now, the Fed has signaled it may be getting close to withdrawing some of the liquidity support it directed at financial markets during the crisis, but has been at pains to decouple this tapering from the prospect of higher policy rates. The Bank of England has started to signal that it is closer to raising rates than markets have previously anticipated, but the ECB has largely pushed the debate out.

The emerging energy crisis has both inflation and growth implications, notably for Europe and the UK. Oil prices are up significantly on a year ago. But natural gas prices have surged 354% year on year (y/y) in Europe and 284% in the UK year to date due to a strong demand for greener energy and tight supply, as both European and Russian gas production has been disrupted, resulting in low late-summer stock levels. Energy has a relatively large weight in European CPI (9.5%), with liquid fuels being the largest component and electricity somewhat smaller.

A similar pattern is visible in the UK, although the total weight is somewhat lower (6%). But there are also indirect price implications as energy works through supply chains and producer prices. Several governments have announced caps or tariffs to limit pass-through, but an initial limited direct impact on both Eurozone and UK inflation is likely, but will build as prices continue to rise. The impact of higher inflation – even unavoidable energy prices – on growth via lower consumption is historically quite small and, for now, seems likely to be cushioned by high levels of saving. Nonetheless, this may become a growing headwind should prices remain high for an extended period.

UNCERTAINTY ABOUT CONTINUED GOVERNMENT SUPPORT

The prospect of a withdrawal of developed economy monetary support has both liquidity and sentiment implications for emerging markets, especially those that are now considerably more indebted than before. The repricing of inflation risk in developed economies could see yields in riskier emerging markets adjust meaningfully upwards.

Many of these countries, such as South Africa, have struggled to return to pre-pandemic growth levels and their economies are not yet fully open. Most of these governments increased spending on health and social relief during the pandemic, and the withdrawal of this support now may have meaningful social consequences, while higher borrowing costs may become a challenge to fiscal sustainability.

Support for the banking and corporate sectors also helped guarantee liquidity through forbearance measures, coupled with accommodative policies. While the number of non-performing loans has risen, a massive surge in bankruptcies has, so far, been averted.

As supportive policies end and policy rates start to rise, the debt sustainability metrics for these companies may become much more challenging, especially if growth can't catch up. Further, concerns about asset quality may emerge as companies face pressure on cash flows and debt service returns to normal.

RISKS ABOUND

In China, a series of announcements aligned to objectives related to 'common prosperity' and aimed at cracking down on corruption, corporate excesses and property speculation roiled markets in September, and may have long-term implications for both Chinese and emerging market growth. These events were accompanied by a step-up in military presence in Taiwan's defence zone. It seems unlikely that the US will not respond, and tensions may continue to simmer. The threat of some tactical error is a persistent risk.

The EU is at loggerheads with the UK over Brexit and its new nuclear alliance with the US and Australia, all exacerbated by fuel shortages and rising prices. The Middle East may again challenge Western limitations on nuclear capacity, with Iran stalling talks to rejoin the Joint Comprehensive Plan of Action, the abandoned 2015 nuclear pact. The return of ISIS to Afghanistan complicates this situation, with the US reluctant to make further concessions in the region.

THE HARD PART MAY JUST BE BEGINNING, BUT THERE SHOULD BE SOME TIME

While we don't want to downplay the potential risks associated with these complex and, in some cases, interconnected risks, it's important to acknowledge some positive developments:

- Latest data suggests that the Delta variant's infection rates have peaked in the US and elsewhere. With rising vaccination rates, the threats to economic reopening seem to be receding, for now.
- While the risk of a US government shutdown is down to the wire, we believe a crisis is in no one's interest and that the Democrats are more likely to unite around revised infrastructure plans than hand the Republicans a victory.
- While political uncertainty in China is likely to persist, the economy should get a fillip from easier policy settings into year-end. Both these factors should support global growth and risk sentiment.
- The coming months will shed more light on inflation dynamics. Central banks have started to signal their preparedness to act should price growth not moderate, suggesting, for now, that runaway inflation will not be tolerated.

Across the globe, policymakers are facing the prospect of tough decisions in a very uncertain world, with little visibility. The risk of error is materially higher than it has previously been. That said, positive – albeit slower – growth momentum looks set to continue, with more accommodative policies in place for longer than we saw in the post-GFC period. In particular, the fiscal support deployed in the pandemic should normalise slowly, with some tolerance for larger deficits to ensure a stable recovery. In the US and Europe, the focus on using fiscal policy to promote longer-term growth is an additional stabiliser and may have the added support of both Germany and Japan, keeping more accommodative fiscal stances in play for longer.

In short, tough policy decisions will need to be made, but the message is still that policy priorities remain focused on supporting global growth. ✚

EMERGING MARKETS

China

Unpacking the recent regulatory interventions

By **SUHAIL SULEMAN**

THE QUICK TAKE

Since November last year, various regulatory changes and investigations have been announced and carried out in China

It's likely that these changes are indicative of a more intrusive regulatory regime going forward, but the impact will vary by sector

Some of these regulations have similar objectives to those commonplace elsewhere – promoting fair competition, protecting consumers and safeguarding data

It's crucial to understand both the risks and opportunities inherent in this market

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

SINCE NOVEMBER LAST year, the Chinese government, through its various organs of State, have announced several regulatory interventions and investigations into companies and industries, some of which are widely held by foreign investors. These regulatory actions have naturally raised the alarm among investors. Questions are being asked about what could be targeted next, and whether these are indicative of a broader attack on capital markets and foreign ownership therein. Given the number of regulatory moves and investigations that have been announced in such a short time period and the impact that these have had on the value of the affected listed businesses, these questions are justified.

PERMANENT HANDICAPPING OF AFTER-SCHOOL TUITION INDUSTRY

In July, widespread intervention in the after-school tuition (AST) industry has most likely permanently handicapped the long-term earnings power of businesses in this sector. Although some form of intervention was expected, the extent was close to the worst possible outcome. On 23 July, Beijing announced that tutoring companies were banned from making profits from classes that cover the core curriculum. In addition, foreign investment and the use of variable interest entity (VIE) structures would not be allowed in this industry going forward. There might be an exception for AST for high school students (years 10 to 12), as these are not 'compulsory years' that are attended by all students. For most tutoring businesses, the compulsory schooling years (pre-school through to the end of middle school/grade 9) represent between 40% and 70% of their revenues. Many of these businesses have announced that they will launch new alternative products, but it is doubtful that classes that do not cover the core curriculum will have the same appeal for parents. This is because their primary anxiety is to ensure that their children are adequately prepared to excel in the grueling university entrance exam – the *gaokao* – which determines who gets into the best universities in China.

We believe that the Chinese government has taken the view that this obsession with *gaokao* exam preparation from such a young age results in a very >

THE NEW REGULATIONS IMPOSED BY THE CHINESE GOVERNMENT CAN BE MANAGED REASONABLY SMOOTHLY BY MOST OF THE AFFECTED COMPANIES.

unhealthy situation for both children and parents, who spend a large proportion of their disposable income on tuition. China faces a demographic crunch, as the population pyramid is skewed heavily away from young people. According to government forecasts, the working age population is expected to see a net decline of 35 million people over the next five years due to retirement. To put this into sharp perspective, this figure represents more than the UK's entire current workforce. To address this, China is actively trying to increase the country's birth rate, as the end of the one-child policy in 2016 did not achieve the desired increase in number of births, and restrictions were subsequently loosened to allow three children per family.

To this end, lowering the cost of raising a family is seen as an essential step in boosting the birth rate and in China's drive to promote a 'common prosperity'. The property and healthcare sectors are also seeing regulatory interventions, as these industries are a large component of the cost of living and, like education, have seen costs rise far in excess of wage growth over the last decade.

INTERVENTION NOT ONLY IN AST

This action against AST came hot on the heels of the announcement of an investigation into ride-hailing service DiDi for inadequate protection of consumers' personal data and trips taken. Two days after DiDi completed its initial public offering (IPO), it was banned from registering new users and its App was removed from the various application stores in China. It is our understanding that the company was warned not to go public until the data privacy issues were sorted. DiDi chose to proceed anyway, hence the high-profile nature of the action taken against the company.

Other key events that have taken place since November 2020 include:

- The fintech company Ant's IPO was blocked in early November and, in February 2021, increased capital requirements were announced for all fintech players.
- In December 2020, customer subsidies were capped and anti-competitive practices in the community group buying[1] ecommerce industry were regulated. This affected Alibaba, Tencent, JD.com, Pinduodo, Meituan and DiDi.
- The practice of 'forced exclusivity' was also banned in December, which meant that Alibaba can no longer require merchants to sell their wares on only one platform. This was followed by a $2.8 billion fine for anti-competitive practices in April.
- An investigation was launched into anti-competitive practices in food delivery in April, particularly aimed at Meituan's practices of exclusivity. The investigation is ongoing.
- The merger of the two largest gaming live-streaming platforms in China was blocked in early July.
- Exclusivity in music licensing by Tencent Music (TME) was ended, and a RMB500 000 fine was imposed.

Sources: Coronation, Bernstein

TAKING A STEP BACK TO UNDERSTAND THE CONTEXT

It is impossible to know definitively whether these interventions signal a more intrusive regulatory regime in the future. However, we can draw inferences based on what is likely and what is not. It is worth stepping back to get some perspective and asking, first, what is the reason for the flurry of regulatory activity, and secondly, how do these regulations compare to what is happening in other countries?

By and large, the Chinese government has allowed technology to develop without significant regulatory impediments, with interventions taking place later to correct for any 'negative externalities' that arose. Our view on why so much regulatory intervention has taken place so quickly is that the government is now playing catch-up after a long period during which its approach was more hands-off.

At present, many of the regulations announced, with the notable exception of those relating to AST, have direct parallels to those that are commonplace elsewhere in the world. The protection of privacy and the promotion of competition are regulated and debated in many countries. In most cases, the new regulations imposed by the Chinese government can be managed by the affected companies reasonably smoothly, without materially affecting their long-term earnings prospects or seriously reducing the 'moat' around their business.

By and large, all the regulatory actions taken against Alibaba, JD.com, Meituan, Pinduodo, Tencent and TME to date fall into this category. Going forward, there could be further actions taken that change this, but for now, it appears that the objective of the government has been to rein in behavioural excesses. In our view, they are replicating standards that already exist or will be implemented in the EU and the US, albeit with a greater emphasis on national security, given >

[1] Community group buying: a community or group of consumers coordinating orders to benefit from bulk discounts.

the sensitivity around data. The most prominent example of copying 'Western' standards is the protection of 'Gig Economy' workers through the provision of social benefits and insurance against injury. This has become commonplace in other jurisdictions. China has an estimated 200 million workers in this sector (almost a quarter of its workforce), so better protections here are a social priority.

Clearly, the manner in which these changes were done damages long-term confidence in the country as an investment destination and we expect that Chinese assets will, all else being equal, trade at a discount to what they used to. This is somewhat reflected already in the sharp decline we've seen in share prices, almost across the board.

As a final consideration, the presence of VIE structures to circumvent foreign ownership restrictions has always been an issue for Chinese shares. These structures remain in place and the government has not taken any steps to end them, despite the fact that they have existed for decades. In the case of education shares, they have been banned going forward and not retroactively. Ending VIE structures would largely cut China off from most foreign capital permanently, which is likely the reason why they have been tacitly tolerated so far. The proportion of profits that flow through VIEs varies by company. In the case of JD.com, for example, close to 90% of profits are outside of the VIE structure, as ecommerce is largely exempted from foreign ownership bans. As a final point, the presence of VIE structures in the local A-share market also suggests that they have gained some tacit acceptance.

NOT ALL REGULATION IS NEGATIVE FOR INVESTMENT; SOME ACTUALLY PROMOTE COMPETITION BY OPENING UP OPPORTUNITIES FOR COMPANIES PREVIOUSLY HELD BACK.

THE WAY FORWARD

We are not complacent about the risks and continually assess and proactively research potential regulatory actions and how these would affect the stocks we own, and the Chinese market in general. As an example, after an August opinion piece in a State newspaper disparaged the impact that (video) gaming was having on society, particularly its addictive qualities for children, Tencent sold off significantly, as it's the largest gaming company in China. Subsequent to this, the government announced tight curbs on when and for what duration children are allowed to play online games.

The short-term impact on Tencent is relatively easy to quantify. Gaming is a material part of Tencent's earnings (around 45%), but only a small portion (single digits) of the gaming earnings relate to spend by minors. Tencent requires identity recognition before one can play games and minors are prohibited from playing content deemed unsuitable. Their game times are also monitored according to the regulated limits (a few hours a week spread over Friday to Sunday). Aside from the protection of minors, recent guidance to game developers has been to avoid 'misrepresenting history' and to promote the correct 'moral and culture' for China.

We have taken the view that this is all manageable for Tencent (and Netease, which is also owned in our Strategy), but what is more difficult to assess is whether the restrictions on minors playing games fundamentally affect their behaviour into the future. If these restrictions are adhered to by children now – and the technology in place to prevent rule-breaking makes it quite hard to skirt them – will the next generation of children be as prolific gamers as current adults are when they in turn reach the age of majority? These are the tougher questions we constantly debate that will determine whether the selloff turns out to have been a buying opportunity or not.

Not every potential regulation is negative for investment opportunities, as a number of recent regulatory proposals actually promote competition by opening up opportunities for companies that were previously held back from competing effectively with a strong incumbent. JD.com, for example, is a big beneficiary of the prohibition on Alibaba demanding exclusivity. JD.com historically struggled with its apparel offering (among other products) due to Alibaba's exclusivity demands and levelling of the playing field is a huge positive for the business.

There has been a selloff of Chinese shares since the changes were announced. Where the share price reaction is significant and the probability of the impact of regulatory change is low, this can be, but isn't always, a potential investment opportunity.

Our portfolios are constructed to take advantage of opportunities while simultaneously managing overall risk to each country, sector and industry. China, as the largest market in emerging markets, with the widest range of investable companies remains, in our view, an attractive investment opportunity for emerging market investors. However, as always, understanding the risks and return opportunities inherent in this market is crucial. +

STOCK ANALYSIS

Prosus' untapped potential

It's not just about Tencent, games and China

By MARC TALPERT

THE QUICK TAKE

Given the diversified and global nature of Tencent's business, it's somewhat better positioned than its peers against the effects of Chinese regulatory tightening

Looking beyond gaming, many of Tencent's other segments have largely untapped potential

There is excellent upside potential in the Naspers/ Prosus overall portfolio of assets that will drive value going forward

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

NASPERS, AND MORE recently Prosus, are two businesses that most South African (SA) investors will know well due to their disproportionate size on the JSE. While the performance of both these stocks has disappointed in the last 12 months, their contribution to the SA savings industry has been immense when you consider longer time periods, with Naspers having generated a cumulative total return of nine times over the past decade versus the JSE All Share Index's return of 1.7 times over the same period.

The more important question now becomes: can this performance be repeated over the coming decade, especially when the primary driver of this historic performance was Tencent?

In our view, while Tencent is still very important for the investment case of Naspers and Prosus, it's the non-Tencent assets that will be significant drivers of long-term value creation. This is a portfolio of assets that is now worth approximately $60 billion based on our assessment of value, which compares to the spot value of the Tencent shareholding of $170 billion.

TENCENT – THE JEWEL IN THE CROWN

One cannot talk about Tencent without mentioning the Chinese regulatory environment that has undoubtably become key when thinking about the outlook for Chinese technology businesses. However, it's important to consider regulation and its impact on the individual businesses, as the long-term impact on a case-by-case basis will most likely be different. At a high level, Tencent has historically navigated regulations well, and has exercised admirable restraint in adhering not just to the letter, but also to the spirit of the law. Historically, it has left money on the table, which positions it relatively better than its peers, in our view. The business will not be immune to the changing regulatory environment, but it should be able to navigate this environment due to a diversified business, which should continue to evolve (Figure 1).

