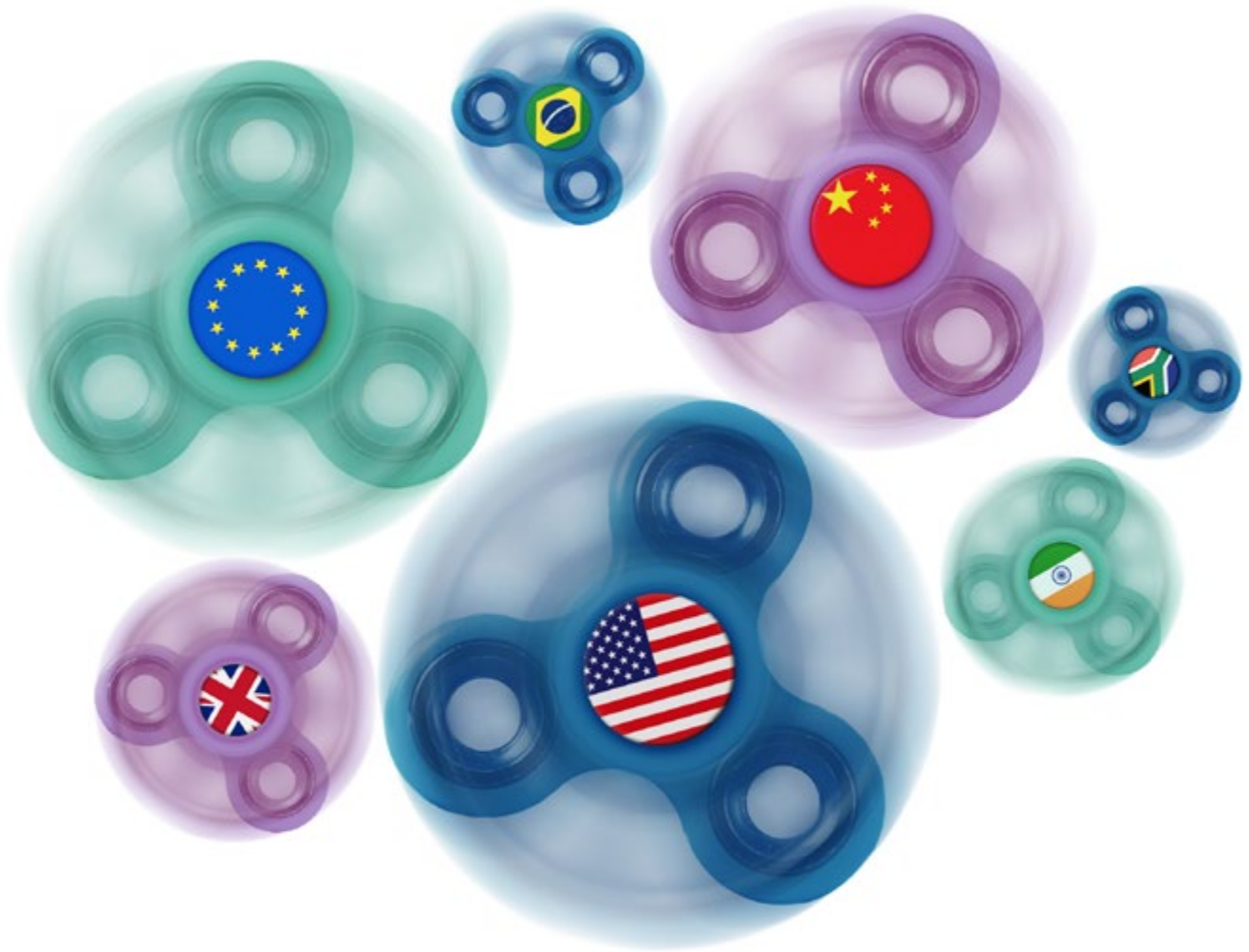


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The Coronation Fund Managers Institutional Quarterly

July 2017, Winter Edition



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NOTES FROM MY INBOX

By Kirshni Totaram

Kirshni is global head of institutional business. She is a qualified actuary and a former manager of the Coronation Property Equity portfolio. Kirshni joined Coronation in 2000.



It is scary how quickly we have reached the halfway mark to this year, which has so far been filled with much newsflow and surprises. The UK electorate delivered another shock result at the start of the crucial Brexit negotiations, the US president's intemperate tweets are slowly shaping a new global diplomatic order and tensions are escalating in the Middle East. Global markets have been moving higher in fits and starts, but a recent sharp sell-off in global bonds, a continuous European banking crisis and a slump in the oil prices have unnerved many.

As an SA company, we have a high uncertainty threshold. There is no doubt that this threshold has been severely tested during the first six months of the year as the political climate in SA has deteriorated further. We have been managing money in an open emerging market for almost a quarter of a century, investing and protecting clients' savings amid ongoing currency and political shocks. This has stood us in good stead, helping us become disciplined investors who can cut through the noise and focus on the long term. It has also helped us to find value where others may only see risk, especially in emerging markets, where we understand the dynamics of formalising economies despite political turmoil.

Our experience in emerging markets has also granted us a firm understanding of the limitations of passive investing – a trend that has gained massive flows in global markets in the last few years. These shortcomings were highlighted recently after the MSCI decided to include selected China A-shares in its emerging markets' benchmark index for the first time. After extensive consultation, it decided on 222 shares (out of more than 3 000) considered suitable for the index.

The decision sparked concern among passive investors who have to track the index. The Chinese market is opaque, with questions about ownership structures, shadow finance and the true extent of state involvement in each company. In addition, the selected companies are skewed towards the problematic Chinese financial sector. Above all, as a number of commentators pointed out, it demonstrated that tracking an index is not a passive investment decision at all.

“It is a neat reminder that the style of investing they (passive investors) think they have embraced does not actually exist,” as the editor of *MoneyWeek*, Merryn Somerset Webb, wrote in the *Financial Times*. “There is no such thing as passive. Someone has to decide what is an emerging market, someone has to decide which emerging markets are the most important and someone then has to decide which stocks define each emerging market.” In fact, what this style of investing does is outsource the investment decision to the index providers themselves.

No matter how artfully the passive sales pitch is presented, all passive investments fundamentally require investors to make an active decision. Investors need to choose from the myriads of indices, many with increasingly complex rules and algorithms, each with a potential materially different outcome over long periods.

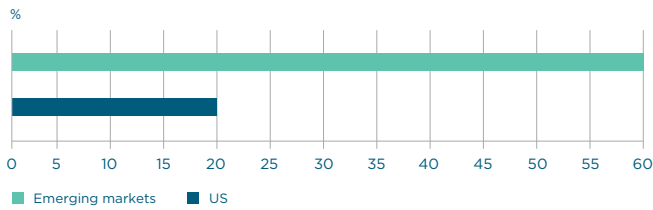
In addition, we have long argued that passive investing is particularly ineffective in emerging and frontier markets. Indices for these markets do not offer investors a true reflection of the investable potential and economic drivers of these markets, nor the best companies that investors could invest in (at the right price). The benchmark indices in



these markets favour shares that are liquid and are usually skewed towards lower-quality companies, which have larger weightings due to their free floats. Typically, these indices have a lot of exposure to the financial sector and other highly regulated industries – and not to companies which can benefit most from fast-growing structural changes in developing markets. Often, these include businesses with large foreign parents (like Heineken, Diageo and Unilever) which have great growth prospects but a lower free float, and therefore smaller weightings in the indices.

ACTIVE OUTPERFORMS PASSIVE IN EMERGING MARKETS

Percentage of actively managed equity funds that outperformed exchange traded funds in past five years



Sources: Morningstar, Bloomberg

Tracking the index can also be hazardous in some highly concentrated markets like SA. While investors tracking the Standard & Poor’s (S&P) 500 will end up with a portfolio where the top 10 largest stocks represent less than a fifth of their portfolio, in a concentrated market like SA, Naspers will represent almost 20% of your portfolio (if you are tracking the Shareholder Weighted Index [SWIX]). One of the biggest selling points of passive investing is that you remove stock-specific risk and simply get the return of the market. In emerging markets, often investors end up with much more single-stock risk, and they do so without a skilled and experienced investment professional held accountable for the appropriateness of that weighting.

At Coronation, we construct clean-slate portfolios of our highest conviction views. We believe that this approach affords us the ability to outperform indices over meaningful periods of time.

IN THIS EDITION

We are extremely concerned about the recent events in SA. Simon Freemantle explains the political forces behind the current turmoil on page 8, a sobering read. The uncertainty

is having a devastating impact on the domestic economy, as detailed in our economic review on page 22.

The respected emerging market analyst Jonathan Anderson has contributed an exclusive article on China’s prospects (page 5). While for the foreseeable future the country should remain stable, Jon warns that investors need to be aware of risks in the Chinese economy. China may not escape its debt boom without pain.

In addition to our quarterly contributions on the markets, you will find a number of investment cases in this edition, including for the US fashion retailer L Brands (page 16), mobile money operators in Bangladesh and Kenya (page 19) and the SA hospital group Mediclinic (page 14).

We hope you enjoy the read as we prepare for the next half of this eventful year. ■

Kirshni

MARKET MOVEMENTS

	2nd quarter 2017	Year to date 2017
All Share Index R	(0.4%)	3.4%
All Share Index \$	2.3%	8.3%
All Bond R	1.5%	4.0%
All Bond \$	4.2%	9.0%
Cash R	1.9%	3.7%
Resources Index R	(7.0%)	(4.6%)
Financial Index R	0.0%	(1.1%)
Industrial Index R	2.2%	9.0%
MSCI World \$	4.0%	10.7%
MSCI ACWI \$	4.3%	11.5%
MSCI EM \$	6.3%	18.4%
S&P 500	3.1%	9.3%
Nasdaq \$	4.2%	16.8%
MSCI Pacific \$	4.0%	11.3%
Dow Jones EURO Stoxx 50 \$	6.5%	15.4%

Sources: Bloomberg, INET



WHITHER CHINA?

FOUR TRENDS IN COMING MONTHS

By Jonathan Anderson

Jonathan is president of the Emerging Advisors Group. He was previously the global emerging market economist at UBS Investment Bank, as well as the IMF's resident representative in both China and Russia.



As we enter the second half of 2017, China is easily the biggest wild card in the global economic outlook. On the one hand, mainland growth has proven to be very resilient; local consumer demand is strong, corporate earnings have rebounded and buoyant import spending has provided a much-needed tailwind for its Asian neighbours as well. On the other, since the beginning of the year the government has placed renewed emphasis on deleveraging and balance sheet control, sharply curbing excessive financial flows and tightening credit.

That is not all; China also faces an unpredictable political environment, as the upcoming 19th Communist Party Congress will allow president Xi Jinping to reshuffle the top leadership ranks and consolidate his power. If successful, many feel that the removal of weaker and opposition players could lead to meaningful changes in policy direction.

Finally, markets are continually worried about financial risks. Chinese debt ratios have been rocketing this decade, and the renminbi already experienced one sudden and sizeable 'run' in 2015/2016. How does this all play out for the rest of the year and beyond?

Here are four trends investors should consider:

SLOWDOWN AHEAD

For starters, there is no question that China is tightening. Emboldened by the strong economy and the visible upturn in corporate profitability over the past few quarters, the government has encouraged financial regulators to 'go to town' in curbing the banking and credit excesses that characterised the previous two years. This included wild balance sheet expansion in the form of opaquely structured investment products, essentially hidden loans intermediated through non-bank financial institutions; dramatic growth in interbank borrowing and lending as well as wholesale funding from shadow banks; and an explosion in direct local government borrowing via bond issuance to banks.

All of these items grew rapidly in 2015 and 2016, but since the beginning of this year new issuance of all has dropped nearly to zero. The result is a sharp drop in the volume of total 'effective' credit extended; Emerging Advisors Group's own flow credit impulse measure is now approaching the lowest recorded level in the post-2009 era, which makes this a serious policy shift indeed.

What impact will this have on the overall economy? Balance sheet retrenchment particularly affects local governments and their affiliated development- and infrastructure-related corporate entities, and in the second half of the year China should see a visible slowdown in new project starts and ongoing investment activity. More important still, there will also be an effect on private property markets. The relationship between aggregate credit flows and new housing sales is one of the strongest in China, and it is hardly surprising that residential demand has already started to tail off over the past few months. As the property market continues to weaken, there will also be a gradual but steady drop in related construction activity, reducing the use of steel, cement and other basic materials.

Add to this our jaundiced view of the sustainability of the current global trade upturn – which has provided tremendous support for the Chinese recovery of the past three quarters in its own right – and by the end of this year China will have gradually moved from an economy firing on all cylinders (infrastructure, property, exports) to an economy firing on none. We are not talking about a growth collapse by any means; mainland consumer demand is relatively protected by the lack of leverage exposure in the household sector, and this lends China a strong element of stability. Nonetheless, from nearly 7% year on year currently, we would expect most private estimates of growth to fall well below 6% by the fourth quarter of 2017.

FADING SUPPORT FOR GLOBAL MARKETS

This, in turn, has big implications not only for China but for other emerging markets as well, in two ways.



The first is through weaker commodity prices. Global prices for 'China-related' ores and materials – not oil per se, but coal, iron ore, copper, aluminium and steel – have fallen about 12% on average since January peaks on the back of tightening fears, and the downturn is likely to continue through the second half of 2017 as China's real economy slows as well. Needless to say, this has big implications for exporting countries from Brazil to Indonesia to SA.

The impact is not limited to commodity producers. There will also be a negative effect on Asian neighbours that supply capital goods and semi-manufactured products into the Chinese industrial machine. The rest of Asia has been a big export outperformer in volume terms over the past few quarters, with almost all of the increase coming from mainland demand. China's own import trade volume data are notoriously volatile and unreliable, but available trade figures from major partner countries show a clear trend: from outright contraction in the beginning of 2016, Chinese real import spending was up by an eye-popping 20% year on year by the end of last year, making this the biggest recovery of the decade.

But of course that import recovery has been driven by a combination of strong domestic upturn in property and investment along with the cyclical improvement in global manufacturing export demand – and again, both of those trends should be fading away in the coming quarters. As a result, we expect Chinese import volume growth to fall to the low single digits by year-end, which implies a broad macro slowdown across Asia as well.

RENEWED EASING CYCLE IN 2018

That is the picture through to the end of 2017. What about next year?

The answer, for us, lies in renewed policy easing.

This may come as a bit of a surprise for those who follow the current political calendar. Remember that the Chinese Communist Party undertakes its congresses in a five-year cycle, with a spate of leadership changes across the party structure in the opening year of each congress. The upcoming 19th Congress will take place towards the end of the year, and while there is no doubt that president (and party secretary) Xi will remain in his post for a second term, there will clearly be a number of big changes directly under him at the Politburo and Politburo Standing Committee level.

