FUND UPDATE

Coronation Global Optimum Growth Fund

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THE FUND DECLINED by 11.4% in US dollars in the first quarter of 2022 (Q1-22). There were a number of drivers behind this very disappointing performance, including weak global equity markets. In addition, the Fund had 3.6% exposure to Russian stocks prior to the Ukrainian invasion, with more than 50% of this in Magnit, the second-biggest food retailer in the region. As it stands today, we have written these assets down to zero but retain ownership and are monitoring the fluid situation to drive the best outcome for our clients.

We are acutely aware of the more recent poor absolute returns generated by the Fund, but we believe that the collection of assets held in the portfolio still offers very compelling long-term risk-adjusted returns with which to deliver on the Fund's goal of compounding capital well ahead of inflation. The weighted average equity upside of the Fund is currently 73%, which is one of the highest levels since inception. Using the rand-denominated Fund's long-term track record (expressed in US dollars) as proxy*, the portfolio has generated a positive return of 4.9% per annum (p.a.), over 10 years, a return of 5.3% p.a. and, since inception over 20 years ago, 8.7% p.a.

The first quarter of 2022 has been event filled, the most notable of which has been the horrific invasion of Ukraine by Russia. This has caused both untold human suffering, along with being a hugely disruptive force to multiple commodity markets due to the role played by both Russia and Ukraine in the production of various commodities. This is further exasperating global inflation concerns, with inflation levels across the world now at levels not seen for decades. It has also brought about global instability, and heightened nationalism with the impact of geopolitics on financial markets being at a level not seen in years. This creates a backdrop of increased uncertainty and lower visibility, which both contribute towards increased market volatility. Environments like this also create opportunity that can be taken advantage of by leveraging our deep research and long-term orientated investment philosophy.

The long-term impact of the Ukrainian invasion, how it ultimately gets resolved and the role China plays in this, all have potential long-term consequences for the world order, and structural trend of globalisation, which has been a material contributor to overall economic growth globally for three decades. Due to numerous contributing factors, there is an incredible amount of complexity in making a call on whether the globalisation trend is over, but it is a topic we remain aware of due to

the historic deflationary impact on global goods production, which made goods more affordable for millions of consumers. Should this trend reverse, the structural implications on global inflation need to be considered due to the important role inflation plays on real return outcomes for investors.

These considerations and associated risks are embedded in the Fund's portfolio construction to deliver the best risk-adjusted returns. The outcome of this is that the Fund is exposed to a diversified basket of companies with distinct and different long-term growth drivers – for example, around 45% of the Fund is invested in diverse categories, such as US large cap internet (13% of Fund), China internet (11% of Fund), luxury and sporting goods (7% of Fund), North American railroads (6% of Fund), mining, including oil (6% of Fund), and gold equities (3% of Fund).

We continue to focus a lot of time on China, with the Fund having about 12% exposure to Chinese assets. We continue to feel these assets are very attractively priced, but acknowledge the risks, most notably the autocratic leadership along with the continued regulatory intervention, but note the government has recently made positive comments regarding the support of capital markets and the need for more predictable and coordinated regulatory intervention. Prosus/Naspers (indirect exposure to Tencent) and JD.com continue to make up just under 70% of this Chinese exposure, and 8.5% of the portfolio in total.

During the quarter, the largest positive contributors were SA government bonds (+12%, 0.59% positive impact), Canadian Pacific Railway (+15%, 0.51% positive impact), Anglo American (+34%, 0.38% positive impact) and Sendas (+45%, 0.33% positive impact). The largest negative contributors were Magnit (-99%, 2.53% negative impact), Naspers (-34%, 1.56% negative impact), Delivery Hero (-60%, 1.14% negative impact) and Yandex (-99%, 1.12% negative impact).

There is a material difference between how Magnit was priced in its London listing before trading was halted (and where it is still halted) and how it is now being priced on the Moscow Exchange (where trading has now resumed). In London, there was significant selling on the day of the invasion and the few days that followed. A large part of this selling was clearly 'get out at any cost' selling, which resulted in Magnit closing at $0.012 a share in London before trading was halted. This values the entire company at $6m. Magnit, in our view, should generate around $500 million of free cash flow (FCF) this year, putting the company on a FCF yield of 8,333%. In contrast, on the Moscow exchange, Magnit is now almost back to its pre-invasion share price, valuing the business at $5 billion (a 10% FCF yield). Whether the Moscow price is artificial can be debated (as foreign investors can't yet participate in the market), but the fact remains that there is good volume being traded between willing local buyers and sellers. We don't know whether the London price (that Magnit is basically worth 0) or the Moscow price (that Magnit is worth $5 billion) is right, or if the answer is somewhere in between. But we do believe that from an operational point of view, Magnit will continue to do well (selling basic essential goods (food) and taking market share from weaker operators), and as we have written down the value to 0, there is now only upside optionality.