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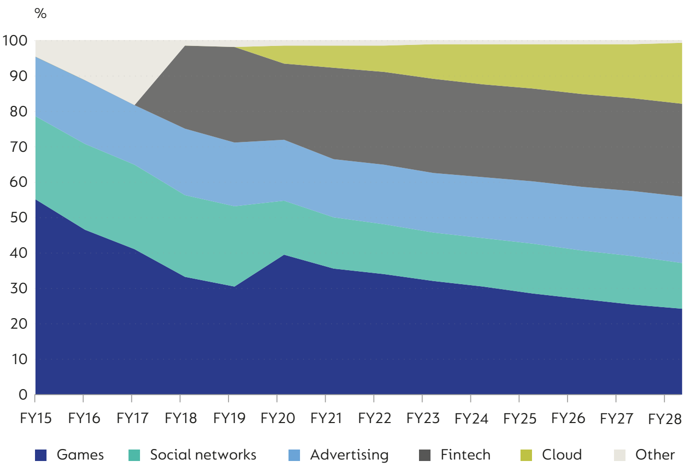
Figure 1

TENCENT'S REVENUE MIX

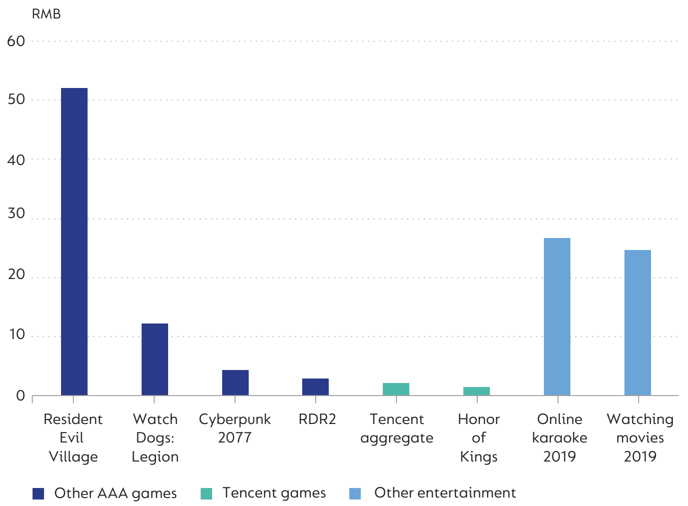


Sources: Tencent, Coronation

Forecasts indicate Tencent's shifting revenue base per segment over time.

Figure 2

COST OF GAME TIME PER HOUR VERSUS OTHER ENTERTAINMENT CHANNELS



Sources: SteamDB, HowLongToBeat, iResearch, Wikimedia Commons, Bernstein estimates and analysis

Per hour of game time, Tencent's top games have not been monetised to the same degree as most AAA game titles, and compared with popular types of offline entertainment like movies and karaoke.

Games

Tencent has a global gaming business, and its ex-China segment already represents 26% of its total gaming business, due to its ownership of iconic gaming studios such as Riot Games (the maker of League of Legions) and Supercell (the maker of Clash of Clans), and a minority ownership of Epic Games (the maker of Fortnite), to highlight just a few.

So, while the Chinese gaming business is exposed to regulatory tightening, most notably a clamp-down on the game time and spend of minors, it should be noted that minors contribute less than 5% of gaming revenue.

Also, gaming is a very cost-effective entertainment activity; overall game spend across adult user demographics is therefore likely to remain robust (Figure 2).

Another important consideration when thinking about Tencent's gaming business and its global expansion is the fact that China represents 25% of the global gaming market, and thus, by expanding globally, it has effectively tripled its addressable market in what is a structurally growing industry.

Advertising

Tencent has always been restrained in monetising its share of online consumer time; this is reflected in the fact that Tencent apps have a 36% share of time spent online in China versus their 11% share of the advertising market. So, while we don't expect the two to converge completely, the mini programme ecosystem[1] that exists within WeChat is driving a significant amount of commercial activity, creating a situation whereby advertising spend can be tracked and attributed to consumer spend.

This is supportive of improved advertising pricing due to the high (and directly measurable) return on investment being achieved by advertisers. There is already RMB1.6 trillion (and growing in triple digits) of gross merchandise value moving through this ecosystem, and we expect the level of commercial activity to continue to increase.

Fintech

Tencent's fintech business is currently dominated by payments, which, while not immune to regulatory intervention, are less exposed than other areas like credit. Growth within the fintech segment has always been managed conservatively due to management's acknowledgement of the regulated nature of financial services. Therefore, the changes required due to new regulations are marginal.

Less than 20% of Tencent's payments volumes relate to consumption, as volumes are still dominated by peer-to-peer payments, which are not monetised. We expect the level of consumption volumes to grow faster than peer-to-peer volumes, which should drive robust revenue growth.

The other part of the fintech business that we feel has lots of potential is wealth management. This leverages the consumer payment relationship to then offer consumers seamless access to various saving and investment products.

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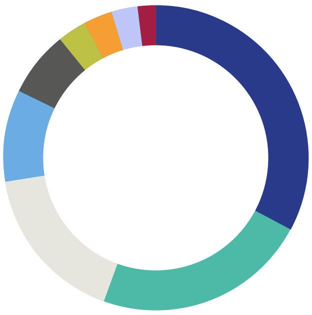
[1] A set of front-end applications and tools that enables comprehensive business operations/mini stores and full-blown marketing services.

Figure 3

EX-TENCENT ASSETS OF NASPERS/PROSUS

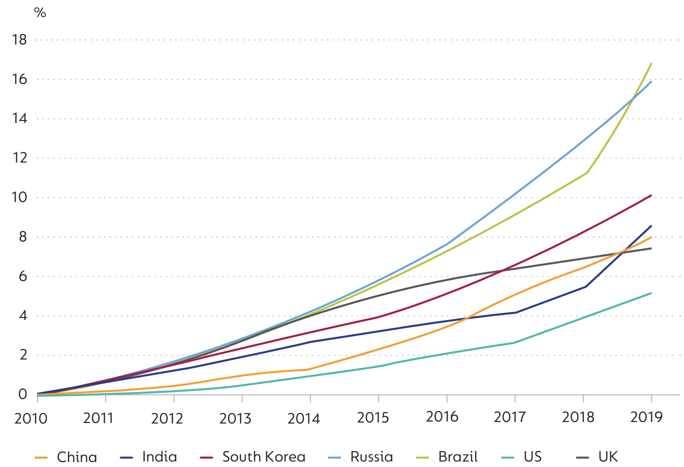


Source: Coronation

Coronation's valuation of Naspers/Prosus' ex-Tencent assets.

Figure 4

OFF-PREMISE EATING IS BOOMING

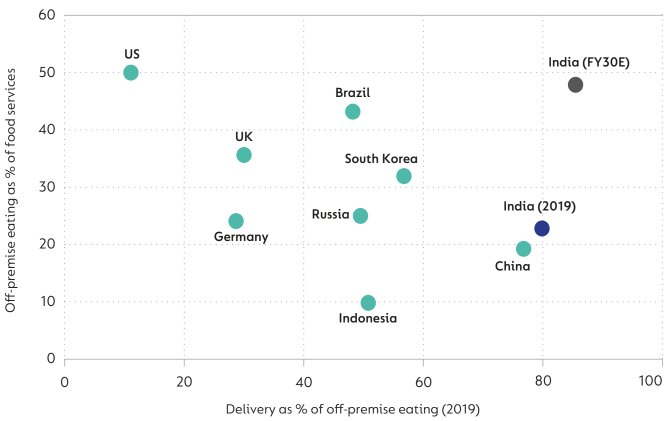


Sources: Euromonitor, NRAI, Goldman Sachs Global Investment Research

Share of off-premise eating has been increasing worldwide over the last few years. The chart shows the change in share of off-premise eating (takeaways, delivery and drive-through) as a total of food services (indexed to 2010). For India, data is for the organised restaurant segment.

Figure 5

GLOBAL DELIVERY INDUSTRY SET TO INCREASE



Sources: Euromonitor, NRAI, Goldman Sachs Global Investment Research

Delivery already makes up the biggest chunk of off-premise eating in India and we expect its share to rise further. The chart indicates off-premise as a percentage of food services, and delivery as a percentage of off-premise eating (2019). Data for India is for organised food services.

Cloud

The cloud business is still very nascent, but represents the number one investment priority of the group. This, when you consider that only c.8% of IT workloads in China have migrated to the cloud versus 25% to 30% in the West, provides a structural growth opportunity for this segment for many years.

Investment portfolio

Finally, an underappreciated aspect of Tencent's business is its astute investment ability that has resulted in an investment portfolio worth c.$220 billion, equating to roughly 38% of the company's current market capitalisation. It remains an active investor across the globe and intends to deploy 60% to 70% of all free cash flow generated into investments, which, based on its investment track record, should yield attractive returns.

THE REST OF NASPERS/PROSUS' PORTFOLIO IS UNDERVALUED

While we think Tencent is an attractive standalone asset, we believe that the upside potential of the Naspers/Prosus ex-Tencent portfolio is underappreciated (Figure 3).

Food delivery

We believe the food delivery space is still early in its innings, with material long-term structural growth drivers, as indicated by Figure 4.

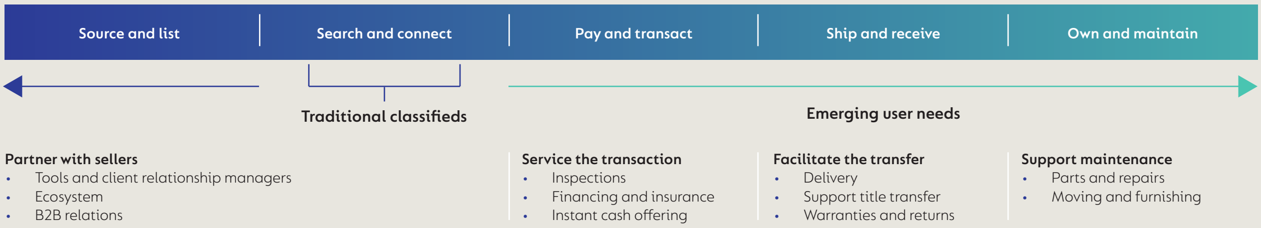
Prosus has a food delivery portfolio that is primarily made up of three assets – Delivery Hero (27% ownership), iFood (62% ownership) and Swiggy (36% ownership). Prosus has been investing in the segment since 2017, which was arguably well timed in hindsight, allowing the business to generate attractive internal rates of return (IRR) on these investments. Delivery Hero is the number one player in 90% of its markets, which span 52 countries. Swiggy operates in a duopoly with Zomato in India, a market which is still nascent but growing rapidly (Figure 5). iFood has an 80% market share in Brazil, creating an enviable competitive position.

Classifieds

This is a segment that the group has been investing in for many years, with the biggest assets being Avito in Russia and OLX in Eastern Europe and Brazil. While primary exposure is to auto and real estate classifieds, the business is currently evolving to cater to user needs, and is transitioning from a search-only business to one that enables consumers to search and connect to a transactional platform. This is most notable within the auto segment, which is building out physical infrastructure that should allow Prosus to move deeper into the actual >

Figure 6

USERS ARE REQUESTING MORE SUPPORT ALONG THE SUPPLY CHAIN

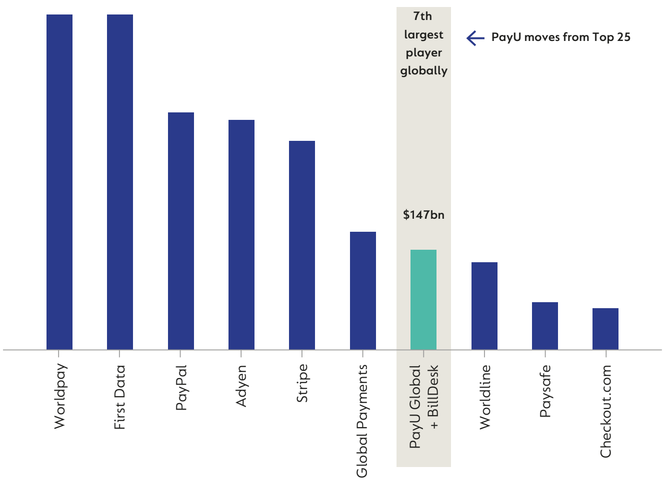


Source: Prosus 2021 Annual Report

As online consumption increases, users are demanding more sophisticated and integrated capabilities.

Figure 7

TOP 10 ONLINE PAYMENTS PLAYERS (TOTAL PAYMENTS VALUE, $ BILLION, FY21)

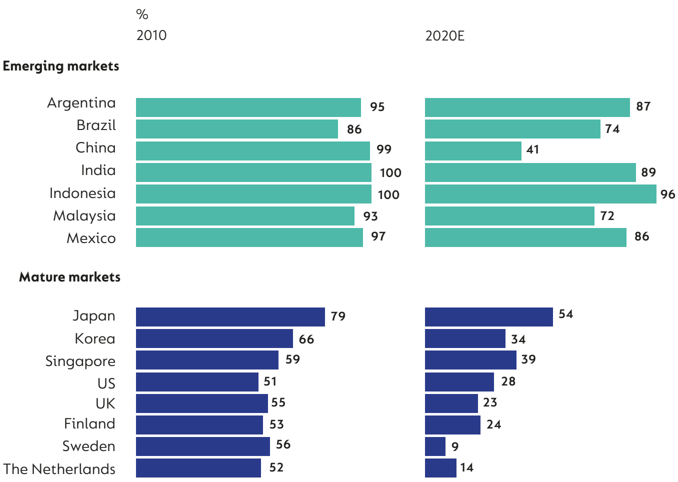


Sources: Company annual reports, Bain, internal estimates, broker research reports

The acquisition of BillDesk significantly shifted the needle for PayU, catapulting it from a top 25 player into a global top 10 payments platform. For global players, CY2020 data is presented as proxy for FY2021.

Figure 8

CASH USAGE BY COUNTRY: PERCENT OF CASH USED IN TOTAL TRANSACTIONS, BY VOLUME



Source: McKinsey Global Payments Map

Cash usage by country in 2010 versus 2020 estimates, according to an October 2020 report.

transaction. As consumers become accustomed to not just researching car purchases online, but also transacting online (Figure 6), offering both services should result in enhanced convenience, higher conversion rates and a greater share of the transaction economics.

Payments/fintech

This segment has recently been expanded via Prosus' payments business PayU's acquisition of BillDesk in India for $4.7 billion. The acquisition significantly increases the scale of its payments business (Figure 7).

The business has extensive merchant relationships due to the fact that PayU provides core infrastructure that enables merchants to accept digital payments. Leveraging this relationship means that PayU can provide additional services, such as offering credit to both businesses with which they have existing relationships and consumers at the checkout phase. The business should continue to benefit from the move away from cash, especially considering the biggest exposure is to India, which is still a cash-dominated economy (Figure 8).

Edtech

The final material pillar of Prosus' investment portfolio relates to education technology. The bulk of its investments relate to enterprise education businesses (reaching 90% of Fortune 100 companies). These address the need for continuous adult education, which is becoming increasingly important as skill requirements constantly evolve in a fast-moving world.

Prosus' most recent acquisition of Stack Overflow for $1.8 billion, which is integral to developer workflows, created a sticky relationship with over 100 million developers, 85% of whom visit the platform every week. Currently this is largely unmonetised, but there is the potential >

to leverage existing enterprise relationships to increase the monetisation touchpoints of this high-utility platform.

Prosus also has a notable 11% shareholding in BYJU, a rapidly growing online K12 education business serving more than 100 million students. While its roots are in India, it has subsequently expanded globally and has turned out to be an exceptional investment for Prosus, generating an IRR of an estimated 81%.

VALUATION

Prosus holds a 29% stake in Tencent, which currently represents c.140% of Prosus' market capitalisation. Prosus' stake in Tencent does not take into account the ex-Tencent assets, as discussed above, which in our view are under-appreciated by the market and represent another 33% of Prosus' current market capitalisation, based on our assessment of their value. Then, when you consider that Tencent has an investment portfolio that accounts for 38% of its current market capitalisation, coupled with a diversified business spanning games, social networks, fintech and cloud, which are all at different levels of maturity, we feel that, notwithstanding the regulatory headwinds facing Tencent's business, the company is still well placed to deliver both double-digit revenue and profit growth over the next few years.

Considering all of the above, we believe that Prosus shares represent a rare combination of both valuation unlock and growth potential, which combine to offer an extremely attractive opportunity for investors. ✚

*Note: Any numbers mentioned are as of 12 October 2021.

BOND OUTLOOK

SA's fiscal position remains on shaky ground

But bond yields continue to make up for underlying risks

By **NISHAN MAHARAJ**

THE QUICK TAKE

- Global investor sentiment turns negative on the back of China activities
- Bonds came off steeply around the world, with SA at the forefront of the decline
- Policy reform and complexity continues to weigh on SA's recovery
- US set to taper stimulus package into H2-22, providing ample warning

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

THE POST-PANDEMIC RECOVERY has been fraught with numerous challenges. Vaccination rates among developed economies remain high and continued economic stimulus has increased demand for finished goods in these countries. However, global supply chains remain slow as emerging economies, which are vaccinating at a much slower rate, are acting as bottlenecks within the global supply chain. Although these bottlenecks might well prove to be temporary, they have resulted in a spike in global goods prices, elevating global energy prices and causing a few sparks in the inflation tinder box. China's definitive move to redistribute wealth and deflate its property market towards the end of the third quarter of 2021 (Q3-21) increased uncertainty in global markets, further hurting already fragile sentiment and pushing risk assets weaker.

South Africa (SA) was among the worst performers within emerging markets, as the rand lost 5.2% against the dollar (two thirds of which was in September alone) and the benchmark bond widened by 40 basis points (bps) over the quarter (close to 50bps wider from the start of September). The FTSE/JSE All Bond Index was down 2.1% over September, bringing its return for the quarter to 0.37% and 12.46% over the last 12 months. Inflation-linked bonds (ILBs) performed significantly better as real yields held, despite the selloff in nominal bonds, putting their return for the quarter at 2% and 15.76% over the last 12 months. Global bond yields have also seen a significant move wider, with the FTSE World Government Bond Index down 2.26% over the month, led primarily by the move wider in US bond yields (up 50bps from their quarter lows). The pace of the selloff has, in part, also contributed to the weaker risk backdrop for emerging markets.