The common assumption in the global press is that this mid-term leadership transition represents a major watershed for the Xi administration. Once he has sent off a number of retiring senior opponents and ensured that his handpicked supporters take their place, thus cementing his political position once and for all, the argument is that Xi will show

his true colours, putting less emphasis on growth and more on reforms – even if it means potentially serious pain for the economy.

The reality is almost certainly the opposite. To begin with, there is little evidence to suggest that president Xi is a closet economic reformer. To the extent that he has weighed in on economic topics at all, he has vocally and often repeated that his main priority is for steady, relatively rapid growth, at a minimum of 6.5% per annum in order to achieve a doubling of real incomes during his tenure. Indeed, this was the driving reason behind the massive stimulus-fuelled balance sheet expansion in the first place.

Yes, Xi has been happy to give in to demands from the central bank and from regulators to carry out tightening this year ... as long as the growth numbers are more than comfortable. But as the economy slows through the second half of 2017 and into 2018, leading to renewed worries about corporate health, profitability and employment, we fully expect the policy pendulum to swing back in favour of pressure on banks to lend out via all available channels to support the pace of expansion.

NO FINANCIAL CRISIS ... (YET)

On a final note, what about the much-touted crisis scenarios? China has added more than the equivalent of 100% of its GDP in financial debt in the past eight years alone, an astounding figure by emerging market standards – and one that takes overall debt levels close to developed-country levels (again virtually unheard of for a low- or middle-income economy). Is this not a bubble, fraught with tremendous risks in the banking and corporate sectors?

There are risks, no question, and our own long-standing conclusion is that China will not escape this debt boom without pain. Moreover, as tightening continues this year we are likely to see some signs of financial and corporate fragility.

However, we need to stress that 2017 is *not* the year that China's financial system falls apart, in the sense of major funding crises or true Minsky shocks.

Why? Because what really matters for financial fragility is not debt itself but rather the funding structure of the debt – and here exposures are building more slowly. China will still reach an eventual crisis point if the government continues to pump credit into the economy indiscriminately, but by our estimates true systemic fragilities will only start to appear three or four years down the road, at the beginning of the next decade.

This is all the more true given that while the authorities may be pursuing a regulatory crackdown on credit and



quasi-credit activity, they are not pulling liquidity wholesale from the system. In the past six months, there have been some of the strongest policy tightening rounds since 2009 in terms of new credit flows, but still one of the weakest in terms of the behaviour of short-term interest rates, which remain profoundly low as we write. Simply put, the central bank is doing everything it can to avoid any hint of illiquidity in the system, which significantly lowers the near-term risk profile.

The same analysis holds for the exchange rate. China had a sizeable renminbi scare in 2015/2016, with large, sudden capital outflows that caused the country to lose nearly \$1 trillion of its \$4 trillion foreign exchange reserves pile. Since then, however, the authorities have made an all-out

frontal attack on outflows in the form of sharp restrictions on capital convertibility and an intensified commitment to broad stability against the trade-weighted basket. This programme will not hold off currency pressures forever – indeed, no peg/quasi-peg could possibly survive the exponential growth of domestic liquidity against the backdrop of flat or falling foreign reserves. However, once again, our analysis suggests that true flash points are still a number of years away on the exchange rate front, and until then things are likely to be relatively quiet.

In sum, investors do need to be vigilant and aware of risks in the Chinese economy. But there is no ‘run for your life’ moment coming any time soon. For the time being, it is all about a gradual slowdown over the year to come. ■



SA POLITICS

A STATE OF PARALYSIS

By Simon Freemantle

Simon is the senior political economist and head of the African political economy unit at Standard Bank. He is a regular presenter on political and economic issues relating to SA and Africa on a variety of local and international platforms.



Paralysis is defined by the Oxford English Dictionary as “the loss of the ability to move in part or most of the body”, or “the inability to act or function properly”. Recent events within the ANC have reflected how deep the state of paralysis is that has set in across the party’s senior structures. Though able to diagnose the crisis that it (and the broader body politic as a whole) faces, the party appears unable to move in any decisive manner to address the challenges it knows to be eroding public trust, and widening what ANC secretary general Gwede Mantashe has referred to as the ANC’s “trust deficit” with the nation.

There are two examples of the ANC’s current inertia which best reflect this internal dilemma.

The first is the manner in which this state of paralysis has undermined the ANC’s capacity to act nimbly with regard to the destruction wrought by President Zuma on the ANC and the alliance, the economy and the country’s wider institutional edifice. President Zuma no longer enjoys the majority of support in the ANC’s national executive committee (NEC), nor does he hold the kind of branch-level endorsement that he was not long ago able to command. At least since his unilateral dismissal of former finance minister Nhlanhla Nene on what has been infamously dubbed ‘9/12’ (9 December 2015) the president’s base of political authority has considerably and consistently weakened. Calls for his removal as head of state have grown louder since his bold cabinet reshuffle in March this year. The president was booed at this year’s May Day rally and is now unwelcome at gatherings of both of the ANC’s tripartite alliance partners – the SACP and COSATU. In a March survey by TNS, just 20% of South Africans living in major metropolitan municipalities stated that they believed President Zuma was doing a good job, a drop from 58% in 2009. Many in the ANC blame the president’s urban unpopularity for the party’s dismal election performance in last year’s municipal polls. Meanwhile, as the allegations of impropriety linked to the Gupta family continue to mount, exploding with even greater clarity into the public conscience as a result of the trove of leaked emails from within the family’s business empire, President Zuma remains stoically silent and tacitly defensive of the

interests he, and more directly his son, Duduzane Zuma, have in ensuring the Gupta family continues to enjoy access to state patronage.

Yet, despite the obvious liability President Zuma has become for the ANC, the party is unable to manage his exit in a manner that presents some image of internal cohesion, and reflects the capacity to ‘self-correct’. The reason for this is simple: factionalism within the ANC has ripped apart its internal accountability mechanisms and undermined its central authority. There is no longer a final word on matters of party concern as all statements are deemed by opposing factions to be designed to undermine their interests and expand those of the groups they oppose. Further, the ANC’s constitution is poorly equipped to manage the intensity of the animosities that now characterise the party’s senior structures.

There is no real mechanism to remove a party president prior to the five-yearly national elective conference, and the decision to rescind the party’s nomination for the president as head of state is not taken by a vote at the NEC level, but rather by a search for ‘consensus’. When such consensus is absent (and President Zuma has enough support still in the NEC to prevent consensus from building against him), the only option is to preserve the status quo, as damaging as this may be for the party and the country it leads. President Zuma has also adopted a typical ‘divide and rule’ strategy as president – so much so that his removal would, in Mr Mantashe’s words, “tear the ANC apart” as groups loyal to the president would mount an aggressive counter to his premature eviction from office. Fearful of this outcome, a cluster of moderate ANC leaders hope to hold the middle line and drag the party to its December elective conference in order to more formally address the crises that President Zuma has bestowed on them.

The second feature of this state of paralysis is the manner in which the ANC and the alliance appear unable to define a coherent course of action to address the country’s crippling economic and social shortcomings. The party’s recent national policy conference was a study in this



dilemma. Indeed, driven by the political jostling which has come to define the ANC's succession battle, delegates at the conference were consumed by proxy battles around the definition of "(white) monopoly capital" and land expropriation with or without compensation (and with or without changes to the Constitution). There appeared to be little substantive engagement on the issues that should most concern the party in order to address the fundamental frustrations of the broader population: unemployment, crime, corruption and social transformation. Though on the day that the conference began, the *Daily Maverick* released a report detailing how the Guptas funnelled money from a failed and state-funded dairy farm in the Free State to pay for a lavish Sun City wedding, delegates did not (or were not able to) voice their resounding condemnation of 'state capture', the definition of which is held hostage by the same factional tensions outlined before. Indeed, such was the party's priorities at the conference that it could not even find the time in an extended six-day gathering to brief the media on its education, health, science and technology resolutions, which it only managed to do the week after the conference had closed. And while there was a focus on the National Development Plan (NDP), which minister in the presidency Jeff Radebe doggedly continues to pursue, the party was able only to concede that 'implementation' remains a crippling hurdle to the realisation of the Plan's goals - with little understanding of how such an impediment can be lifted. Broadly speaking, the ambiguous mantra of radical economic transformation, which has vastly divergent interpretations within the ANC, has replaced the NDP as a guiding force for internal policy discussions. It is worth noting that this was the ANC's last scheduled policy conference before the 2019 elections, where it will undoubtedly face its sternest national test since 1994.

While resolutions to these issues will not be straightforward, the ANC does at least have an opportunity to address the depth of internal disunity that it faces at its national elective conference in December. Here there are three broad types of outcomes, though only one of the three offers the opportunity for any form of decisive and positive change.

The **first outcome** is one in which a reformist movement secures the party reins. This movement appears most likely to be led by Deputy President Cyril Ramaphosa, but there are other ANC leaders capable of driving a similar type of sentiment (including human settlements minister Lindiwe Sisulu and, to an extent, ANC treasurer Zweli Mkhize). Under this scenario a collective of leaders with stronger moral mettle and a more moderate approach towards the tackling of the country's economic malaise would defeat those clustered around President Zuma and the 'premier league' of provincial power barons who have sustained his party power. It would be important for a 'winner-takes-all' outcome in which a reform movement secures all of the ANC's top positions and squeezes President Zuma's staunchest provincial supporters out of the party's senior leadership.

A **second outcome** is the exact opposite of the first, and would see the ANC Youth League's (ANCYL) slate of preferred leaders elected as a bloc. The group pulled together by the ANCYL is an ominous one, with Nkosazana Dlamini-Zuma as president, Mpumalanga premier David Mabuza as deputy president and Free State premier Ace Magashule as secretary general. It is the extraordinary bias of this slate, and the apparent inability to attract moderates to balance its scales, that are undermining its chances in December. But the residual branch power that the president enjoys in KwaZulu-Natal and in the more compliant 'premier league' provinces of the Free State and the North West still sustains its viability. Should this slate succeed, the consequences for the ANC and the alliance would be dire, leading to the kind of split that would almost certainly undermine the party's grip on Gauteng in 2019, and quite possibly at the national level too.

A **third outcome** is one of compromise between the warring factions in the party, which many in the ANC are seeking as the means through which to avoid the split that they fear would result from either of the above outcomes triumphing as a bloc. President Zuma has floated a compromise 'solution' as well, suggesting in his closing remarks at the recent national policy conference that the losing presidential candidate should automatically slot in as one of two party deputy presidents. It is likely that the president made this recommendation from a position of weakness, cognisant (finally) of the fact that his branch-level support is more precarious than he assumed it to be. This does suggest that Mr Ramaphosa is well positioned to lead the compromise collective, if such an outcome is pursued. A critical swing province in this regard is Mpumalanga, which will account for around 15% of voting delegates at the conference. As it stands, Mr Mabuza is hedging his bets, shifting subtly away from his previous defence of President Zuma and the 'premier league' and offering to position himself on Mr Ramaphosa's ticket in exchange for his endorsement as deputy president. Though this would fundamentally improve Mr Ramaphosa's chances of success, it would come at the cost of profoundly undermining the reformist zeal that he would seek to project as party and state leader. Though a compromise would at least prevent a more cataclysmic outcome in December in which President Zuma's allies secure even more profound control of the party reins than they currently enjoy, it would not offer the kind of momentum for reform that is required to shatter the paralysis that has set in at a party/alliance and national policy level.

The probabilities assigned to each of the aforementioned outcomes remain exceptionally fluid, and there are pervasive unknowns that will have a profound bearing on the process itself. For instance, the outcome of the ANC's Eastern Cape and Free State provincial elections, which will both be held in the coming months, and the resolution in court in August of the contested KwaZulu-Natal party leadership election of 2015, will have a potentially marked bearing on



events in the lead-up to December. Above all, though, the finalisation of the ANC's contested membership audit will be all-important. There have been reports of KwaZulu-Natal branch membership having exploded, from 158 199 in 2015 to over 500 000 currently. The composition of voting delegates in December is determined by the proportionate size of each branch, and the relative share of total membership that each province contributes to the party. As such, if there are 4 000 branch delegates at the conference, and KwaZulu-Natal accounts for 25% of total ANC membership, then 1 000 of those 4 000 voters will come from the province. Mr Mantashe's task in injecting integrity into these fraught audit systems will be a towering one, and vigorous contestation within the branches seeking to superficially inflate their importance will again expose the depth of disunity that the party suffers from.

Meanwhile, as the ANC is consumed with its own internal wrangling, a new kind of national opposition collective appears to be forming. Galvanised by resistance to President Zuma and mounting evidence of Gupta-orchestrated 'state capture', a coalition of opposition parties, tripartite alliance members (the SACP primarily), ANC veterans, civil society organisations, and business and religious groupings has

found common cause. It is therefore not only the ANC's waning capacity for 'self-correction' upon which the nation's hopes rest, but also on a movement that has mobilised as a result of the ruling party's paralysed reaction to the unfolding crisis of the past five years in particular.

Here the country is in marked contrast to some of its more oppressive emerging market peers, where resistance to the creeping autocracy of the state is more easily and systematically squashed. In fluid democratic systems, actors - even ones as dominant as the ANC - cannot afford to stand still for too long, and it has been in the shadows created by the state of paralysis that the ruling party has allowed to consume the broader body politic that the seeds for a new political realignment have formed. How this realignment takes shape will of course also rely on the ANC's succession outcome, which is now just five months away and presents the opportunity for the lifting (for better or worse) of our collectively paralysed state. ■

Disclaimer: The views and opinions expressed in this article are those of the author and have originally been prepared and previously shared with other financial market participants, primarily institutional clients of Standard Bank.



PERFORMANCE MANAGEMENT

THE IMPORTANCE OF STRONG BUSINESS LEADERS

By Quinton Ivan

Quinton is head of SA equity research and co-manages Coronation's Core Equity Strategy. He joined the business in 2005.



"Success leaves traces." – Sir John Templeton

Quality businesses possess certain attributes that make them long-term winners: enduring competitive advantages (such as the franchise value of brands or a store footprint that is hard to replicate), robust and adaptable business models, good cash flows and excellent returns. These characteristics often result in such businesses compounding revenue and earnings at a higher rate than expected – and the market rewarding this superior growth with a premium rating when compared to the average company. However, one attribute that is often overlooked when assessing a business's track record, is the role played by management. While most companies are heavily subject to the macroeconomic conditions of the day, good management make things happen and get on with the job of driving shareholder value.

In his excellent book, *The Outsiders: Eight Unconventional CEOs and Their Radically Rational Blueprint for Success*, author William Thorndike attempts to identify the key traits and methods of eight CEOs. Each is responsible for delivering exceptional shareholder returns, which ultimately results in their companies handsomely outperforming both their peers and the market. We are fortunate to have many examples of truly exceptional businesspeople in SA, who have created enormous value for shareholders over time. Similar to Thorndike, I consider two SA case studies in an attempt to identify what it is that makes the managers in question so special.

