corospondent

The Institutional Quarterly

JANUARY 2018 SUMMER EDITION

Enough already!

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CORONATION
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Notes from my inbox

New year, new hope

By Kirshni Totaram

SURELY THERE MUST be a 'system overload' warning on its way!

What a year it has been. Looking back, it is hard to imagine that so many events occurred in 12 months only – it felt like decades had been compressed into shorter and shorter time frames.

Accelerated political and economic change is the only constant at the moment. Isolationism and populism continued to stoke unrest and strain relations between countries. For the first time in many decades, nuclear attack warning systems were tested in the US, as the erratic leader of the free world tweeted his country closer to the brink of nuclear war.

It was a year of profound political crisis, also in SA. At times, news headlines bordered on the surreal as we lived through a number of shocks. Long forgotten is the midnight hour cabinet reshuffle at the end of March which triggered a shock wave of ratings downgrades, the effects of which will be felt for years to come. We lost our investment grade rating, which was secured >

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through great fiscal discipline 17 years ago. This achievement by the first democratically elected government has had a tremendous positive impact on the domestic economy. The negative political events of earlier in the year delivered a major blow to the nascent economic recovery that was widely anticipated.

A culture of patronage and corruption was truly ripping SA apart, which is why the outcome of the ANC elective conference in December 2017 was such a highly anticipated and important vote.

It has been said that in SA the worst – and the best – never happens. For now, averting the worst may seem like an excellent outcome. Hope for the best has long faded. The election of Cyril Ramaphosa as president of the ANC could bolster SA, depending on how much stomach he has for a fight, and how he and his allies play their cards, as our guest columnist, Steven Friedman, suggests on page 7.

SA continues to face many deep-seated structural issues, such as a very uncompetitive labour force, poor education and low productivity. New leadership of the governing party can make a difference to some of the shorter-term issues, but to truly address the long-term issues will take decades, as we detail in our economic overview on page 9.

Still, politics matter – because they materially affect and shape the trajectory of business and the economy, changing investment opportunity but also increasing risks and uncertainty. We have seen both positive and negative political outcomes over the past 18 months.

Some of the most significant positive leadership changes in the last few months took place in Zimbabwe and Angola. Zimbabwe in particular was a watershed moment. It highlighted that there is indeed limits to the abuse of power, even in Zimbabwe. After 37 years of dictatorial rule, Robert Mugabe was ousted as Zimbabwean president.

The final overreach of placing his extravagant wife in direct succession while millions of desperate Zimbabweans face starvation unravelled nearly four decades of rule. So we are cautiously optimistic that the winds of change are blowing in the right direction. We know that forecasting the outcome of change and the intention of new roleplayers is tricky. But the people have demonstrated that their tolerance for long-serving dictators is wearing thin. This is a good thing for citizens and investors alike.

Without a doubt, one of the biggest cultural milestones over the past year has been the outpouring of confessions and accusations regarding sexual assault and harassment. The #MeToo movement has reached critical mass, with both *Time* magazine ('The Silence Breakers') and the *Financial Times* (Susan Fowler, who exposed harassment at Uber) choosing 'people of the year' to reflect this. It has galvanised a strong movement that I expect will meaningfully reshape many industries and traditional norms around the world. As Oprah Winfrey recently put it, "a new day is on the horizon ...".

No account of the past year would seem complete without mentioning Bitcoin. In our previous edition we articulated our views on blockchain (a revolutionary new technology which we believe has a very positive future) and Bitcoin (a cryptocurrency that we believe is firmly in the midst of the speculative bubble).

But the price movement of Bitcoin continues to confound. Bitcoin is an asset perhaps most similar to gold (a historic store of value) – as such it can and will be sustained indefinitely by a pool of willing buyers.

However, this 'currency of the future' (as heralded by the bulls) has a serious flaw. It is really, really volatile. One of the key attributes of successful currencies has been that they represent reasonable and stable value relative to goods and services. On a single day (22 December 2017), the currency managed to fall by a third, just to retrace all of its losses in less than 24 hours. Notwithstanding the fact that investors have earned outsized gains, this crazy volatility should raise serious doubts over Bitcoin's adequacy as a currency.

MARKETS

Looking at global markets, it may seem that someone forgot to tell them about the threat of nuclear war.

For the first year since records began, the S&P 500 scored a so-called 'perfect' calendar year – it delivered positive total returns (including dividends) every month of the past year. The Dow Jones Industrial Average, meanwhile, saw 70 fresh closing records in 2017, breaking a record dating back to 1896. The FTSE All-World Index advanced nearly 22% during 2017 and has now enjoyed its longest winning streak on record.

Confounding expectations, global bond markets also enjoyed a remarkable 2017. The Bloomberg Barclays Global Aggregate Bond Index returned more than 7%, its largest annual gain in a decade.

Flows into exchange-traded funds and index trackers hit record highs this year, significantly growing the share of savings assets that are now index linked. This indiscriminate inflow – at a time that the market grows increasingly expensive – seems absurd.

We have continually written about the risks of index-linked investing (which can never be 'passive investing'; choosing an index is the ultimate active decision). It will be interesting to watch this investment trend unfold over the coming years.

Despite the increasingly exuberant market levels, we continue to caution that more muted investment returns are to be expected from all asset classes. This makes achieving savings goals far more challenging. As such I emphasise again that in a low return world, the additional, compounded benefit of alpha (excess returns) becomes ever more vital. These excess returns (net of fees) will be crucial to the total returns earned by investors.

Emotion and fear cause massive stock market price volatility and obvious mispricing seems increasingly obscured, given the pace of change in a complex world. The positive here is that markets have not become efficient. Skilled and diligent investors can still earn alpha through detailed analysis and unique insights. New opportunities emerge all the time, often a by-product of overreaction, fear, greed and the short-term biases of many market participants. In this edition of *Corospondent* we highlight a number of these opportunities, including Alphabet (page 14) and the UK retail property giant Hammerson (page 18).

MARKET MOVEMENTS

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

Sources: Bloomberg, IRESS

LEARNING ENDURING LESSONS – STEINHOFF

Successful long-term investing requires hard work, great patience and strict discipline. There is limitless information available to be sorted, examined and weighed. No one can process it all. We always monitor dissenting views to counterbalance our perspective. It is foolish and arrogant to assume that we are always right and others are always wrong. We consistently attempt to learn from our mistakes and draw enduring lessons.

Process is crucially important in investing. Beyond just detailed analysis, there must be a great deal of debate and truth-seeking. As we learn from the counterintuitive and pathbreaking work done by behavioural economists Daniel Kahneman and Amos Tversky, a decision cannot only be judged on its results, whether it turned out to be right or wrong, but also needs to be assessed in terms of the processes and thinking that informed the decision.

It is in this light that we contextualise our investment in Steinhoff. Our stringent investment process has been tested for almost a quarter of a century. Our long-term record of consistent alpha generation is testament to its rigour. However, we still sometimes get it wrong. Steinhoff is a case in point.

This one is hard to stomach, though. The failure of the board and the company's independent auditors to identify what is at least two years of misstated financial statements is frustrating. It is mystifying that so many smart insiders, who, by definition, had better information than outsiders, were so heavily invested in the company and so blindsided by recent events.

At the time of writing, stakeholders find themselves in an information vacuum. Possible outcomes range from the best-case scenario of tax evasion and inadequate disclosure of related-party transactions to that of sophisticated fraud orchestrated by the CEO. The former would result in a material, albeit manageable, reduction in Steinhoff's intrinsic value. The latter holds much more serious implications for the long-term future of the company. Until we have a better understanding of the nature and scale of these improprieties, we simply cannot speculate further.

Without such information, and an understanding of how the banks are responding to the crisis, it is just not possible to value the company with any conviction. The stock could just as easily be worth more than the current market price as it could be less. At current prices, we are therefore likely to retain our equity holding in the company until more information has been made available publicly. It is important to highlight that none of our portfolios have exposure to any debt or convertible instruments issued by Steinhoff.

While we were not invested in Steinhoff for many years, this changed with its purchase of the Pepkor group in 2014. We were shareholders in Pepkor at the time of its listing on the JSE in the early 2000s. It is a formidable company, with one of the best track records in SA. It generates lots of free cash and continues to grow strongly despite a demanding base. We were very optimistic about the company's growth prospects in both SA and Eastern Europe, where the apparel market is large but the opportunity significant for a well-managed value/discount retailer. We believed that Steinhoff had bought Pepkor at a good price and that it had fundamentally changed the quality and prospects of Steinhoff.

We performed extensive due diligence that extended far beyond analysis of the company's financial statements.

Much of our detailed thinking has been communicated to our clients in a letter from our CIO, Karl Leinberger; as such, I will not repeat all of that information.

Suffice it to say that over the last 15 years, we have constantly challenged Steinhoff's quality of earnings, cross-checking margins against competitors for reasonability and cross-referencing management's assertions with more junior employees of the company, nonexecutive board members and outsiders (typically competitors and suppliers). Although we cannot, for confidentiality reasons, disclose the names of those people, we can confirm that we spoke to at least 82 individuals during that research process (51 of those being outsiders). Our external research on management always reached the same conclusion: Steinhoff was managed by an aggressive and entrepreneurial team, but one that was respectful of the law.

In addition, over time, more and more astute and experienced businesspeople joined the group – many of whom had no history with the company. Most of them stayed with the company right up until the events of December.

These included Sean Summers, a former Pick n Pay CEO, who managed some of the group's UK and Australian retail businesses and Andy Bond, previously the CEO of Asda (the third largest grocer in the UK), who is personally invested in Poundland and currently manages the European general merchandise segment (Poundland and Pep Europe).

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Finally, after extensive due diligence over the years we also gained comfort around the company's quality of earnings, as it dramatically improved its conversion of earnings to cash flow over time.

As with all investments, we were cognisant of the risks inherent in the investment case (a low tax rate, numerous acquisitions, and complex accounting and off-balance sheet transactions) and duly accounted for them in our valuation. Our investment case was premised on the fact that the company had an extremely undemanding valuation which we felt significantly undervalued the underlying businesses, providing sufficient compensation for the identified risks.

If this turns out to be a case of serious fraud, it would have been highly sophisticated and well concealed. It is highly likely that the audited financial results misrepresented the facts.

Somehow Deloitte, which is a top-four audit firm with access to all the internal information it needed to perform those audits, did not pick this up. Even an independent review by a second audit firm that, we understand, was commissioned by the board to investigate the allegations, came out clean. Finally, David Young, a professor of accounting and control at INSEAD who analysed Steinhoff's financial statements post the events of December, concluded that these off-balance sheet structures could not have been uncovered using the group's annual financial statements or other publicly available information.

It is really only when more information comes to light that we will be able to undertake a more comprehensive study of what went wrong and update our clients accordingly. As much as the loss on Steinhoff is disappointing, we do take comfort from the fact that it is ultimately portfolios, as opposed to single-stock views, that we produce for our clients, and that our portfolios proved resilient in their performance, both through that first week of December and for 2017 as a whole.

OUR COMMITMENT TO YOU

At Coronation, we understand that it is a great privilege to be entrusted to manage your assets. We recognise and value your appreciation of, and alignment with, our long-term investment approach. Without that alignment, our job of creating long-term value for your portfolios would be near impossible. I therefore wish to extend my sincere gratitude for your loyalty and support over the years.

It is because of the trust you place in us that we tirelessly strive to improve and remain steadfast in our commitment to deliver investment excellence for our clients. +

Kirshni

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GUEST COLUMN

Divided we stand

Real change will depend on the will to fight

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By Steven Friedman

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

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

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

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He writes a column in *Business Day* on current political and economic developments.

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

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

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

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

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

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

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

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

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

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

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

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

SA ECONOMY

A new 1994?

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

By Marie Antelme

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

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

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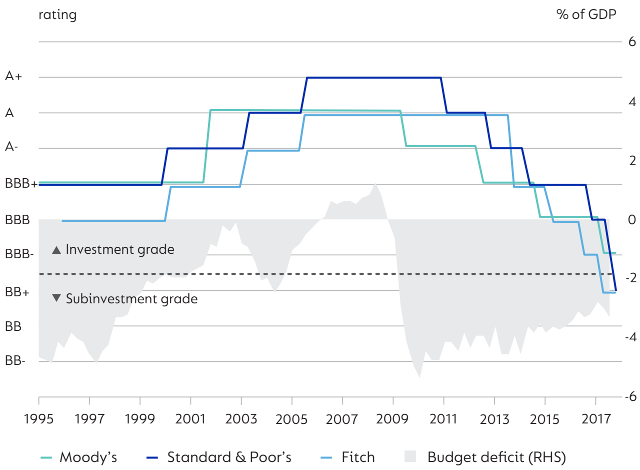
Critically, however, is that since 2015, on a per capita basis, real growth has been contracting – for the first time since the early 1990s. The fiscal position has deteriorated noticeably and the country's sovereign ratings have been downgraded five times since 2012, leaving SA with a subinvestment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

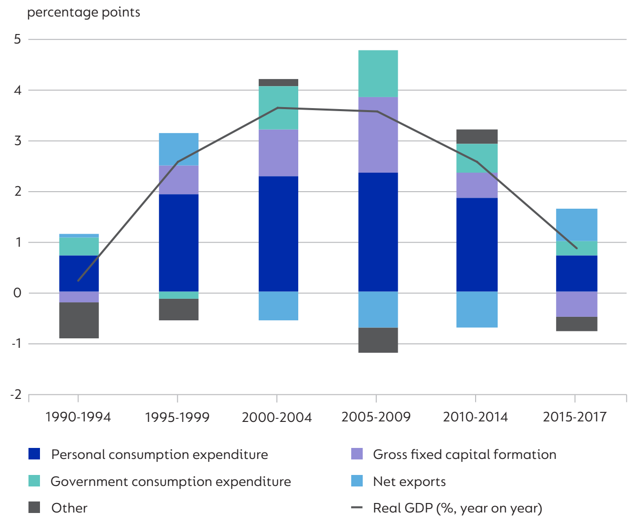
SA CREDIT RATINGS VS BUDGET DEFICIT



Source: HSBC

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

CONTRIBUTIONS TO SA ECONOMIC GROWTH



Sources: SA Reserve Bank, Statistics SA

HOW DID WE GET HERE?