Locally, monetary policy is in the enviable position of being supportive of SA's growth recovery. Most major developing economies have already started (in some cases they are close to finished) their rate normalisation process. SA government bonds (SAGBs) are still the most attractive emerging >

market bonds due to their high implied real yield, but SA policy rates remain quite negative, below the emerging market average and in deeply accommodative territory (Figure 1). This has raised concerns about the South African Reserve Bank (SARB) falling behind the inflation curve and has contributed towards the poor sentiment towards SA assets.

Figure 1

COMPARISON OF EMERGING MARKET IMPLIED 10-YEAR BOND YIELDS AND REAL POLICY RATES

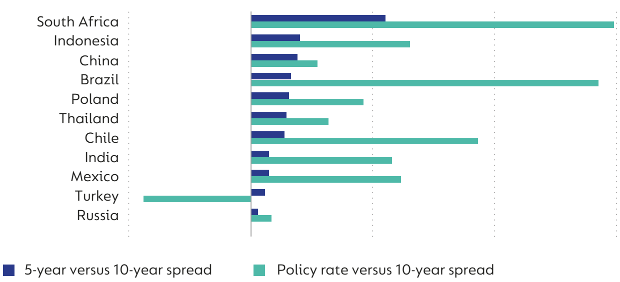
	Implied 10-year real yield	Implied policy real yield
Turkey	1.91	2.16
Russia	2.01	1.52
China	1.11	1.19
Indonesia	3.79	1.11
Brazil	4.67	0.09
Mexico	2.50	0.00
Malaysia	1.20	(0.39)
Average	**1.58**	**(0.40)**
India	1.60	(0.53)
South Africa	**4.92**	**(0.91)**
Israel	(0.16)	(1.18)
Czech Republic	(0.68)	(1.22)
Hungary	(0.70)	(1.35)
Chile	1.72	(2.24)
Poland	(1.81)	(3.80)

Sources: Coronation, Bloomberg

SAGBs remain attractive in relation to their peers, suggesting that the effect of the fiscal deficit is already priced in.

Figure 2

COMPARISON OF THE STEEPNESS OF EMERGING MARKET YIELD CURVES



Sources: BBG, Coronation

The SA yield curve encapsulates a significant risk premium.

LOCAL INFLATION BREAKS FROM PEERS

SA's inflation outlook is considerably different relative to its emerging market counterparts, due in large part to very little demand-side pressure or credit extension. Inflation is expected to remain close to the midpoint of the target band over the medium term, hence lessening the pressure on the SARB to increase rates aggressively in the short term. However, to keep inflation expectations under control, reduce the need to hike rates aggressively later and provide policy room to react if a crisis does rear its head again, it will likely start the process of gradual monetary policy normalisation by the end of 2021. In addition to a gradual approach to hiking rates, policy rates are expected to peak at much lower levels than in previous cycles. Our expectations are for a gradual rise in the repo rate to between 5.5% and 6% by 2023/24.

BAD WEATHER AHEAD?

The clouds of SA's precarious fiscal position continue to darken the outlook for the local economy. The cyclical tailwinds from strong commodity prices are not going to last forever, and the expenditure pressures continue to mount. The recent revisions to SA's GDP numbers, combined with the better-than-expected tax revenue for 2021/22, implies a lower starting position for SA's debt-to-GDP ratio. However, the trajectory of this debt is concerning and more needs to be done to turn this around. Expenditure requirements are only going to increase from here, given the ailing financial health of local State-owned enterprises and municipalities. This places pressure on reform implementation as an accelerant for growth. Although much has been done over the last year to provide the platform for higher growth, the pace of implementation, combined with the lack of State capacity, has meant that longer-term expectations for growth are still anchored at c.1.5% to 2%, quite a way from the 3% to 3.5% required.

Capital expenditure growth and employment, which are key for growth, are challenged by policy complexity and low levels of confidence. The only socially palatable way to avert a debt trap is to accelerate the pace of reforms, simplify policy and implement quickly. This will go a long way to re-instill investor and consumer confidence, which will contribute to a more sustainable and higher growth path. The ship has set sail in the right direction, but the sea is rough, and much courage is needed to stay the course.

Despite the risk posed by the deterioration in SA's fiscal position, the valuation for SAGBs remains quite appealing and suggests that a large part of the risk is already reflected in bond yields. While Figure 1 shows how SAGBs still have the highest real yield among the emerging market universe, Figure 2 shows that SA's yield curve remains the steepest among its peers. This indicates that, from a global perspective, SA still has a relatively high embedded risk premium. The 10-year SAGB trades at close to the highest multiple of cash (Figure 3), meaning that bond yields can sell off more than 100bps before they start to underperform cash.

Our fair value estimate for the 10-year SAGB – which uses the US 10-year Treasury note as the risk-free rate, the inflation differential between SA and the US, and SA's credit risk premium – also suggests there is a significant risk residual in SAGBs.

Figure 3

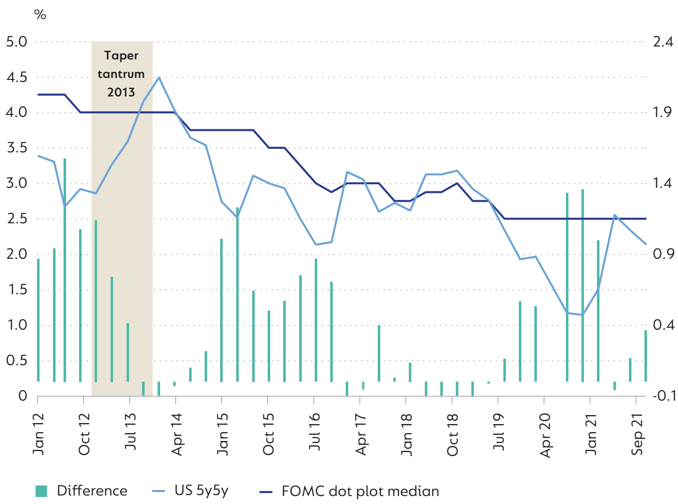
SAGB 10-YEAR BOND YIELD AS A MULTIPLE OF CASH

Sources: Coronation, Bloomberg

The 10-year SAGB is delivering attractive returns relative to cash deposits.

Figure 4

US RATE EXPECTATIONS VERSUS FED LONG-TERM RATE EXPECTATIONS



Sources: Coronation, Bloomberg

FOMC rates data, US 5y5y rates and fair warning suggest that post-pandemic tapering will differ vastly from the post-GFC taper tantrum.

SA 10-year fair value = 2% (expected US 10-year)
+ 5.5% (expected SA inflation)
– 2.5% (expected US inflation)
+ 3.66% (current SA/US credit spread) = 8.66%

The fair value equation above compares favourably to current trading levels of 9.70%. This, combined with the evidence presented in figures 1, 2 and 3, leaves us confident that current bond yields reflect adequate compensation for the underlying fundamental risks.

US TO WIND UP STIMULUS

At its September meeting, the Federal Open Market Committee (FOMC) indicated that it was closer to starting its process of reducing the size of its asset purchase programme by the end of 2021, with tapering to be complete by the second half of 2022. The suggested pace of the reduction is quicker than the market expected; however, this was balanced by increased emphasis on the decoupling of tapering and rate hikes. In 2013, when the Federal Reserve Board (the Fed) reduced its asset purchasing, it injected a huge amount of volatility and uncertainty into market, which caused risk assets to sell off aggressively. This time around, we think a few key things have changed:

- The process of tapering is a more familiar concept than it was in 2013 and much more is known about the process.
- The announcement of tapering in 2013 was a surprise and no forewarning was given. In fact, in the months leading up to that tapering, the Fed had revised its expectations of the long-term neutral rate lower. This time, the Fed has signalled its intentions well in advance, and even when it's still only thinking about thinking about tapering.
- In 2013, the Fed's expected long-term neutral rate (as disclosed in its projections) was 4%, yet 5y5y rates (market expectations for five-year rates in five years' time) were at 2.75%. The Fed also didn't downplay the risk that policy rates would go higher once tapering ended. This resulted in an aggressive repricing of US 10-year rates to represent long-term expectations. Currently, the Fed has guided to the longer-term policy rate being 2.5% and explicitly decoupled higher policy rates from the end of tapering. In addition, current 5y5y rates are at 2.15%, just marginally below the Fed's expected long-term neutral rate at 2.5% (Figure 4).

>

It is for the above reasons that we do not believe that tapering this time around will result in the amount of volatility that was created in 2013, or a large selloff in risk assets. There will, of course, be some volatility around the event and there might in fact be higher volatility, but it won't be the announcement or start of tapering that would cause it.

REWARD FOR RISK

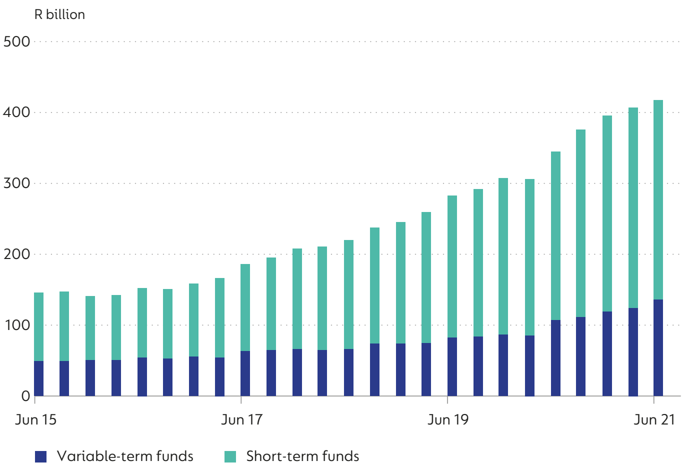
In previous iterations of this report, we have spoken in detail about the listed credit markets and our view that valuation does not adequately compensate for the underlying risks in most tradable, listed credit instruments. This remains the case. In fact, spreads have continued to compress, making most of the asset class unattractive.

The increased amount of money being allocated to interest-bearing funds (Figure 5), combined with a drop-off in issuance levels in the listed credit market (Figure 6), has exacerbated the supply/demand imbalance. As such, we continue to remain cautious on this asset class.

A new segment of the credit market has presented itself, which we believe warrants investment. Sustainability-linked bonds (SLBs), while a new domestic asset class locally, are well established internationally. Unlike green bonds, which restrict the use of proceeds from the bonds to be invested only in projects linked to environmental, social and governance (ESG) issues, SLBs reward lenders by providing a funding benefit if certain sustainability targets are met within a defined period. This funding benefit is reflected in a tighter credit spread (0.05% to 0.1%) after a specified period, provided that the sustainability targets are met. These targets can be anything from greenhouse gas emissions and photovoltaic capacity to water-use efficiency and green-building certification. Issuance has been small (approximately R3 billion year to date), but this is a segment that will grow. Spreads have been more attractive than those of traditional listed credit, as is generally the case with a young and lesser understood asset class. Coronation has been an anchor investor in this new segment and, provided valuation stays attractive, we will continue to support this segment going forward.

Figure 5

ASSETS UNDER MANAGEMENT OF SA INTEREST-BEARING FUNDS

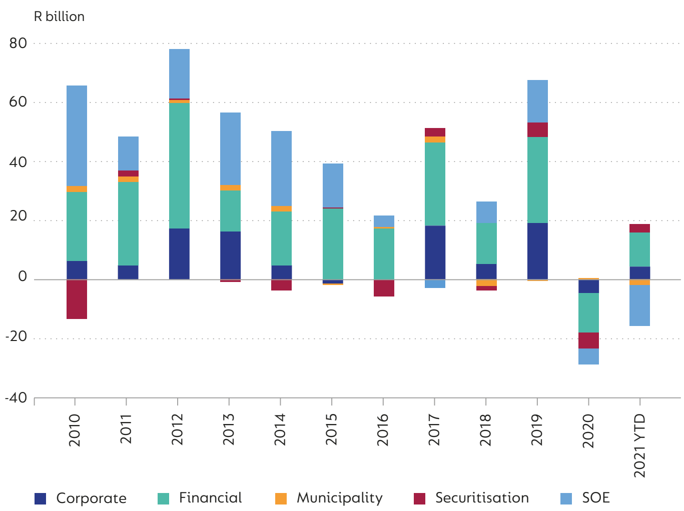


Source: ASISA

The ongoing flight to safe-haven investments reflects low investor risk appetite.

Figure 6

ISSUANCE IN THE LISTED CORPORATE MARKET



Source: Standard Bank Group Securities

Diminishing net outstanding balances per listed credit sector illustrate issuance drop-off.

VALUATIONS OUTWEIGH RISKS

As inflation remains under control and growth recovers, local economic recovery should keep on track. While medium-term expectations for inflation remain contained, longer-term expectations for growth are below the level needed to avert continuing concerns of SA being in a debt trap. However, current valuations remain attractive, relative to both local and global alternatives, suggesting that the embedded risk premium is sufficient to compensate for the underlying risks currently. The start of the tapering of the Fed's asset purchase programme should not inject the same amount of volatility and uncertainty into markets as it did in 2013, and therefore should not have the same negative impact on SAGBs. We continue to view SAGBs in the 10- to 15-year area of the curve as the most attractive asset and advocate overweight positions for bond portfolios. ✚

INSIGHTS

Tax-free investing

It's a no-brainer

THE QUICK TAKE

- Tax-free investing should be on every investor's radar
- We've increased our range of tax-free fund options
- Tax free means just that – no income, dividends or capital gains tax
- Boost your investment by adopting a 'first in, last out' approach

A TAX-FREE INVESTMENT (TFI) is one of the best ways for South Africans who have extra money to save outside of their retirement fund to build up a nest egg for the future. It's why we encourage investors to take full advantage of their annual tax-free allowance every year.

And, from November, the total number of funds available within Coronation's TFI offering will increase to 22.

You'll now have tax-free access to not just the best value we are seeing in the South African equity market through the Coronation Top 20 and Equity funds, but also to attractive offshore opportunities via the rand-denominated Global Optimum Growth Feeder and Global Emerging Markets Flexible funds.

WHY MAKING THE MOST OF YOUR TAX-FREE ALLOWANCE IS MORE IMPORTANT THAN EVER

Something that living through a global health and economic crisis has taught us is not to take anything for granted. Many South Africans have suffered deep losses during this tough time and are concerned about the uncertainty that lies ahead. But one thing that can't be taken away from us is how we respond in times of crisis.

Focusing on doing the best we can with what we have, and to plan ahead as best we can to secure our futures, is something we can all do to regain control of our lives. And investing tax free is an opportunity to do just that.

NOW IS THE TIME TO TAKE ADVANTAGE OF TAX-FREE INVESTING

The current tax year ends on 28 February 2022. So, you still have time to ensure that you take full advantage this year of the valuable perk offered to us by government to encourage us to save – an annual allowance of R36 000 that can be invested tax free.

In your tax-free investment, you pay no income, dividend or capital gains tax on your investment gains, which boosts your realised investment return.

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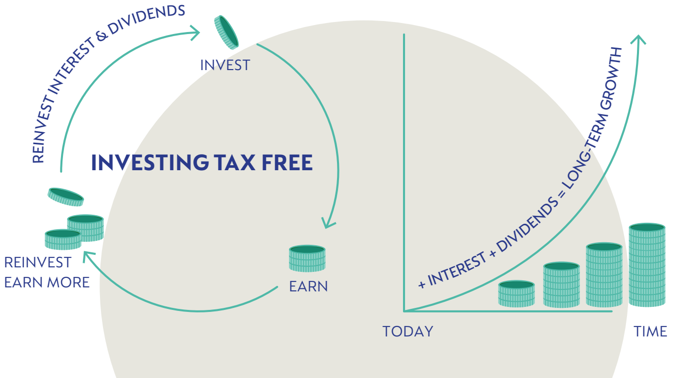

THINK 'FIRST IN, LAST OUT' WHEN IT COMES TO INVESTING TAX FREE

We encourage tax-free investors to build up towards their lifetime limit as early as possible in their investment journey, and then to keep that money invested for as long as possible as they build up to a healthy nest egg.

FIRST IN

If you have extra money outside of your retirement fund to invest for yourself or your children, first consider taking advantage of your annual tax-free allowance. By starting to invest tax free early, you give yourself the best opportunity to begin reaping the benefits of compound interest early on your investment journey.

Remember that when you invest tax free, you can withdraw your cash whenever you like, but you can't put it back. All amounts invested count towards your annual (R36 000) and lifetime (R500 000) tax-free limits regardless of any withdrawals you make. In other words, you can't 'replace' the money you withdraw with a new investment. So, we encourage you to start building up to that lifetime limit as early as possible to maximise the time it has to benefit from compound interest.