STEPHEN SAAD – ASPEN PHARMACARE HOLDINGS (ASPEN)

Saad is one of SA's great entrepreneurs. His first job in 1989 was at a startup, Quickmed, a small medical wholesale business operating mainly in townships around Durban. Quickmed later merged with Zurich, which was bought by Prempharm (now Adcock Ingram) in 1993 for R75 million. Saad, who was 29 years old at the time, made approximately R20 million on the deal. Not resting on his laurels, he teamed up with Aspen's current deputy CEO, Gus Attridge, later that year and together they bought a stake in Varsity

College, which was struggling at the time. They turned the educational business around, partly through innovative marketing offering students a refund on tuition fees if they failed their courses, provided that they attended all of their lectures. Saad and Attridge sold their stake in Varsity College to Leisurenet in 1997 for R100 million – they had bought it for R1.5 million.

Aspen listed on the JSE in 1998 via a reverse listing into Medhold. Shortly after, it launched a hostile takeover of SA Druggists (SAD), acquiring the old Lennon drug business (a pioneer in generic medicines) as well as a manufacturing plant in Port Elizabeth.

Today, Aspen has successfully transformed from a SA generic pharmaceutical company into a global player focusing on anticoagulants, anaesthetics, high potency pharmaceuticals and cytotoxics, and infant milk formula in both developed and emerging markets.

Since listing, revenue and normalised headline earnings per share have compounded at close to 40% per annum, through a combination of acquisitive and organic growth. More recently, Saad has concluded large deals with GlaxoSmithKline (GSK), Merck and AstraZeneca, which has seen it become a significant player in the highly specialised therapeutic classes of anticoagulants and anaesthetics. This has been the culmination of years of relationship building and a focused strategy to internationalise the business and focus on niche, post-patent products that are complex to manufacture.

A few things about Saad stand out throughout Aspen's successful history:

- **A passion for the business and an unwavering ambition to globalise.** The following quote from Aspen's 1999 annual report is noteworthy: "The group recognises the advantages to the internationalisation of its business in today's global economy. The development of this strategy will be off the base of a successful and stable domestic operation."



- **Having conviction in his strategy and betting big, even in the face of market scepticism.** Noteworthy deals over the years include:
 - acquisition of SAD in 1999 for R2.4 billion – still regarded by Saad as the riskiest deal he has ever done;
 - two deals with GSK in 2008 and 2009 for R7.3 billion;
 - acquiring Sigma Pharmaceuticals in Australia in 2011 for R5.9 billion;
 - acquiring Merck’s anticoagulant portfolio and manufacturing sites for R10 billion; and
 - the recent acquisition of AstraZeneca’s anaesthesia portfolio for approximately \$770 million.

While investors are typically wary of acquisitive growth and tend to find more comfort in lower-risk, organic growth strategies, Saad has delivered on all of these transactions. Aspen’s acquired businesses are highly cash generative and the group has simplified the manufacturing process of acquired product portfolios, delivering – and in most cases exceeding – promised synergies.

- **Acting like an owner.** Saad owns 12% of Aspen and has never sold a share. Despite the enormity of recent transactions, equity has only been issued on two occasions:
 - the SAD acquisition in 1999, where the immature balance sheet was geared 4.7 times – the maximum lenders would allow; and
 - the GSK transaction in 2008 and 2009, where GSK insisted on a partial share offer as a condition of the deal (GSK ended up with a 16% stake in Aspen at the time).

As an owner, Saad understands that equity is precious and an expensive source of funding (if you believe your business is undervalued), as any issued shares need to be serviced, via dividends, in perpetuity.

- **Surrounding himself with good people.** While Saad is clearly a special individual, and Aspen will be a poorer business without him, he has ensured that each major geographic hub is run by a capable management team that is empowered to act. He also has a very strong deputy in Attridge – himself a significant owner – who deserves credit for the financial structuring and integration of these various acquisitions.

SIMON CRUTCHLEY – AVI LIMITED (AVI)

Crutchley established his reputation as a top-tier manager in his role as managing director of Consol, the glass-packaging

manufacturer, from 1998 to 2002. During this time, Consol was delisted and significantly restructured – Crutchley’s tenure was characterised by focused investment in plant, improved marketing efforts and rigorous cost management. The result: Consol dominated the SA glass market, and the once loss-making plastics division turned profitable. Revenue grew by 10% per annum and profits doubled over this five-year period – an admirable result in a mature, highly competitive industry.

In 2002, Crutchley became the business development director of AVI. He took over as CEO in 2005. This coincided with AVI transitioning from an industrial conglomerate to a focused branded consumer goods company. As part of the transition, AVI sold Vector Logistics, unbundled Consol and acquired Spitz and Green Cross. While much of this happened prior to Crutchley’s appointment as CEO, he was instrumental in shaping the group’s new strategic direction given his role as business development director.

Under Crutchley’s leadership, brand portfolios were aggregated to leverage off shared services, thereby saving costs. He also invested heavily in plants, marketing and innovation efforts to grow key product categories. Productivity metrics were benchmarked against international best practice, and any shortcomings were addressed. In addition, Crutchley demonstrated good discipline on capital allocation, walking away from numerous potential deals as he was not prepared to overpay. Excess cash was returned to shareholders in the form of share buybacks and special dividends. This was in stark contrast to peers that paid up handsomely for similar assets, or to expand their footprint into Africa – a strategy that ultimately ended up costing shareholders dearly.

Crutchley’s standout strengths as CEO are:

- **An extremely disciplined approach to capital allocation.** Underperforming assets that could not be fixed were disposed of (Alpesca, Denny and Sir Juice). He also walked away from numerous potential acquisitions for which vendors had unrealistic price expectations, and invested heavily in existing product categories where he believed returns could be enhanced. The result was an increase in return on equity from 13% to 27% from 2005 to 2016.
- **A razor-like focus on shareholder returns.** Crutchley ensured that AVI returned excess cash to shareholders by consistently increasing the ordinary dividend payout, share buybacks and special dividends.
- **Tight cost control.** However, this is coupled with a willingness to invest in entrenching and growing brands and product categories to enhance returns.
- **Judicious price management.** This ensures that value market share is protected and maximised.



- **Rigorous talent management.** Control is reasonably centralised and divisional managers are given scope to execute their strategies – but are quickly removed if they underperform. Between management changes, Crutchley has often stepped in to run and fix underperforming divisions.

While I have used Saad and Crutchley to identify the key attributes I believe make them special, they are by no means the only examples of exceptional business leaders in SA. Several others readily spring to mind:

- **Koos Bekker**, former CEO of Naspers. Bekker is a visionary and has successfully identified megatrends and shifts in technology very early on. This has allowed him to transform Naspers from a predominantly SA pay TV and print business into a globally significant company focused on its core verticals of media, e-commerce and classifieds.
- **Pat Goldrick**, former CEO of Cashbuild. Under Goldrick's stewardship, Cashbuild was repositioned from a business dependent on government's erratic infrastructural spend to one of the country's most successful discounters of building materials, servicing the neglected informal trade. What makes this achievement all the more impressive is that Goldrick had very little formal education (he had a poor Irish upbringing and never completed high school). His success came from pure determination, relentless focus on customer service and good old-fashioned hard work.
- **Adrian Gore**, current CEO of Discovery Holdings. Gore is a true entrepreneur who is not afraid to challenge the status quo. He is a major proponent of innovation and of using data analytics to disrupt well-established industries such as private healthcare funding, short- and long-term insurance and, more recently, retail banking.
- **Kevin Hedderwick**, former CEO of Famous Brands. Hedderwick created a culture of operational excellence across Famous Brands' key platforms of food services and logistics, which still endures today. This enabled the

business to offer its franchisees exceptional service and value. It also allowed additional brands to be plugged into the existing supply chain infrastructure, thereby transforming what was Steers Holdings into the enviable portfolio of quick service restaurant brands it is today.

While these individuals are by no means homogenous – some are born entrepreneurs, while others are highly skilful managers – they have certain common qualities:

- **They have enormous shareholder focus.** More often than not, these people are significant owners of the businesses they run and guard the value of that equity jealously.
- **They are prepared to think big, act big and follow through on their convictions if they believe these to be correct.** They do so even when it may be unpopular with the broader investment community.
- **They are focused.** While their control is often centralised, they have an intimate knowledge of all underlying operations.
- **They are highly strategic.** But they are also prepared to roll up their sleeves and get stuck in to fix and turn around underperforming operations.
- **They are very good allocators of capital.** They are prepared to invest if it enhances shareholder returns, but will otherwise return excess cash to shareholders.

Warren Buffett is famous for saying that he prefers to buy businesses that are so wonderful that an idiot can run them because sooner or later, one will. There is some truth to this statement – after all, a business with good fundamentals and average management is preferred over a business with average fundamentals run by good management. However, there are several examples in our market that prove that exceptional people have generated outsized returns for shareholders in both good and average businesses. Once you identify these special people, back them and you will be rewarded handsomely. ■



MEDICLINIC

SUNSHINE AFTER THE RAIN

By Sarah-Jane Alexander

Sarah-Jane joined the Coronation investment team in 2008 as an equity analyst. Her current responsibilities include co-managing the Coronation Industrial Fund as well as researching food producers and hospital stocks among others.



Global demand for healthcare is rising. Ageing populations, technological innovation and growing incidences of lifestyle disease are among the contributing factors. People require more healthcare, at great expense to governments and individuals. As a result, funders are increasing their efforts to rein in these costs.

Demand for healthcare is difficult to constrain. Better preventative care is helpful. Medical advances mean procedures become less invasive, reducing the required lengths of hospital stay – although often increasing technology costs. Limited ability to control demand means most energy is spent on tackling the cost to supply services. Wholesale structural changes to market practice and efficiency are usually the result of regulatory interventions, while pricing is constantly interrogated. As affordability becomes even more of an issue, the continued pressure on healthcare providers will only grow stronger.

Despite these challenges, well-run hospital businesses should continue to thrive. Private hospitals deliver critical services efficiently in environments where traditional providers (often the government) are very constrained, with limited ability to fund the growing demand. If rational funders want to optimise value-for-money healthcare, the private sector has a role to play if it can deliver efficient services.

Investors in SA have access to three high-quality listed hospital groups: Life Healthcare, Netcare and Mediclinic International. All provide good clinical care domestically. However, it is the size and quality of their international businesses that really set them apart. Mediclinic International generates the bulk of its earnings offshore through market-leading businesses in Switzerland and the United Arab Emirates (UAE). While the outlook for its SA operations is dimmed by a government inquiry, a sluggish economy and challenged affordability, Mediclinic's international footprint offers an opportunity for growth and protection against adverse risk in a single market.

However, over the last year, Mediclinic has been hit by an almost perfect regulatory storm. In addition to SA's

long-running market inquiry, operations in its largest Swiss hospital faced a potential punitive tax on private patients and Abu Dhabi regulators introduced a 20% co-payment fee on all nationals using private hospitals. The Swiss tax has been averted and Abu Dhabi reversed its regulation, so there is some respite over the short term. Still, we expect regulation will continue to impact hospital businesses from time to time as governments strive to maximise value for their healthcare spending.

Any pressure exerted on pricing must tread a fine line between incentivising investments in desired additional capacity without encouraging excessive investment. Underutilised assets make for an expensive healthcare system. Growing demand means additional capacity must be created in most markets we consider and prices therefore need to be sufficiently high to encourage investment. Our analysis of regional returns shows that Mediclinic does not earn excessive returns on newly deployed capital. In SA, adjusting its assets to replacement asset costs delivers returns in the low double digits. It is the long duration of the asset life (hospital buildings and land), rather than high upfront earnings generation ability, that delivers the returns over time. This low upfront return provides protection from excessive pricing cuts later on, with geographical diversification providing further defence.

Steady earnings and valuations, underpinned by tangible portfolios of land and buildings, mean hospital purchases can be highly geared, reducing the amount of equity needed to fund these transactions. This improves the underlying return that is achievable. These factors deliver returns to patient, long-term investors who are prepared to invest and wait for returns delivered over the asset lifetime. Mediclinic has continued to invest on this basis.

Despite threats posed by regulation, hospital groups trade on high multiples, reflecting the market's recognition of their structural growth prospects and ability to deliver steady, defensible earnings over time. Mediclinic trades on a one-year forward price earnings of 21 times. High short-term valuation multiples will unwind as earnings grow.



In the case of Mediclinic earnings, the base is low. In a reverse takeover, Mediclinic acquired the FTSE-listed Al Noor Hospitals Group last year. It has been a rocky start. Al Noor had suffered significant doctor losses as Mediclinic began to transition the group to comply with its global clinical policies. In addition, occupancies were substantially undermined when Abu Dhabi regulators introduced co-payments for state patients using private hospital facilities. First-year reported earnings for the combined regional group collapsed.

We believe that the private sector can be an efficient supplier of high-quality, critical services to the state – a position that was confirmed by Abu Dhabi’s decision to reverse the co-payment regulations in April 2017. Growth in the regional structural demand remains intact and the existing hospital base has spare capacity to be filled. Attracting more doctors is essential to lure patients back, now that regulatory obstacles have been removed. The recruitment of doctors into the UAE is a slow process as work permits, relocation and the build-up of patient bases take time – but the programme is well under way and we would expect earnings to recover strongly in coming years.

The Swiss business has its own challenges. The market has an effective regulator, which tackles areas where overinvestment and excessive profits are detected. From time to time, changes in tariffs on basic insured patients should be expected and the business will face this in the next year. While this will have a short-term impact, over time costs and investment will be adjusted to mitigate the tariff cuts. In addition, the business is investing in integration,

building a strong central platform to offer efficient services to its hospitals. Over time, these investments should serve the dual purpose of making existing operations more competitive and creating a lean infrastructure. The platform investment allows for future acquisitions to be simply ‘bolted on’. Mediclinic announced a small hospital acquisition in June, and more are expected.

SA faces a challenging time and the private hospital companies cannot escape this. A lack of growth in private sector employment means membership of medical aid schemes is sluggish. Growth in demand comes from the existing memberships, which is putting pressure on affordability. Attempts to control spiralling healthcare costs by large schemes like Discovery add to the pressure on hospital volumes. Despite this, Mediclinic is reasonably well positioned. Global learnings have been implemented and Mediclinic has focused on clinical quality and patient experience. In addition, a well-located footprint across SA’s secondary towns makes it an important part of any medical scheme network. This will prove significant in a market where we expect competitive forces to accelerate. With this in mind, we expect SA earnings to be relatively resilient.

Hospital companies are attractive businesses with long-duration assets and the ability to deliver steady and defensive earnings over time. While the market recognises this earnings quality with high multiples, the Mediclinic multiple is likely to unwind over the coming years as its Middle Eastern business recovers and its other platforms deliver sustainable earnings. ■



L BRANDS

BEAUTY IS IN THE EYE OF THE BEHOLDER

By Ryann Dean

Ryann joined Coronation in 2014 as a global developed markets analyst. He is a qualified chartered accountant and completed his articles in the financial services division of KPMG.