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

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

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

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

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

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

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

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

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

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

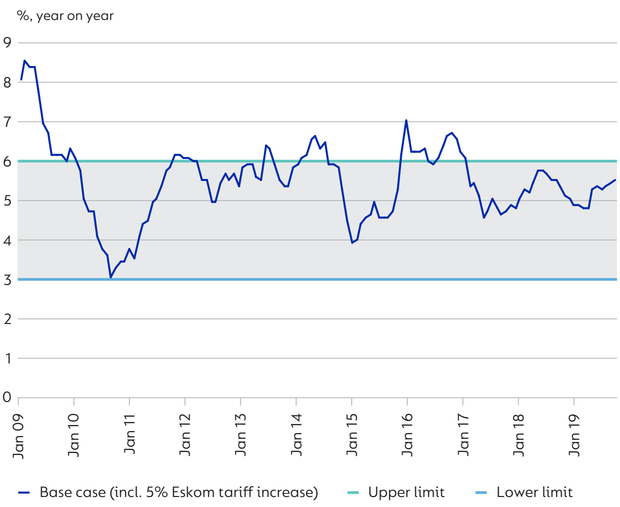
In 2007, Jacob Zuma was elected as the ANC president and became national president in 2009. By this time, GEAR had been abandoned and the fledgling Accelerated and Shared Growth Initiative never really saw daylight. Under president Zuma, the broad growth strategy fell under the National Development Plan,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

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

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

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

SA CPI FORECAST



Source: Coronation forecast

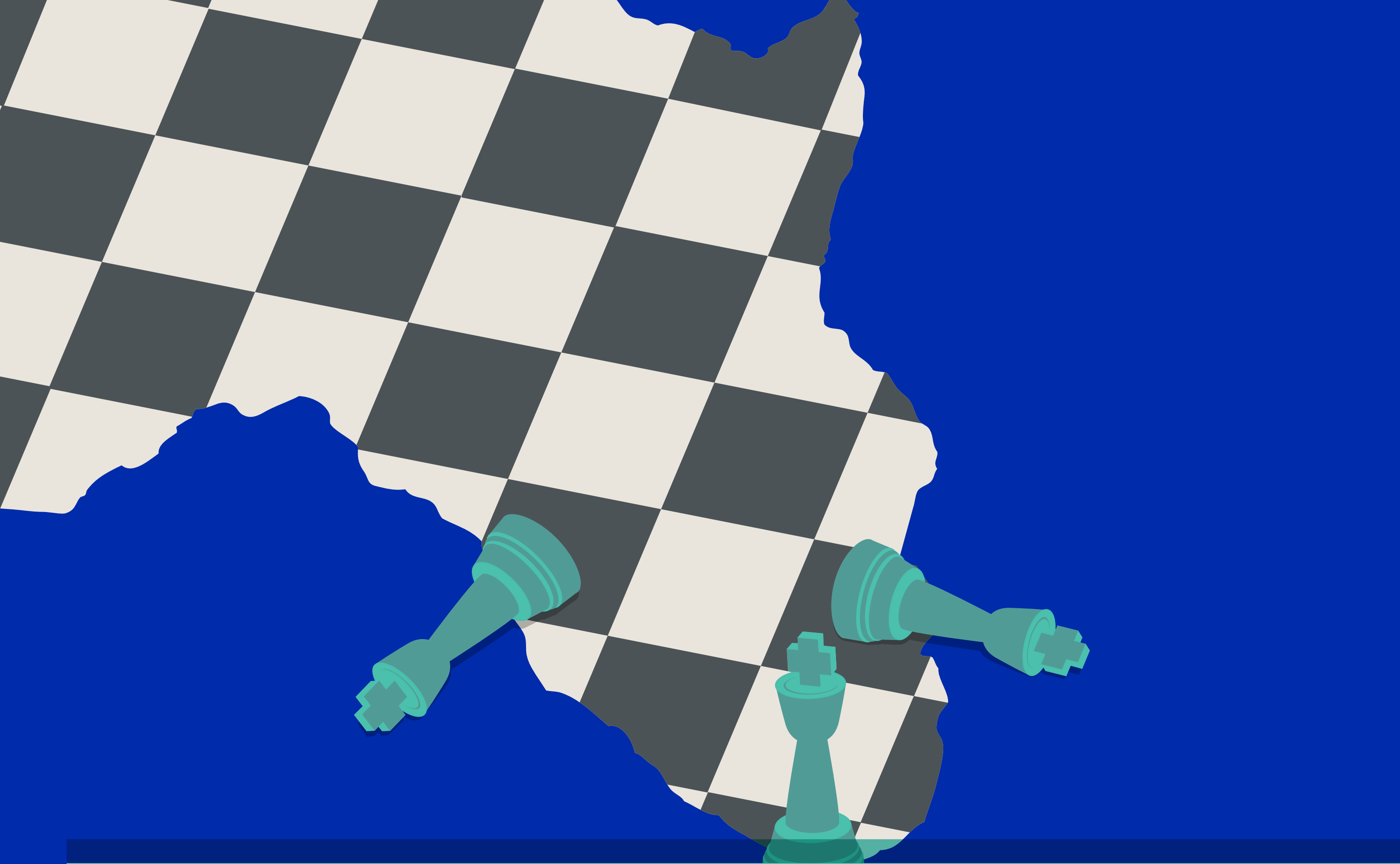
MUCH HINGES ON DOMESTIC POLITICS

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

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

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

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



FRONTIERS

Making Africa great again

What now that the kings are gone?

By Peter Leger

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

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

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

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

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

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

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

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

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

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

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

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

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

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

GLOBAL

Alphabet

The next generation of big bets

By Humaira Surve

Humaira is an analyst within the Global Developed Markets investment unit. She joined Coronation in 2012 after working for Accenture. She holds an MBA from INSEAD.

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

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

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

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

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

CULTURE

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

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

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

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

YOUTUBE

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

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

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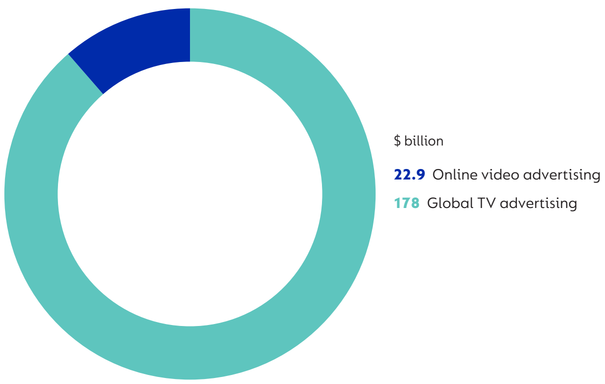
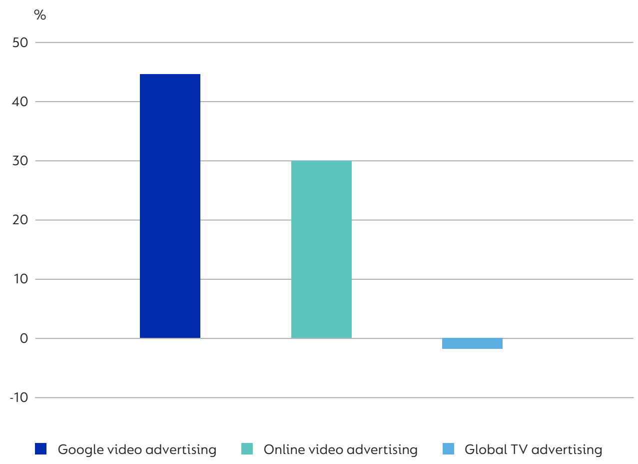
ESTIMATED GLOBAL TV ADVERTISING REVENUE IN 2017



Sources: Bloomberg, Coronation

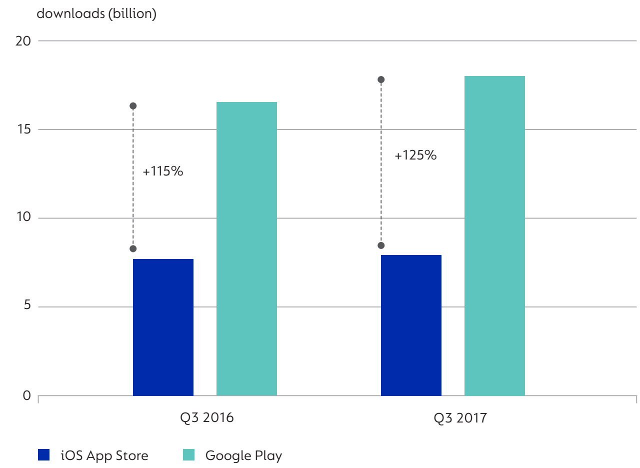
[1] *How Google Works*, by Eric Schmidt and Jonathan Rosenberg
[2] *Ibid*

ESTIMATED 2017 GROWTH



Sources: Bloomberg, Coronation

WORLDWIDE APP DOWNLOADS BY STORE



Source: App Annie

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

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

GOOGLE PLAY

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

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

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

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

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

MOONSHOTS

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

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

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

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

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

VALUATION

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

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

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

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LISTED PROPERTY

Hammerson

Well positioned in an evolving environment

By Anton de Goede

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

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

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

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

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

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

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

PORTFOLIO DOMINANCE

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

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

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

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

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

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

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

PHYSICAL STORES BOOST ONLINE INTEREST

Sources: British Land, Connexity Hitwise

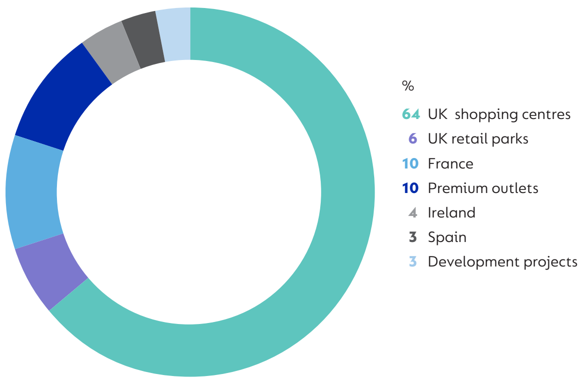
PORTFOLIO DIVERSIFICATION

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

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

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

HAMMERSON'S PORTFOLIO SPLIT



Source: Company reports

STRATEGIC MANAGEMENT

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

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

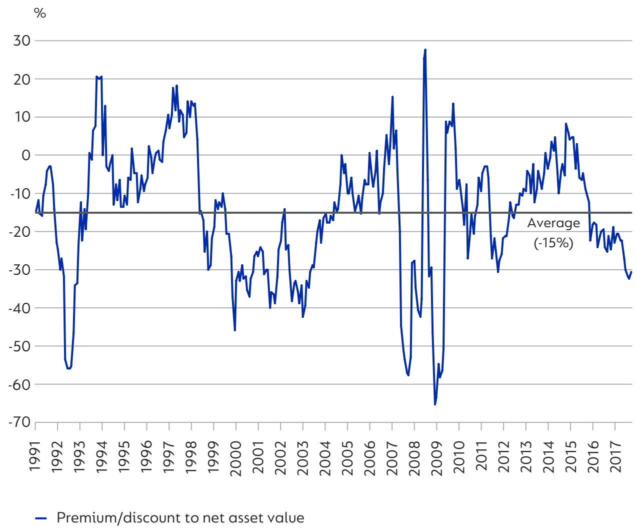
Strategically, Hammerson has proven itself a good allocator of capital, often confounding initial market skepticism relating to acquisitions or disposals.

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

CONCLUSION

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

HAMMERSON'S PREMIUM/DISCOUNT TO NET ASSET VALUE



Sources: Reuters, Coronation

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BOND OUTLOOK

An important year for SA

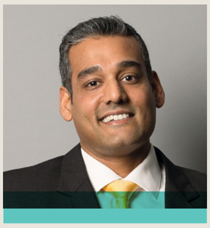
Renewed optimism and contained inflation could benefit government bonds

By Nishan Maharaj

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

2017 was a difficult year for every South African, with the economy basically grinding to a halt as policy inaction and political uncertainty sapped confidence in the prospects of the local economy. In thinking about SA, an age-old story comes to mind. One day a farmer's dog fell down into a well. The farmer was at a loss as the animal cried piteously for hours. Finally, he decided the animal was old, that the well needed to be covered anyway and that it was just not worth retrieving the dog. He grabbed a shovel and began to shovel dirt into the well. The dog realised what was happening and yelped horribly. Then, to the farmer's surprise, he quietened down. A few shovel loads later, the farmer finally looked down the well and was astonished at what he saw.

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



With every shovel of dirt that hit his back, the dog would shake it off and take a step up. As the farmer continued to shovel dirt on top of the animal, he would shake it off and climb a little bit higher. Soon, to his amazement, the dog stepped up over the edge of the well and trotted off. Could this be SA in 2018?

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

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

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

THE ISSUE OF POLICY INACTION HAS LED TO A STEADY DETERIORATION IN SA'S CREDIT FUNDAMENTALS, AS ILLUSTRATED BY THE CONSTANT DOWNGRADES OF SA'S CREDIT RATING OVER THE LAST TWO YEARS.

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

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

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

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

In the table overleaf, we bring together the various elements of our fair value model and then incorporate some of the main points from our discussion in this article. The key takeaway is that at current levels, the SA 10-year bond is fairly valued. Under an adverse outcome (scenario B), we could see a 50 bps move higher >

in yields, while under a favourable outcome (scenario A), we could see a 58 bps compression in yields. Under scenario A, we assume that the market is correct and the Fed only hikes interest rates twice this year, that SA inflation averages 5% over the next year and that the country adopts a reform agenda as is currently expected. With scenario B, we assume that the Fed hikes four times, SA inflation averages at the top end of expectations (5.5%), US inflation averages 2.25% (resulting in the aforementioned four hikes) and that SA's reform agenda takes longer to implement, resulting in a wider credit spread.