LAST OUT

A TFI is money that you ideally want to leave invested for as long as possible. The longer you leave your money invested tax free, the harder compounding will work for you. So, for example, if you are saving for short-term goals such as a holiday or a deposit on a car, do so separately and let your TFI simmer.

Investing over multiple decades, and leaving your money invested, also enable it to withstand the effects of short-term market volatility that is typical of the financial markets. Over the long term, the bumps smooth out and the overall trend is for your money to grow.

NOT YET A CORONATION TAX-FREE INVESTOR?

You can start investing with us via a monthly debit order from as little as R250, or you can make lump-sum investments from R5 000 to R36 000. If you have an existing tax-free savings account with a bank, you can switch it to a TFI at no cost.

To select the funds that suit your needs, speak to your financial adviser if you have one, or visit www.coronation.com and follow our simple online investment process. +

Key performance indicators and fund performance

AS AT 30 SEPTEMBER 2021

		QTD	YTD	1 YEAR	3 YEARS	5 YEARS	10 YEARS	15 YEARS	20 YEARS
INTERNATIONAL INDICES [USD]									
Global Equity	MSCI ACWI	(1.1%)	11.1%	27.4%	12.6%	13.2%	11.9%	7.2%	8.1%
	MSCI WORLD	0.0%	13.0%	28.8%	13.1%	13.7%	12.7%	7.5%	8.1%
	MSCI GEM	(8.1%)	(1.2%)	18.2%	8.6%	9.2%	6.1%	5.7%	11.0%
	S&P 500	0.6%	15.9%	30.0%	16.0%	16.9%	16.6%	10.4%	9.5%
Global Property	Global Property (FTSE EPRA/NAREIT Developed Index)	(0.7%)	15.3%	30.8%	7.2%	5.5%	9.3%	4.6%	9.4%
Global Bonds	Barclays Global Bond Aggregate	(0.9%)	(4.1%)	(0.9%)	4.2%	2.0%	1.9%	3.5%	4.3%
US Cash	3 Month Libor	0.0%	0.1%	0.2%	1.3%	1.4%	0.9%	1.3%	1.6%
SPOT RATES AND COMMODITY PRICES									
Exchange Rates	Rand Dollar exchange rate	14.3	14.7	16.8	14.2	13.7	8.1	7.7	9.0
	Rand Dollar % change	(5.3%)	(2.5%)	11.2%)	(2.1%)	(1.9%)	(6.0%)	(4.3%)	(2.5%)
	Rand Euro exchange rate	16.9	18.0	19.6	16.4	15.4	10.8	9.8	8.2
	Rand Pound exchange rate	19.8	20.1	21.6	18.4	17.6	12.6	14.5	13.1
Select Commodities	Gold price (USD)	1 763.2	1 891.1	1 886.9	1 187.3	1 322.5	1 620.0	599.3	290.9
	Oil price (USD barrel)	74.6	51.8	42.3	82.9	50.2	102.8	62.5	23.3
SOUTH AFRICAN INDICES [ZAR]									
SA Equity	ALSI (J203T)	(0.8%)	12.2%	23.2%	8.6%	7.8%	11.5%	10.6%	14.4%
	CAPI (J303T)	0.5%	15.2%	27.4%	8.8%	7.8%	11.6%	10.9%	-
	Capped SWIX (J433)	3.2%	16.9%	30.3%	6.5%	5.0%	10.6%	-	-
	Resources Index (J258)	(3.6%)	8.8%	17.8%	17.4%	17.9%	6.4%	6.0%	11.4%
	Industrial Index (J257)	(4.3%)	8.9%	17.0%	7.5%	5.0%	13.3%	13.7%	16.5%
	Financials Index ex property	13.2%	26.4%	51.1%	0.0%	3.0%	10.9%	8.9%	
SA Property	Africa All Property Index (J803T)	6.5%	27.9%	58.1%	(8.3%)	(6.7%)	4.8%	-	-
SA Bonds	BEASSA (TR) All Bond Index	0.4%	5.4%	12.5%	9.1%	8.5%	8.3%	8.5%	9.3%
SA Cash	Short Term Fixed Interest 3 Month Cash Rate	0.9%	2.6%	3.5%	5.4%	6.0%	5.9%	6.7%	7.4%
SA Inflation	Inflation	1.7%	4.5%	4.9%	4.0%	4.4%	5.0%	5.6%	5.7%

	QTD	YTD	1 YEAR	3 YEARS	5 YEAR S	10 YEARS	15 YEARS	20 YEARS	SINCE LAUNCH
DOMESTIC FUNDS (PERFORMANCE IN ZAR)									
Coronation Top 20 Fund	3.0%	15.8%	30.7%	11.6%	7.9%	11.6%	12.5%	16.8%	16.9%
ASISA Mean of South African Equity General	3.0%	16.6%	28.0%	7.1%	5.5%	9.5%	9.2%	13.7%	13.4%
Coronation Market Plus Fund**	1.8%	13.6%	24.6%	9.9%	7.2%	11.3%	11.4%	15.1%	14.8%
ASISA Mean of South African Multi-Asset Flexible	3.4%	14.8%	24.2%	7.2%	6.1%	10.5%	9.6%	-	11.2%
Coronation Balanced Plus Fund	2.4%	13.2%	23.5%	9.4%	7.4%	10.9%	10.9%	14.0%	14.0%
ASISA Mean of South African Multi-Asset High Equity	2.5%	12.2%	18.8%	7.2%	6.2%	9.0%	8.5%	12.2%	12.1%
Coronation Capital Plus Fund	1.2%	9.5%	17.2%	7.0%	5.8%	8.3%	8.9%	11.4%	11.3%
ASISA Mean of South African Multi-Asset Medium Equity	2.1%	10.0%	15.0%	6.8%	6.1%	8.4%	7.9%	-	10.8%
Coronation Balanced Defensive Fund	1.2%	7.6%	12.8%	7.0%	6.6%	9.0%	-	-	9.2%
ASISA Mean of South African Multi-Asset Low Equity	2.0%	8.1%	12.0%	6.5%	6.2%	8.0%	-	-	7.6%
Coronation Strategic Income Fund	1.3%	4.7%	7.1%	6.5%	7.1%	7.9%	8.6%	9.4%	9.8%
ASISA Mean of South African Multi-Asset Income	1.4%	4.7%	7.3%	7.0%	7.3%	7.0%	7.7%	-	8.8%
INTERNATIONAL FUNDS (PERFORMANCE IN USD)									
Coronation Global Equity Select Fund	(7.4%)	3.8%	21.3%	11.1%	10.6%	-	-	-	7.8%
Coronation Optimum Growth Fund	(7.0%)	(5.2%)	7.3%	9.3%	8.1%	8.5%	6.2%	10.2%	9,5%
Coronation Global Managed Fund	(5.2%)	1.6%	13.1%	7.1%	6.6%	7.8%	-	-	6.5%
Coronation Global Capital Plus Fund	(2.3%)	1.9%	7.5%	4.5%	3.9%	4.5%	-	-	4.1%
Coronation Global Strategic Income Fund	0.1%	1.1%	2.6%	2.2%	1.8%	-	-	-	2.3%

* All ASISA averages exclude Coronation funds in that category.

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

Meaningful periods

Not listed here. but included in the following commentaries Global Emerging Markets Fund (launch date: July 2008): highest annual return 106.2% (Mar 2009 - Feb 2010); lowest annual return -33.6% (Sep 2014 - Aug 2015).
Rest of funds' details available on pages 42-46.

Figures as at 30 September 2021.

FUND UPDATE

Coronation Top 20 Fund

By **NEVILLE CHESTER** *and* **NICHOLAS STEIN**

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

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

TOP 20 RETURNED 3.0% for the quarter and 30.7% for the last 12 months. The long-term performance of the Fund remains pleasing, with alpha since inception of 3.5%. The commodity space experienced very divergent fortunes over the last quarter.

Energy prices (particularly coal) rose sharply, while iron ore and platinum group metals (PGMs) came under pressure. While we have been bullish on thermal coal, the price spike from $80 per tonne at the start of the year to over $200 per tonne at the time of writing took us by surprise. We have written before about the underinvestment in thermal coal supply and the potential this creates for robust prices. Added to this, we have seen a warm Northern Hemisphere summer, Chinese bans on Australian coal imports, lower Russian gas supply into Europe, lower EU renewable power production and South African (SA) coal export issues all contributing to the current price. Our holdings in Glencore and Exxaro were beneficiaries of this price increase over the quarter.

Iron ore prices came under pressure as Chinese authorities sought to cap domestic steel production. Prices fell from over $200 per tonne towards the $100 per tonne level. This coincided with a slowing Chinese economy, particularly in property demand in the wake of property developer Evergrande's debt issues. The continued global semi-conductor shortage has dramatically impacted automotive production and, with it, PGM demand. An estimated 11 million cars have not been produced this year because of the shutdowns – 13% of production estimates at the beginning of the year. Spot PGM demand has declined materially and, combined with Amplats releasing its refined inventory, we've seen the industry revenue basket decline by 38% since the peak in April.

We expect PGM markets to re-enter into deficits next year as the chip shortage is resolved and automotive production ramps back up. We assumed prices would be materially lower than the spot prices in our forecasts and thus get attractive upside in the equities in all three commodities. In the earlier part of the quarter, we rotated some of our PGM holdings into the diversified miners. We also added to our gold position in AngloGold.

On the global front, the news was dominated by multiple regulatory announcements from the Chinese authorities who are seeking to introduce or tighten regulations spanning antitrust, data privacy, online platforms and 'gig work' protections, among others. Authorities are also focusing on practices in the housing, education and healthcare sectors. In most cases, mooted regulations are reasonable and in line with what developed markets want to implement. The uncertainty caused by the various regulations and some regulations that lack clarity (for example, Chinese authorities want Chinese enterprises to embrace 'common prosperity') saw investors sell many >

Chinese stocks lower. This includes Naspers/Prosus, which closed the quarter down 17%/15%, respectively. Our view is that the Chinese government still embraces local tech champions like Tencent.

The regulations will also result in winners and losers. We would expect Tencent to emerge as a winner, given its more open platform versus those of its peers, its conservative approach to monetising its various verticals and its conservative regulatory/government approach. While it's likely that Tencent's growth rate will be lower than we expected at the start of the year, we still expect above-average rates of growth to persist for many years to come. Furthermore, Tencent's investment portfolio accounts for approximately 40% of its market cap, reducing the core business price earnings multiple. In addition, Naspers/Prosus also have underappreciated assets outside China, spanning classifieds, food delivery and online education. We added marginally to our Naspers/Prosus position during the quarter.

Aspen performed very strongly over the quarter. With its elevated debt now firmly under control, the focus shifted to its vaccine manufacturing capability. Aspen stands to benefit from the increased production of Covid-19 vaccines. Should it successfully negotiate an agreement with Johnson & Johnson to produce its vaccine on a first-party basis, rather than as a contract manufacturer, this will add material upside to its manufacturing profitability. Aspen is also in talks to sell its Heparin active pharmaceutical ingredient business, which should improve its working capital position going forward.

Anheuser-Busch is a new position. The share has been weak and the valuation now offers attractive upside. Anheuser Busch has a new CEO in Michel Doukeris who previously held the role of CEO of North America at the group. He is credited with improving the region's fortunes, in part by investing in new brands and driving premiumisation. This is something the broader group has been accused of lacking and, we believe, will be a focal point for him. We believe the market is placing undue focus on short-term headwinds, such as input cost pressures from higher soft commodity and can prices. We believe Anheuser is a group with pricing power and will be able to claw back any lost margin over time. We sold our Woolworths holding for Anheuser, as the Woolworths share price has performed well and offers a lower margin of safety now.

On the domestic front, the news was mixed. As is often the case in SA, what the one hand gives, the other takes away. We saw very favourable policy announcements early in the quarter. First, the announced sale of SAA to a credible player, which should see it no longer being a drain on the fiscus. Telkom provides a shining example of the potential success of a State-owned enterprise being well run in private hands. Secondly, the President's announcement lifting the limit for companies to generate electricity without a licence from 1MW to 100MW has the potential to generate meaningful investment into the energy sector, help with SA's carbon transition and help stave off loadshedding, which has been a massive headwind to sustained growth. In both cases, execution will be key, but it is pleasing to see government shift its stance on so-called 'red lines'.

Sadly, the above two announcements were overshadowed by the looting that took place in KwaZulu-Natal and Gauteng in the wake of former President Jacob Zuma's imprisonment. The cost has been massive and the impact will be felt for a long time to come. Aside from the direct cost to business and employment, the longer-term impact is likely to be felt by lower investment into SA. It also increases pressure on the Treasury for higher wages and a Basic Income Grant. This comes at a time when Treasury was making headway in reining in government spending and the debt quantum. This, coupled with the slow pace of reform (inter alia, implementing high-demand spectrum and challenges to the court ruling on 'once empowered, always empowered') and the decline in key commodity prices (PGMs and iron ore), poses headwinds to SA growth and consumer spend.

The Fund remains relatively defensively positioned in counters exposed to the SA economy. Our holdings span the banks, life insurers and food retailers. During the quarter, we sold out of FirstRand as its margin of safety reduced and initiated a new position in DisChem. A large number of independent pharmacies dominate the pharmacy market. Over time, this has been shifting towards the formal pharmacy players, led by Clicks and DisChem. We expect this trend to continue, providing the formal pharmacy players with many years of strong store rollout opportunities. This is expected to drive continued strong topline growth. In addition, we believe DisChem's operating margin is currently at a depressed level owing to meaningful investment into the business, which should pay off in years to come. The combination of strong topline growth and margin improvement should drive earnings growth in the teens for years to come. We continue to find attractive opportunities across the breadth of the market – mining stocks, global businesses that happen to be listed here and pure SA-exposed stocks. We believe this sets the Fund up well for prospective returns in the coming years. +

FUND UPDATE

Coronation Balanced Plus Fund

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

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

Sarah-Jane is a portfolio manager with 17 years of investment experience.

THE FUND RETURNED 2.4% for the quarter, resulting in a return of 23.5% over the last year. Performance benefited from recovering markets, asset allocation decisions, and alpha in the domestic and global equity building blocks. The Fund has performed well against its peer group over all meaningful time periods. The global recovery continued, supported by high vaccination rates in developed markets and easing economic restrictions. Markets were weaker, reflecting fears that growth would not live up to the high expectations priced in. The MSCI All Country World Index declined -1% in US dollars for the quarter (+27% over 12 months).

As discussed previously, the Fund has reduced its exposure to global equities, given the high market levels. We do continue to see opportunities for stock picking. Developed markets (MSCI World Index 0%) were broadly flat, although they fell in September (-4%) as concerns about growth increased. Emerging markets underperformed their developed market counterparts (MSCI Emerging Markets -8%). Brazil (Bovespa -20%) and China (MSCI China -18%) both had a particularly weak quarter. Investor confidence in China was shaken by a raft of new regulations across multiple sectors that were invoked swiftly and largely without consultation. While China's authoritarian political system has always posed a risk, recent actions have heightened this. The remit of government interventions widened to include a drive for common prosperity and wealth redistribution, as well as social engineering. These policies are in direct conflict with the economic opening that has taken place over the past few decades. The role that foreign capital will be permitted to play is less certain.

Evidence of slower Chinese growth also emerged after a very rapid recovery earlier in the pandemic. Rapidly increasing global demand put strain on supply chains, resulting in stock shortages and rising input prices. The oil price (Brent crude) rose 5% for the quarter and is now up 92% over 12 months. Higher prices prompted fears that inflation may be less transitory than initially hoped. Labour markets remain tight but may ease as Covid-19 wage subsidies subside. The strong recovery in demand also opens the door to rising interest rates and a tapering of asset support. Indeed, hawkish central bank comments alluded to the latter.

High levels of sovereign indebtedness and insufficient yields keep us cautious on global bonds. For the quarter, the Barclays Global Aggregate Bond Index declined -1% in US dollars. South African (SA) investor confidence was dealt a blow early in the quarter, with the rioting and looting in KwaZulu-Natal. Social inequality and high unemployment >

(worsened by the pandemic and associated economic restrictions) remain a major concern. An additional Basic Income Grant has been extended to those most in need. The additional grant, ongoing support of State-owned enterprises and a higher-than-anticipated public sector wage agreement further strained the fiscus. SA needs sustained economic growth to heal its fiscal woes. The decline in prices of some of SA's key export commodities (iron ore -28% in Q3-21 in US dollars and platinum group metals [PGMs]) is a threat to the current account surpluses that have supported the rand. The local currency declined -5% against the US dollar for the quarter.

While the quarter heralded a disappointing number of setbacks to the fiscal outlook, the government remains committed to fiscal discipline. The new Minister of Finance is not expected to make any major changes. The FTSE/JSE All Bond Index delivered 0% for the quarter. The Fund has meaningful exposure to SA bonds, with the long end of the curve offering very attractive yields in both absolute terms and relative to other emerging markets and alternatives such as cash. SA's vaccine rollout has been slow to ramp up, with 20% of the adult population now fully vaccinated. Easing Covid-19 infection numbers have supported a lowering of restrictions, with the country moving to level 1 at the end of the quarter. The risk of further waves remains, given low levels of vaccination.