The performance of Naspers was impacted by the discount to its net asset value (NAV) widening materially in the quarter from ~40% to ~60%. They had ~4% of NAV exposed to Russian assets, along with owning (outside of Tencent) primarily loss-making internet assets, which have derated globally – both of these factors most likely contributed to the widening of the discount. We retain our views that Tencent is attractive in its own right and that the non-Tencent assets have and continue to create value for the group (as evidenced by our assessment of the 12% p.a. Internal Rate of Return (IRR) generated by non-Tencent assets over a 17-year period). It should also be noted that management have made public comments that all structural solutions are being considered at these extreme discount levels.

Delivery Hero (offering food take-out delivery in 72 countries) is both an underlying investment of Prosus/Naspers (with them owning ~27% of the asset) and an outright shareholding by the Fund. Delivery Hero's share price came under significant pressure post their Q4-21 results, which disappointed from a near-term probability standpoint, with the business incurring higher-than-expected losses. The latter was primarily driven by their investments in on-demand grocery. This was further exasperated by the group's high debt levels, which saw them still generate negative free cash flow. While these issues are real, we believe they are more transitory in nature and have provided a compelling opportunity to increase our exposure to the asset. Management has numerous levers to pull to drive profitability higher longer term, and this is already happening in more mature markets, providing evidence that the model is working. The business still has a leadership position in markets accounting for 95% of their gross merchandise value (GMV), with the industry still nascent. This is due to low order frequencies that continue to

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improve, as shown by customer cohort data indicating spend per individual customer increases in excess of 2x two times over a two-year period. This illustrates both loyalty and demand for the service. As growth investments normalise, we feel the FCF potential of the business will become apparent, and the current valuation is extremely compelling in our view.

The Fund ended the quarter with 79.4% net equity exposure, slightly higher than the exposure on 31 December 2021, as we bought attractive stocks selectively. Post quarter end, the exposure has come down to around 74%, primarily as a result of buying more protection (put options), mainly in Europe, where the risks are increasing in our view. The put option protection at the time of writing was 14.2% of Fund (effective), which is at the very high-end of where it has been historically. This is given the above-normal risks and a resultant wider range of potential outcomes we see in the world right now.

Our negative view on global bonds remained unchanged, but as rates have begun to rise, we will be on the lookout for opportunities. However, we still do not feel that global bonds look attractive yet, and do not compensate you for the risks undertaken, which are increasing due to inflation and rising interest rates. We do, however, continue to hold South African government bonds (SAGBs) that now represent 6.2% of Fund. Our view on the SA fiscal situation has improved somewhat, which, coupled with the fact that we are receiving a ~10% yield on these bonds, is attractive in our view. Furthermore, considering that inflation within SA remains controlled, the real yields of SAGBs are among the highest in the world.

The Fund continues to have a physical gold position of 2.8%, a 2.4% holding in AngloGold Ashanti, and a 0.4% holding in Gold Fields, amounting to just under 6% in total gold exposure. The gold price is up 7% in US dollars for the first quarter, and we continue to hold the position for its diversifying properties in what we characterise as a low visibility world with increasingly visible inflation and geopolitical risks. AngloGold Ashanti has performed well more recently (+49% in the past six months),but remains attractive due to the likelihood of operational improvements under the newly appointed CEO, which should lead to improved business performance, with the business trading on a 12 times price-earnings ratio. The balance of the Fund is invested in cash, largely 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 with elevated inflation and geopolitical risks. Also, because the Fund is a multi-asset flexible fund, we have access to additional tools with which to take advantage of dislocations in the market, along with risk control measures such as put options. Current index put option exposure is 14% (effective) and over 30% (nominal), as a percentage of Fund, which will shield the Fund somewhat should there be a significant drawdown in equity indices.

Notable increases in position sizes during the quarter were Alphabet, Amazon, Microsoft, and Delivery Hero. We have selectively increased our exposure to big technology companies (as mentioned above) due to their attractive valuations relative to their growth prospects, which are supported by structural growth drivers that should remain in place even through macro volatility or weakness.

There remains an elevated number of unknowns today compared to the past due to a potential structural change in inflation rates across the globe, along with geopolitics bringing about another element of risk. We remain aware of these risks, and they are factored into our portfolio construction, but the primary focus remains bottom-up analysis of individual businesses. Against this uncertain 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 in a variety of future scenarios. ✚

*Note that this is a new fund and as such does not yet have a track record for the relevant periods. As it is the dollar-denominated version of the same investment strategy deployed historically in the management of the rand-denominated Coronation Global Optimum Growth ZAR Feeder Fund, we show the track record of the latter portfolio, converted to USD, to indicate historical results achieved by the strategy.

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