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

An event that could prove problematic is if Moody's chooses to downgrade SA to subinvestment grade, resulting in an exit from the Citigroup WGBI. The magnitude of the associated outflow could be anywhere between \$5 billion to \$9 billion, which is quite sizeable.

However, much depends on the global environment and the trajectory of the local economy. If we are still loosely following the conditions suggested in scenario A, the outflows could be easily digested. This will have very little sustained impact on bond levels, as market participants will use the flow to allocate more to SA government bonds. However, if fiscal consolidation and the reform agenda continue to be pushed out, it is likely that the SA 10-year bond will settle at levels of 9.25% to 9.5%.

SA BONDS: FAIR VALUE MODEL

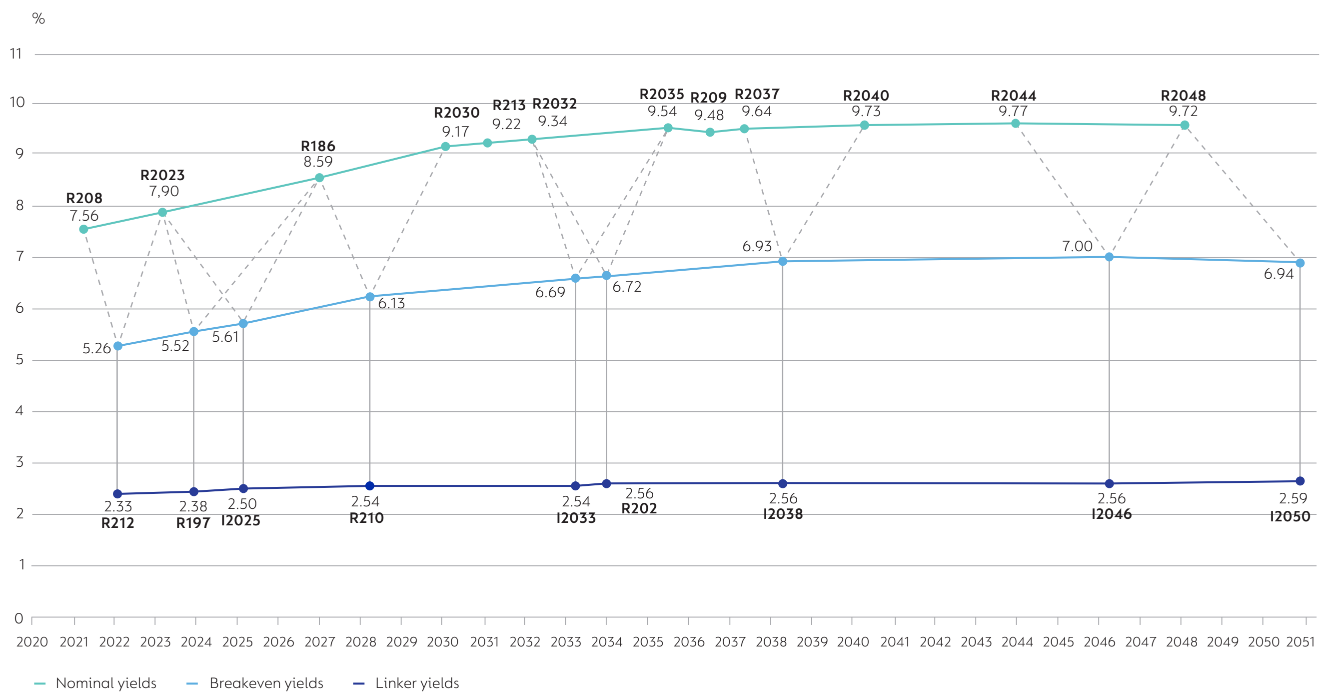
	Market level	Scenario A	Scenario B
US 10-year bond	2.40%	3.0%	3.5%
Plus the market-implied 10-year average inflation expectation for SA	6.09%	5.0%	5.5%
Minus the market-implied 10-year average inflation expectation for US	1.98%	2.00%	2.25%
Plus the SA sovereign risk spread	2.2%	2.2%	2.5%
Equals the implied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

Source: Coronation

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

Inflation-linked bonds (ILBs) had a tumultuous year, underperforming bonds and cash considerably. Given the current implied market breakeven inflation levels, we still see little value in ILBs with a maturity of greater than seven years. The market expects

NOMINAL BONDS VS INFLATION-LINKED BONDS



Source: Coronation

inflation to average above 6% (close to 7% in the longer-dated bonds), which, given our inflation expectations (5.5%), remains too rich (see the graph on the previous page).

Our preference is to hold longer-end nominal bonds instead of ILBs. The shorter end of the ILB curve remains an area of interest. Average inflation breakeven levels sit between 5.25% and 5.5%, which is more in line with our forecast and provides one with protection against inflation moving above 5.25% to 5.5%.

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

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

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

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SA PORTFOLIO UPDATE

Performance of our SA investment strategies

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

SPECIALIST EQUITY STRATEGIES

	Launch date	1 year	5 years	Since inception
Houseview Equity	Oct 93	15.74%	12.56%	17.54%
Benchmark		18.06%	11.75%	14.96%
Aggressive Equity	Jan 04	15.96%	11.44%	18.55%
Benchmark		18.17%	12.18%	17.33%

Annualised
Sources: Coronation, IRESS

The domestic market had a roller-coaster ride in the final quarter of 2017 as rand volatility caused a large amount of market movement given the high weighting to dual-listed shares in the FTSE/JSE All Share Index (ALSI). The rand sold off to R14.50 mid-November and then retraced to end the year at R12.40 after the results of the ANC's elective conference in December were welcomed by the market.

Still, domestic equities delivered strong returns in 2017, reversing the lacklustre performance of the past few years. The FTSE/JSE Capped All Share Index returned 18.1% for the year, compared to an annualised 8.9% over three years.

The return in US dollar terms was 30.6% thanks to rand strength, reflecting a positive shift in sentiment on the back of the appointment of Cyril Ramaphosa as ANC president in December. Mr Ramaphosa is expected to introduce better fiscal discipline, though a divided party leadership will make necessary policy reform challenging.

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

In particular, the past quarter's rally in domestic banks (+28%) is cause for review, with higher earnings expectations being priced in. Domestic bank valuations are pricing in a more optimistic outcome. Slow advances in growth over the last few years could be accelerated with more accommodative economic growth, though a benign credit cycle leaves little room for credit loss improvements. We have adjusted position sizes to reflect a reduced margin of safety.

Calendar 2017 was a relatively robust year for commodity prices, with most strengthening as Chinese demand remained resilient. Supply remained constrained as miners persisted with disciplined allocation of capital and Chinese environmental regulation capped domestic supply. While higher commodity prices have reduced the margin of safety in resource valuations, reasonable exposure is maintained to Exxaro, Anglo American and Mondi.

In contrast, some of the dual-listed shares on the JSE do look quite attractive once again and we have added to two positions in particular.

First, British American Tobacco (BAT) has pulled back quite substantially and is now rated well below its peers in its category. We think the outcome of the recent deal to buy out Reynolds American will provide plenty of opportunity to deliver strong results in the years ahead as cost synergies are extracted and the revenue synergies from rolling out BAT's full product suite in the US is achieved. The potential reduction in US tax rates is a further fillip to the group, which now has a significant portion of its earnings derived from the US.

Secondly, we have added again to our position in Mondi, having sold down substantially earlier in the year. Mondi has now underperformed the ALSI after advising the market that while its results would be solid, it would be a couple of percent behind market expectations. Strangely, the market took this very negatively and the stock sold off almost 20% from peak to trough. We think the fundamentals for the company remain very favourable and all evidence is of further price increases to come for its key product ranges. In addition, Mondi has announced a transaction in the consumer packaging space which should be earnings accretive, and we still expect a special dividend to be announced with the company's results. All of this adds up to an attractive investment case and we have increased our exposure to Mondi significantly.

During December, the Frankfurt- and JSE-listed general merchandise retailer Steinhoff announced that its CEO would be stepping down and that its financial statements could not be released due to what appears to have been a number of years of misstatement of its audited accounts.

This resulted in the price of Steinhoff collapsing, which had a negative impact for the quarter. As things stand today, we have not received any further information to be able to assess the scale and magnitude of accounting irregularities and the impact this will have on the value of the company. Steinhoff owns many retail assets around the world, including the iconic locally-based Pep group and businesses such as Poundland (in the UK), Conforama (in France) and Mattress Firm (in the US) which are, on their own, valuable companies.

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

BALANCED STRATEGIES

	Launch date	1 year	5 years	Since inception
Global Houseview	Oct 93	14.13%	13.18%	16.42%
Peer median		13.88%	11.97%	15.17%
Managed	May 96	12.54%	13.06%	16.75%
Peer median		13.88%	11.97%	14.10%

Annualised
Sources: Coronation, IRESS

Our balanced strategies, Global Houseview and Managed, continued to deliver outperformance over meaningful periods. The strong run in global equity markets continued into the quarter, >

with a quarterly US dollar return of 5.7% (MSCI All Country World Index) supporting the 12-month number at 24.0%.

Major markets were broadly strong across the developed and emerging world, with both the US and eurozone reporting healthy growth. This was achieved despite political tensions continuing to boil under the surface – North Korea's ongoing development of its nuclear agenda, alleged Russian interference in US politics and a tumultuous Middle East.

As the economic outlook for most markets remains good, with Europe, Asia and the US still showing very positive underlying growth metrics, we do not believe we should be underweight equities, but given high levels of valuation, it is no longer prudent to maintain a large overweight position.

The recent rand strength and a rally in domestic assets meant the large offshore holdings and limited exposure to government bonds detracted from performance in the quarter. Over the longer term, significant offshore exposure remains a meaningful contributor to the performance of the funds.

The past quarter's domestic rally in equities has created the opportunity to buy some of the more attractively valued rand hedge shares as the market prices in a very optimistic economic outcome domestically, despite lingering challenges. The overall portfolios remain largely unchanged, consistent with our commitment to invest where we see long-term opportunity.

Along with SA stocks, domestic bonds have had a very strong rally at the end of the year. Given our very low exposure to government bonds, this was also a detractor from our performance in the last quarter. The rally presented an opportunity to further reduce our exposure as the domestic bond market faces a number of challenges in the year ahead.

SA's dire fiscal position will require much greater funding, especially as the parlous position of the finances of state-owned enterprises becomes more evident. With debt to GDP spiralling ever higher, worsened by the prospect of free tertiary education, we do not believe current bond levels are sufficient to reward investors. As our debt rating moves to junk status across all rating agencies, we do not see the potential pool of investors getting any bigger. Instead, it will shrink.

WE DO NOT BELIEVE WE SHOULD BE UNDERWEIGHT GLOBAL EQUITIES, BUT GIVEN HIGH LEVELS OF VALUATION, IT IS NO LONGER PRUDENT TO MAINTAIN A LARGE OVERWEIGHT POSITION.

Importantly, this is happening in an environment where we see government bond yields in developed countries starting to rise, which will put further pressure on domestic bond yields.

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

Within the offshore component outside of equities, we are also very underweight bonds, with the exception of a few high-yield opportunities where we believe the credit spreads will more than compensate for adverse yield.

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

ABSOLUTE RETURN STRATEGIES

	Launch date	1 year	5 years	Since inception
Domestic Absolute	Apr 02	10.26%	8.18%	15.09%
CPI		4.67%	5.47%	5.83%
Inflation Plus	Oct 09	9.09%	9.17%	10.88%
CPI		4.67%	5.47%	5.19%
Global Absolute	Aug 99	8.93%	10.42%	15.73%
CPI		4.67%	5.47%	6.10%

Annualised
Sources: Coronation, IRESS

The absolute return portfolios all have dual mandates of beating inflation by a certain target while also protecting capital. The strategies continued to achieved their mandates in the past period, delivering strong performances.

In the period under review, domestically-focused stocks gained sharply, while bond yields dropped sharply, turning a poor year for bond investors into a good one. The All Bond Index ended up delivering a total return of 10.2% for the year of which 5.7% accrued in December alone.

In the bond component of the portfolios, we had an extremely short modified duration leading up to the Medium Term Budget Policy Statement. The very disappointing budget then drove yields to attractive levels, allowing us to buy some longer-dated government bonds at an average yield of 9.8%.

The portfolio was therefore better positioned to benefit from the sharp improvement in yields subsequent to the ANC's elective conference.

The strength in the rand towards year-end had a greater negative effect on performance as it impacted the value of the fund's offshore holdings, as well as many of the large equity holdings such as BAT, Richemont, Anheuser-Busch InBev, Mondi and other rand hedge stocks. BAT in particular looks cheap for a global consumer staple on a one-year forward price earnings ratio of 15.4 times, with the opportunity to grow earnings through next-generation tobacco products and margin uplift on the back of the recently completed Reynolds takeout.

Over the course of the year, the biggest contributors to performance were Naspers, Anglo American, global equities and Mondi. Major detractors include Steinhoff, US dollar cash, Aveng and RECM & Calibre.

Looking forward to 2018, the market will be focused on how Mr Ramaphosa will lead the ANC and, in particular, for how long Jacob Zuma will remain president of the country and therefore in control of key cabinet appointments and government policy.

In our view, the deeply divided top six officials of the ruling party and its national executive committee will make it difficult for the new president to act decisively.

We think the markets have been too euphoric in its assessment of recent events and expect some retreat in those market sectors that were so buoyant in December. ✚

INTERNATIONAL OUTLOOK

Navigating in unchartered waters

Valuations are high and uncertainty is increasing

By Tony Gibson

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

BROAD-BASED GROWTH

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

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

level in over a decade, suggesting that any impact on purchasing power from higher oil prices is likely to be modest.

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

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

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

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

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

THE RISKS OF COMPLACENCY

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

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

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

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

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

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

STRUCTURAL PROBLEMS ALLEVIATED BUT NOT SOLVED

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

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

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

WHAT CAN GO WRONG?