The Fund's exposure to SA equities is sitting at a decade high, given the breadth of value across many sectors, including resources, locally listed global stocks and domestic shares. For the quarter, the JSE Capped SWIX Index delivered 3% in rands. The FTSE/JSE Financials Index returned 12% as banking earnings continued to improve, fuelled by a faster-than-expected recovery in bad debts. Industrials declined -4%, as major constituent Naspers (-17%) dragged down the Index return. The FTSE/JSE Resources Index also declined (-4%) as global growth concerns and commodity price pressures weighed on a number of stocks. The Fund has long had considerable exposure to a number of global businesses that are listed in SA. Major holdings include Naspers (-17%) / Prosus (-15%), Aspen (69%), Bidcorp (4%), British American Tobacco (-1%), Quilter (-0%) and Textainer (13%). All are attractive for stock-specific reasons.

Naspers came under considerable pressure during the quarter as regulatory intervention in China intensified. Within the technology sector, much of the regulation is consistent with what is seen elsewhere, including those governing fintech, antitrust, competition law, data security, protection of personal information and 'Gig employee' labour protection. More specifically, for Tencent, government attempts to protect minors mean increasing restrictions on time spent gaming. Thus far, none of the restrictions is expected to change Tencent's prospects meaningfully. However, the breadth and depth of Chinese regulatory intervention and the amplified threat to foreign capital have increased the risk of any Chinese investment. Valuations now look extremely attractive, with Chinese technology businesses trading at considerable discounts to their developed market peers. Tencent is a formidable company that generates good free cash flows, has a very engaged user base and is growing businesses across multiple verticals. At the Naspers/Prosus level, investors benefit from an undervalued rump where management has been achieving good returns on recent portfolio actions.

Aspen delivered strong returns for the quarter (+69%), bringing 12-month returns to 130%. While organic delivery has been pleasing, the more recent share price performance stems from two specific opportunities. Aspen is under cautionary related to the potential disposal of its active pharmaceutical ingredient business, which is expected to be accretive. More materially, Aspen could potentially benefit from a vaccine licensing deal from Johnson & Johnson, which would materially increase its revenues.

Domestic companies continued to report results ahead of our expectations due to more resilient economic activity and stringent cost-cutting. We are concerned about the secondary effects of this cost-cutting and the ongoing weak employment numbers. Like many holding companies, RMI (+20%) has seen the discount (at which it trades to the value of its underlying parts) widen over the last few years. We believe this undervalues some of the attractive assets it owns, including OUTsurance, an unlisted short-term insurer with a strong history of delivering earnings growth while achieving high levels of cash flow conversion.

We've had many engagements with RMI management over the years about how this value could be unlocked and were pleased to note the restructuring announced in September. RMI intends to unbundle its holdings in Metropolitan Momentum and Discovery to shareholders, leaving a smaller, more focused company with its major holdings in short-term insurance (OUTsurance and Hastings). RMI has also committed to paying out 50% free cash flow to shareholders. Although a capital raise in the form of a rights issue will be required to achieve this, the restructuring and higher payout are undoubtedly positive. We hope that these are the first steps on a journey to further improve >

shareholder returns by passing through more of the underlying dividends.

The portfolio has a small overweight in resource shares, which comes from the holdings in the diversified miners. Holdings in Glencore and Anglo American have contributed strongly to performance over the past few years, but we believe they continue to offer good value. They trade on low multiples with solid free cash flow generation and attractive upside. We are not bullish on all commodities but expect an accelerating global drive to decarbonise to create increasing demand and tight markets in commodities like copper, cobalt and nickel. Glencore is particularly well exposed. The portfolio has continued to increase its holding in gold equities, which offer upside and reasonably priced protection against stretched sovereign balance sheets and high global market levels. Both AngloGold and Goldfields have improved their production profiles and geographic diversification. We anticipate a period of increased returns to shareholders under their new leadership teams. These positions have been funded by taking profits in the PGM shares. The portfolio has moderate property exposure, preferring to use its risk budget in equities and bonds. Holdings are predominantly in the A shares, with some exposure to logistics assets. The medium-term outlook remains subdued as a weak economy and a structural shift in demand from increasing digital engagement and work-from-home trends undermine rental tension.

Several sector balance sheets remain undercapitalised. Markets are ever-changing. The disturbance wrought on the world by Covid-19 has accelerated disruption in many industries while placing significant pressure on sovereign balance sheets. The sweeping changes effected by the pandemic has created opportunities where longer-term consequences are being mispriced. We con stantly challenge our beliefs to enable us to take advantage of these opportunities. ✚

FUND UPDATE

Coronation Balanced Defensive and Capital Plus funds

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

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

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

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

COVID-19 CONTINUES TO impact the global economy. Despite increasing vaccination rates, there has been a resurgence in infections in many countries, resulting in ongoing lockdowns. In July, South Africa (SA) was particularly hard hit with a third wave and a return to level 4 lockdown. While restrictions were not as draconian as the first wave, a number of sectors continue to be impacted, particularly those exposed to hospitality and tourism. 32% of the adult population have now received either the Johnson & Johnson, or at least one dose of the Phizer vaccine. While there is broad consensus that we will see a fourth wave towards the end of the year, the hope is that sufficient vaccines would have been administered to mitigate the need for a return to stringent lockdowns. In addition, it looks likely that SA will once again be open to a number of our key international tourist markets, which will provide a sorely needed boost to the domestic economy.

We highlighted some of the recent positive domestic political developments in our June commentary. This narrative has faded somewhat, and much of the goodwill that was starting to build was undone by the riots and looting that occurred in KwaZulu-Natal and parts of Gauteng in the first two weeks of July. Consumer confidence undoubtedly took a knock, but the accumulation in personal savings by those still employed will probably be put to use sooner or later. More importantly, though, these incidents have further dented already low levels of business confidence and will put the brakes on sorely needed direct investment by both domestic and international corporates. The incident has also increased the longer-term risk of losing skills due to emigration, something this country can ill afford.

Despite this, the domestic market managed to eke out a positive return of 3% (Capped SWIX) for the quarter, lifting the one-year return to 30% (still off a low base). Much of the quarter's performance was driven by financial stocks, with both banks and life insurers delivering double-digit returns. The resources sector was the laggard, returning -4%, largely driven by the platinum group metals (PGM) stocks. After three years of almost uninterrupted upward travel, the rand PGM basket retreated by 21% during the quarter, something worth noting, given the contribution this sector has made to both terms of trade and tax collection in previous quarters. The FTSE/JSE All Bond Index was up 40 basis points for the quarter and 12% over the past year, while the rand weakened 5% against the US dollar but is still 11% stronger than it was a year ago. Returns from global equity markets were weaker – the MSCI All Country World Index returned -1% for the quarter, although it is still up 27% over the past year.

Globally, inflation is starting to rise, driven by higher energy prices, disruptions to supply chains and labour shortages in certain areas. The debate continues as to whether this is structural or simply a temporary phenomenon as the world gradually returns to normalcy. What is clear is that the extremely accommodative stance of central banks is likely to start winding down – for example, the US Federal Reserve Board has indicated that it is likely to begin to taper its asset purchase programme, and long bond rates have risen as a result.

Also noteworthy during the quarter is the regulatory crackdown on the Chinese technology sector. This forms part of Xi Jinping's 'common prosperity' drive, and has completely eroded the profit pool in the EdTech industry and curtailed others to varying degrees, including online gaming. Much of the regulation aligns China with what many western governments are trying to do with their own technology industries, and one would ultimately expect the country to champion a sector consisting of world-class businesses. But this is China, and it is extremely difficult to know with certainty what the end game is likely to be and which sectors will receive attention, with property and healthcare being the most obvious.

Amid this uncertainty, Balanced Defensive delivered a return of 1.2% for the quarter and 12.8% over the past year, well ahead of its target of inflation +3%, while Capital Plus delivered a return of 1.2% for the quarter and 17.2% over the past year, also well ahead of its inflation +4% target.

Over the more meaningful five-year period, Balanced Defensive has delivered an annual return of 6.6% – 2.2% ahead of inflation but slightly below its target – while Capital Plus delivered an annual return of 5.8% – 1.3% ahead of inflation but below its target. Since inception, both funds have delivered total annualised real returns ahead of target, with Balanced Defensive deli-vering 3.5% and Capital Plus returning 5.7%.

Over the past 12 months, the allocation to SA equity has been the biggest contributor to returns, followed by domestic bonds. Within equities, Altron, Anglo American, FirstRand, MTN and Richemont were the biggest contributors, while British American Tobacco, gold shares and Naspers were all small detractors.

During the quarter, we increased exposure to emerging markets (via the Coronation Global Emerging Markets Fund) following the selloff in China tech stocks. Our emerging markets team has done extensive work, speaking to management teams and independent experts in an attempt to better understand the government's regulatory intent and the likely impact on profit pools. Greater uncertainty means that a higher discount rate needs to be applied in valuing future anticipated cash flows from these businesses. However, many of these stocks have sold off heavily and are trading at attractive multiples, given what we still anticipate to be superior earnings growth profiles.

Our actions have been measured as we acknowledge that, while valuations are attractive, risks have also increased, and the range of outcomes could be wide. Additionally, after a very strong performance since building a meaningful position a year ago, we sold the funds' entire holding in Richemont.

Our change in view stems from the fact that the company derives approxi-mately 40% of its revenues from the Chinese consumer. The move to 'common prosperity' has uncertain implications for luxury goods purchases in China, but they are unlikely to be positive. Despite owning several highly desirable heritage brands that should command a high multiple, at R180, the company's stock traded on 25 times two-year forward earnings, leaving an insufficient margin of safety, given the uncertain longer-term outlook, and we exited the position.

We continue to be cautious on most global asset classes. Developed market equities look finely priced, and government bonds will perform poorly if rates continue to rise. SA equities offer attractive value, particularly the global businesses that happen to be listed here. For this reason, our allocation to this asset class is relatively high. Domestic bonds continue to offer very attractive real yields, but one needs to be mindful of longer-term fiscal pressures that could impact returns.

The funds have delivered resilient performance over the last year, comfortably meeting their mandates, despite uncertainty remaining high. This has been achieved by having a considered mix of income and growth assets, and a judicious approach to instrument selection. We think that both funds are capable of delivering on their mandates over the medium term, specifically CPI +4% from Capital Plus and CPI +3% from Balanced Defensive. ✚

FUND UPDATE

Coronation Global Managed Fund

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

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

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

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

EQUITY MARKETS DECLINED by 1% over the third quarter, with a weak September (down approximately 4%) ending a strong run of consecutive positive monthly gains since February this year. The global bond market was down by a similar amount (0.9%), bringing the year-to-date decline to -4%. Despite these price declines, the US 10-year Treasury Bond yield is still low, at around 1.5%. The Global Managed Fund underperformed over the quarter, declining 5.2%. The return for the last year is a more satisfactory 13.1%, albeit 2.3% behind the benchmark. Over five years, the Fund has returned 6.6% p.a. (2.4% behind), and over 10 years has returned 7.8% p.a. (0.4% behind). For the quarter, cash and commodity holdings were the primary contributors to return, while the Fund's equity holdings, specifically those positions exposed to China, were the primary detractors. Since November last year, various regulatory changes and investigations have been announced and carried out in China.

It is likely that these changes are indicative of a more intrusive regulatory regime going forward, but the impact will vary by sector. Some of these regulations have similar objectives to regulations that are commonplace elsewhere globally, aimed at promoting fair competition, protecting consumers and safeguarding data. We think the intrusiveness of the various regulators and the resultant uncertainty have raised the hurdle rate for investing in China. But over the long term, we think China will remain a country with significant investment opportunities. We used the dislocations in the market to reorient the portfolio to those businesses on the right side of regulatory change or where good businesses suffered price declines that meaningfully overshot our assessment of the regulatory risk. To do justice to this important topic, please refer to Suhail Suleman's article on page 10.

Netflix was a top contributor to performance in the third quarter. Netflix is the world's largest paid streaming video platform, with over 200 million subscribers worldwide. The company, led by visionary founder Reed Hastings, is extremely innovative and has shown the ability to disrupt itself to stay ahead of a dynamic market on numerous occasions – pivoting from rented DVDs to streaming in 2007, launching its first Netflix Original in 2013 and, more recently, its move into gaming, which we believe will bring significant benefits to already strong engagement metrics. Netflix offers an unrivalled combination of global content production capabilities and distribution reach, giving it the ability to make and break great shows and movies around the world. The company has proven that good stories resonate globally, as evidenced by hit shows such as Narcos, Lupin and the recent phenomenon Squid Game, and Netflix Originals now dominate its Top 10 viewing lists. Netflix has long been considered the disruptor of >

the traditional pay-TV bundle. However, we still see a significant growth runway, driven by latent pricing power and strong subscriber growth in international markets.

The US home market is often labelled mature, but we believe Netflix's pricing power is underappreciated. Over 70 million US households are still paying around $100 per month for a traditional pay-TV bundle. Against this backdrop, Netflix is an absolute steal, with an average revenue per user (ARPU) of $14.50 per month, and it will continue to be a beneficiary of accelerating pay-TV declines in its core market for years to come. Netflix is no longer without streaming competition, but we consider it well placed to be the streaming anchor in households around the world. With continued strong tailwinds from the global disintermediation of the pay-TV bundle, its subscriber base could double over the medium term, with above-inflation price increases.

We expect earnings growth of over 25% per year over the medium term, with the company set to generate significant free cash flow going forward, as content costs begin to moderate off a massive $17 billion base after years of accelerated investment. The Fund increased its position at prices below $500 earlier this year.

The Fund's aggregate exposure to North American railroads detracted from returns in the quarter. While we haven't discussed these investments in detail previously, our initial research work into these stocks dates back to 2012, when the first internal research note on Union Pacific began as follows: "UNP has a strong, defendable moat, an ongoing pricing opportunity, and an inherent cost advantage relative to its substitute, trucking. At the current share price, the risk/reward is in one's favour". It's quite remarkable how enduring the core of this investment thesis has proved. In many ways, today, nine years later, the investment case is largely unchanged. The North American rail industry comprises three duopoly rail networks and one network traversing from Kansas City to Mexico. These assets cannot be replicated, form an important part of the North American supply chain backbone and have a measure of pricing power that has allowed them to price in excess of their cost inflation over time.

Over the past few years, there have been several developments in the industry that we think create an opportunity for these to be good investments over the next five years. First, CSX and Union Pacific, two of the US railroads, embarked on a new system of managing the railroads called Precision Scheduled Railroading (PSR), which emphasises moving cars through the network in a scheduled, point-to-point manner as opposed to the old hub-and-spoke model. This improved network throughput, lowered operating costs, increased the network's physical capacity and improved the responsiveness of the rails, as demonstrated by limited margin compression during the volume downturn in the second quarter of last year. The improved service levels enabled by PSR will help the rails take market share from trucking over time. Historically, trucks have achieved over 90% of deliveries on time compared to 50% to 60% for rail. The gap has reduced significantly, with CSX claiming to have been on par with trucking in 2019.

Secondly, Covid-19 decimated the economy last year and, as mobility improves, we expect economic growth to pick up. However, as we stand today, inventory levels in the economy are below normal and global supply chains are stuttering. The railroads will be critical to getting inventory levels back to a normal level so that the economy can begin operating more smoothly. This should drive solid volume growth for the rails. Thirdly, the rails compete with trucks over shorter haul lengths and for certain commodities. The truck market is currently facing driver and truck shortages, resulting in high truck prices. This has created an environment for the rails to achieve healthy pricing.

Given the above points, we think the US rails are well positioned to generate low double-digit free cash flow per share growth, with an attractive starting valuation. Union Pacific is trading at a free cash flow yield close to that of the market, and we think it is an above-average business with better growth prospects over the next five years and above-average prospects in the case of surprise inflation. Canadian Pacific has, arguably, the best management team in the North American rail industry and is in the process of merging with Kansas City Southern, the Mexican railroad. The combined railroad can offer more efficient single-line service instead of having to interchange, the reliability of which we believe will be highly valued by shippers. Both seemingly have been impacted by concerns related to supply chain issues. In time, the supply chain will untangle, and the rails will be important in supporting this.

At quarter-end, the Fund was positioned with 72% in growth, or risk, assets comprising the following:

- 56% effective equity
- 2% in property
- 6% in infrastructure
- 8% in high-yield credit

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The remaining 28% of the Fund is invested in either more stable assets or diversifying assets, which we think have a lower correlation to equities:

- 7.5% in commodities
- 2% in inflation-linked bonds
- 7% in absolute return
- 11.5% in investment-grade fixed income

As highlighted in prior commentaries, we continue to feel that the fundamental diversification evident in this portfolio construction, with an intentional tilt towards inflation protection at the expense of nominal government bonds, is both more appropriate and more robust than that of the Fund's benchmark, which includes a 40% weighting to global bonds. In addition, certain sectors of the equity market have suffered price dislocations, leaving us more optimistic about potential prospective returns.