L Brands is a global retailer with a long history of success, a loyal customer base and a dominant brand in a compelling category of apparel retail. Its leading brand should be familiar to most as it is a name synonymous with lingerie globally – Victoria’s Secret. Besides Victoria’s Secret the company owns PINK (the younger sister brand to Victoria’s Secret), Bath & Body Works, La Senza and Henri Bendel.

Les Wexner founded the company in 1963 and today is the longest serving executive in the Fortune 500 at 55 years – even longer than Warren Buffett!

When we first did detailed work on L Brands we liked the fundamentals of the company, but there was insufficient margin of safety due to its high valuation. Accordingly, we originally chose not to own any shares. A series of subsequent short-term struggles at Victoria’s Secret caused the price to drop (50% from its peak at one stage), allowing us an opportunity to build a position. The fundamentals still remain attractive, but the share now trades for less than we think it is worth. We address the concerns and the investment case for L Brands in this article.

RECENT CONCERNS

We believe the struggles faced by Victoria’s Secret are short term in nature and do not affect the long-term attractiveness of the company. Firstly, Victoria’s Secret chose to cease selling swimwear, apparel and footwear in 2016 which, combined, accounted for \$525 million (c. 7%) of revenue. These categories were deemed noncore, lower return and more seasonal, leading to increased markdown risk and pressure on margins. Freeing up store space that was used by these categories could also be utilised better with higher-return categories, for example sports and beauty.

Secondly, management decided to significantly reduce direct mail couponing and replace it with targeted category and product promotions instead. Although this has pressured near-term results, these strategic changes are beneficial to the sustainability of the brand and the long-term returns and earnings power of the company.

These changes also coincided with broad-based weakness in overall US retail sales, with multiple store closures (especially department stores) and the continued growth of online retail. The underlying narrative for any retailer with an extensive store base is not favourable and has led to further negative sentiment towards the retail sector as a whole. Having first owned shares in Amazon in 2011 we are fully aware of the threat online retail poses to traditional bricks-and-mortar shops. However, Victoria’s Secret has key attributes which differentiate it from other retailers. Firstly, it is focused primarily on lingerie, a category which is more attractive than general apparel due to the emotive nature of the product which engenders high customer loyalty and repeat purchases. This results in industry-leading store productivity (on a sales per square foot basis), with 99% of stores generating positive free cash flow (after tax).

Furthermore, L Brands also enjoys significant lease protections¹ as its ‘destination’ stores drive traffic to malls. These protections create flexibility in what is typically a large fixed cost for most retailers. Victoria’s Secret also has above-average ecommerce penetration (20% of domestic sales versus the industry average of 13%) and is therefore well placed to adapt to changing shopping habits and potentially capture market share as competitors close doors.

So while L Brands works through these headwinds (which impact near-term earnings), we believe the strengths of the business are as relevant today as when we first researched the company three years ago.

BRAND POWER

In a world where anyone can call up a product on a smartphone and where multiple brands are competing for a share of the consumer’s wallet, ownership of a compelling brand is vitally important to stay relevant and grow. In fact, it is almost impossible to place an explicit numerical value on it. This is something management clearly understands,

¹ Should the occupancy of a mall fall below a certain level or anchor tenants leave, L Brands’ rental costs drop and it is able to vacate on short notice with no financial penalty.



given the growth of Victoria's Secret into the dominant global lingerie brand over many years. The Victoria's Secret Fashion Show, a springboard for many successful international models' careers, is shown in nearly 200 countries and has generated 100 billion media impressions worldwide. It has a strong social media presence, with 27 million Facebook followers and 56 million Instagram followers, and is the market leader in the fragmented lingerie category, with market share of approximately 27% in the US.

PINK is the sister brand to Victoria's Secret aimed at university-age women. The brand was created internally to address the younger consumer and has grown to a sizeable business with industry-leading productivity metrics (over \$1000 sales per square foot). PINK also has a strong social media presence, with 13.6 million Facebook followers and 7.2 million Instagram followers.

Recently Goldman Sachs, in partnership with Condé Nast, conducted a survey which focused on millennial female shoppers' affinity for various brands. Victoria's Secret was the clear leader in the lingerie space, more than eight times more favoured than the second-placed brand. Victoria's Secret dominates its category more so than any other brand, beating Nike, lululemon, Coach and Michael Kors, to name a few. According to the survey, the millennial shopper controls over one quarter of dollars spent in fashion categories already and their spending will increase almost 40% in the coming 15 years due to rising disposable income. With its high brand affinity, Victoria's Secret is well placed to capture a fair share of this increasing spend.

INTERNATIONAL POTENTIAL

L Brands has followed an approach unlike most other retailers with regard to its international expansion. While many retailers rapidly expanded through a combination of wholesale sales, franchise agreements and their own stores, L Brands focused first on succeeding in the North American market and building its brand premium. In 2016, international revenue only accounted for 3% of total revenue.

With a globally recognised brand portfolio (particularly Victoria's Secret), there is clearly a significant international growth runway remaining. Its brand and customer experience remain the highest priority for management and as such the company has approached its expansion in a steady and measured way, ensuring that every store around the world meets strict standards (unusually for a retailer, it gives final approval on all store locations for franchise partners).

International growth is focused on a few key geographies – Europe, the Middle East and most recently (and importantly) China. China is a market with massive long-term potential, highlighted by the company's decision to assume control from its former franchise partner and operate its own stores and ecommerce (in partnership with Alibaba). The opportunity is sizeable as China could be the same size as the US business in time. Victoria's Secret is already well recognised in China and management intends to have the 2017 Fashion Show in Shanghai, confirming its commitment to the country. We believe that the international potential for L Brands is incredibly attractive and will be a revenue and earnings growth theme that plays out for many years.

BRAND AFFINITY AMONG MILLENNIALS



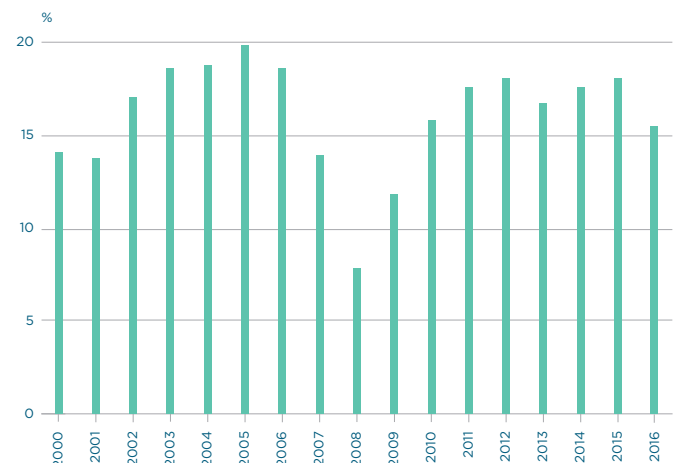
● Highest favourability scores within categories

Source: Goldman Sachs and Condé Nast (2017 Brand Affinity Index)

MARGIN POTENTIAL

L Brands has multiple avenues for future operating margin improvement from 2016 levels.

VICTORIA'S SECRET OPERATING MARGINS

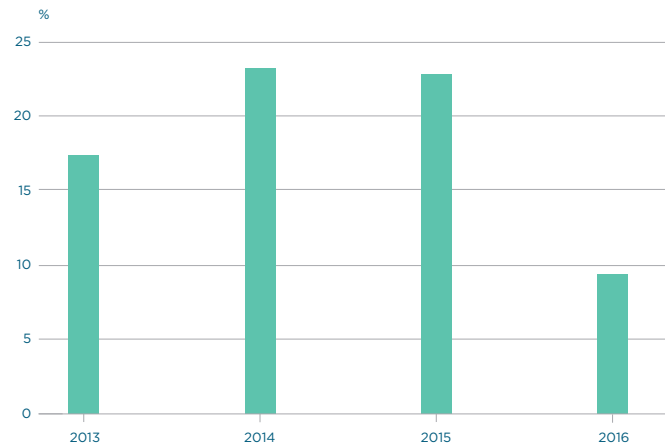


Source: Company reports



The aforementioned strategic changes have depressed merchandise margins due to the need to discount product in order to clear it quickly. The new targeted promotional strategies should also result in fewer margin-dilutive promotions. For example, in the past, direct mailers were used to offer a free pair of underwear (no corresponding purchase required) and 40% of customers simply came into store to collect their free product with no additional purchase. Clearly, giving away products for nothing is very dilutive to margins.

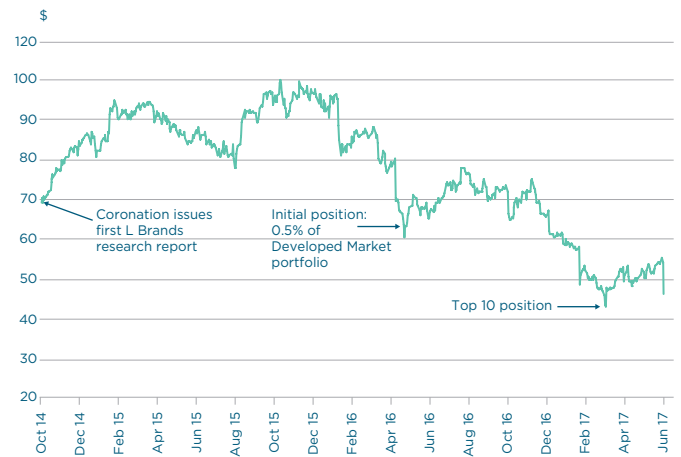
L BRANDS' INTERNATIONAL SEGMENT OPERATING MARGINS



Source: Company reports

L Brands' decision to enter and roll out stores in China with its own team also does not come without short-term costs. It has depressed margins in the international segment, which historically earned higher margins than the core company. However, as the Chinese business gains scale over time we expect margins to improve meaningfully from current levels.

L BRANDS SHARE PRICE



Sources: Bloomberg, Coronation

CONCLUSION

L Brands owns world-class brands, with leading market positions in attractive categories. Although cyclical, the company has tremendous potential to grow as it expands internationally.

“Long ago, Ben Graham taught me that price is what you pay; value is what you get”, Warren Buffett wrote in a Berkshire Hathaway shareholder letter nearly a decade ago. “Whether we’re talking about socks or stocks, I like buying quality merchandise when it is marked down.” As investors, much like consumers, we are constantly on the lookout for markdowns like these. But the skill lies in determining whether the headwinds the company faces are cyclical or structural, a once-off or a permanent (value-destroying) change. In our view, the challenges L Brands faces today are mostly temporary and short term. We believe L Brands is quality merchandise that has been temporarily marked down. ■



MOBILE MONEY IN FRONTIER MARKETS

SAFARICOM LEADS THE WAY

By Floris Steenkamp

Floris joined Coronation as an investment analyst in the Global Frontiers unit in 2014. Previously, he was an audit manager in the financial services division of PricewaterhouseCoopers.



Certain brands are not only well known, they are so renowned that they have actually become generic terms for products. People will refer to any bandage as a Band-Aid, or will call a hot tub a Jacuzzi, irrespective of whether it was actually manufactured by these companies. Other brands have become verbs: you often hear people say, “I will Uber home”, and just think how frequently we use the phrase, “Let me Google it”.

When you visit Kenya you will find another brand that has become a verb – M-Pesa, the leading mobile money business in the country. “Should I just M-Pesa you the money?” is commonly heard and is evidence of a business that has become completely entrenched in the Kenyan economy. M-Pesa is owned by Safaricom, the leading mobile operator in Kenya. Safaricom recently became particularly relevant for SA investors when Vodacom announced in May 2017 that it will acquire a 35% stake in the company.

We have been following Safaricom closely since we participated in its listing in 2008. We have held this company in different sizes in our portfolio for many years, and as a result our Global Frontiers team, as well as many of our SA-focused analysts and portfolio managers, is very familiar with this business.

Typically it is our years of experience investing in SA that assist us in analysing companies in frontier markets, but in some cases, like with Safaricom, it is our experience in Kenya that helps us to better analyse an investment in SA.

Safaricom’s telecommunication business is highly cash generative and offers attractive growth due to low mobile and data penetration in Kenya. The risk of aggressive price competition is also small due to the low profitability levels among its competitors and the fact that tariffs in Kenya are already among the lowest in Africa. In addition to these factors, what really excites us is the potential of M-Pesa, a business started in 2007 as a service to transfer money using your mobile phone. M-Pesa was specifically targeted at people without a bank account, evidenced by its first advertisement campaign with the simple slogan “Send

money home”. The low banking penetration and supportive regulations, particularly at the time when M-Pesa was launched, resulted in a rapid uptake. M-Pesa now accounts for 27% of Safaricom’s revenue and has grown to 26 million customers, 19 million of whom were active in the past 30 days. This means that two out of every five Kenyans have used M-Pesa in the last month!

Today, M-Pesa is a phenomenal ecosystem with a strong moat of agents and satisfied customers, as well as large economies of scale. The velocity of money within M-Pesa is quite spectacular and continues to grow. In the most recent financial year alone, \$18 billion was deposited into the system and \$16 billion person-to-person (P2P) transfers were made using M-Pesa.

The evolution from P2P transfers to an integrated payments platform is only just beginning. Supermarkets now allow customers to use M-Pesa to pay for goods, businesses increasingly use M-Pesa for bulk payments such as wages and you can now even buy government bonds using M-Pesa. The profit margins of these new services are significantly higher than for P2P transfers where Safaricom has to pay an agent commission every time money is deposited or withdrawn from the ecosystem. There is significant potential to add more services to the platform as over 90% of transactions in the Kenyan economy are still done with physical cash. M-Pesa is increasingly looking like a payments network such as Visa or Mastercard, whose attractive economic fundamentals are well documented.

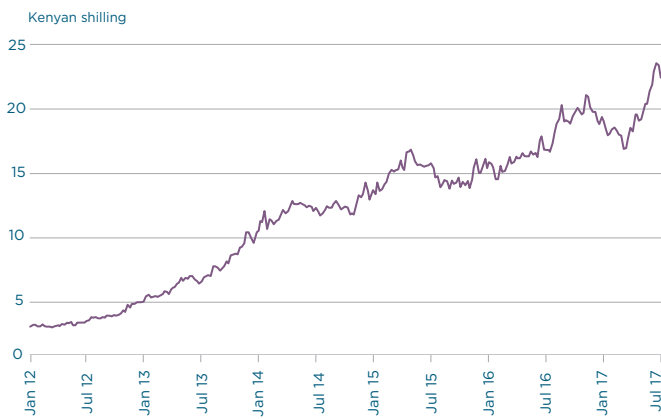
M-Pesa has already begun to disrupt the banking landscape in Kenya. We have argued for many years that the Kenyan banking industry is simply too profitable, leaving the door open for disruptive competitors such as M-Pesa. Although M-Pesa currently does not have intentions to become a fully-fledged bank, we view this as a natural progression over time. We estimate that deposits in the M-Pesa system have grown to such an extent that they eclipse the deposits of at least 26 of the 40 banks in Kenya. Currently Safaricom is not entitled to keep the interest earned on the float (the interest is paid to charities), but there is significant



potential to mobilise these deposits should M-Pesa get a full banking licence. In addition, we would argue that the information it has on customer behaviour, based on their M-Pesa transaction history, means that Safaricom's ability to do credit scoring must be well ahead of many of the banks.