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

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

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

As things stand now, bonds would do particularly badly given their very low real yields. However, shares could get more severely hit given their extremely high valuations. Although we do not know if an inflation surge is inevitable, it is something that investors should have in the forefront of their minds when they think about what could go wrong for their portfolios.

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

FACTFILE

Coronation Strategic Bond

INCEPTION DATE

1 January 2008

PORTFOLIO MANAGERS

Nishan Maharaj, Mark le Roux and Adrian van Pallander. Nishan is head of Coronation's Fixed Interest investment unit and has 15 years' investment experience. Mark is a senior member of the unit, which he headed for more than a decade. He has more than 25 years' experience in managing both traditional and alternative fixed interest portfolios. Adrian is a portfolio manager and has 16 years' investment experience.

OVERVIEW

Coronation Strategic Bond has a proven track record of consistently outperforming bond markets. The actively managed strategy invests across all the different fixed income instruments. It has a flexible mandate with no duration or term restrictions. It invests in the traditional fixed interest assets, but can also have exposure to listed property, preference shares and inflation-linked bonds (ILBs), which are typically excluded in most specialist mandates. This flexibility allows the strategy to maximise every opportunity in the SA fixed interest space. The strategy aims to offer better returns than the JSE ASSA All Bond Index (ALBI) over the medium to long term.

COMPELLING TRACK RECORD

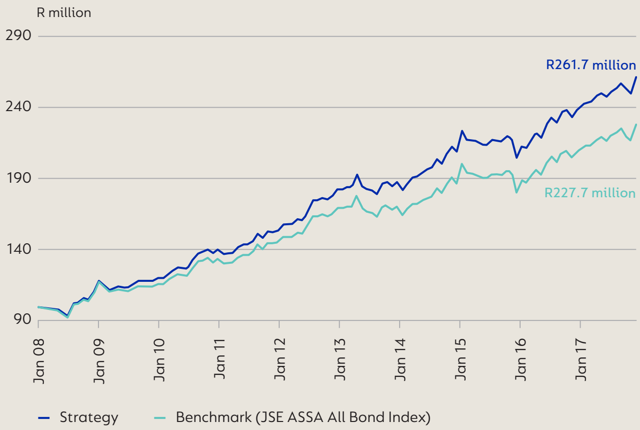
The Coronation Strategic Bond strategy has delivered an annualised return of 10.1% since inception in 2008. The strategy has outperformed its benchmark (the JSE ASSA ALBI) by 1.5% per annum.

STRATEGY RETURNS GROSS OF FEES (AS AT 31 DECEMBER 2017)

Period	Strategy	Benchmark	Active return
Since inception (cumulative)	161.7%	127.7%	34.0%
Since inception per annum	10.1%	8.6%	1.5%
Latest 5 years per annum	7.7%	6.3%	1.4%
Latest 3 years per annum	8.0%	6.9%	1.1%
Latest 1 year	11.1%	10.2%	0.9%
Year to date	11.1%	10.2%	0.9%
Month	5.7%	5.7%	0.0%

Source: Coronation

GROWTH OF R100 MILLION INVESTMENT



Source: Coronation

PORTFOLIO CONSTRUCTION

The portfolio is positioned according to a long-term strategic market view, but this is balanced by taking advantage of shorter-term tactical opportunities when the market lags or runs ahead of that strategic view.

As an actively managed strategy, investment opportunities across the full spectrum of potential return enhancers are considered. These include duration and yield curve positions, inflation-linked assets as well as yield enhancement through credit enhanced assets. Coronation's highly rated fixed interest investment team is quick to take advantage of opportunities as they present themselves in a changing environment.

Coronation's own proprietary fundamental economic and fixed income research forms the backbone of the investment process. Returns are maximised by actively combining a top-down approach (deriving the macroeconomic view which drives the bond investment cycle) and a bottom-up approach (generating a fair value for bond yields) in portfolio construction.

A portfolio with the required targeted modified duration and yield curve position is constructed by the careful selection of individual instruments on the basis of the expected return they can contribute to the performance of the fund. We make use of derivatives for risk management when optimal to do so.

ASSET SELECTION

Projected total returns for each instrument in the strategy's universe are calculated based on Coronation's view of the overall future direction of interest rates, the shape of the yield curve going forward and expected changes in credit spreads for particular bonds over the course of the following 12 months.

These factors are balanced against their liquidity and credit risk constraints; for example, due to its higher tradeability and low-risk nature, a government bond will carry a higher inclusion limit than a nongovernment bond.

Coronation maintains a very conservative approach to credit risk; the strategy aims never to put capital at asymmetric risk. Credit selection is primarily focused on mitigating downside risk. We combine detailed analysis with rigorous pricing techniques, drawing from the knowledge and experience of our broader investment team during this process. Our aim is to ensure that the credit spread adequately compensates us for the underlying risk of the entity.

Detailed proprietary research is conducted on issuers and structures to determine their full spectrum of risks and to determine a fair value for the assets, both at issue date and during the life of the instrument.

Our property investment strategy includes fundamental analysis of individual counters. We invest where we believe the total return as a result of our fair value yield and distribution growth (together with a healthy margin of safety) is superior to that of the other investable asset classes.

Coronation incorporates environmental, social and governance factors when evaluating investments. For debt securities, we assess the impact on issuer cash flows and the ability to repay debt, and require additional credit spread to compensate for the risk. Governance factors such as corruption and political risk can also affect sovereign issuers' willingness to repay their debt.

CURRENT POSITIONING

In Coronation's view, the strategy's current neutral positioning in government bonds reflects appropriate levels of caution, given the risks in 2018 emanating from potential policy inaction and the possibility of SA's exclusion from the Citigroup World Government Bond Index.

SA government bonds should benefit from renewed optimism and contained inflation. However, given the aforementioned risks, at current levels, these bonds are trading at their fair value; we require more attractive levels to enter overweight positions.

The strategy's yield remains attractive relative to its duration risk and it is invested only in assets and instruments that we believe have the correct risk and term premium, to limit investor downside and enhance yield.

The strategy reduced exposure to corporate credit over the second half of 2017 as spread-tightening rendered certain issues unattractive. However, we continue to maintain holdings in those issues where we see selective value.

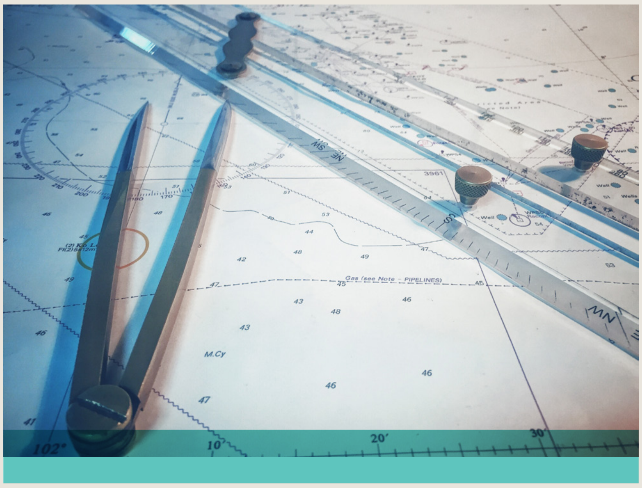
In the listed property sector, the current weighted average yield of 7.9%, when combined with its projected 5% to 7% annualised distribution growth over the next few years, results in an attractive total return relative to long bond yields. The strategy maintains higher than normal holdings in listed property counters that offer strong distribution and income growth with upside to their net asset value valuations.

ILBs had a tumultuous year, underperforming bonds and cash considerably. Given the current implied market breakeven inflation levels, we still see little value in ILBs with a maturity of greater than seven years. +

ASSET ALLOCATION (AS AT 31 DECEMBER 2017)

Asset type	% strategy
Fixed rate government bonds	65.9%
Fixed rate corporate bonds	14.0%
Property	8.8%
Floating rate corporate bonds	7.0%
Corporate inflation-linked bonds	1.6%
Fixed rate negotiable certificates of deposit (NCDs)	1.0%
Fixed rate other	1.0%
Floating rate NCDs	0.4%
Cash	0.2%
Preference shares	0.1%

Source: Coronation



International portfolio update

CORONATION GLOBAL EQUITY FUND OF FUNDS

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Jul 00	25.13%	9.46%	12.77%	6.90%
Benchmark		23.97%	9.85%	12.24%	4.93%

Annualised, quoted in USD
Sources: Coronation, Bloomberg

The fund advanced 5.1% against the benchmark return of 5.7%. This brings its one-year performance figure to 25.1%, compared to the MSCI All Country World Index (ACWI) return of 24.0%.

Japan was the best-performing region this quarter, rising 8.5% (in US dollar terms). The weakest return came from Europe, which rose 2.3% (in US dollar terms). The Pacific ex-Japan region returned 7.1% and North America rose 6.4%, while emerging markets advanced 7.1% (all in US dollar terms). The fund continues to be overweight North America, underweight Europe and Japan, and overweight emerging markets.

Among the global sectors, information technology (+8.1%), materials (+7.6%) and energy (+5.9%) generated the best returns. The worst-performing sectors were utilities (-1.0%), healthcare (+0.6%) and telecommunications (+0.9%). On a look-through basis, the fund benefited from its overweight positions in information technology and consumer discretionary and its underweight positions in utilities and telecommunications. Its underweight positions in energy and materials detracted from performance.

>

In general, the underlying managers had a weak quarter, although two of the fund's holdings (Lansdowne Developed Markets Strategy and Contrarius Global Equity) delivered very strong returns over the period.

Egerton Capital lagged the index over the quarter, but has otherwise had a very good year. Detractors from its performance include Ryanair (which declined 8% due to cancellations and pilot strikes) and Charter Communications (which also declined 8% after losing more customers than expected). The fund was further held back by its low exposure to resources.

Coronation Global Emerging Markets Equity had a difficult quarter, although its return for the one-year and longer-term periods remain very strong (refer to page 37 for a detailed commentary). Magnit, the Russian retailer, declined 33% after raising equity, while X5 Retail Group (a competitor to Magnit), declined 16%. Ctrip (Priceline, Expedia) fell 16%. The fund did have some good performers including Porsche, which rose 29% after the dismissal of long-outstanding lawsuits against the company, and Chinese insurers Ping An Insurance Group (+36%) and AIA Group (+16%), which benefited from a relaxation in regulations. However, these gains did not offset the detractors.

Maverick Capital and Tremblant Capital also closed the quarter behind the index. Maverick was again held back by its healthcare exposure after the industry recorded another poor earnings quarter. Tremblant, in turn, held UniCredit (-14%), The Tile Shop (-24%) and Telefónica Deutschland (-11%).

Contrarius and Lansdowne both generated strong alpha for the quarter. Contrarius benefited from its large weighting to energy and materials companies, while Lansdowne benefited from exposure to airlines and banking stocks.

Global growth is strong and a key consideration for 2018 is whether the pace of expansion would be curbed by inflationary pressures arising from such growth. A recent Bloomberg survey indicated that the consensus was for little or no acceleration in global inflation. Monetary policy is expected to remain benign, with markets anticipating two to three rate hikes by the US Federal Reserve (Fed) in the medium term. The ECB has already guided that its quantitative easing programme would last until at least September 2018 and that rates would be on hold until well past this date. The Bank of Japan, in turn, is not looking to change its relaxed monetary policy any time soon. It would be prudent to watch closely for any surprises on the upside that may modify these positions.

CORONATION GLOBAL EQUITY STRATEGY

	Launch date	1 year	3 years	5 years	Since inception
Strategy	14 Nov 14	26.89%	9.45%	-	8.55%
Benchmark		23.97%	9.30%	-	8.69%

Annualised, quoted in USD
Sources: Coronation, Bloomberg

The last quarter of 2017 continued to bring good news and strong returns to equity investors worldwide. A combination of surprisingly strong economic data points (especially in regions such as Europe and China) and a relatively benign outlook on interest rate normalisation in the US fuelled equity markets to new highs. Investor euphoria grew even stronger when the US legislative forums agreed to a radical reform of the US tax system, one of the cornerstones of the Trump administration's efforts to kick-start growth in the US economy. The headline corporate federal tax rate is proposed to drop from 35% to 21%, in return for the introduction of a territorial tax system. This will result in US-based multinational companies paying slightly more tax on their non-US earnings but seeing a drastic reduction in domestic tax rates. At the time of writing, much of the detail remains unclear, but it does not take away from the fact that this is a significant event that in the short term will lead to a jump in the earnings of the Standard & Poor's (S&P) 500 Index of around 7% to 10%, and in the longer term could propel the US economy onto a higher growth path.

Global equity markets returned 5.7% over the past quarter, and a very strong 24.0% over 2017. The S&P 500 ended the year with a positive return in every month – a historic first. Inflationary pressures around the world continued to surprise on the downside and global central bank liquidity remained at close to peak levels throughout the year. This scenario culminated in very low volatility levels, with the cost of protection on equity markets continuing to reach new lows at the time of writing.

Emerging markets had a blowout year, producing 37.8%, with China registering the strongest performance among the grouping (+54.3%). Within developed markets, performances were closely aligned, with Europe and Japan marginally outperforming the US. This was primarily as a result of the weaker dollar, as the US performed better than most other markets in local currency terms. The dollar weakened by 14% against the euro over 2017. However, over the longer term, the US equity market has performed significantly better than any of the other developed equity markets.

While there was not much diversion among the performances of the various sectors, healthcare continued to lag, as did utilities and telecommunication services. Energy stocks benefited surprisingly little from a strong rebound in the oil price, resulting in energy (+6.9%) being the worst-performing subsector on the MSCI ACWI over 2017. Energy is probably the sector (outside of real estate) that stands to benefit the least from the tax reform. Information technology was the best-performing sector, with an annual return of 41.8%. Other notable laggards were telecommunications (+8.1%) and utilities (+14.1%).