Thank you for your continued support and interest in the Fund. +

FUND UPDATE

Coronation Global Optimum Growth Fund

By **GAVIN JOUBERT** *and* **MARC TALPERT**

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

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

THE FUND DECLINED 1.8% in the third quarter of 2021 (Q3-21). The continued underperformance of the Fund is disappointing. Yet, we believe that the collection of assets held by the Fund still offers compelling long-term risk-adjusted returns with which to deliver on its goal of compounding capital well ahead of inflation. Over the past five years, the Fund has generated a positive return of 10.2% per annum (p.a.), over 10 years a return of 15.5% p.a. and, since inception over 20 years ago, 13.9% p.a. (All returns in rands).

We continue to challenge our assumptions relating to the investments held, and through this exercise, we are of the view that the Fund is holding a collection of incredibly attractive assets. This is most notable in terms of the Fund's holdings in the Chinese companies that have been the primary contributor to the more recent underperformance. While the regulatory backdrop in China has undoubtedly changed negatively and the risk premium associated with Chinese assets has gone up, it remains critical to assess the prospects of each company we own from a bottom-up basis and consider valuation.

The Fund has about 14.5% exposure to Chinese assets, with just under 50% of this exposure concentrated in two assets – JD.com and Prosus (and therefore indirect exposure to Tencent). JD.com is a business that should benefit from regulatory changes due to the ending of 'pick one' tactics employed by competitors, which ultimately resulted in merchants having to choose only one ecommerce platform to sell on, which negatively impacted JD's assortment and overall customer value proposition. As merchants begin to sell on multiple ecommerce platforms, JD.com should benefit as its assortment improves, driving its expectation of adding more than 100 million customers in 2021 from a starting base of 472 million.

JD.com is also well positioned due to its extensive owned fulfilment network, which spans more than 1 200 warehouses covering 23 million m^2 of space and supported by 200 000 delivery personnel, allowing it to deliver 90% of its packages either on the same day or the day after a customer's order. We estimate that the retail business is currently trading on a 12 times price earnings multiple while still generating well below normal profit margins, making the valuation particularly compelling. Prosus holds a 29% stake in Tencent, which currently represents 138% of its market capitalisation but doesn't take into account the other non-Tencent assets, which in our view are underappreciated by the market and represent another 34% of Prosus' current market capitalisation based on our assessment of its value.

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Then, when you consider that Tencent has an investment portfolio of $210 billion that accounts for 38% of its current market capitalisation, coupled with a diversified business spanning games, social networks, fintech and cloud, which are all at different levels of maturity, we feel that notwithstanding the regulatory headwinds facing Tencent's business, the company is still well placed to deliver both double-digit revenue and profit growth over the next few years. Our estimate of the look-through Tencent one-year forward price earnings multiple by owning the asset via Prosus is nine times, which we feel is extremely attractive.

During the quarter, the largest positive contributors were Magnit (+22%, 0.48% positive impact), Aspen (+69%, 0.44% positive impact), Alphabet (+16%, 0.41% positive impact) and Netflix (+21%, 0.32% positive impact). The biggest negative contributors were Tencent Music Entertainment (-50%, 1.09% negative impact), New Oriental Education (0.85% negative impact) and Naspers (-14%, 0.65% negative impact). Tencent Music Entertainment's performance has been disappointing, and the business will be negatively impacted by regulations, most notably the ending of exclusive music licensing. It should, however, be noted that the vast majority of listening happens via nonexclusive titles. Furthermore, a user's listening experience is more than just access to music; how this music is curated and presented to users in a personalised manner are what drives user loyalty. The other segment of Tencent's business that is currently under pressure is its live streaming and online karaoke product that has experienced some operational mishaps, combined with increased competition, which is impacting growth. As the live streaming and online karaoke segment represents c.60% of revenue and more than 100% of the combined business profits currently, this will negatively impact the business's short-term revenue and profitability outlook. It is, however, our expectation that these headwinds will abate in time, with the overall business growth supported by continued paid-music user growth, which only has c.11% paying ratio (versus Spotify's 45%), along with low monthly subscription revenue per user, at $1.4 per month (versus Spotify's at c.$5). The business has c.27% of its current market capitalisation in net cash and another c.19% in listed investments (2% ownership of Spotify, 2% ownership of UMG and a 1% ownership of Warner), and is trading on a 15% yield based on our 2023 expectation of free cash flow.

The Fund ended the quarter with 74.8% net equity exposure, roughly 4.5% lower than at the end of June 2021, as we reduced our risk appetite and sold down some US technology stocks that have performed strongly. Our negative view on global bonds remained unchanged as a large portion of developed market sovereign bonds offers negative yields to maturity. The follow-on effect is that most corporate bonds also offer yields that do not compensate for the risk undertaken. However, we continued to buy South African (SA) government bonds in the quarter, representing 4.25% of the Fund. Our view on the SA fiscal situation has improved somewhat which, coupled with the fact that we are receiving a c.10% yield on these bonds, is attractive, in our view. Furthermore, considering that local inflation remains controlled, the real yields of SA government bonds are the highest in the world.

The Fund also has c.1.14% invested in global property. Lastly, the Fund has a physical gold position of 3.4%, a 1.52% holding in AngloGold Ashanti and a 0.69% holding in Barrick Gold Corp. The gold price is down approximately 10% in US dollar year to date, but we continue to hold the position for its diversifying properties in what we characterise as a low visibility world with inflation risks. AngloGold Ashanti is down 32% in US dollar year to date due to operational challenges, but management changes have been made and thus there's a reasonable likelihood of operational improvements, which should lead to improved business performance and closing the gap between its share price performance and the underlying gold price movement. We have thus been adding to the position. The balance of the Fund is invested in cash, largely offshore.

As has been the case for many years, the bulk of the Fund (over 90%) is invested offshore. As the outlook for the future remains uncertain and hard to predict, we take comfort in the fact that the Fund holds a collection of businesses that we feel are attractively priced and can operate in what we deem a highly complex and fast-changing environment. Also, because the Fund is a multi-asset flexible fund, we have access to additional tools to take advantage of dislocations in the market and risk control measures like put options. Current index put option exposure is 8% effective and 32% nominal, as a percentage of Fund, which will shield the Fund somewhat should there be a significant drawdown in equity indices.

Notable buys/increases in position sizes during the quarter were Canadian Pacific Railway and Canadian National Railway, both of which are North American rail operators. The area where these two railway operators have networks is occupied by four players, creating a stable and rational market structure. These assets cannot be replicated, form an important part of the North

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American supply chain backbone and have a measure of pricing power that has allowed it to price in excess of its cost inflation over time. Furthermore, over the past few years, the industry has gone through a period of increasing efficiency, which has made it more competitive, with trucking driving market share gains for rail. The trucking industry is also facing a driver and truck shortage, leading to price increases, which provides support for rail pricing due to the substitutive nature of the two modes of transport. Canadian Pacific has arguably the best management team in the North American rail industry and is merging with Kansas City Southern, the Mexican railroad. The combined railroad can offer more efficient single-line service instead of having to interchange, the reliability of which, we believe, will be highly valued by shippers. We expect Canadian Pacific to generate low double-digit free cash flow per share growth with an attractive starting valuation. Canadian National Railway benefits from many of the trends mentioned above but has historically been under-managed versus its peers, resulting in inferior operating metrics and resultant shareholder returns.

However, an activist investor has recently become involved and is pushing for a management change to address these operational deficiencies. So, while there is a turnaround element associated with this particular investment case, it appears reasonable to assume that change should take place due to shareholder pressure, with initial commitments in this regard already made, which should drive material margin improvements from a comparatively low starting base.

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

FUND UPDATE

Coronation Global Emerging Markets Fund

By **GAVIN JOUBERT** *and* **SUHAIL SULEMAN**

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

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

THE FUND RETURNED -12.0% during the third quarter of 2021 compared with the -8.1% return of the benchmark MSCI Emerging Markets (Net) Total Return Index. Taking the negative relative performance of the second quarter of this year into account, the Fund is 8.3% behind the benchmark year to date and by a similar amount over the last year. This has been a challenging short-term period, driven almost exclusively by China. The top five negative contributors over both the quarter and year to date were Chinese holdings. Over longer-term time periods, the Fund has comfortably outperformed the market, with 0.5% p.a. over 10 years and 1.6% p.a. since inception just over 13 years ago. The largest positive contributor was Russian food retailer Magnit, returning 16% in the quarter and contributing 82 basis points (bps) to performance. Aside from continued solid operational performance, best evidenced by 5% like-for-like sales growth in the latest reporting quarter, Magnit also announced the purchase of a smaller food retailer (Dixy) and an ecommerce co-operation agreement with Wildberries (the current leading ecommerce operator in Russia).

The latter will assist in improving Magnit's ecommerce offering, which is essential in the larger cities in Russia and an area where the business has lagged its peers, in particular X5. The Dixy acquisition adds 10% to group selling space, and, besides the obvious cost synergies, also gives it lots of attractive sites in Moscow and St. Petersburg, the two most important metros where Magnit needs scale. This acquisition doubles its market share in both cities overnight, with Moscow market share increasing from 4% to over 8% and St. Petersburg market share from 9% to 17%.

Magnit is very attractive from a valuation standpoint, in our view, with the share trading on around 13 times forward earnings and offering a 9% dividend yield. Magnit now represents a 4.6% position in the Fund and is the third-largest holding. In terms of positive contributions, the Russian stocks generally featured prominently for the Fund, with both Yandex (fifth largest) and Sberbank (seventh largest) also being in the top 10 quarterly positive contributors, together adding 75bps of performance. The next biggest positive contributor to performance in the quarter was the zero direct weight in Tencent as it fell 21% during the period, contributing 64bps to relative performance.

This was, however, fully offset by the holdings in Prosus and Naspers, which, combined, are the largest effective exposure in the Fund. There was material corporate action in Prosus and Naspers that was completed during August, whereby Naspers shareholders were invited to tender part of their shares for Prosus shares. This was part of various ongoing measures to reduce the discount at which Naspers trades to Prosus and at which Prosus trades to the value of its Tencent stake. The Fund's

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exposure to these three entities is now almost fully held via Prosus, as we accepted the offer from Prosus, receiving Prosus shares in return for Naspers shares.

Prosus itself had a busy quarter in terms of investments, having increased its stake in Delivery Hero (food delivery) by 2% to 27%, and acquiring BillDesk (payments) in India. The BillDesk acquisition adds to its existing PayU business and moves the combined entity into the top 10 payments providers in the world by transaction processing value (TPV), the standard metric by which these providers are compared. The 'rump' of Prosus, comprising all assets except its 29% stake in Tencent, is, in our view, worth almost a third of the current market capitalisation of Prosus. In contrast, Prosus trades at a discount to the value of its Tencent stake alone. This completely ignores all other assets in Prosus (a range of emerging market internet assets with a focus on food delivery, online classified ads, ecommerce, payments and online education, none of which is in China). Although there is still much that management must do to narrow this discount over time, we believe the recent moves to unlock value are a good step in the right direction, not least of which is a $5 billion share buyback scheme.

A few other notable positive contributors are worth mentioning. HDFC, the Indian mortgage loan provider and financial services holding company, returned 11% and contributed 50bps. The Fund also has a relatively smaller exposure to Alibaba (preferring to own more in JD.com), and with Alibaba falling 35%, this positioning helped to provide 45bps of positive performance.

The Fund was, on the whole, very negatively affected by the Chinese regulatory developments that unfolded during the quarter. The single biggest event was the action taken against the After School Tuition (AST) industry in late July. Although there is still some uncertainty over the final regulations and the companies themselves are still unable to clarify the impact to investors, the general principle is that there will be severe curbs on AST in K1 to 9 (pre-school, primary and middle school). This segment will be closed to foreign capital and become 'not for profit'. There is some ambiguity regarding AST in high school (years 10 to 12 inclusive) and the industry may be able to continue to operate here, although the scale of the industry will shrink significantly regardless. The Fund started the quarter with a 2.3% position in New Oriental Education (EDU) and 0.9% in Youdao. During the month of July, final regulations came out with a very punitive outcome for the industry. We had sold a portion of the EDU holding before the final regulatory announcement but were still impacted by the material fall in the share price on the day of the regulatory announcements.

Despite the substantial decline in EDU's share price, we decided to sell the remaining position to zero as the company's long-term prospects had clearly been materially impaired. EDU cost the Fund 1.2% of performance during the quarter, while Youdao cost the Fund 0.3%. Youdao has been retained in the Fund (a 0.5% position) as its business model is very different, being exclusively online (as opposed to having a large physical learning centre presence, as is the case with EDU), and skewed more toward adult education and education hardware tools (almost 60% of the business), which is outside the purview of the regulations.

The second-largest detractor was Tencent Music Entertainment (TME), which cost the Fund 1.2%. While the bulk of TME's revenue and profits today comes from social entertainment, it's the music streaming part of the business (à la Spotify) that attracts us and makes up 80% of our valuation for TME. The large decline in TME's share price during the quarter was primarily driven by regulatory moves in music streaming, as well as the significant selling of all Chinese internet stocks in general. In early August, the government announced that exclusivity on music would be banned in most circumstances.

Our investment case was not primarily based on exclusivity remaining in place forever, as China was an outlier in this regard – the likes of Spotify, Apple Music and Amazon don't have exclusivity in their various markets around the world. Factors other than exclusivity, such as the overall attractiveness of the ecosystem and user experience, the strength of curation and the range of music (and increasingly long audio, live concerts) play a significant role in success, and TME, with 75% market share in music streaming in China today, is the clear leader in this regard.

In addition to this, the music streaming industry is still in its early stages in China, in particular from a paying ratio point of view and from a pricing/average revenue per unit point of view (both still very low but increasing). While we believe that TME will lose some market share over time, in our view it will remain the clear leader in what is a growing market. Also, for independent artists (those without a record label), three years of exclusivity is still permitted, and there is a permitted 30-day exclusivity for new tracks from all non-independent artists, which act as a counter to the negative impact from an exclusivity point of view. Lastly, the market structure of music streaming in China is far >

more attractive than in other global markets due to the much smaller presence in China of the three dominant global labels (Universal Music Group, Warner Music and Sony Music). At the same time, the higher representation of (fragmented) local Chinese labels increases the bargaining power of the music streaming companies, leading to far higher long-term profitability.

Besides the very attractive long-term fundamentals of the company, the market value of TME's listed investments (small stakes in Spotify, Universal Music Group and Warner Music) and net cash amount to approximately 45% of TME's market capitalisation today. The music streaming segment is still marginally loss making, so earnings are depressed, but using our estimate of normal margins and applying them to estimated revenue would put TME on nine times free cash flow and closer to five times free cash flow if excluding the investments and net cash. TME is a 1.4% position in the Fund.

The next three largest detractors in the Fund (excluding Naspers/Prosus, EDU and Youdao, already discussed) were also all Chinese stocks, meaning that all of the seven largest detractors were Chinese stocks. Melco Resorts (gambling, Macau) cost 61bps, Baijiu spirits producer Wuliangye Yibin cost the Fund 41bps and China Literature 31bps. Having for some time been the most attractive investment destination in emerging markets in recent years, the Chinese market has now attracted commentary akin to being uninvestable.

We continue to talk to as many China experts/insiders/locals as we can on an ongoing basis, and our view at this stage is more nuanced: clearly the relationship between capital and the State has changed in a negative direction (and the risks and discount rate for China have increased) but, as a counter, the authorities have taken great pains to explain that these are targeted decisions with specific objectives and the country is still very much 'open for business'. The extent to which this affects individual industries and names within these industries is where tough decisions need to be made. First movers in the tech industry that abused their dominant market position are likely to be the most negatively affected, while companies that were hurt by anticompetitive action will likely benefit going forward.

Regulatory clarity (as one has seen in music streaming and arguably in ecommerce as well) also assists one in getting to grips with what future earnings streams may look like, as opposed to 'not knowing' in other sectors where regulatory actions are still taking place. The most material changes in the Fund as a result of regulatory changes in China (AST aside) were therefore the sale of Meituan Dianping to zero and the reduction in the Alibaba position from around 4.5% to 2.0%. In the case of Meituan, aside from anticompetitive behaviour, the drive by the government to have better working conditions for so-called 'Gig Economy' workers will raise costs significantly, for both Meituan and its peers. Alibaba, while still cheap from a valuation perspective, in our view, is no longer attractive enough to be a top 10 position.

JD.com remains our preferred ecommerce operator and is the second-largest position (7%) in the Fund after Prosus/Naspers. Aside from a very attractive valuation – it trades on 11 times forward (below normal) earnings (and with over 100% free cash flow [FCF] conversion, the FCF multiple is lower than this) when listed subsidiaries, associates and net cash are stripped out – the company ticks all the regulatory boxes by investing in infrastructure, employing full-time workers, paying them well and providing all the benefits typically denied to workers in the 'Gig Economy'. In our view, JD.com will be the biggest beneficiary of the end of the 'choose one of two' rule (also unique to China) historically employed by Alibaba and ended by regulation, and we also believe its predominantly first-party (1P) business model will be the long-term winner in the eyes of the consumer.