The following graph shows the share price performance of Safaricom over the past five years. During this period, the company often appeared to be expensive on near-term multiples, but by looking a number of years out and valuing the business based on what we believed to be a normalised earnings level, we continued to find the valuations attractive. We believe today is no different and that M-Pesa's evolution over the coming years will continue to surprise investors.

SAFARICOM'S SHARE PRICE



Source: Bloomberg

Across frontier markets there are a number of countries that offer similar opportunities. The low banking penetration in countries like Mali and Pakistan offers the ideal environment for mobile money, while in Zimbabwe the tight liquidity environment acted as a boon for mobile money adoption. However, the investment opportunity we are most excited about is bKash in Bangladesh, another example of a brand that has become a verb.

bKash has close to 80% market share of mobile money transactions in Bangladesh. The business is run by a management team with a lot of experience in mobile money and, similar to Kenya, Bangladesh has low banking penetration with supportive regulation, focused on financial inclusion in the country. We have seen that the network effect in a business like this is incredible, with the number of transactions growing exponentially as the number of users expands. This means that the strongest player usually just gets stronger and in this 'winner takes all' industry, bKash is extremely well positioned to capture the Bangladeshi mobile money market. We believe that bKash is today where M-Pesa was about four or five years ago, and if M-Pesa's growth trajectory is anything to go by, bKash has enormous growth ahead of it.

Firstly, bKash should experience strong revenue growth as the number of users and the transactions per user increase. The following table and graphs show that although Bangladesh's population is almost four times the size of Kenya, its mobile money revenue is (still) significantly lower than that of M-Pesa, clearly highlighting the potential for bKash.

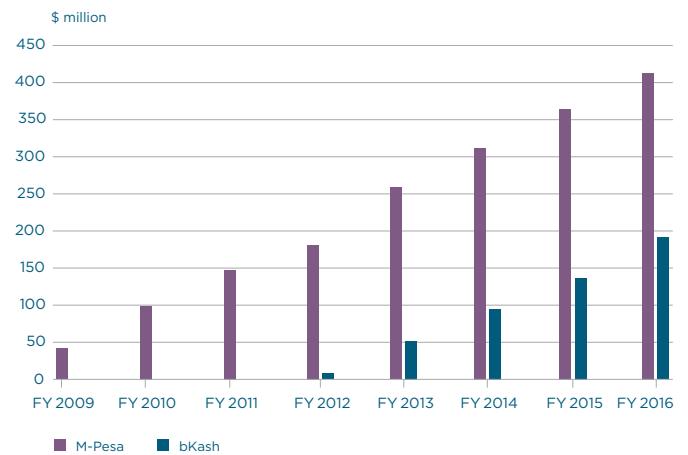
REVENUE FROM MOBILE MONEY VS POPULATION

	M-Pesa (Kenya)	bKash (Bangladesh)
Revenue from mobile money (FY 2016, converted to \$ million)	415	192
Population (million)	46	162
GDP per capita (\$)	1516	1411
Number of active users* (million)	19	11
Active users as % of population	41%	7%

* Active users are defined by M-Pesa as those users active within the last 30 days and by bKash as those active within the last 90 days.

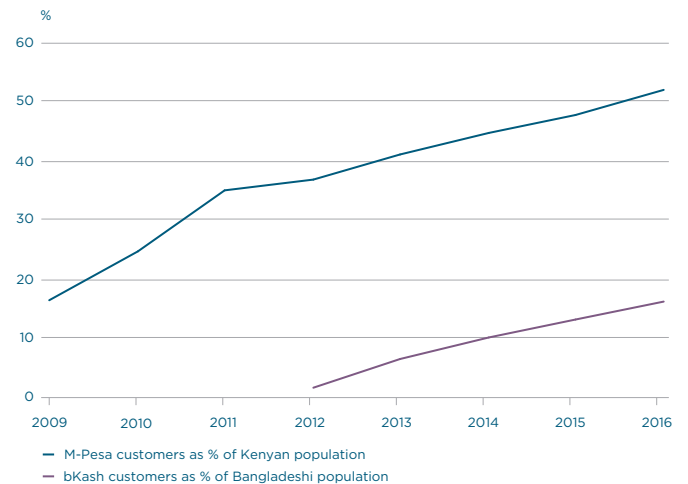
Sources: Company reports, IMF

REVENUE (CONVERTED TO US DOLLAR)



Source: Company reports

PERCENTAGE OF POPULATION WITH A MOBILE MONEY ACCOUNT



Sources: Company reports, IMF



Secondly, the profit margin of bKash is still well below where it could be once this business reaches maturity. bKash is investing heavily to build its agent network and entrench its market position. This, as well as the fact that virtually all its transactions are still the traditional lower-margin P2P transfers, both point to significant growth in margins in the future. The gross profit margin of bKash has grown to 19% in 2016, but this is well below that of M-Pesa, which we estimate to be in excess of 50%. Over time, we see no reason why bKash cannot have similar gross profit margins as the business matures and new high-margin services are added to the bKash platform.

When it comes to net profit margins, bKash should be able to achieve margins well above that of M-Pesa, given that it is entitled to the interest earned on the float balance. If M-Pesa had this benefit, its profit margin would have been more than 10 percentage points higher. Many articles have been written on the benefits of a business which generates float, usually quoting Warren Buffett's explanation that float

is essentially free money which a business can use to invest. The bKash float has grown rapidly from \$50 million in 2013 to over \$200 million currently. The float has the potential to be a multiple of this balance in a few years' time and, similar to M-Pesa, we believe the ability of this business to gather these cheap deposits is a major threat to banks.

Currently investors can get exposure to bKash through its listed parent, BRAC Bank. We expect that bKash will be unbundled from BRAC Bank at some point in the future - firstly to give investors direct exposure to this attractive business, but also to allow bKash even more freedom to pursue new products and services which will inevitably compete with its parent. Similar to Safaricom, we believe that while the BRAC Bank valuation might look stretched on near-term multiples, the share price does not yet fully reflect the growth potential and optionality inherent in the mobile money business. We believe this offers an attractive opportunity for long-term investors. ■



SA ECONOMY

TAKING A TURN FOR THE WORSE

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.

So much has changed. When I wrote about the prospects for the SA economy at the start of the year, I was comfortable that 2017 would, in economic terms, be a lot better than 2016. Relief from the crippling drought would help ease grain prices and provide support for both growth and trade. Falling inflation – especially food prices – should boost real incomes, providing relief for strapped consumers, and while tax increases were always likely, lower inflation raised the possibility of some monetary support for spending. A helpful global backdrop for growth would reinforce improved trade and, taken together, confidence would lift.

Then president Zuma reshuffled his cabinet on 30 March and in the weeks that followed the political landscape changed dramatically. The initial shock of the replacement of SA’s immensely credible finance minister Pravin Gordhan and his deputy Mcebisi Jonas was followed by a series of serious allegations about the capture of key institutions. Public revelations – through leaked emails in the media, as well as in academic work – detailed the degree to which political decisions have been compromised in the interests of a few.

More recently, and most unhelpfully, the independence and mandate of the central bank have been brought into question. Even if these contentions do not pass constitutional muster, the scrutiny politicises an institution which has to date remained above reproach, and justifiably trusted by South Africans and more broadly, financial markets.

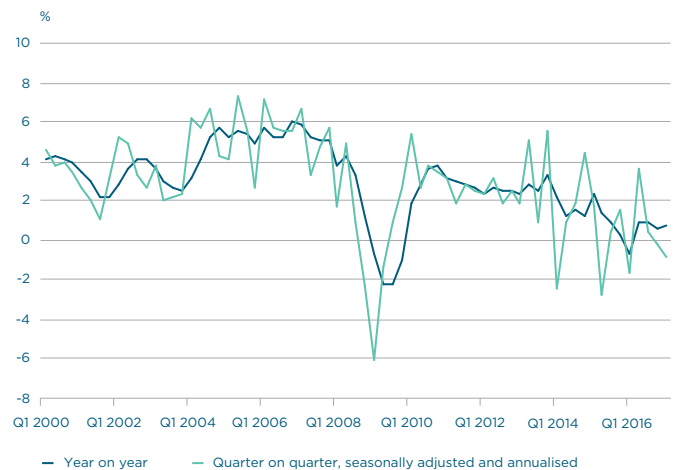
And this, really, changes everything. Because the decisions that are now being made by households and businesses are very different to the ones which might have been made before these events. Confidence, at the end of the day, is the engine of growth, and growth is the single most important condition for poverty relief. So, as we look ahead, the outlook for growth in SA is now severely constrained.

GROWING OFF A WEAKER BASE, INTO UNCERTAIN TERRITORY

Already, data published for the first quarter of 2017 were much weaker than expected. Notwithstanding some volatility,

relative to the previous quarter, growth contracted 0.7% in seasonally adjusted terms. Because output also declined in the fourth quarter, SA entered a technical recession in the first quarter of 2017. Perhaps more alarming than the weak headline reading was that household spending – typically a pretty solid driver of growth, usually accounting for about 60% of GDP – was the main source of the weakness.

SA REAL GDP



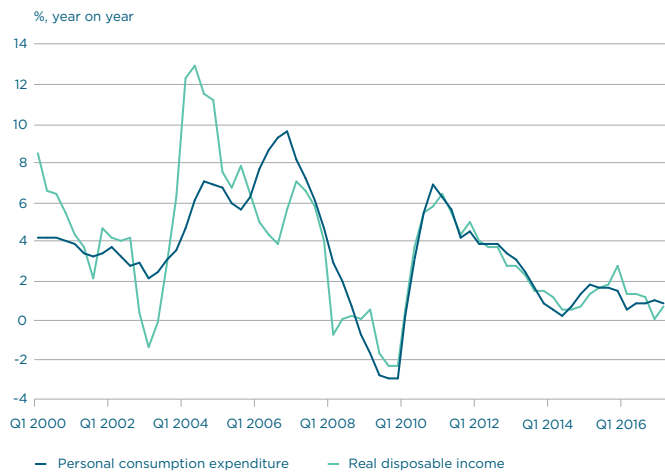
Source: Statistics SA

Household spending in real terms contracted by 2.3% quarter on quarter (seasonally adjusted and annualised), after growing 2.2% in the fourth quarter of 2016. Household spending, in turn, is a function of employment, remuneration, changes in tax and inflation (which give us a measure of disposable income), followed by households’ decisions to save or spend what is left (household confidence).

When looking at potential drivers for growth at the start of the year, my assumption was firstly that employment would grow in line with the 1% average of the past couple of years, and that nominal remuneration growth would remain broadly stable at about 7%. With inflation set to fall from 6.3% in 2016 to just over 5%, real income growth should have more than offset the impact of higher taxes on aggregate consumption.



SA SPENDING AND DISPOSABLE INCOME

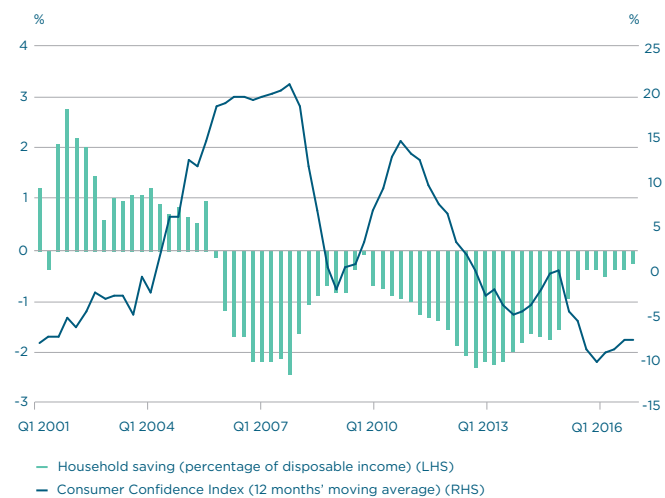


Source: SA Reserve Bank

I also assumed that wealthier households, with greater financial resources, would save a little less to consume at the same rate as before, despite the increased outlay to SARS.

What the data, compounded by increased political uncertainty, now suggest is that while real income growth should improve into year-end as inflation eases (the first quarter of 2017 was certainly the worst combination of high inflation, low wage growth and a hit from taxes), households are choosing to increase their savings as confidence deteriorates, rather than spend it. Delayed consumption might not apply only to big-ticket items like fridges or cars, but could filter through semidurable and nondurable goods and into nonessential services too. It also means household spending is likely to remain weak for a considerable period.

SA HOUSEHOLD SAVING AND CONFIDENCE

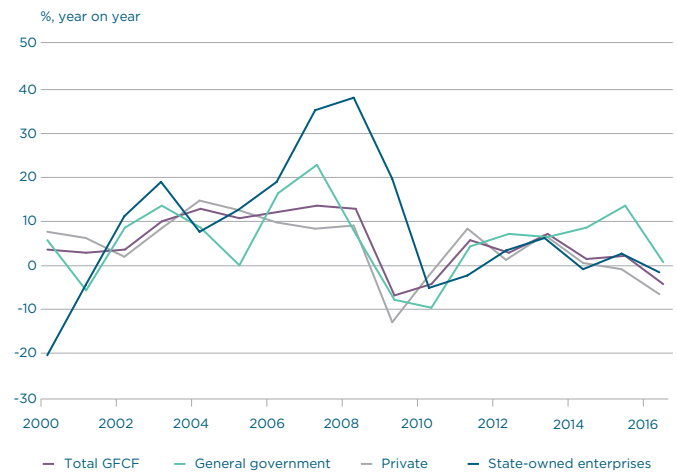


Sources: SA Reserve Bank, Bureau for Economic Research

What about other growth drivers? The next biggest component of GDP is fixed investment. The private sector

(60% of total gross fixed capital formation [GFCF]) and combined government and public corporations (the remaining 40% of total GFCF) account for just under 20% of GDP. Here too the news is probably worse than it might have been. Private sector investment has been weak for a while, faced by successive headwinds: a combination of low global growth and trade volumes, ongoing strikes in 2012 to 2014, policy uncertainty in key industries like mining and healthcare, and electricity shortages causing capacity constraints. Improved global growth and some support for commodity prices might have eased some of these constraints, but the publication of a new Mining Charter, which has far-reaching implications for the industry, coupled again with heightened political uncertainty, may see companies invest less than would have been the case otherwise, accelerate offshoring or deferring investment decisions.