The strategy performed well against this backdrop. Its gross return of 26.9% for 2017 should be viewed against a very strong performance in 2016, which means that alpha for the two-year period now amounts to 4.3% per annum. Over three years and since inception, the strategy performed more or less in line with its benchmark, given the very challenging first year of the fund's existence.

The biggest positive contributor this quarter was L Brands, a position that we have previously discussed in detail. It bounced back spectacularly from highly oversold levels, but subsequent to quarter-end sold off in response to poorer than expected Christmas trading numbers. Other strong contributors over the quarter included Fox (on the back of a proposed takeover by Disney), Amazon, Spirit Airlines (a low-cost US airline introduced into the portfolio a few quarters ago), Naspers and Intu Properties (after announcing a merger with Hammerson).

By far the biggest detractor was Altice NV, a new position that was severely punished by the market for producing poor trading numbers (especially in its French operation), which led to concerns about Altice's ability to service its reasonably high debt levels. Other disappointments included Allergan (a loss of patents and an adverse court outcome), Newell Brands (a poor trading update), and CVS Caremark and Walgreens (both were punished due to fears that Amazon will enter the retail pharmacy market).

Over the last year, Fortress remained our biggest positive contributor, following its takeover by Softbank. Estácio and JD.com added significantly to performance, as did most of our other alternative asset managers (Apollo Global Management, KKR and the Carlyle Group). The strategy's internet positions (Amazon, Naspers and Facebook) benefited from the strong uplift in the sector. The biggest detractors over 2017 were Altice NV, Allergan and the retail pharmacy stocks Walgreens, CVS Caremark and Rite Aid. Put options to protect the fund from a significant drawdown cost the fund 28 basis points (bps) over the 12-month period.

The US tax reform signed into law is a game-changing event, and investors should expect the portfolio to change once the details of the programme have been fleshed out. During the last quarter our decision to increase the fund's exposure to US cable stocks Comcast Cable Communications, Charter and even Altice NV was partly influenced by the fact that this sector will be a prime beneficiary of the proposed changes. The sector is almost exclusively focused on the US domestic market, provides for tax at the maximum rate, and is a significant investor in capital equipment, which will receive preferential tax deductions in terms of the current proposals. While the outcome of the tax reform initiative remained uncertain until just before Christmas, some of these stocks have reacted strongly before and after the bill has been passed. We will continue to assess investment opportunities with an open mind, but are also conscious of the fact that in a competitive environment like the US, there is a chance that at least some of the benefits of the tax reform will be competed away.

CORONATION GLOBAL MANAGED STRATEGY

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Nov 09	17.89%	7.02%	9.32%	9.41%
Benchmark		17.09%	6.78%	7.42%	7.32%

Annualised, quoted in USD
Sources: Coronation, Bloomberg

The strategy performed well over the quarter. For the year its gross return of 18.0% is very strong in absolute terms, and ahead of the benchmark return of 17.1%. The strategy has outperformed its quantitative benchmark over all meaningful periods, and since inception almost eight years ago, this outperformance amounts to an impressive 1.82% per annum.

It is gratifying to note that the strategy's equity carve-out beat the MSCI ACWI benchmark comfortably over one and three years, and marginally over five years. The property carve-out was particularly strong over one year, yielding a return of 24%. This subsector of the fund added significant value relative to the global bond index, which is being considered the alternative.

Our credit positions underperformed the global bond index over the last year, which was expected given our conservative positioning in this bucket. The merger arbitrage bucket detracted from performance after our Rite Aid position was negatively impacted by the renegotiated terms of the deal with Walgreens. The strategy's direct gold position contributed positively.

Probably the biggest detractor to performance was the decision just over a year ago to reduce the equity exposure in the fund to below the benchmark weight of 60%. We finished the year with an exposure of around 55%, and given how strong equity markets performed, the opportunity cost to the fund was material. We continue to manage the risk profile of potential returns, and therefore felt that it was the appropriate thing to do. We remain underweight equities in our positioning, as we believe that the current trading levels are discounting a lot of good news.

Please refer to the Global Equity Strategy commentary on page 36 for the fund's equity performance.

With regard to the other asset classes, we remain concerned about the level of long-term interest rates, and as such remain negative about the outlook for global bonds. We also think credit markets are discounting a benign outcome in terms of corporate defaults, and have very low exposure to this asset class. Listed property still looks appealing to us in some of the geographies, and we will continue to selectively add to this sector over time.

CORONATION GLOBAL EMERGING MARKETS STRATEGY

	Launch date	1 year	3 years	5 years	Since inception
Strategy	14 Jul 08	40.67%	8.71%	7.12%	8.62%
Benchmark		37.28%	9.21%	4.56%	3.83%

Annualised, quoted in USD
Sources: Coronation, Bloomberg

The Coronation Global Emerging Markets Strategy returned 40.7% in 2017, which was 3.4% in excess of the benchmark's return of 37.3%. In our view, longer time periods are a far more meaningful indicator of performance, and in this regard the strategy has outperformed the market by 4.8% per annum since inception nine-and-a-half years ago. Over seven years and five years, the strategy has outperformed the market by 4.0% per annum and by 2.6% per annum, respectively.

The largest positive contributors to alpha over 2017 were Naspers (+89.3%, a 2.6% contribution), 58.com (+155.2%, a 2.6% contribution), Estácio (+99.0%, a 1.6% contribution), JD.com (+63.2%, a 1.2% contribution) and Porsche (+55.8%, a 0.96% contribution). Other notable positive contributors (with a larger than 0.5% contribution) were Hering, Melco Resorts & Entertainment, >

Sberbank and Brilliance China. In terms of detractors, Magnit was the single largest detractor (with a -3.6% contribution), followed by Steinhoff (a -3.4% contribution) and not owning Tencent (a -2.7% contribution, although this was largely offset by Naspers's positive contribution). Smaller negative detractors included Samsung (a -1.3% impact from not owning the stock for most of the year), Tata Motors (a -1.2% contribution) and Alibaba (a -1.1% contribution, although this was partly offset by a 0.4% positive contribution from Altaba).

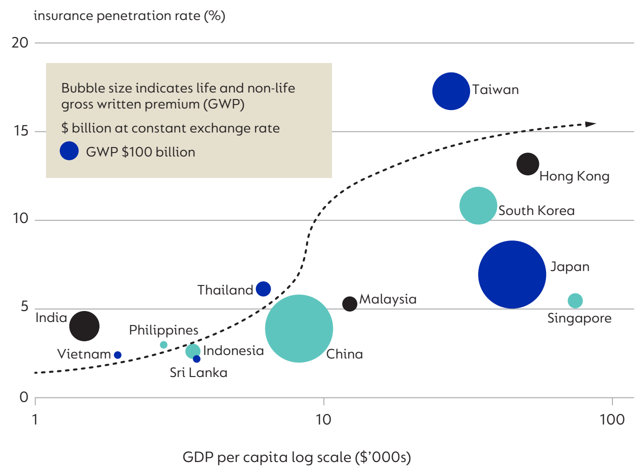
By country, the three largest positive contributors were China (with a +3.1% contribution which largely came from the Chinese internet stocks, but also from Brilliance China Automotive and Melco Resorts), Brazil (with a +3.0% contribution, mainly from the Brazilian education companies and the clothing retailer Hering) and Taiwan (a +1.4% contribution). The three largest negative contributors by country were Russia (with a -2.4% contribution, largely from Magnit), Korea (a -1.8% contribution) and India (a -1.5% contribution).

In terms of strategy activity over the past quarter, there were four new buys: Ping An (2.3% of strategy), Samsung Electronics preference shares (2.1% of strategy) and smaller new positions in Fomento Económico Mexicano (Femsa) (0.6%) and Reckitt Benckiser (0.5%). We also added to existing positions in Magnit, X5 Retail and Ctrip (all three of these as a result of weak share prices with little change in their long-term prospects, in our view, and the resultant increased upside to fair value), Yes Bank and Indiabulls Housing Finance (following a financials research trip to India in November).

In terms of positions sold, the strategy sold out of Melco Resorts, Norilsk Nickel and Discovery (all three had performed strongly and reached our estimation of their fair value), and also out of Anheuser Busch (better value was represented in other consumer staples like Heineken and British American Tobacco, which we added to, as well as the new Reckitt Benckiser buy). We also reduced the positions in Hering, Taiwan Semiconductor and YUM Brands (all three were getting closer to fair value due to share price appreciation) and also in Axis Bank (with better value represented in other selected Indian financials).

Ping An, the largest private insurance company in China, was the largest new purchase in the strategy over the quarter. The company has 153 million customers in China, and besides insurance products (life and non-life) it also offers asset management and banking services. The company is extremely entrepreneurial, with a founder chairman who is still very involved in the business and who owns a significant stake. Ping An's value of new business has grown by 33.7% per annum over the past five years, net profit by 32.8% per annum and dividends per share by 35.1% per annum over the same period. China has one of the lowest penetrated insurance markets in the world, and Ping An has a number of competitive advantages – a high-quality brand, a large and productive sales force (1.4 million agents with industry-leading productivity), and significant investment in technology and the resultant leadership in financial technology. It is also privately run, compared to most competitors who are state owned. These advantages ensure that Ping An is well placed to take a high share of the growing Chinese insurance market over time.

UNDERPENETRATED INSURANCE MARKET IN CHINA

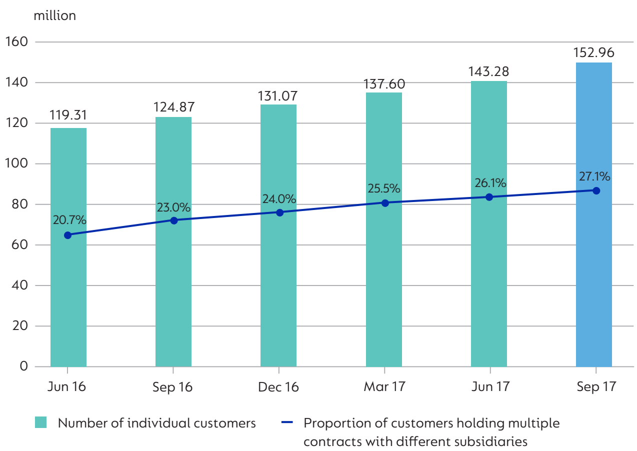


Source: Bank of America

While we have not owned Ping An before, we have followed it for many years and have owned AIA (the pan-Asian insurer and a key Ping An competitor in China) for the past few years, as well as Discovery (a joint venture partner to Ping An in China) until recently. Over time, these holdings have given us additional (positive) insight into the company. We have always held the view that the insurance assets of Ping An are very good and that the company is entrepreneurial and well run. In contrast, Ping An Bank (part of the Ping An Group) has historically been a concern to us, but over time, as the insurance business has grown at a high rate, the contribution from the bank has declined and is now only 17% of profits (from 35% of profits a few years ago) and a far smaller part of our fair value.

Besides an underpenetrated insurance market, in our view Ping An has the opportunity to continue to drive cross-selling through its large customer base. As can be seen from the graph below, over the past five years the cross-selling ratio (the percentage of customers who have more than one contract with the Ping An Group) has increased from 20.7% to 27.1%. The use of technology, together with a productive, well-paid and incentivised agency force should lead to further gains.

PING AN: IMPROVEMENTS IN CROSS-SELLING TO CUSTOMERS



Source: Ping An

Ping An generates a return on embedded value north of 20% and today trades on around 14 times earnings (9 times embedded value earnings), with a 2% dividend yield. Given the long-term prospects for Ping An, we believe this is a very attractive valuation.

The strategy has not owned Samsung for a few years but in the last quarter bought a new 2% position in Samsung Electronics preference shares, which trade at a 20% discount to its ordinary shares. Over time we have become more positive about the long-term prospects for the semiconductor industry (which now makes up c. 65% of Samsung's profits) as the industry has continued to consolidate and as additional revenue streams (such as 'Big Data' and artificial intelligence) have emerged. In recent months, two of the analysts in the Coronation Emerging Markets and Global Developed Markets teams have been researching two semiconductor companies (ASML in Europe and Applied Materials in the US), and this work has further contributed to a more positive long-term view of the industry. That said, the industry is cyclical and will continue to be so, and it is this cyclicality and concern over the industry's profitability in 2018/2019 that have resulted in Samsung's share price declining over recent months. In our view, semiconductor profitability is indeed above normal and this is very likely to result in earnings pressure in the year or two ahead.

However, the valuation of the Samsung preference shares in particular are very attractive (c. 5.5 times 2018 earnings with a 3.5% dividend yield), and given the more favourable long-term prospects for the industry we believe that this is an attractive entry point. Our two main concerns with Samsung over the past few years have been whether the high profitability of the semiconductor division could be sustained, and poor corporate governance, as indeed is the case with most South Korean companies. In this regard, besides the improvement in the long-term prospects for the semiconductor industry, there have in recent times also been corporate governance improvements at Samsung Electronics, including the effective separation of the chairman and CEO roles, and a change in the capital return policy, with a doubling of the dividend and a commitment to pay out 50% of free cash flow to shareholders between 2018 and 2020.

Femsa (0.6% of strategy) is a company that the strategy has owned in the past but has not owned for some time due to valuation. A recent decline in the share price, as well as the sharp depreciation of the Mexican peso, brought the share into buying range for a brief period. Femsa owns two great assets, which together make up over 70% of the value of the company – the Oxxo convenience stores and pharmacies in Mexico and the rest of Latin America (c. 50% of our valuation), and a stake in Heineken (c. 22% of our valuation). Its third major asset is a majority stake in Coca-Cola Femsa (c. 20% of our valuation) which is the largest Coke bottler in Latin America and the second largest Coke bottler in the world. In our view, this is a decent asset that generates significant cash but which faces some long-term challenges. Overall, given its mix of assets, Femsa is in our view a high-quality asset which owns very cash-generative assets and has shown strong capital allocation skills over long periods of time.