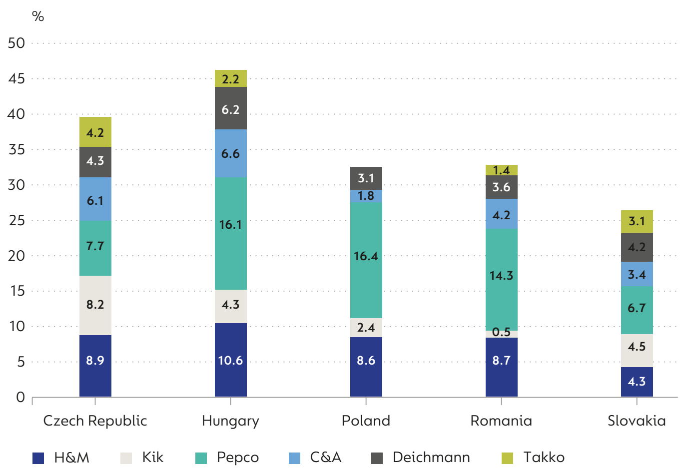
There were a few new buys in the quarter, all under 1% positions. The first of these was the leading South Korean ecommerce retailer Coupang. In our view, Coupang is a very attractive business; we did a lot of work on it before the recent initial public offering (IPO), but the share traded well above our buying range, peaking at over $50 in the days after the IPO. Coupang has now steadily retraced down to below $30. Selling by pre-IPO shareholders (with the lock-up expiring mid-August) is very likely playing a role, as arguably are concerns over potential regulation in Korea given the China experience, and lastly, rising US long bond yields, impacting long-duration stocks in particular.

The ecommerce market in Korea, while already quite well penetrated (at 30% of retail sales), is still very fragmented. Coupang is number one, but with just a mid-teen market share. The company differentiates itself through its 1P model and best-in-class logistics, with 99% of items delivered within one day of ordering. It is also investing significantly in its marketplace offering to leverage its fulfilment infrastructure, and expanding its fresh grocery options. Other initiatives include fintech and food delivery (Coupang Eats), which is an effective duopoly with Delivery Hero (1.8% of Fund) in Korea. Coupang is currently a 1% position in the Fund. >

The second notable new buy was Eastern European retailer Pepco Group (PG). PG is a multi-format discount retailer with over 3 200 stores spread across the continent. The largest format is PEPCO, which sells clothing and general merchandise in Poland and other countries in Central and Eastern Europe and Italy. PG also owns Poundland in the UK and Dealz (the Poundland equivalent in Poland and Spain). Poundland's product range is similar to the PEPCO format but also includes the fast-moving consumer goods category. Most of the group's profits come from the PEPCO format, which makes up around two thirds of the total store base. The customer proposition is a wide variety of basic products at very low prices for cost conscious 'mums on a budget' looking to shop for the full family's clothing and merchandise needs under one roof. The very low price points and small basket size make this segment more difficult for ecommerce to compete with. The data from price surveys suggests that in almost all categories, PEPCO prices are in line with or lower than the opening price point, and is between 30% and 45% cheaper than mainstream retailers like H&M and IKEA in their respective categories. PG has great financial metrics, with high returns on capital and full conversion of earnings into free cash flow.

Figure 1

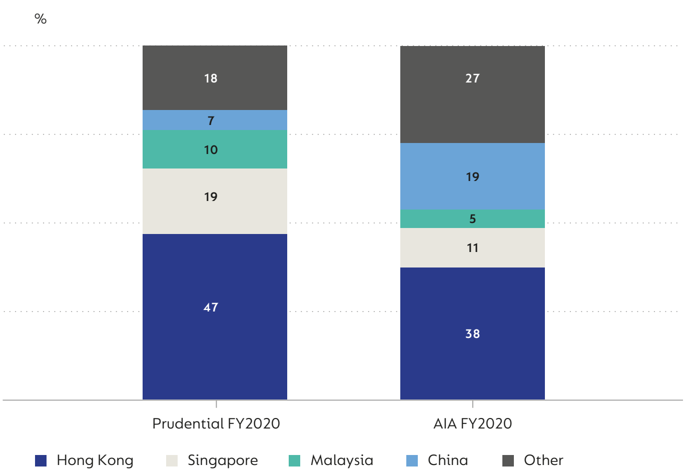
MARKET SHARE PER REGION



Source: Euromonitor

Figure 2

EMBEDDED VALUE



Source: Bank of America Global Research, derived from company filings

We acknowledge that ecommerce is a potential longer-term threat to the business model and continue to evaluate developments here. In the meantime, the ongoing store rollout and market share gains should continue to enhance PG's lead over competitors, as shown by market shares in Figure 1 – it's the largest player in all countries in the region, bar the Czech Republic. PEPCO is currently a 0.9% position in the Fund.

The final notable new buy was Prudential which has now sold/spun out its UK and US businesses, leaving it as a pure Asian/emerging market life insurer (much like AIA). Prudential has a slightly different geographical exposure to AIA, not least because its China exposure is much smaller due to being part of a joint venture, as opposed to AIA which owns 100% of its Chinese business. As a counter, a large part of the Hong Kong exposure for both insurers comes from sales to China mainlanders. The difference in embedded value makeup between the two insurers is shown in Figure 2.

Adjusting for differences in accounting practices and assumptions to compare the two insurers like for like, Prudential trades at a one-third discount to AIA, despite delivering higher renewal premium growth over the last 10 years. We think both insurers are attractive and 2% of the Fund is collectively invested in AIA (1.25% position) and Prudential (0.75% position). The new buy was fully funded by the sale of Ping An to zero. Besides a poor response to increased online competition, we have become concerned that Ping An's exposure to the Chinese property market and its subsidiary Ping An Bank undermine the investment case and, given the risk of a high impact event on Ping An, felt the risk/reward equation was not in favour of retaining the position. There were a few other sales of smaller positions during the quarter.

We sold the small remaining positions in Stone (Brazilian payments provider) on valuation, Walmart de Mexico (retailer) due to more attractive risk-adjusted opportunities being available, Momo.com (Taiwanese ecommerce) on valuation (exceeded fair value) and lastly B3, the Brazilian stock and derivatives exchange on a change in the investment case in the form of new, potentially material, legal liabilities. We sold the remaining exposure as the share price converged to the new buyout price. +

Domestic flagship fund range

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

INVESTOR NEED

	INCOME ONLY	INCOME AND GROWTH		LONG-TERM CAPITAL GROWTH	
FUND	**STRATEGIC INCOME** Cash†	**BALANCED DEFENSIVE** Inflation†	**CAPITAL PLUS** Inflation†	**BALANCED PLUS** Composite benchmark† (equities, bonds and cash)	**TOP 20** FTSE/JSE C-SWIX†
FUND DESCRIPTION	Conservative asset allocation across the yielding asset classes. Ideal for investors looking for an intelligent alternative to cash or bank deposits over periods from 12 to 36 months.	A lower risk alternative to Capital Plus for investors requiring a growing regular income. The Fund holds fewer growth assets and more income assets than Capital Plus and has a risk budget that is in line with the typical income-and-growth portfolio.	Focused on providing a growing regular income. The Fund has a higher risk budget than the typical income-and-growth fund, making it ideal for investors in retirement seeking to draw an income from their capital over an extended period of time.	Best investment view across all asset classes. Ideal for pre-retirement savers, as it is managed in line with the investment restrictions that apply to pension funds. If you are not saving within a retirement vehicle, consider Market Plus, the unconstrained version of this mandate.	A concentrated portfolio of 15-20 shares selected from the entire JSE, compared to the average equity fund holding 40-60 shares. The Fund requires a longer investment time horizon and is an ideal building block for investors who wish to blend their equity exposure across a number of funds. Investors who prefer to own just one equity fund may consider the more broadly diversified Coronation Equity Fund.
INCOME VS GROWTH ASSETS[1] ● INCOME ● GROWTH	95.3% 4.7%	56.3% 43.7%	37.3% 62.7%	22.2% 77.8%	-0.1% 100.1%
LAUNCH DATE	Jul 2001	Feb 2007	Jul 2001	Apr 1996	Oct 2000
ANNUAL RETURN[2] (Since launch)	9.8% 7.4%†	9.2% 5.7%†	11.3% 5.6%†	14.0% 13.0%†	16.9% 13.4%†
QUARTILE RANK (Since launch)	1st	1st	1st	1st	1st
ANNUAL RETURN (Last 10 years)	7.9% 5.9%†	9.0% 5.0%†	8.3% 5.0%†	10.9% 11.9%†	11.6% 11.8%†
STANDARD DEVIATION (Last 10 years)	2.1% 0.3%†	5.6% 1.3%†	7.1% 1.3%†	9.6% 8.7%†	14.1% 13.8%†
FUND HIGHLIGHTS	The Fund remains the top-performing fund in its category since launch in 2001 and outperformed cash by 2.3% over this period.	Outperformed inflation by 3.5% p.a. (after fees) since launch, while producing positive returns over 12 months more than 98% of the time.	The Fund remains the top-performing fund in its category since launch in 2001 and outperformed inflation by 5.7% p.a. (after fees) over this period.	No. 1 balanced fund in South Africa (SA) since launch in 1996, outperforming its average competitor by 1.9% p.a. Outperformed inflation by on average 8.0% p.a. since launch and outperformed the ALSI on average by 1.0% p.a. (since launch).	The Fund added 3.5% p.a. to the return of the market. This means that R100 000 invested in Top 20 at launch in October 2000 grew to more than R2.6 million by end-September 2021. The Fund is a top quartile performer since launch.

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

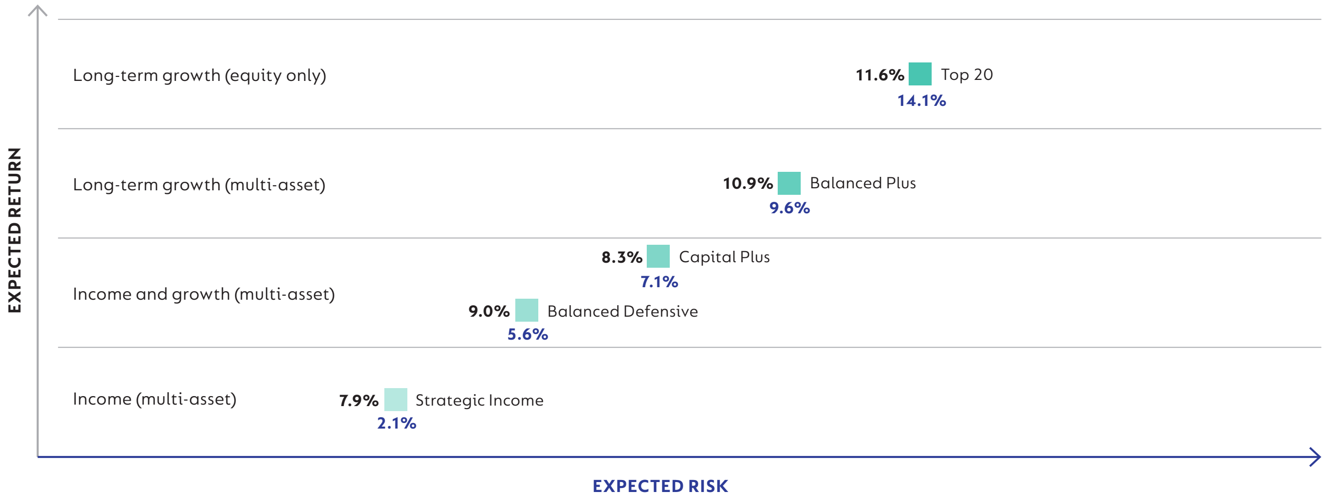
2 *Highest annual return*
Balanced Defensive: 23.1% (Apr 2020 - Mar 2021); Balanced Plus: 49.3% (Aug 2004 - Jul 2005); Capital Plus: 33.8% (Aug 2004 - Jul 2005); Strategic Income: 18.7% (Nov 2002 - Oct 2003); Top 20: 68.9% (May 2005 - Apr 2006)

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

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

RISK VERSUS RETURN

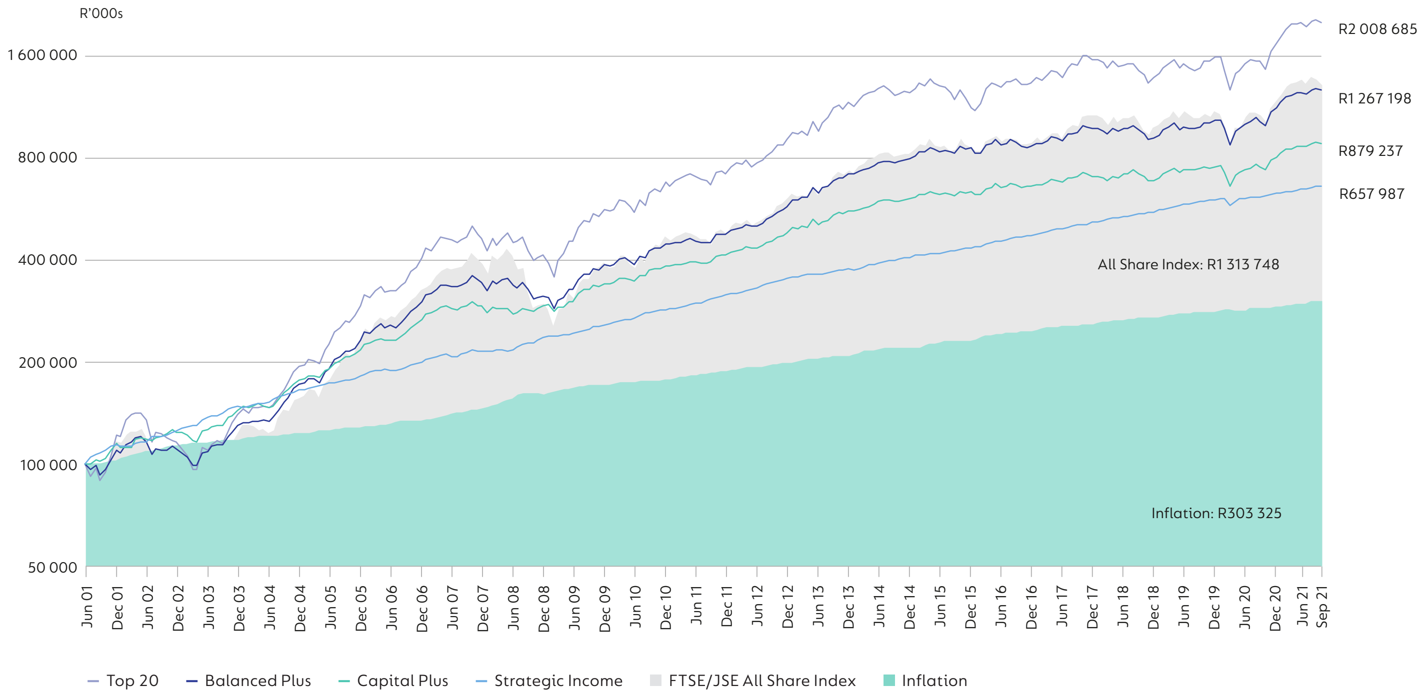
10-year annualised return and risk (standard deviation) quoted as at 30 September 2021. Figures quoted in ZAR after all income reinvested and all costs deducted.



Source: Morningstar

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

Value of R100 000 invested in Coronation's domestic flagship funds since inception of Capital Plus on 2 July 2001 as at 30 September 2021. All income reinvested for funds; FTSE/JSE All Share Index is on a total return basis. Balanced Defensive is excluded as it was only launched on 1 February 2007.