SA REAL GROSS FIXED CAPITAL FORMATION (GFCF)



Sources: SA Reserve Bank, Statistics SA

MATERIAL ECONOMIC CONSEQUENCES

Political uncertainty, the weakening of state institutions and persistently lower growth in the short to medium term now also carry a more sinister risk. Further ratings downgrades will see SA excluded from a large benchmark bond index like the Citigroup World Government Bond Index (WGBI). As things stand, the risk is too close for comfort: WGBI inclusion requires that both Moody's and Standard & Poor's hold the sovereign local currency rating in investment grade. Both agencies now have this on the limit at Baa3 (negative outlook) and BBB- (negative outlook) respectively, and both have signalled more downside to come. It seems very likely that a downgrade will happen over the next 12 months, and with index exclusion will come a weaker currency and considerably higher borrowing costs.

This leaves government in an increasingly challenged position. Weak growth will undermine this year's fiscal



targets, and put the medium-term expenditure framework at risk. Debt has risen to over 50% of GDP, and the pace of accumulating cannot slow – unless fiscal measures are implemented to pull the deficit back onto the consolidation path outlined in the Budget. With weak growth, this comes at an even greater cost.

Still, there is a bit of good news. SA's trade performance is supported by relatively buoyant global conditions, and positive terms of trade will help keep the currency stronger than might be the case otherwise. Inflation has been falling steadily, and should be well below 5% by the end of the year. The inflation outlook for 2018 (annual average of 5.2%) is still favourable. This suggests that real disposable household income, which is now under chronic pressure, should improve. With growth as weak as it is, the SA Reserve Bank (SARB)

might see an opportunity to provide some cyclical support too – although even this is likely to be affected by the emerging public debate about the SARB mandate.

What politicians seem at risk of forgetting is that it really is all about growth. Growth is being hamstrung by battered confidence that seems to have trumped a nascent improvement in underlying conditions. Long periods of very low growth become reinforcing: as infrastructure is worn down and inadequately maintained, production processes become inefficient and costly, and profitability suffers. Unprofitable companies retrench workers and disinvest – the economic infrastructure shrinks, people become increasingly unemployable and reliant on state support, and potential growth falls. Lower potential growth implies higher real rates over time, and a weaker currency. ■



BOND OUTLOOK

BIG-PICTURE INVESTING

By Nishan Maharaj

Nishan is head of Coronation's fixed interest investment unit. He joined the business in 2012 and has 14 years' experience in the investment industry.



THE BIGGER PICTURE

In investing, it is dangerous to lose sight of the bigger picture. This is unfortunately easy to do when financial markets consistently deliver short-term disruptions and distractions that obscure the complete view, to the detriment of achieving longer-term objectives. The risk of getting caught up in the detail is best illustrated by an ancient parable. It tells the story of six blind men who came across an elephant for the first time. Each tried to discern what the animal looked like based on the body part they could feel. The blind man who got hold of a leg concluded that an elephant looks like a pillar. Another, who held its tail, surmised that it resembled a rope. The one with its trunk said it was like a tree branch. The man who felt its ear said the elephant was like a hand fan. Feeling the elephant's belly, another blind man sagely replied that the elephant was like a wall. Lastly, the one who felt its tusk said it was like a solid pipe. Each of them correctly assessed their specific part, but did not realise that the elephant was in fact the sum of all those parts.

Losing sight of the bigger picture is particularly dangerous when change is afoot, as we believe is evident in the SA bond market. The market enjoyed a relatively decent second quarter, with the All Bond Index up 1.5% for the quarter ending 30 June 2017, slightly behind cash (1.9%) but well ahead of inflation-linked bonds (1.0%). In the year to date, bonds remain the star performer in the fixed-income asset class, returning 4.0%, well ahead of cash (3.7%), inflation-linked bonds (0.4%) and even preference shares (2.3%), which have been the stand-out performers over the last 18 to 24 months.

The performance of local bonds was in large part a function of the strong performance of emerging markets, with the JP Morgan Emerging Markets Bond Index (EMBI) Global Diversified composite (a proxy for emerging market bond performance in dollars) returning 2.2% the second quarter and 6.2% year to date. This has supported inflows into the local bond market of approximately R40 billion this year (R21.3 billion in the second quarter), keeping local

bond yields relatively well contained despite a deteriorating fundamental backdrop. Key for bond investors is whether current levels in the local bond market are sustainable – or are investors failing to see the bigger picture?

VICIOUS CIRCLE

Over the last quarter, there have been some significant developments on the local front. Firstly, inflation has continued to fall and the SA Reserve Bank (SARB) has started to tilt towards monetary easing as growth collapsed, pushing SA into a technical recession. Much-needed policy reform remains hamstrung by accusations of endemic corruption at the core of government and state-owned companies, pushing policymakers further into a state of paralysis. Confidence in the economy and in the ability of policymakers to make the right decisions has continued to decline, as seen in recent business and consumer confidence indicators. This creates a vicious cycle: no new private or corporate investment is adding to the downside risks and dragging on growth momentum over the next year (and more importantly, over the longer term). The net effect is an economy with no buffer or ability to withstand any further bad news or deterioration in global risk sentiment.

The SA economy is set on a path of deteriorating creditworthiness due to worsening debt and fiscal metrics. Without serious policy action, we will have to endure further downgrades into subinvestment grade over the next 12 months. This will result in our bonds being excluded from key investment indices, which we expect will trigger large outflows from the bond market. The impact will not only be felt in the financial markets, but will inevitably affect the man on the street through higher borrowing costs and possibly higher inflation over the longer term. Accordingly, local economic prospects remain quite dim.

When we were faced with such poor prospects in the past, investors could take comfort in the fact that local asset prices were reflecting the same (if not a greater level) of pessimism. Being able to buy assets at a decent risk-adjusted discount helped to compensate for feelings of



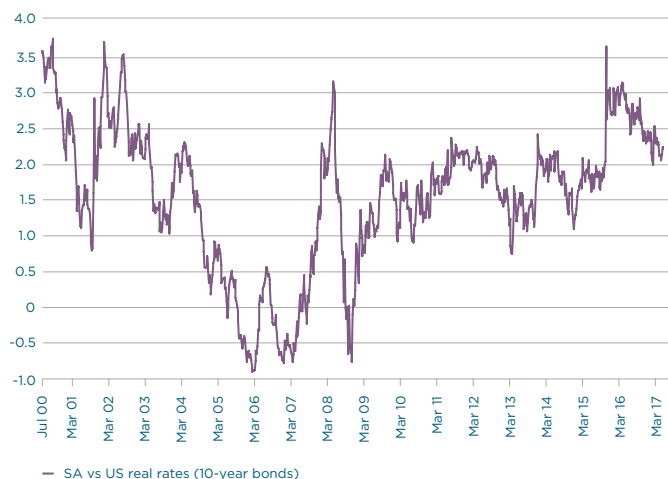
personal misery. Unfortunately, this is currently not the case, especially in the local bond market, where yields have managed to remain quite stable at relatively expensive levels (8.65% average over the last quarter, reaching a low point of 8.38%). This is primarily due to a renewed global hunt for yield.

KEY RISKS

Since the global financial crisis (2008/2009), US 10-year real yields have fallen steadily and traded as low as -1% before settling into a range of 0% to 1% in the last five years. This has anchored global bond yields, supporting the hunt for yield into many emerging and frontier markets. The implied real yield of SA 10-year bonds, which has been oscillating between 1% and 2% above the US 10-year real yields, looked quite attractive. The implied 10-year real yield is calculated by using a static inflation assumption of the realised inflation average (5.8%) over the period. The key risks to SA government bond yields are whether US 10-year real yields (currently at 0.57%) will remain below 1% over the long term, and whether SA bonds are trading at a fair price relative to US bonds. SA's implied 10-year real rates currently trade at a spread differential of approximately 2% to US 10-year real rates. This is probably insufficient given SA's deteriorating macroeconomic backdrop. If anything, this spread represents the best possible scenario.

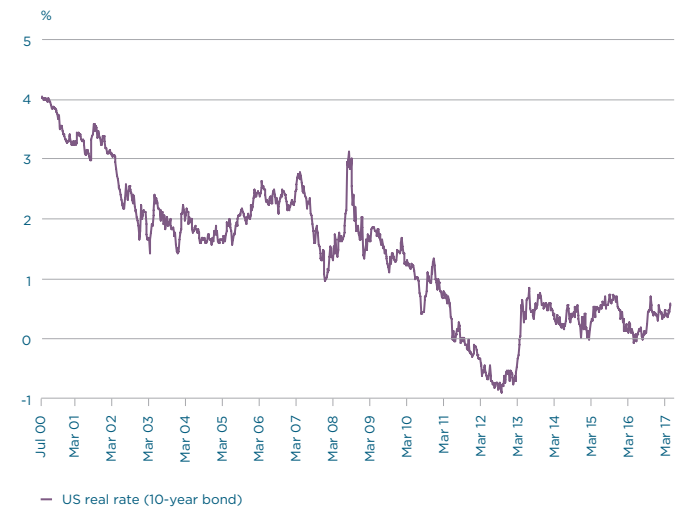
The current key US interest rate sits between 1% to 1.25%, with the Federal Reserve (Fed) expected to hike it to 3% over the longer term. Inflation in the US, as measured by the Fed's chosen measure (personal consumption expenditure) sits at 1.4%, but is expected to move towards the Fed's target of 2%. This implies that currently the real US policy rate is at -0.39% (very accommodative, considering that growth is above 2%). Over the longer term, this will move to around 1% (assuming inflation of 2% and the Fed's interest rate of 3%).

SA VS US REAL RATES



Source: Bloomberg

US REAL RATES



Source: Bloomberg

Based on these numbers, it is apparent that there are two key risks to the current level of the US 10-year real rates. Firstly, the US policy rate is too accommodative, and should move towards a more appropriate level. Secondly, if the US policy rate moves towards a real rate of 1%, then US 10-year real yields at 0.57% (or even sub 1%) are not sustainable. Taking a step back to examine the bigger picture, it is clear that SA government bonds are at risk of widening given the combination of strong upside risk to US real yields and a SA risk premium that is priced only for very good domestic news.

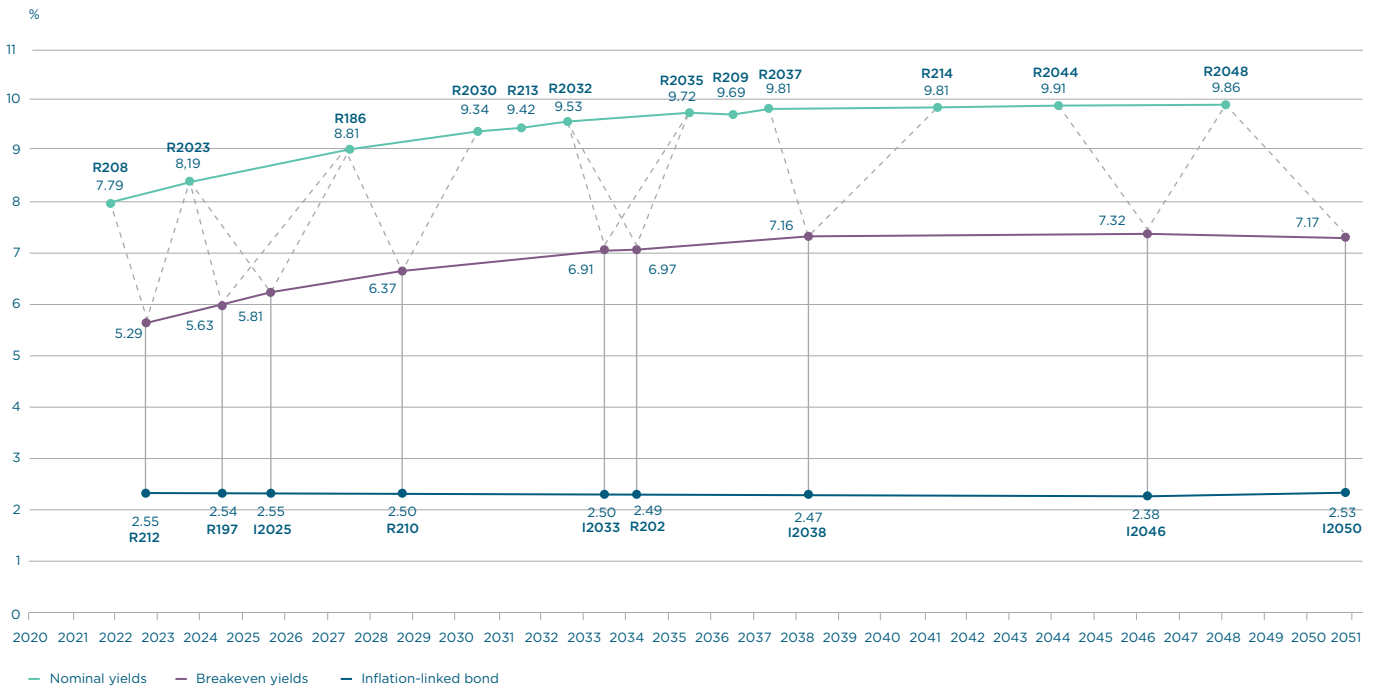
OUR VIEW

At Coronation, we aim to construct portfolios that are well diversified, robust and resilient. So, given that we are cautious on almost 70% of its investable universe, where are we investing our bond portfolio? Two key areas in the SA bond market are starting to look quite interesting, the first being shorter-dated inflation-linked bonds (ILBs) and the second, the long end of the government curve.

The ILB curve (the lowest line in the graph overleaf) is currently very flat, with almost all bonds trading at 2.5%. SA's repo rate is at 7%, implying a real policy rate of 1.5% (assumed inflation at 5.4%). This implies one can buy a short-dated ILB (five-year maturity) at a spread of 1% above policy rates, which is quite attractive, especially when one considers that over the next 12 to 18 months, the policy rate in SA will probably moderate by around 50 basis points (bps), which will act as a strong anchor for shorter-dated ILBs. In addition, from a total return perspective, if inflation averages 5% over the next year, the five-year ILB will return 7.8%, which is slightly higher than the equivalent five-year nominal government bond. However, in the case of inflation averaging 5.5% to 6%, the ILB will return 8.33% to 8.82%. In the worst-case scenario, this asset provides one with an equivalent nominal



NOMINAL BONDS VS INFLATION-LINKED BONDS



Source: Coronation

bond return but gives one added protection in the case of an upside surprise in inflation. This makes an ILB an attractive alternative to a nominal SA government bond, especially in a traditional bond portfolio. Due to the flatness of the ILB curve, the implied breakeven levels for longer-dated ILBs (greater than 15 years) sit north of 6.5% (the middle line in the graph above), compared to the shorter-end ILBs (five years) being closer to 5%. Breakeven inflation is where the market expects inflation to average over the life of the underlying bond, so in the case of an ILB with a maturity greater than 15 years, one would need inflation to average above 6.5% before the ILB outperforms its nominal equivalent – a highly unlikely scenario considering we have an inflation-targeting central bank. This further enhances the relative attractiveness of the shorter-dated ILB since breakeven inflation expectations are closer to 5%.