Reckitt Benckiser (0.5% of strategy) was the last small buy during the quarter. Reckitt is in our view one of the best-run global consumer companies and the owner of some of the best consumer health brands out there (including Durex, Nurofen, Strepsils, Clearasil and Gaviscon). Emerging markets contribute 41% of group earnings and are growing at a far higher rate than developed markets. In recent times, Reckitt has produced disappointing sales and earnings growth, which in turn resulted in a large decline in its share price. Whilst Reckitt undoubtedly faces some challenges, in our view the below-average performance is temporary in nature and the share price decline enabled us to buy a stake in this high-quality business at an attractive price.

We continue to travel widely to meet with companies we own, or are interested in purchasing for the strategy, and trips to both Brazil and India are planned for the first few months of 2018. While emerging markets have appreciated strongly over the past year, we continue to find good selected value and the overall upside of the portfolio – our assessment of fair value versus current share prices – is around 40% on a weighted average basis.

CORONATION AFRICA FRONTIERS STRATEGY

	Launch date	1 year	3 years	5 years	Since inception
Strategy	1 Oct 08	36.93%	(0.72%)	5.65%	10.17%
Benchmark		1.29%	0.79%	0.58%	0.59%

Annualised, quoted in USD
Sources: Coronation, Bloomberg

The performance of markets across Africa continued to be strong over the past three months. The strategy's gross return was 9.9% during the quarter, compared to its benchmark (3 Month USD Libor + 5%) which was up 1.6%, and the FTSE/JSE All Africa ex-SA 30 Index, which gained 3.3%. For the year, the fund delivered 36.9% compared to the All Africa ex-SA 30 Index, which returned 29.0%.

In 2017, many African markets rebounded strongly after two very painful years in 2015 and 2016 (see the graph below).

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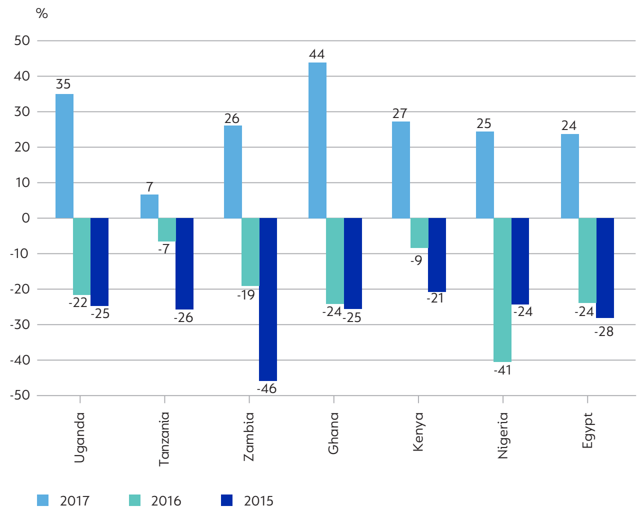
A LOT CAN CHANGE IN A YEAR

One-year US dollar returns for selected African markets



Source: Bloomberg

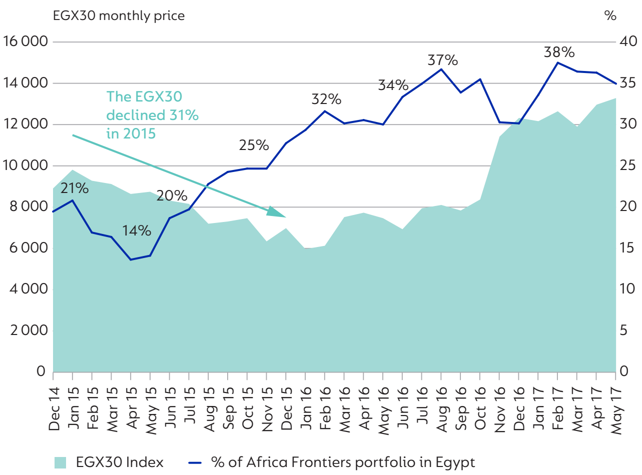
Nigeria gained 24.5% on the back of a number of positives which included the introduction of the Nigerian Autonomous Foreign Exchange (NAFEX) exchange rate window; the easing of forex liquidity pressure and normalisation of the parallel rate in response; and increased oil production and the opening of the Forcados terminal after its 16-month closure, combined with a more sustainable agreement with rebel forces. Similarly, Kenya (+27.5%), Egypt (+24.1%), Ghana (+44.0%) and Uganda (+35.0%) all gained.

If there had to be a theme across African markets for 2017, it would probably be that 'a lot can change in a year'. While Zimbabwe, Nigeria and to a lesser extent Kenya all bear testament to this, the real poster child must surely be Egypt. This time last year, Egypt was dealing with a year of foreign exchange shortages and economic pain that ultimately culminated in the November flotation of the Egyptian pound. The value of the pound plummeted, inflation skyrocketed and equity investors held their breaths.

One year on, the country has seen $19 billion of inflows into government debt (as at October 2017) and c. $1 billion of net foreign purchases in the equity market. For the year, the dollar value of the equity market is up 24.1%, compared to a decline of 24.0% in 2016 (see the graph below). Local dollar migration into formal channels has been astounding, totalling an estimated $35 billion since the float, while another $15 billion was remitted from outside of Egypt in the first three quarters of 2017. In the corporate sector, Egyptian companies finally gained access to US dollars again – although at the cost of higher interest rates and inflation, which also resulted in consumers' disposable income being squeezed. Encouragingly, businesses have adjusted well, with third-quarter results showing some green shoots as volumes recovered. While inflation (26% in November) and interest rates (c. 20% in December) remain elevated, we believe company earnings are on the path towards normalisation and valuations continue to look attractive.

IGNORING THE MACRO NOISE

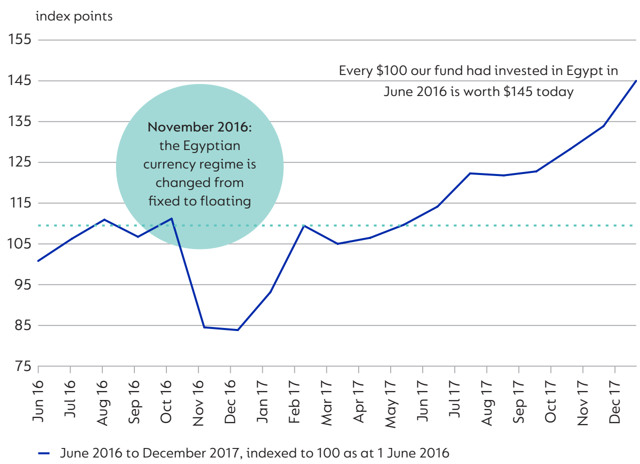
Egyptian exposure of the Africa Frontiers Fund vs. the EXG30



Sources: Coronation, Bloomberg

Our holdings in Egypt have performed very well for clients, in part due to the fact that we built large positions in high-conviction ideas that were trading at what we believed to be very attractive valuations and below-normal earnings when many other investors had written off the market. This required us to ignore the macroeconomic noise. In 2015, for example, the Egyptian market was down 30.9% while our fund's exposure to Egyptian equities went from 20% to 28% and increased further to 34% by June 2016 (see the previous graph). As at the end of December 2017, every $100 we had invested in Egypt in July 2016 was worth $145 (see the graph below).

AFRICA FRONTIERS: EGYPT HOLDINGS' RETURN IN US DOLLARS



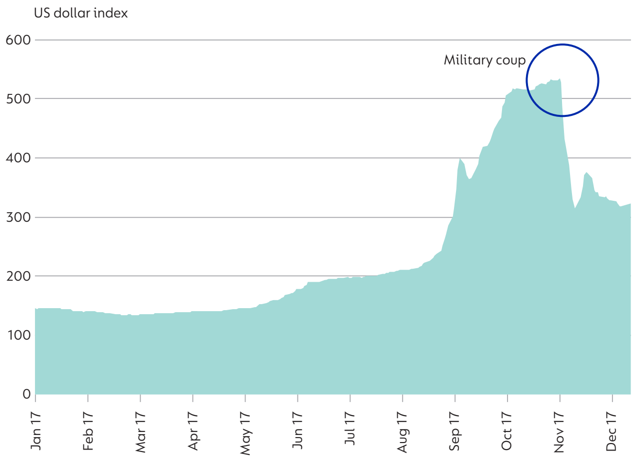
Source: Coronation

Our holdings of Egyptian equities and bonds remain the largest geographic exposure in the fund as we continue to believe that companies are trading below their intrinsic value. In 2017, roughly half of the fund's performance was contributed by our Egyptian holdings, which included Eastern Tobacco (Egypt's monopoly tobacco manufacturer), EIPICO (an Egyptian pharmaceutical manufacturer that is a market leader in the export sector) and Commercial International Bank (Egypt's largest private sector bank).

In light of our experience in Egypt and seeing first-hand just how much can change in a year when the business environment improves for companies, we are particularly excited about our holdings in Zimbabwe. In the previous quarterly commentary, we wrote about the dire currency situation. Zimbabwe's economic and political issues are well known. However, in the fourth quarter we saw the end of 37 years of dictatorial rule by Robert Mugabe. The rapid unwind of the stock market (see the graph on the next page) since the military coup is proof of the return of confidence in some level of currency normalisation. Those who had been using equities as safe havens appear to be building up cash again in the hope of a return to currency liquidity.

We share our views on the Zimbabwean landscape on page 12, but in short, we do not believe the economic damage done under Mugabe is irreversible. Zimbabwe is a deeply blessed country with unrivalled mineral and human resources. Allowing its people to get on with life unfettered and providing capital a degree of security will be transformational. Yes, forecasting the outcome and intention of the new roleplayers is tricky. We do know, however, that those vacating the throne had long outlived their usefulness. Being a long-serving dictator is increasingly a lonely and endangered pastime. This is a good thing for citizens and investors alike.

ZIMBABWE INDUSTRIAL INDEX



Source: Bloomberg

At Coronation, we have been patient investors in what we believe are very high-quality companies in Zimbabwe. We currently recognise our holdings in Zimbabwe at our internal fair value, but as share prices have given up some of the paper gains of recent months, if one were to look at current prices adjusted for the Old Mutual discount, our positions are worth quite a bit more.

A little over a year ago, our funds were heavily invested in three markets with delinquent currency exchanges: Egypt, Nigeria and Zimbabwe. The first two have since normalised and proved very profitable for our clients. For the patient investor, we believe that Zimbabwe will ultimately prove so too.

CORONATION GLOBAL FRONTIERS STRATEGY

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Dec 14	35.50%	7.23%	-	7.33%
Benchmark		1.29%	0.79%	-	0.78%

Annualised, quoted in USD
Sources: Coronation, Bloomberg

Over the past three months, the strategy delivered a gross return of 10.1% compared to the benchmark (3 Month USD Libor + 3.5%), which was up 1.3% and the MSCI Frontier Markets Index, up 5.6%. It was a strong quarter across the frontier universe, with Vietnam (+23.4%), Argentina (+15.3%), Egypt (+8.1%), Nigeria (+7.9%), Kenya (+5.5%), Bangladesh (+2.5%), Qatar (+2.5%) and Morocco (+2.1%) doing well. Kuwait (-4.1%), Pakistan (-2.0%) and Sri Lanka (-1.1%) lagged.

For 2017 as a whole, the frontier universe also saw some very strong market performance, with Vietnam (+59.5%), Argentina (+51.9%), Kenya (+27.5%), Egypt (+24.1%), Bangladesh (+18.4%), Morocco (+15.3%), and Kuwait (13.0%) all doing well. During the year, Pakistan was down 14.3% on the back of numerous factors, including the country's upgrade into the MSCI Emerging Markets Index, the resignation of its prime minister following the 'Panama Paper' leaks, the removal of the central bank governor and chairman of the securities and exchange commission, the indictment of the finance minister and foreign investors becoming increasingly concerned about the possibility of a devaluation of the rupee. Qatar (-18.9%) and Oman (-11.7%) were down while Sri Lanka (-0.2%) and Saudi Arabia (+0.3%) closed the year flat. Over the year, the fund returned 35.5% compared to the MSCI Frontier Markets Index, which was up 31.9% and the benchmark (3 Month USD Libor + 3.5%), which was up 4.8%.

This quarter also saw the three-year anniversary of the fund. Over this period, the fund's annualised return of 7.2% per annum outperformed both the benchmark return of 4.3% per annum and the MSCI Frontier Markets Index return of 5.0% per annum, placing it in the top third of frontier funds[1]. While this is still early days, we are very pleased with the fund's track record thus far.

We are a firm believer in running concentrated portfolios of high-conviction ideas. We believe that this is a key differentiator of the fund compared to many other 'active' funds that hold a significant number of stocks and often look more like an index than a portfolio. The impact of a concentrated portfolio is that a handful of stocks can have a significant impact on performance. 2017 bore testament to this. Over the year, the main contributors to the fund were two stocks, Eastern Tobacco and BRAC Bank, which contributed a combined 10.4% to the fund's performance.

We continue to believe that the fund holds some incredibly exciting companies that trade at well below our estimate of their intrinsic value. We are also often able to find businesses that just do not exist in other, more developed, markets. We have highlighted two of these opportunities below.

Al Eqbal Tobacco. Al Eqbal is the global market leader in shisha molasses sales, with an estimated 40% market share by volume and a 60% share of the profit pool. Al Eqbal is a dominant global multinational with a market capitalisation of only c. $1 billion. The company is best positioned to benefit from shisha increasing in popularity globally, and from an industry in the midst of formalising. The runway for growth is long.

Grameenphone. Grameenphone is the mobile market leader in Bangladesh, with 53% share of industry revenue and the largest network coverage. Bangladesh has a population of 163 million people and is the densest among those countries with a population of more than 10 million. The number of towers or base stations needed to provide coverage to the country is relatively low. This results in the cost to service the population being very low and profitability per tower is thus incredibly high. It is this dynamic which allows Grameenphone to achieve very healthy and sustainable earnings before interest and tax margins despite Bangladesh having some of the lowest call rates globally.

We continue to remain focused on identifying companies in global frontier markets that trade below our estimate of their intrinsic value. By doing so, we believe that the fund will perform well and deliver attractive returns to our investors.