Source: Morningstar

International flagship fund range

INVESTOR NEED

	DEPOSIT ALTERNATIVE	CAPITAL PRESERVATION	LONG-TERM CAPITAL GROWTH (MULTI-ASSET)		LONG-TERM CAPITAL GROWTH (EQUITY ONLY)
FUND[1]	**GLOBAL STRATEGIC USD INCOME** US dollar cash (3 Month Libor)†	**GLOBAL CAPITAL PLUS** US dollar cash (3 Month Libor)†	**GLOBAL MANAGED** Composite (equities and bonds)†	**OPTIMUM GROWTH** Composite: 35% JSE CAPI, 15% ALBI, 35% MSCI ACWI, 15% BGBA	**GLOBAL EQUITY SELECT** MSCI All Country World Index
FUND DESCRIPTION	An intelligent alternative to dollar-denominated bank deposits over periods of 12 months or longer.	A low-risk global balanced fund reflecting our best long-term global investment view moderated for investors with smaller risk budgets. We offer both hedged and houseview currency classes of this fund. In the case of the former, the Fund aims to preserve capital in the class currency over any 12-month period.	A global balanced fund reflecting our best long-term global investment view for investors seeking to evaluate outcomes in hard currency terms. Will invest in different asset classes and geographies, with a bias towards growth assets in general and equities in particular.	The aim of the Fund is to maximise long-term investment growth by investing in a range of opportunities available in public asset markets from both SA and around the world. Our intent is to provide competitive after-inflation returns measured in rand over all five-year periods.	The Fund aims to give investors access to the best opportunities in global equity markets. The Fund is biased to developed markets and actively seeks out attractively valued shares to maximise long-term growth. Our intent is to outperform the global equity benchmark over all periods of five years and longer.
INCOME VS GROWTH ASSETS[2] ● INCOME ● GROWTH	97.5% 2.5%	58.0% 42.0%	25.9% 74.1%	20.7% 79.3%	0.3% 99.7%
LAUNCH DATE OF OLDEST FUND	Dec 2011	Nov 2008	Oct 2009	Mar 1999	Jan 2015
ANNUAL RETURN[3] (Since launch)	2.3% 0.9%†	5.0% 0.8%†	6.7% 7.6%†	9.5% 7.3%	6.4% 9.9%
QUARTILE RANK (Since launch)	–	1st	1st	1st	3rd
ANNUAL RETURN[3] (Last 5 years)	1.8% 1.4%	3.9% 1.4%	6.6% 8.9%	8.1% 8.7%	10.4% 13.2%
ANNUAL RETURN[3] (Last 10 years)	–	4.2% 0.9%	7.6% 8.3%	8.5% 7.0%	- -
QUARTILE RANK (Last 5 years)	–	2nd	2nd	1st	3rd
FUND HIGHLIGHTS	Outperformed US dollar cash by 1.4% p.a. (after fees) since launch in December 2011.	The Fund has outperformed US dollar cash by 4.2% p.a. (after fees) since launch in 2008.	No. 1 global multi-asset high-equity fund in SA since launch in October 2009.	The Fund has out-performed the composite benchmark since launch and was a top quartile performer in the Worldwide MA Flexible category since launch in 1999.	The Fund continues to seek attractively valued shares to maximise long-term growth.

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

[2] *Income versus growth assets as at 30 September 2021 (for US dollar funds). Growth assets defined as equities, listed property and commodities (excluding gold).*

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

Highest annual return
Global Strategic USD Income: 7.1% (Jan 2012 - Dec 2012); Global Capital Plus [ZAR] Feeder: 34.8% (Jun 2012 - May 2013); Global Managed [ZAR] Feeder: 48.9% (Jan 2013- Dec 2013); Global Equity Select: 56.6% (Apr 2020 - Mar 2021); Optimum Growth [ZAR]: 51.1% (Jan 2013 - Dec 2013)

Lowest annual return
Global Strategic USD Income: -2.0% (Apr 2019 - Mar 2020); Global Capital Plus [ZAR] Feeder: -11.9% (Jun 2020 - May 2021); Global Managed [ZAR] Feeder: -7.7% (Apr 2017 - Mar 2018); Global Equity Select: -21.9 % (Mar 2015 - Feb 2016); Optimum Growth [ZAR]: -31.5% (Mar 2008 - Feb 2009)

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

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

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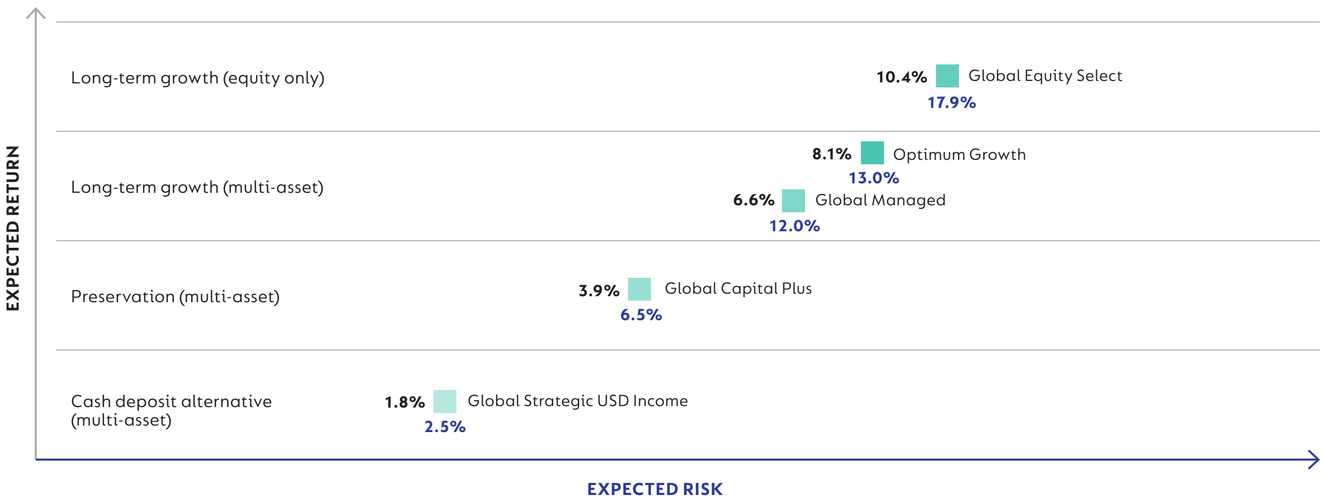
RISK VERSUS RETURN

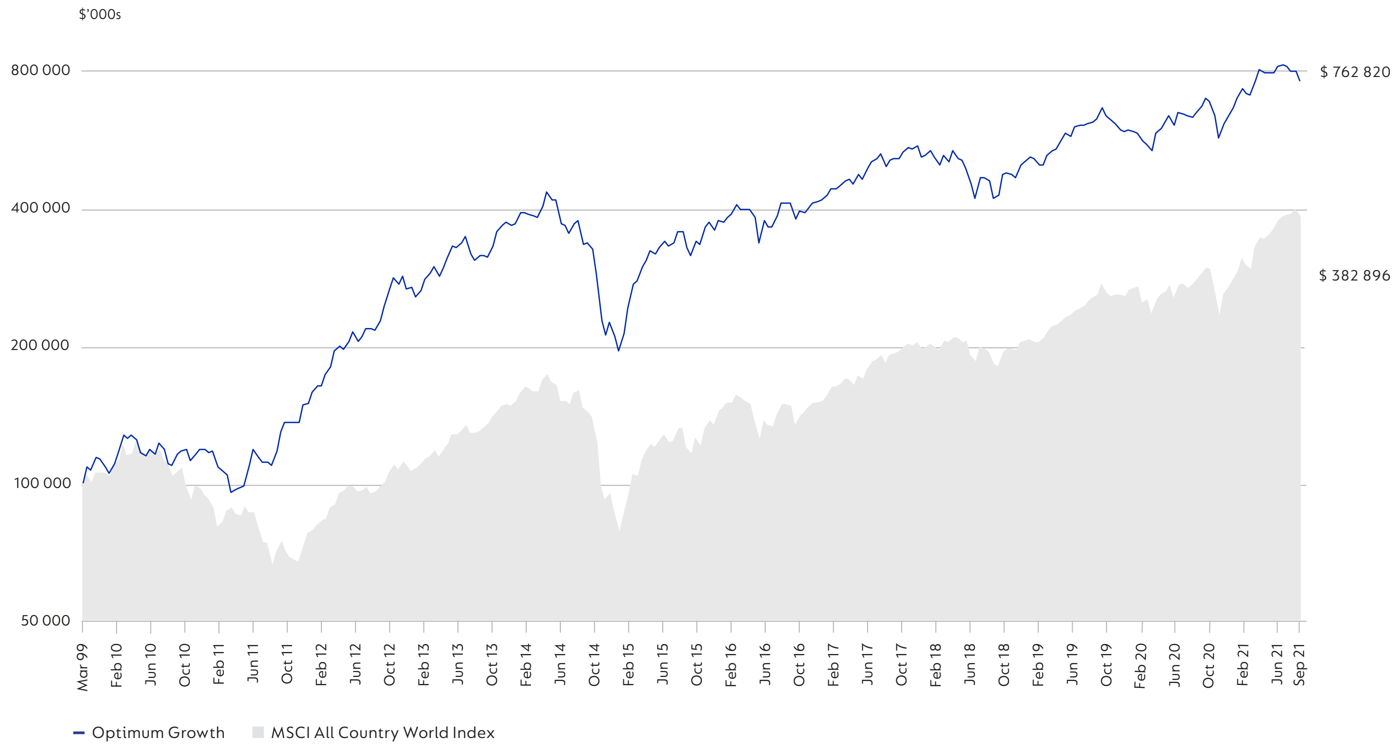
5-year annualised return and risk (standard deviation) quoted as at 30 September 2021. Figures quoted in USD (for the oldest fund) after all income reinvested and all costs deducted.



Source: Morningstar

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

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



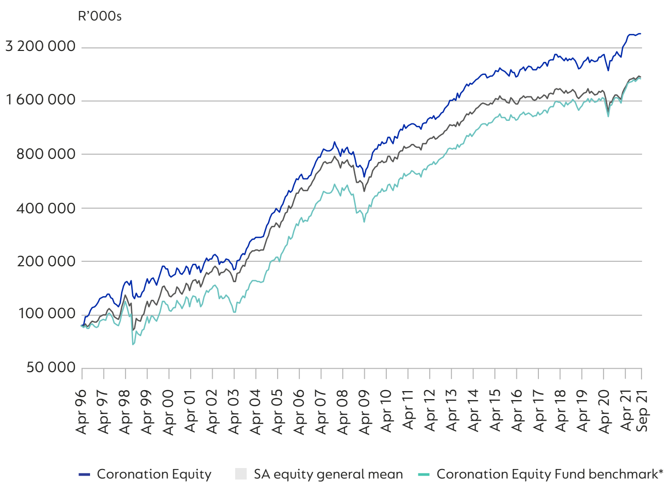
Source: Morningstar

Long-term investment track record

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

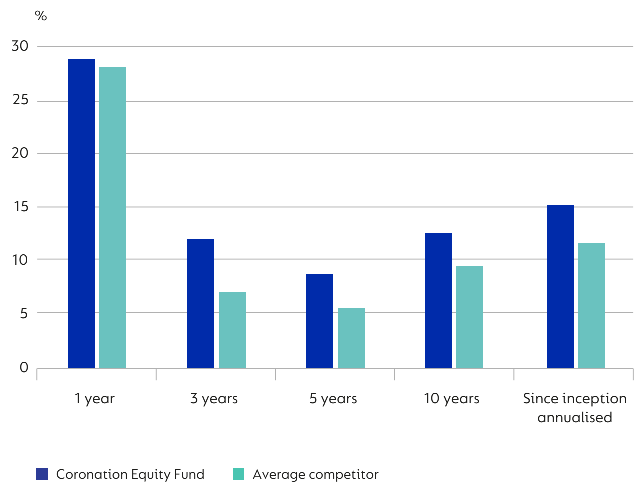
10-YEAR ANNUALISED RETURNS	CORONATION EQUITY	AVERAGE COMPETITOR	OUTPERFORMANCE OF AVERAGE COMPETITOR
2006	19.38%	17.09%	2.30%
2007	21.45%	19.23%	2.22%
2008	17.62%	18.47%	(0.84%)
2009	16.53%	16.68%	(0.15%)
2010	19.59%	19.14%	0.45%
2011	18.03%	16.98%	1.05%
2012	21.12%	18.94%	2.19%
2013	21.60%	18.68%	2.92%
2014	18.44%	16.32%	2.12%
2015	14.86%	12.62%	2.24%
2016	11.95%	9.54%	2.41%
2017	11.99%	8.90%	3.09%
2018	12.77%	10.54%	2.23%
2019	11.35%	8.71%	2.63%
2020	10.48%	7.10%	3.38%
9 years 9 months to September 2021	11.99%	11.77%	0.23%
ANNUALISED TO 30 SEPTEMBER 2021	**CORONATION EQUITY**	**AVERAGE COMPETITOR**	**OUTPERFORMANCE**
1 year	28.72%	27.95%	0.77%
3 years	11.96%	7.06%	4.90%
5 years	8.68%	5.47%	3.21%
10 years	12.51%	9.53%	2.98%
Since inception in April 1996 annualised	15.19%	11.65%	3.54%
Average outperformance per 10-year return			1.78%
Number of 10-year periods outperformed			14.00
Number of 10-year periods underperformed			2.00

CUMULATIVE PERFORMANCE



Source: Morningstar

ANNUALISED RETURNS TO 30 SEPTEMBER 2021



Source: Morningstar

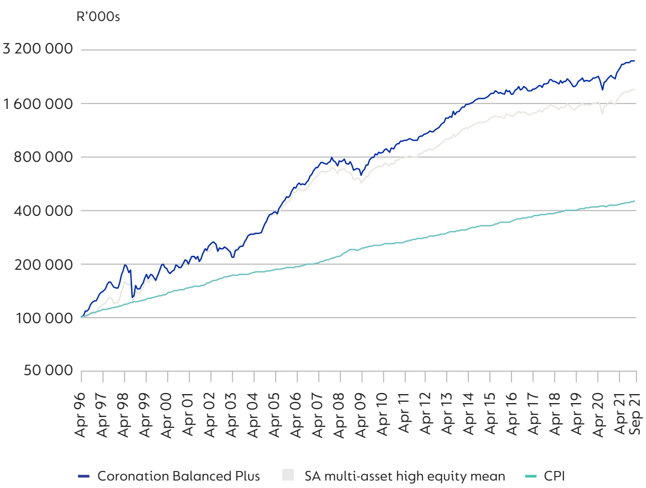
An investment of R100 000 in Coronation Equity on 15 April 1996 would have grown to **R3 639 919** by 30 September 2021. By comparison, the returns generated by the Fund's benchmark over the same period would have grown a similar investment to **R2 088 807**, while the SA equity general sector would have grown a similar investment to **R2 126 204**.

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

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

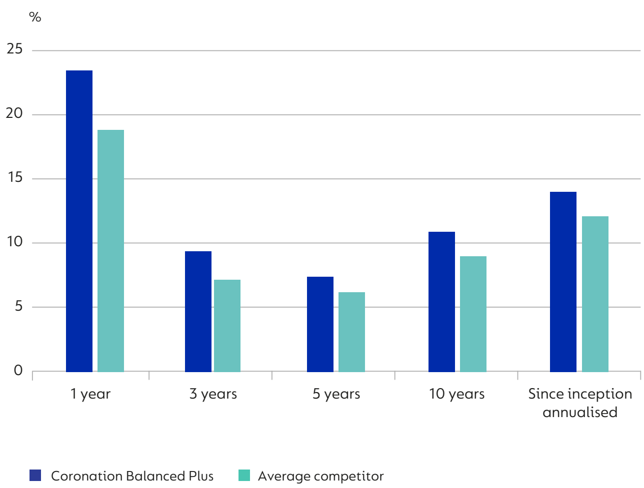
10-YEAR ANNUALISED RETURNS	CORONATION BALANCED PLUS	INFLATION	REAL RETURN
2006	18.33%	6.47%	11.86%
2007	17.81%	6.59%	11.22%
2008	16.96%	6.87%	10.09%
2009	15.69%	6.75%	8.94%
2010	17.20%	6.28%	10.93%
2011	15.78%	6.24%	9.54%
2012	17.85%	5.76%	12.09%
2013	18.63%	5.90%	12.73%
2014	16.58%	6.00%	10.57%
2015	14.01%	6.12%	7.89%
2016	11.08%	6.30%	4.77%
2017	11.04%	5.92%	5.12%
2018	11.26%	5.34%	5.92%
2019	10.30%	5.11%	5.19%
2020	9.66%	5.07%	4.58%
9 years 9 months to September 2021	10.58%	5.01%	5.57%
ANNUALISED TO 30 SEPTEMBER 2021	**CORONATION BALANCED PLUS**	**AVERAGE COMPETITOR**	**OUTPERFORMANCE**
1 year	23.45%	18.79%	4.67%
3 years	9.36%	7.19%	2.17%
5 years	7.39%	6.24%	1.14%
10 years	10.88%	9.00%	1.88%
Since inception in April 1996 annualised	13.98%	12.07%	1.91%
Average 10-year real return			8.56%
Number of 10-year periods where the real return is >10%			7.00
Number of 10-year periods where the real return is 5% - 10%			7.00
Number of 10-year periods where the real return is 0% - 5%			2.00

CUMULATIVE PERFORMANCE



Source: Morningstar

ANNUALISED RETURNS TO 30 SEPTEMBER 2021



Source: Morningstar

An investment of R100 000 in Coronation Balanced Plus on 15 April 1996 would have grown to **R2 782 934** by 30 September 2021. By comparison, the SA multi-asset high-equity sector over the same period would have grown a similar investment to **R1 916 900**.

[1] *Median of Peer Group is the median of the fully-discretionary retirement portfolios of the largest managers as published in performance surveys and calculated by Coronation Fund Managers.*