As we have outlined, SA 10-year government bonds are not appealing. So why would we be interested in government bonds on the longer end of the curve (more than 15 years), which traditionally are even riskier? It is important to note that at Coronation, we do not position a portfolio for only a single outcome. Our portfolios are carefully constructed to make sure that as a whole they should create attractive longer-term returns. Our historical analysis suggests that over the last 15 years the longer end of the bond curve has only a maximum of a 50% correlation to the 10-year area of the curve (if the 10-year bond rallies/sells off 100 bps, then the greater-than-20-year bond only rallies/sells off 50 bps). In addition, given that over the next 12 to 18 months, the SARB is likely to reduce the repo rate by 50 bps, these

longer-end bond yields of close to 10% are going to find it difficult to move out 100 bps, in line with the 10-year benchmark, as their relative attractiveness to cash rates will be hard to ignore. What this implies is that we are likely to see a flattening of the bond curve in the event of a 100 bps sell-off in the benchmark. However, one might argue that given that the sell-off in bond yields will probably be driven by a weakening in SA's fiscal and debt metrics, it is highly unlikely that we only see a 50 bps sell-off in 23-year bond yields if 10-year bond yields sell off 100 bps. Therefore we need to be extra conservative. Let us assume the 23-year bond sells off 80 bps, in the event of a 100 bps sell-off in the 10-year benchmark. In the table below, we show the total return numbers over various time periods, based on a 100 bps sell-off in the 10-year bond and an 80 bps sell-off in the 23-year bond.

SA 10-YEAR AND 23-YEAR GOVERNMENT BOND RETURNS

	Starting yield	Total return over period		
		1 year	2 years	3 years
10-year bond	8.75%	3.45%	13.44%	24.13%
23-year bond	9.85%	3.35%	14.05%	25.52%
Performance differential	1.10%	(0.10%)	0.61%	1.39%

Source: Coronation

It is clear that in periods greater than a year, the 23-year bond actually outperforms – demonstrating how powerful yield can be over the longer term. Longer-end bonds



definitely carry greater risk, but investors are more than adequately compensated for this risk in the spread relative to the 10-year benchmark. Accordingly, longer-end bonds are an attractive alternative within a bond portfolio.

Given the local macroeconomic backdrop, we remain cautious. We expect low growth and policy inaction to contribute to a deterioration in SA's fiscal and debt metrics, inevitably leading to further moves into subinvestment grade territory and index exclusion if we see no immediate policy

reaction. The hunt for yield in emerging markets has diverted attention away from this deterioration. But low global real rates may not last forever, and when the easy money stops flowing into the country, it will expose SA's harsh reality. It is for this reason that we adopt a cautious approach when it comes to investing in the local bond market. A significant repricing of local bond yields would be required for us to invest. In the interim, we do see selective value in short-dated ILBs and the longer end of the government bond curve, which provide relative value in difficult times. ■



SA PORTFOLIO UPDATE

OPPORTUNITY DESPITE UNCERTAINTY

Our portfolios have performed well amid continued strain in domestic markets.

The JSE had another poor quarter, with the FTSE/JSE Capped All Share Index losing 1% (1.4% over a rolling 12 months).

The local economy remains mired in recessionary conditions. It is, in fact, deteriorating at an accelerating rate as business and consumer confidence have evaporated in response to a tough economy and very concerning political developments.

Markets are reflecting this uncertainty, and conditions remain as challenging as ever. However, we are comforted by the fact that we find more value today than we have at any time over the last five years. Volatility is not to be feared. It typically presents great opportunity to the patient, long-term investor. We remain alert to opportunity. We also understand the risks that the current environment presents to the real value of our clients' retirement capital. We believe that it is in these difficult times that we can add most value to our clients.

SPECIALIST EQUITY STRATEGIES

	Launch date	1 year	5 years	Since inception
Houseview Equity	Oct 93	2.11%	13.78%	17.38%
Benchmark		1.35%	12.30%	14.60%
Aggressive Equity	Feb 02	7.69%	12.66%	17.81%
Benchmark		1.35%	12.30%	14.95%

*Annualised
Sources: Coronation, INET*

The defining positions in our local equity portfolios remain the high-quality global companies that happen to be listed on the JSE (Naspers, British American Tobacco, UK-listed property holdings and Steinhoff). Naspers advanced 10% over the quarter as its key associate, Tencent, reported strong results. Tencent remains an exciting proposition, with new opportunities such as cloud services and payments starting to gain traction.

Despite depressed conditions, we are starting to see value among local companies. We have used the weakness in domestic stocks to start accumulating high-quality stocks that have begun to discount the bad news. Examples include Spar and Pick n Pay. These businesses are battling in the tough trading environment; however, both are high-quality businesses that have multidecade track records of performing well in tough economic times. High-quality businesses always fare better than poor-quality businesses in times of adversity.

Financials had a muted quarter. We added to our holdings in Nedbank, which remains underrepresented in the retail market and has opportunities to grow its share and improve cross-selling. It has a strong corporate franchise and a low earnings base in Ecobank, its African unit. Trading on eight times our assessment of normal earnings, Nedbank has a wide margin of safety.

The much-feared mining charter was gazetted in the past quarter. This is a draconian piece of regulation (it is technically not legislation because it was not passed by parliament) that would ultimately destroy the mining industry if sanity does not prevail. The local mining industry is on its knees and has shrunk significantly over the last decade. However, the decline over this period will be minor compared to the damage this charter would do to the industry, its employees and the surrounding communities. SA cannot afford such a damaging outcome. We hold some local mining stocks, although they are largely ones that have excellent empowerment credentials (Northam and Exxaro). No miner will be immune, but these companies will suffer less collateral damage than the rest of the industry should this charter come to pass.

We live in uncertain times, both locally and globally. Domestically, growth is low and the consumer is facing unprecedented strain. Globally, growth is more robust, but geopolitics continue to cause much uncertainty. We remain constant in our long-term valuation philosophy and process to help us identify the right holdings for the fund. This patience and discipline will ultimately deliver long-term alpha for our clients.



BALANCED STRATEGIES

	Launch date	1 year	5 years	Since inception
Global Houseview	Oct 93	4.99%	14.32%	16.38%
Peer median		3.30%	12.49%	15.00%
Managed	May 96	8.17%	14.94%	16.82%
Peer median		3.30%	12.49%	13.85%

Annualised
Sources: Coronation, INET

Our balanced strategies, Global Houseview and Managed, continued to outperform over meaningful periods.

Global equity markets continued to climb a wall of worries in the second quarter, with the MSCI All Country World Index returning 4.3% in US dollar terms (18.8% over a rolling 12-month period). While valuations have grown steeper than in the recent past, we remain steadfast in the view that global equity returns are likely to exceed those of other major asset classes. We believe that valuations are fair (outside of a few overvalued pockets) and that the global economy continues to heal (albeit slowly).

Our global equity position has performed well, thanks in part to a higher allocation to other emerging markets. These markets continued their strong rally that began in the first quarter of 2016. The MSCI Emerging Markets Index returned 6.3% in US dollar terms over the quarter and 23.8% over a rolling 12 months. Despite the challenges faced by many important countries such as Brazil, China and Russia, we continue to find exceptional businesses with good long-term prospects trading at undemanding ratings. In the past, investors had to pay high prices for good quality companies. Emerging market indices trade close to c. 20% below their absolute peaks and offer a large margin of safety in our view.

A high exposure to UK property stocks remains a big differentiator. They delivered marginally positive returns in the quarter. We consider our three holdings (Intu, Hammerson and Capco) to be exciting opportunities for the patient investor. Our largest holding is Intu, which owns a portfolio of high-quality shopping centres. It currently trades on a 5.5% forward dividend yield and at a 34% discount to net asset value (NAV). The NAV represents the value that independent valuers believe the portfolio is worth in the current depressed retail environment (post a c. 6% knock taken for transaction costs). At these yields, we are happy to earn a dividend yield of more than 5% and wait for the uncertainty surrounding Brexit to clear.

We remain of the view that global bonds are in a bubble. Yields in most developed countries trade close to multicentury lows. Notwithstanding this demanding base, the World Government Bond Index has produced negative returns over one, three and five years. We have seen only the smallest of cracks in one of the great bubbles of our

time. We remain of the view that the risks of further capital losses are high and therefore do not have any developed market government debt exposure in the fund. We also have very low fixed-rate bond exposure in SA. We believe that fiscal discipline is wavering at a time of steadily increasing government indebtedness. In addition, there are risks to the very strong monetary discipline we have seen in SA since the introduction of inflation targeting in 2000. Should these concerns prove correct, then the outcome will be painful for holders of fixed-rate government debt. We believe that pricing is currently asymmetric, with limited return for the risks investors bear.

The domestic equity market has now delivered a paltry 3.6% per annum return over the last three years. The local savings industry is not accustomed to so many years of anaemic returns. As a result, we believe that many investors are abandoning equities in favour of the yielding asset classes that have outperformed over this period. We believe this to be an error. We believe that fixed-rate bonds are overvalued, and that equities offer more value than at any other time in the last five years. Over the last two years we have been steadily increasing equity exposure from a low base. We consider our current equity exposure to be marginally overweight, the first time we have been overweight in many years.

ABSOLUTE RETURN STRATEGIES

	Launch date	1 year	5 years	Since inception
Domestic Absolute	Apr 02	4.98%	8.84%	15.12%
CPI		5.10%	5.65%	5.91%
Inflation Plus	Oct 09	5.84%	9.93%	10.90%
CPI		5.10%	5.65%	5.31%
Global Absolute	Aug 99	4.87%	11.63%	15.85%
CPI		5.10%	5.65%	6.18%

Annualised
Sources: Coronation, INET

The strategies have the dual mandate of protecting capital over all rolling 12-month periods and to beat inflation. While our absolute return strategies have delivered strong performances over meaningful periods, beating inflation in the near term has proved challenging given the tough investment environment where real returns across asset classes have been far lower than the historical trend.

The strengthening of the rand relative to major developed market currencies over the past year has also been a headwind. We believe a maximum offshore allocation remains appropriate given the benefits of diversification, value in the underlying offshore assets and our expectation of future SA rand weakness.

SA's deteriorating growth outlook, along with concerns around government finances and an increase in both



socioeconomic and political uncertainty, continues to weigh on sentiment. The publication of extremely weak first-quarter GDP data in early June paints a picture of an economy that is heavily constrained and in a technical recession after two consecutive quarters of negative growth. With inflation expectations moderating, it seems increasingly likely that the SA Reserve Bank monetary policy committee will move to a more accommodative stance in the coming months.

From an asset allocation perspective, exposure to local government bonds was further reduced during the quarter given our view that valuations are not attractive on a risk-adjusted basis. Although overall domestic equity exposure remained largely unchanged, we used share price weakness to add to our positions in Aspen, Steinhoff and MTN.

Global conditions remained relatively benign, with macro data in developed economies maintaining a healthy momentum during the second quarter. Europe remained

the best-performing region and markets were relieved when centrist Emmanuel Macron comfortably beat far-right populist Marine Le Pen in the French presidential election. Despite reasonable economic growth in developed markets, inflation remains subdued. In a widely expected move that reflects the US Federal Reserve's confidence in the domestic economy, US interest rates were hiked in June by a further 25 basis points. The outlook for emerging markets is generally linked to China, either through the trade in commodities or demand for light manufacturing. During the quarter the concerns around the Chinese government's tightening of liquidity in the domestic economy weighed on commodity prices.

In an incredibly uncertain world, we continue to strive to build diversified portfolios that can absorb unanticipated shocks. We will remain focused on valuations and will seek to take advantage of whatever attractive opportunities the market presents us to generate inflation-beating returns for our investors over the long term. ■



MERE MONETARY MORTALS

CENTRAL BANKERS DO OFTEN GET IT WRONG

By Tony Gibson

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



TAKING STOCK

The first half of 2017 was largely characterised by momentum investing, especially rallying behind large-cap technology stocks. Passive (index-tracking) investment flows no doubt continued to play a major role in these flows. Although this trend appeared to have peaked in early June, there were impressive gains in top-tier technology stocks as they retained their leadership in the US equity market in the past six months. Stocks such as Tesla, Facebook, Amazon, Apple and Netflix were the clear winners.

By comparison, industrial, materials and energy stocks had a very tough six months. Financial stocks also materially lagged the technology sector. As has become a familiar pattern in recent years, the underperformance of the industrially sensitive stocks was essentially due to fears over the resilience of the US economy. In particular, this was sparked by signs of weakening motor vehicle demand and ongoing gridlock within US government. Additionally, pre-Brexit uncertainty in the UK did not help sentiment.

Despite these concerns, and even with increased tensions between the US and North Korea, equity market volatility remains low. Although this is a potential red flag in terms of investor complacency, it no doubt represents (for now, anyway) a prudent commitment to equity investing. This is supported by continued liquidity injections from central banks, rising earnings and a slow but steady return towards expectations for modest but synchronised global growth for 2017 and into 2018.

MARKET ROTATION

When looking at returns beyond US equity markets, it must be borne in mind that the US Dollar Index fell by 6.4% in the first half of 2017. This currency rotation towards the euro and the yen therefore exaggerated the first-half gains in many foreign equity markets when measured in US dollars. European equity markets outperformed the Standard & Poor's Index by a range of between 12% (Spain) and 6% (Sweden), measured in US dollars.

Additionally, the broad rise in global equity prices over the first half of 2017 fed strong gains in liquidity-sensitive emerging equity markets. Anticipation that Germany (to preserve the EU) will provide further support for peripheral market banks and debt exaggerated the rotation toward Greece, Italy and Spain. Also, the modest pullback in the US dollar, combined with economic resilience in the US and China, enhanced the rotation toward most emerging market equities - with the exception of oil-sensitive Russia, which fell by 12%. The top-performing emerging markets were Greece (39%), Turkey (29%) and Mexico (25%).

As already mentioned, a rotation out of the momentum-driven technology sector and towards value in emerging markets, financials and industrials began in June. By way of example, despite a further 4.7% drop in the price of West Texas Intermediate crude oil in June, the Journal of Commerce Material Price Index and the Integrated Oil & Gas Index fell only 0.7% and 0.9% respectively. Hence, fears that US equities are overpriced *may* be counterbalanced during the second half as domestic economic resilience attracts some capital back toward US financials, industrials and the energy sector.

Given that the expectation is for the cost of money to continue to rise, it is not surprising to note that bond yields have moved up during June and July. This is a change in trend from earlier in 2017 when bond yields fell due to a waning of the overexuberant expectations of stimulatory policies under US president Donald Trump. Additionally, it should be pointed out that companies with high levels of borrowings have underperformed the broad equity market so far in 2017.

RE-EMERGENCE OF INFLATION

Looking towards the remainder of 2017, the issues currently weighing on investors' minds relate to the following two questions: Has the US recovery peaked or will it remain resilient through into 2018? And have equity prices peaked or will the rally be supported into next year by strong earnings and a broader rally, possibly lifting financials and energy stocks?