[1] We monitor the performance of 26 frontier fund managers on a monthly basis; all data, sourced from Bloomberg, reflect managers' gross returns and include dividends where they are paid/reinvested.

CORONATION GLOBAL BOND FUND

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Oct 09	9.61%	4.09%	1.98%	3.68%
Benchmark		7.40%	1.97%	0.26%	1.49%

Annualised, quoted in USD
Sources: Coronation, Bloomberg

Core developed markets posted modest returns over the quarter as the upswing in global growth continued and inflationary pressures remained absent. Corporate bonds enjoyed another strong three-month period as risk appetite continued to be healthy. Support for emerging markets remained robust with the performance of outlying markets, for the most part, driven by political developments. Despite rising short-dated yields, the US dollar continued to languish. The fund returned 1.21% for the quarter and 9.61% for 2017, compared to returns of 1.08% and 7.4% respectively from the Bloomberg Barclays US Aggregate Bond Index.

Volatility within the US Treasury market remains very low, with 10-year yields having traded around 2.35% for most of the quarter and one-year realised volatility having fallen to its lowest level since the early 1980s. Meanwhile, the US yield curve has continued to flatten aggressively, with two-year yields rising 40 bps during the quarter, while 30-year yields fell 10 bps. The vast majority of the movement in rates during the quarter came through changes in real rates, given that breakeven rates were very stable throughout the period. The Fed raised the Fed funds rate by another 25 bps in December (the rate's upper band is now 1.5%), and its projections suggest a further three rate hikes in 2018. This is in contrast to the market, which currently prices only two rate hikes. Jay Powell, a Fed governor since 2012, is set to replace Janet Yellen as chairperson in February. While markets do not anticipate material policy changes, Powell's apparent willingness to embrace the nitty-gritty of financial markets may prove valuable as the Fed continues to wind down its balance sheet.

THE CHALLENGE FOR CREDIT MARKETS IN 2018 WILL BE HOW THEY WEAN THEMSELVES OFF THE SUPPORT THAT HAS EMANATED FROM CENTRAL BANKS' QUANTITATIVE EASING PROGRAMMES.

When the Fed updated its Summary of Economic Projections in December, its GDP projection for 2018 rose from 2.1% to 2.5%. The subsequent minutes revealed this amendment captures some of the anticipated effect (seen at around 0.5% in 2018 and probably slightly less for 2019) from the tax reform package that was passed in December. Longer-term expectations for GDP growth were left unchanged and most economists are sceptical of the administration's claims that the reform will lead to a sustainable boost to growth. Given the already tight conditions in areas such as the labour market, it is more likely that the reform (which comes with a frontloaded bias) will merely magnify the cyclicality of the current cycle.

It may seem odd that the debt ceiling issue remains unresolved at the very time the US has passed $1.5 trillion worth of tax cuts (over a period of 10 years), 30% of which will be frontloaded over 2018 and 2019, boosting the fiscal deficit by just under 1% in these two years. A divided Congress had to agree on a long-term spending bill by 19 January to avoid another government shutdown, with the new tax bill potentially bringing forward the date (to mid-March) at which the US Treasury will exhaust its cash reserves. To add to the fiscal mix, the Trump administration, now emboldened by the passage of the tax bill, has said it will make infrastructure the next big legislative priority. However, delivering tax cuts to the already healthy consumers and private sectors of the economy will make it more difficult to fund any upgrades to the country's ageing public infrastructure that could improve the economy's competiveness and potential growth rate.

While we believe US Treasuries are less expensive than some developed markets, we still expect a gradual rise in US yields, in particular in maturities beyond five years where we believe the aggressive yield curve flattening (and lack of term premium) has gone too far.

During the quarter, the fund switched some of its exposure to ten-year maturities into five-year maturities.

Sentiment towards Europe has improved markedly and economic activity looks balanced and sustainable, with euro area GDP likely to be around the mid-2% level in 2018. Core inflation measures signal that some upward pressure is under way, and pressures on wage growth are also likely to become more prominent in 2018. For now though, the ECB's commitment to ultra-low rates and continued quantitative easing remain extremely powerful drivers of yields. Markets expect the ECB's deposit rate to remain negative until early 2019, guided by ECB president Mario Draghi's comments that rates will not change until 'well past' the end of its asset purchase programme (current purchases will fall from €60 billion to €30 billion a month from January 2018), which is expected around the third quarter of 2018.

In the UK, Gilts performed well despite the Bank of England (BOE) reversing the 0.25% emergency rate cut in November that has been put in place following the Brexit referendum decision. The UK was deemed to have made 'sufficient progress' to begin phase two of Brexit negotiations. While that may seem encouraging, it merely brings one closer to the make-or-break decisions that need to ultimately take place. With inflation above target, it seems likely that the BOE will hike rates again during 2018. With long real yields in deeply negative territory, there seems little value given the uncertain backdrop.

The Emerging Markets Bond Index spread was little changed during the quarter, at 310 bps. Sentiment remains supportive, with the view that developed rates are unlikely to rise far enough to undermine the hunt for yield. Local currency debt should, for the most part, garner some support from benign inflation outlooks, amidst a softening in food prices. Debt metrics are arguably decelerating at a reduced pace, and in most cases at a no worse rate than in developed markets. The fund's hard currency emerging market exposure is biased towards shorter maturities. During the quarter, we increased the fund's exposure to these instruments through buying bonds issued by SA, Turkey and Qatar. The fund also increased its exposure to local currency SA government debt after a substantial sell-off in late October, but subsequently reduced its exposure following the ANC elective conference in late December, after which these bonds rallied significantly.

The outlook for corporate credit, meanwhile, looks more challenging after another very strong performance this past quarter. Credit spreads are now largely back to pre-financial crisis levels as corporate bonds outperformed government bonds by another 1% during the period. This takes their annual outperformance of government bonds to around 3.5% for 2017. Stronger economic growth and slightly more debt-friendly corporate behaviour do lend support to credit markets, but valuations arguably already reflect this, and in the absence of significant drawdowns, the market may be complacent. Despite large volumes of new issuance, inflows into the asset class have meant that credit availability has often been scarce, dissuading selling and dampening volatility.

The challenge for credit markets in 2018 will be how they wean themselves off the support that has emanated from central banks' quantitative easing programmes. While national quantitative easing programmes are important, the cross-border effects are also material. In this regard, the reduction in the ECB's programme is especially interesting, as low rates in Europe have resulted in investors selling European bonds to the ECB and buying assets overseas. These volumes are not immaterial, with net foreign buying of US spread products equal to half the net issuance of US investment grade issuance in 2017. Global buying from central banks during 2018 will be approximately $1 trillion less than in 2017. The fund added some exposure to MTN debt and bought a new tier one issue by Investec PLC, funded through selling existing, more senior exposure. The fund's Old Mutual debt holdings were tended for at attractive levels and we sold our exposure to Barclays and Absa. The fund has been very active in convertible bonds (Intu Properties, Impala Platinum, Remgro and Brait), which we believe are attractive.

Within foreign exchange markets, the continued US dollar weakness is noteworthy as it is at odds with the rising interest rate differentials, relative upside surprises in economic data and more recently the likely support that should flow from the US tax reforms. For now it seems the politics of a Trump administration are outweighing the fractious politics within Europe. As a result, the fund is once again using the euro as a funding currency for positions within emerging markets. The fund has exposure to Mexico, Turkey and SA. Domestic politics meant that all three countries' currency markets were volatile during the quarter, allowing the fund to take advantage of this by varying its exposure. In frontier markets the fund remains exposed to Egypt and Argentina.

The fund remains underweight duration, predominately via low duration positons in Europe and no exposure to Japanese bonds. We retain our preference for US bonds and the US dollar generally. The fund's exposure to mainstream credit is low (we see these areas as most vulnerable to lower quantitative easing), with our preference for higher yielding assets being expressed via short-term emerging market bonds and convertibles. We see value in some emerging markets, but less global liquidity will mean increasing headwinds. We continue to view low levels of volatility as the result of a lack of market conviction rather than a sign of healthy dynamics, and believe this argues for greater risk premiums going forward. ✚

Institutional fund performance

PORTFOLIOS[Δ]	FEES[º]	LAUNCH DATE	1 YEAR	3 YEARS	5 YEARS	10 YEARS	15 YEARS	CUM SINCE LAUNCH[†]	ANN SINCE LAUNCH[†]
GLOBAL BALANCED									
Global Houseview	G	Oct-93	14.13%	8.73%	13.18%	12.70%	16.64%	3 895.14%	16.42%
Median of the Peer Group*			13.88%	9.09%	11.97%	11.18%	15.78%	2 972.41%	15.17%
Alpha			0.25%	(0.36%)	1.21%	1.52%	0.86%	922.73%	1.25%
Managed	G	May-96	12.54%	8.49%	13.06%	13.25%	16.90%	2 765.65%	16.75%
Median of the Peer Group*			13.88%	9.09%	11.97%	11.18%	15.78%	1 642.56%	14.10%
Alpha			(1.34%)	(0.60%)	1.09%	2.07%	1.12%	1 123.09%	2.65%
DOMESTIC BALANCED									
Domestic Houseview	G	Jan-98	14.80%	8.11%	11.27%	12.12%	17.22%	1 856.35%	16.03%
Domestic Balanced Benchmark			15.16%	8.06%	10.23%	10.49%	14.42%	1 165.10%	13.53%
Alpha			(0.36%)	0.05%	1.04%	1.64%	2.80%	691.25%	2.50%
SPECIALIST EQUITY									
Houseview Equity	G	Oct-93	15.74%	7.37%	12.56%	12.97%	19.53%	4 939.95%	17.54%
Houseview Equity Benchmark			18.06%	8.88%	11.75%	10.92%	16.81%	2 837.42%	14.96%
Alpha			(2.33%)	(1.51%)	(0.81%)	2.05%	2.71%	2 102.52%	2.59%
Aggressive Equity	G	Jan-04	15.96%	7.03%	11.44%	12.93%	-	982.43%	18.55%
Aggressive Equity Benchmark			18.17%	8.44%	12.18%	11.39%	-	837.19%	17.33%
Alpha			(2.21%)	(1.41%)	(0.74%)	1.54%	-	145.24%	1.21%
Core Equity	G	Mar-04	21.99%	8.92%	13.35%	13.83%	-	1 058.68%	19.37%
FTSE/JSE Shareholder Weighted Index			21.21%	9.36%	12.75%	11.67%	-	823.48%	17.43%
Alpha			0.77%	(0.44%)	0.60%	2.15%	-	235.20%	1.94%
SPECIALIST FIXED INTEREST									
Strategic Cash	G	Sep-06	8.96%	8.25%	7.50%	8.11%	-	144.78%	8.22%
Short Term Fixed Interest 3 Month Index			7.09%	6.74%	6.18%	6.85%	-	117.85%	7.11%
Alpha			1.87%	1.51%	1.33%	1.26%	-	26.93%	1.11%
Active Bond	G	Jul-00	11.55%	8.08%	7.53%	9.75%	10.27%	583.20%	11.61%
BEASSA All Bond Index			10.22%	6.92%	6.27%	8.58%	9.26%	487.96%	10.65%
Alpha			1.34%	1.16%	1.27%	1.17%	1.01%	95.23%	0.95%
Strategic Bond	G	Jan-08	11.07%	8.00%	7.66%	10.10%	-	161.69%	10.10%
BEASSA All Bond Index			10.22%	6.92%	6.27%	8.58%	-	127.74%	8.58%
Alpha			0.86%	1.08%	1.40%	1.52%	-	33.95%	1.52%
Absolute Bond	G	Mar-03	10.87%	8.59%	7.76%	10.70%	-	341.99%	10.54%
CPI			4.67%	5.55%	5.47%	5.92%	-	126.51%	5.67%
Alpha			6.20%	3.04%	2.28%	4.78%	-	215.48%	4.87%
Flexible Fixed Income	G	Jul-10	11.49%	8.93%	8.38%	-	-	108.70%	10.31%
BEASSA All Bond Index			10.22%	6.92%	6.27%	-	-	86.19%	8.64%
Alpha			1.28%	2.00%	2.11%	-	-	22.51%	1.67%
Short Term Fixed Interest 3 Month Index			7.09%	6.74%	6.18%	-	-	54.57%	5.98%
Alpha			4.40%	2.19%	2.20%	-		54.13%	4.33%
Medical Aid Cash	G	Dec-05	8.63%	8.20%	7.35%	8.04%	-	155.75%	8.08%
Short Term Fixed Interest 3 Month Index			7.09%	6.74%	6.18%	6.85%	-	129.30%	7.11%
Alpha			1.54%	1.46%	1.18%	1.19%	-	26.45%	0.97%
INFLATION-LINKED BENCHMARK									
Global Absolute	G	Aug-99	8.93%	7.21%	10.42%	11.28%	15.18%	1 373.82%	15.73%
CPI			4.67%	5.55%	5.47%	5.92%	5.67%	197.71%	6.10%
Alpha			4.26%	1.66%	4.95%	5.36%	9.52%	1 176.12%	9.63%
Domestic Absolute	G	Apr-02	10.26%	6.14%	8.18%	10.33%	14.89%	815.30%	15.09%
CPI			4.67%	5.55%	5.47%	5.92%	5.67%	144.10%	5.83%
Alpha			5.59%	0.59%	2.71%	4.41%	9.23%	671.19%	9.26%
Inflation Plus	G	Oct-09	9.09%	7.61%	9.17%	-	-	134.41%	10.88%
CPI			4.67%	5.55%	5.47%	-	-	51.86%	5.19%
Alpha			4.42%	2.06%	3.70%	-	-	82.56%	5.68%
Medical Absolute	G	May-04	7.62%	5.69%	7.50%	9.86%	-	425.97%	12.92%
CPI			4.67%	5.55%	5.47%	5.92%	-	114.08%	5.73%
Alpha			2.96%	0.14%	2.03%	3.95%	-	311.89%	7.19%

PORTFOLIOS[Δ]	FEES[º]	LAUNCH DATE	1 YEAR	3 YEARS	5 YEARS	10 YEARS	15 YEARS	CUM SINCE LAUNCH[†]	ANN SINCE LAUNCH[†]
HEDGE FUNDS									
Coronation Presidio Hedge Fund[1]	N	Oct-05 Oct-17[‡]	(2.76%)	2.47%	11.25%	13.67%	-	446.25%	14.87%
Cash			6.69%	6.34%	5.83%	6.47%	-	122.94%	6.76%
Alpha			**(9.45%)**	**(3.87%)**	**5.42%**	**7.20%**	**-**	**323.31%**	**8.10%**
Coronation Multi-Strategy Arbitrage Hedge Fund[2]	N	Jul-03 Oct-17[‡]	(5.79%)	7.49%	7.23%	9.80%	-	385.09%	11.51%
Cash			6.69%	6.34%	5.83%	6.47%	-	163.66%	6.91%
Alpha			**(12.48%)**	**1.15%**	**1.40%**	**3.34%**		**221.43%**	**4.59%**
Coronation Granite Hedge Fund[3]	N	Oct-02 Oct-17[‡]	9.84%	8.58%	7.98%	9.30%	9.86%	333.41%	10.09%
Cash			6.69%	6.34%	5.83%	6.47%	7.10%	188.38%	7.19%
Alpha			**3.15%**	**2.24%**	**2.15%**	**2.83%**	**2.76%**	**145.03%**	**2.90%**
OFFSHORE FUNDS[4]									
Coronation Global Equity FoF (US$)	G	Jul-00	25.13%	9.46%	12.77%	7.27%	11.56%	221.19%	6.90%
Coronation Global Equity FoFs Benchmark			23.97%	9.85%	12.24%	5.62%	9.45%	132.26%	4.93%
Alpha			**1.15%**	**(0.38%)**	**0.53%**	**1.64%**	**2.11%**	**88.93%**	**1.96%**
Coronation Global Managed (US$)	G	Nov-09	17.89%	7.02%	9.32%	-	-	108.48%	9.41%
Coronation Global Managed Benchmark			17.09%	6.78%	7.42%	-	-	78.03%	7.32%
Alpha			**0.79%**	**0.24%**	**1.90%**	**-**	**-**	**30.45%**	**2.10%**
Global Capital Plus (US$)	G	Sep-09	9.06%	4.77%	5.12%	-	-	65.98%	6.27%
Global Capital Plus Benchmark			1.29%	(0.54%)	(1.07%)	-	-	(6.51%)	(0.81%)
Alpha			**7.77%**	**5.31%**	**6.19%**	**-**	**-**	**72.49%**	**7.07%**
Global Bond (US$)	G	Oct-09	9.61%	4.09%	1.98%	-	-	34.77%	3.68%
Global Bond Benchmark			7.40%	1.97%	0.26%	-	-	12.97%	1.49%
Alpha			**2.21%**	**2.12%**	**1.72%**	**-**	**-**	**21.81%**	**2.19%**
Coronation Global Strategic Income	G	Jan-12	3.19%	2.37%	2.74%	-	-	23.66%	3.60%
110% of 3 Month USD Libor			1.42%	0.87%	0.63%	-	-	3.70%	0.61%
Alpha			**1.77%**	**1.50%**	**2.10%**	**-**	**-**	**19.96%**	**3.00%**
Global Emerging Markets Equity Strategy	G	Jul-08	40.67%	8.71%	7.12%	-	-	118.75%	8.62%
Coronation Global Emerging Markets Equity Benchmark			37.28%	9.21%	4.56%	-	-	42.74%	3.83%
Alpha			**3.39%**	**(0.51%)**	**2.56%**	**-**	**-**	**76.01%**	**4.79%**
Coronation All Africa Strategy	G	Aug-08	37.67%	0.72%	5.34%	-	-	131.20%	9.31%
3 Month USD Libor			1.29%	0.79%	0.58%	-	-	6.08%	0.63%
Alpha			**36.38%**	**(0.07%)**	**4.77%**	**-**	**-**	**125.12%**	**8.68%**
Coronation Africa Frontiers Strategy	G	Oct-08	36.93%	(0.72%)	5.65%	-	-	144.86%	10.17%
3 Month USD Libor			1.29%	0.79%	0.58%	-	-	5.54%	0.59%
Alpha			**35.64%**	**(1.51%)**	**5.07%**	**-**	**-**	**139.31%**	**9.58%**
Coronation Global Frontiers	G	Dec-14	35.50%	7.23%	-	-	-	24.38%	7.33%
3 Month USD Libor			1.29%	0.79%	-	-	-	2.41%	0.78%
Alpha			**34.21%**	**6.44%**	**-**	**-**	**-**	**21.97%**	**6.56%**
Coronation Global Equity Strategy	G	Nov-14	26.89%	9.45%	-	-	-	29.67%	8.55%
MSCI All Country World Net US$			23.97%	9.30%	-	-	-	30.18%	8.69%
Alpha			**2.92%**	**0.16%**	**-**	**-**	**-**	**(0.51%)**	**(0.14%)**

[1] *Highest annual return: 44.6%; lowest annual return: (10.8%)*

[2] *Highest annual return: 30.4%; lowest annual return: (5.8%)*

[3] *Highest annual return: 17.3%; lowest annual return: 6.4%*

[4] *Figures quoted in US$ as at 31 December 2017.*

[Δ] *Figures are quoted from the Independent Retirement Fund Survey as at 31 December 2017.*

[*] *Median of the Peer Group is the median of the largest fund manager's fully discretionary retirement fund portfolios as published in performance surveys and calculated by Coronation Fund Managers.*

[º] *G = Gross, N = Net*

[†] *CUM SINCE LAUNCH = Cumulative returns since launch, ANN SINCE LAUNCH = Annualised returns since launch. Figures of one year and less indicate percentage change.*

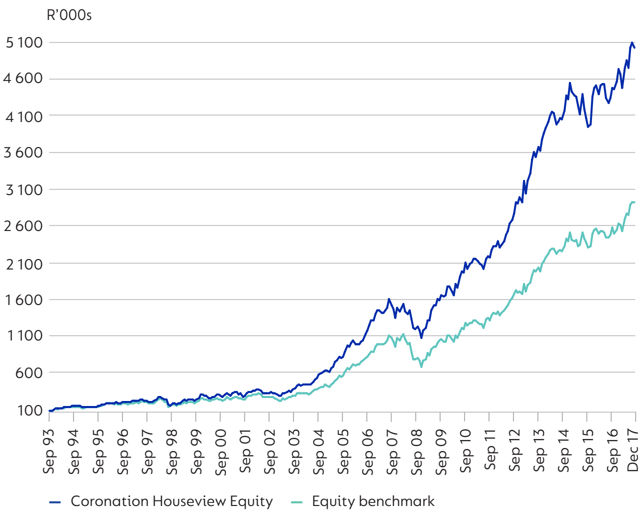
[‡] *CIS launch date*

Long-term investment track record

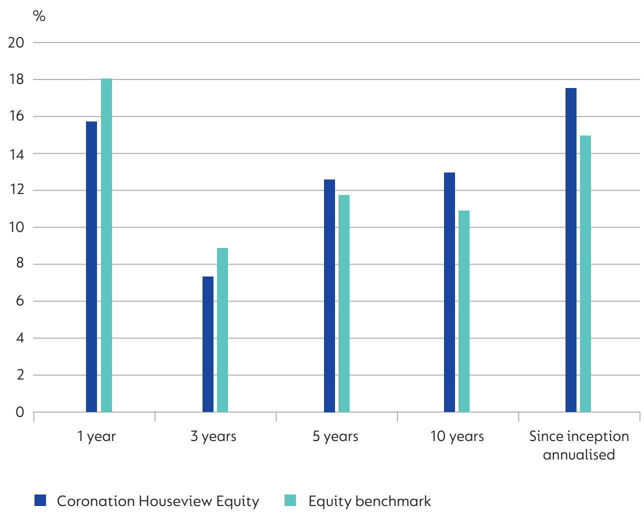
CORONATION HOUSEVIEW EQUITY RETURNS VS EQUITY BENCHMARK

5-YEAR ANNUALISED RETURNS	CORONATION HOUSEVIEW EQUITY	EQUITY BENCHMARK	ALPHA
1998	8.15%	6.49%	1.66%
1999	14.23%	10.91%	3.33%
2000	10.93%	7.52%	3.41%
2001	10.95%	9.38%	1.57%
2002	9.46%	7.80%	1.66%
2003	18.02%	13.78%	4.24%
2004	14.12%	9.63%	4.49%
2005	23.35%	18.94%	4.41%
2006	28.38%	23.66%	4.72%
2007	33.79%	29.55%	4.24%
2008	23.36%	19.73%	3.63%
2009	22.23%	20.67%	1.56%
2010	18.55%	15.73%	2.82%
2011	11.58%	8.73%	2.85%
2012	13.39%	10.10%	3.29%
2013	24.37%	20.21%	4.16%
2014	19.39%	16.08%	3.31%
2015	14.05%	13.14%	0.91%
2016	14.77%	13.33%	1.44%
2017	12.56%	11.75%	0.81%
ANNUALISED TO 31 DECEMBER 2017			
1 year	15.74%	18.06%	(2.33%)
3 years	7.37%	8.88%	(1.51%)
5 years	12.56%	11.75%	0.81%
10 years	12.97%	10.92%	2.05%
Since inception in October 1993 annualised	17.54%	14.96%	2.59%
Average outperformance per 5-year return			2.93%
Number of 5-year periods outperformed			20.00
Number of 5-year periods underperformed			-

CUMULATIVE PERFORMANCE



ANNUALISED RETURNS TO 31 DECEMBER2017

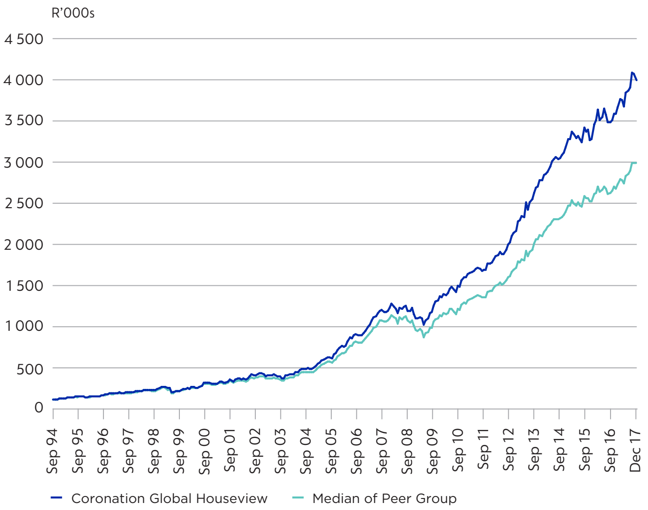


An investment of R100 000 in Coronation Houseview Equity on 1 October 1993 would have grown to **R5 039 946** by 31 December 2017. By comparison, the returns generated by the Equity Benchmark over the same period would have grown a similar investment to **R2 937 423**.

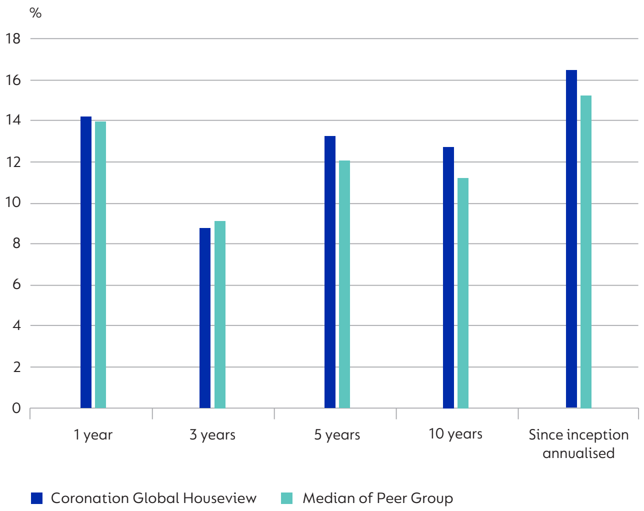
CORONATION GLOBAL HOUSEVIEW (BALANCED) RETURNS VS MEDIAN OF PEER GROUP*

5-YEAR ANNUALISED RETURNS	CORONATION GLOBAL HOUSEVIEW	MEDIAN OF PEER GROUP*	ALPHA
1998	11.21%	11.26%	(0.04%)
1999	16.36%	15.54%	0.82%
2000	13.82%	13.17%	0.65%
2001	16.54%	15.02%	1.52%
2002	12.74%	12.05%	0.69%
2003	17.67%	15.96%	1.71%
2004	14.35%	13.30%	1.05%
2005	19.58%	18.16%	1.42%
2006	20.74%	19.53%	1.22%
2007	24.93%	24.82%	0.10%
2008	18.96%	17.52%	1.44%
2009	18.28%	15.19%	3.09%
2010	15.23%	12.02%	3.21%
2011	10.75%	8.32%	2.43%
2012	12.23%	9.83%	2.40%
2013	20.13%	17.67%	2.46%
2014	17.52%	15.64%	1.88%
2015	15.69%	14.61%	1.08%
2016	14.65%	13.61%	1.04%
2017	13.18%	11.97%	1.21%
ANNUALISED TO 31 DECEMBER 2017			
1 year	14.13%	13.88%	0.25%
3 years	8.73%	9.09%	(0.36%)
5 years	13.18%	11.97%	1.21%
10 years	12.70%	11.18%	1.52%
Since inception in October 1993 annualised	16.42%	15.17%	1.25%
Average outperformance per 5-year return			1.47%
Number of 5-year periods outperformed			19.00
Number of 5-year periods underperformed			1.00

CUMULATIVE PERFORMANCE



ANNUALISED RETURNS TO 31 DECEMBER2017



An investment of R100 000 in Coronation Global Houseview on 1 October 1993 would have grown to **R3 995 145** by 31 December 2017. By comparison, the Median return of Global Large Managers over the same period would have grown a similar investment to **R2 989 816**.

** 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.*