We believe that conditions favour continued resilience in US consumer spending and a modest but synchronised upturn in global growth later this year and into 2018. That said, we believe that the outlook for inflation, and central bank actions, will be vital to understand the direction in the near future.

After a decade of central bank intervention aimed at preventing a deflationary contraction and restoring liquidity and solvency in the banking system, the return to market pricing for money and risk will be slow, halting and unpredictable. That said, the first steps toward normalcy have been taken and despite continued central bank bond buying in Europe and Japan (and the reinvestment of the Federal Reserve's [Fed] massive bond portfolio), interest rates have begun to rise. Since real rates remain negative in much of the northern hemisphere, the slow withdrawal of intervention over the next 18 to 24 months is not likely to affect consumer spending or private sector investment materially.

The potential re-emergence of inflation is a critical issue investors face today. This is partly because three decades of benign inflation have bred investor complacency – and that complacency has become even more entrenched in the nearly nine years since the financial crisis. As a result, investors are largely underweight assets that stand to do well in an inflationary environment, probably leaving their portfolios insufficiently insured against a significant rise in prices.

Influencing this is the fact that, during the current recovery, traditional measures of inflation have lagged significantly when compared to prior recoveries. Implied inflation measures remained extremely subdued until late 2016. The result is that most equities sell-offs over the past decade were associated with fears of deflation, not inflation. As a result, investors in recent years have gravitated toward assets that tend to do well in low-growth, low-inflation environments, and these assets did indeed provide valuable diversification.

Economists often attribute the benign inflation that prevailed since the 1980s to a number of institutional changes, including monetary policy independence and globalisation, which suppressed the cost of goods and labour. This allowed investors and consumers to anchor their inflation expectations better. The 2008 global financial crisis and its aftermath – particularly a slow recovery in business confidence and corporate spending, and overcapacity in the commodity sector – intensified these trends and increased fears about outright deflation. Historically speaking, this was highly unusual. As a recovery takes hold, inflation normally rises as debt levels and aggregate demand increases. But this recovery was a weak one and, without inflation, companies lacked pricing power. That, combined with low productivity, led to an earnings recession that lasted from

2012 until 2016. This contributed to weakness in confidence, hiring and capital spending.

However, there is reason to believe things will be different in the years ahead. Several disinflationary factors that kept prices in check over the last three decades, such as globalisation, are fading. At the same time, cyclical factors such as earnings growth, rising confidence and capital spending plans, tighter labour markets and capacity rationalisation in commodity markets are setting the stage for rising inflation. Additionally, governments' willingness to expand fiscal policy despite a low level of slack in their economies is raising inflation expectations in the US, Japan and the UK.

CENTRAL BANKER FALLIBILITY

In our opinion, too many investors like to take their cue from the utterings of central bankers – simply due to the belief that these central bankers have a great deal more insight than most. In our opinion this a dangerous and flawed approach. Central bankers can and do frequently get things wrong. Not because they are being duplicitous, but rather due to the reality that they are seemingly blind to the bubble-creating effect that their policies have had in the last 20 years or so. As we know, bursting bubbles can devastate both investment markets and the real economy.

To illustrate this point, one need look no further than quotes from former Fed chair Ben Bernanke around the time of the housing peak in 2005/2006:

"We've never had a decline in house prices on a nationwide basis. So, what I think is more likely is that house prices will slow, maybe stabilise, might slow consumption spending a bit. I don't think it's going to drive the economy too far from its full employment path, though." (Bernanke, July 2005).

"Housing markets are cooling a bit. Our expectation is that the decline in activity or the slowing in activity will be moderate, that house prices will probably continue to rise." (Bernanke, February 2006).

As it turns out, Bernanke was wrong. House prices did not continue to rise, or even stabilise. Shortly after his comments, house prices started to fall across the US, and would only begin to stabilise after a 25% decline over five years.

Recent weeks have been no different, with central bank comments and statements abound. One of the more recent comments, from Fed vice chair Stanley Fischer, referred to high asset values – specifically that "high asset values may lead to future stability risks". In essence, he is warning that central bankers are now worried that their extraordinary policies have created significant asset bubbles, and a future bear market would hurt both financial markets and the real



economy. Their poor forecasting track records aside, when central bankers tell us that asset values are “somewhat rich” (Fed chair Janet Yellen) and that they are worried about future stability – whilst at the same time raising interest rates and potentially reducing their balance sheet – we as market participants should take note. Our view remains that the Fed will continue to walk a bit of a tight rope, that is, tightening policy until something ‘breaks’, either in the US or globally.

Of course, even if the Fed is worried that they have created a massive bubble, they will be very careful in the way they manage markets. As a result we will continue to get ridiculous comments such as when Yellen recently said she did not believe that there will be another financial crisis in our lifetime. This statement conveniently ignores the fact that, historically, every period when asset markets have become this expensive and debt this high has been followed by a financial crisis. This is of course looking backwards.

The trigger for past crises has always been falling asset values; we now have a Fed that is acknowledging high asset values and yet is still tightening policy. Logic suggests to us that the monetary policymakers are also privately worried about this, and are now trying to dig themselves out of a very deep hole with their policy tightening. What worries us is the implicit reason that many investors are remaining invested in risky assets – despite the increasing warning signs. Many investors simply believe that during the next crisis, the Fed will be very quick to slash interest rates and print money. After all, Fed governors have told us that this is what they expect to do.

CONFIDENCE VERSUS ANGST

Analysing 2017 thus far can be summed up as follows: capital flows, exaggerated by central bankers’ liquidity injections (in Europe and Japan in particular) aimed at suppressing interest rates, flowed towards risk from January into early February. Capital then became overexposed to economic risk and allocations were pulled back, crowding again into the momentum of top-tier large-cap equities in the tech sector. The perceived safety of sovereign debt also attracted money flows. This rotational momentum was exaggerated as a mild northern-hemisphere winter triggered a gathering exodus from the energy sector. Simultaneously, delays in passing meaningful fiscal reforms in the US tempered expectations for the scope and timing of monetary tightening, pulling capital away from interest rate-sensitive financial equities. In our opinion, current investor worries should be balanced by our expectation of renewed confidence in the outlook for global growth as we move into 2018, triggering a rotation back toward economically sensitive stocks and sectors. Capital will again flow from safe havens and bonds toward financials, industrials, commodities and the deeply over-sold energy sector.

While any investment forecast is dangerous and flawed, the current dynamics influencing the direction of global equity markets are particularly hard to predict. The primary reason for this is the relentless growth in passive investing. Passive investment products represent a very large part of flows into US equities in particular, thereby changing the demand dynamics. What is very difficult to predict is how passive investors will respond to any material market correction. ■



CORONATION INFLATION PLUS

INCEPTION DATE

01 October 2009

PORTFOLIO MANAGERS

Charles de Kock and Duane Cable. Charles is head of Coronation's Absolute Return unit with 31 years' investment experience. Duane is head of SA equity with 10 years' investment experience.

OVERVIEW

Coronation Inflation Plus is designed to provide investors with a consistent real return while trying to preserve capital over short periods of time. As such, it is suitable for low-risk investors who are either approaching retirement or as part of an investment portfolio after retirement. The strategy has a strong track record of protecting investor returns, while also delivering investment growth over the long term. It is managed as part of our absolute return series of strategies, which Coronation first introduced to SA in 1999.

The strategy's dual target of positive real returns with an overriding focus on limiting downside returns or portfolio losses means that capital preservation in real terms is equally important as return optimisation.

MANDATE

Coronation Inflation Plus has the dual mandate of protecting capital over all rolling 12-month periods and beating inflation by 3% over rolling three-year periods.

It can invest up to 40% in domestic and foreign equities. The strategy is managed in accordance with the limits of Regulation 28 of the Pension Funds Act.

PORTFOLIO CONSTRUCTION

The Coronation Inflation Plus Strategy is actively managed in terms of both asset allocation and stock selection. Investments are selected on their equal measure of upside return and downside risk. Both return optimisation and investor protection are achieved through the inclusion of non-correlated asset classes.

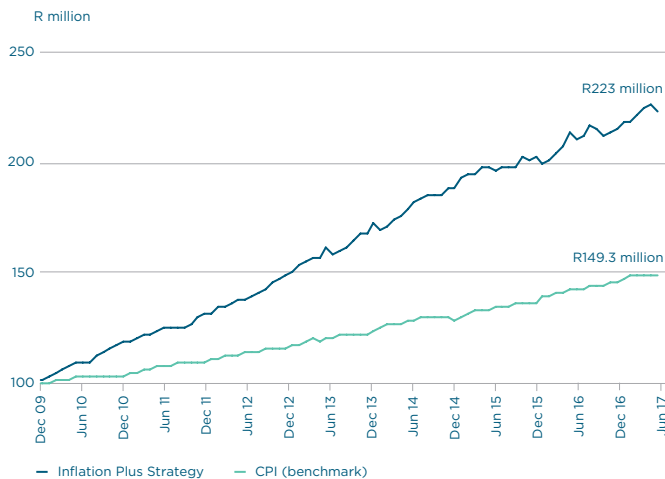
The strategy is invested in mispriced assets that trade below Coronation's assessment of their long-term fair value. Only assets that offer a substantial margin of safety compared to our fair value estimates qualify for inclusion in our absolute portfolios. We use our own proprietary models, developed over many years, to assist with optimising the asset allocation in the strategy. The models incorporate our own risk, return and correlation expectations for the different asset classes, and are used to 'sense check' the bottom-up construction of the portfolio. Through these tools and continual assessment of portfolio positioning, we focus on avoiding key risks and unintended bets in the strategy.

We do not reference a benchmark in our selection of investments in the strategy, and risk is not equated with tracking error or divergence from a benchmark, but rather with a permanent loss of capital. Given the well-diversified, multi-asset nature of our strategy, we aim to ensure that the portfolio is robustly constructed to withstand unforeseen events.

COMPELLING TRACK RECORD

Coronation Inflation Plus has delivered a return of 10.9% per annum since inception, outperforming the CPI (its benchmark) of 5.3% by 5.6% per annum during this time. Equally important is the fact that the fund has never been below zero over any rolling 12-month period.

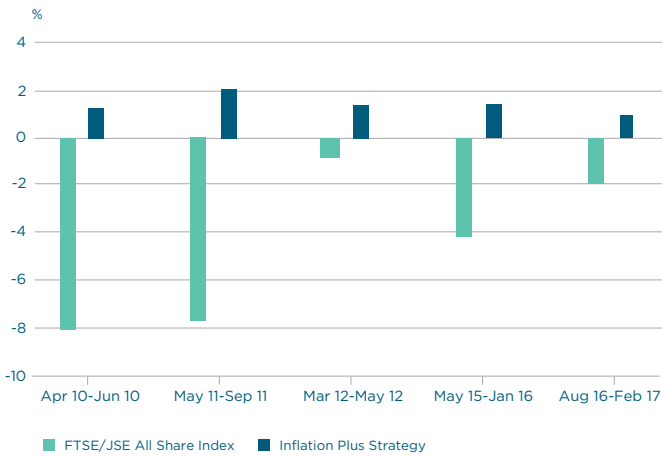
GROWTH OF R100 MILLION INVESTED SINCE INCEPTION



Source: Coronation

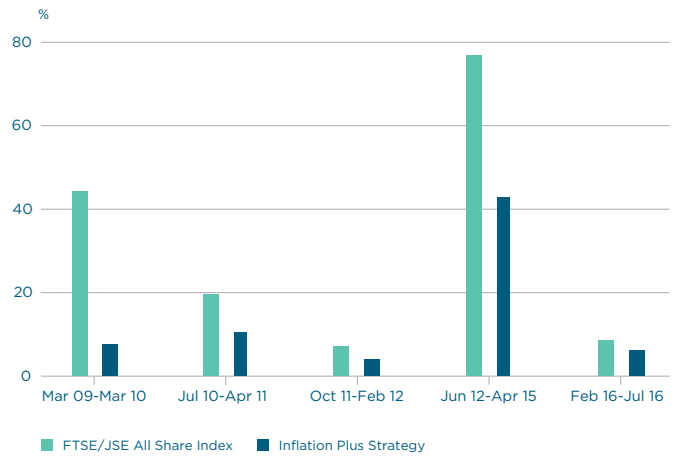


BEAR MARKETS



Source: Coronation

BULL MARKETS



Source: Coronation

As is clear from the graphs above, Inflation Plus offers a demonstrated ability to protect capital – its losses were much more shallow than those of the market during

downswings. As is evident from the second graph, the strategy also enjoyed healthy upside participation in bull markets. ■



INTERNATIONAL PORTFOLIO UPDATE

CORONATION GLOBAL EQUITY FUND OF FUNDS

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Jul 00	20.22%	5.55%	12.79%	6.42%
Benchmark		18.78%	5.69%	11.92%	4.43%

Annualised, quoted in USD
Sources: Coronation, Bloomberg

Europe was the best-performing region in the second quarter, rising 7.7% (in US dollar terms). The weakest return was from North America, which declined -3%. Japan returned 5.2% (in US dollar terms). Pre-Brexit uncertainty did not help sentiment in the UK. The fund continues to be overweight North America and marginally underweight Europe.

Among the global sectors, healthcare (+7%), industrials (+5%) and information technology (+5%) generated the best returns. The worst-performing sectors were energy (-6%), telecoms (-2%) and materials (+2%). On a look-through basis, the fund was positively impacted by its overweight position in information technology and underweight in energy and telecommunication.

Over the quarter, the fund advanced 4.3%, in line with the benchmark gain of 4.3%. Egerton and Conatus were the top performers for the quarter, with alpha of 4% above the market. Egerton benefited from holdings in Ryanair (+24%), Constellation Brands (+20%) and Safran (+16%). Conatus benefited from holdings in PayPal (+25%), Aena (+18%) and AIA Group (+18%). Ryanair reported a 6% rise in earnings despite a difficult trading environment. Safran cut its bid price for acquiring Zodiac Aerospace and Constellation Brands raised its full-year profit forecast. PayPal's revenue grew 17% year on year and the company announced stock buybacks. Aena announced profits significantly above what the market had expected. AIA Group reported record new business growth of 55% for the first quarter of 2017.

Detractors for the quarter were Contrarius and Vulcan. Contrarius' energy exposure drove its underperformance as the oil price dropped from \$52 to \$46 by the end of the

quarter. Vulcan was held back by its holdings in National Oilwell Varco (-17.7%) and Discovery Communications (-11%). National Oilwell Varco suffered on the back of the oil price decline and Discovery Communications was hurt by fears over future advertising revenue.

We believe that conditions favour continued resilience in US consumer spending and a modest but synchronised upturn in global growth later this year and into 2018. That said, we believe that the outlook for inflation, and central bank actions, will be vital to understanding market direction in the near future.

CORONATION GLOBAL EQUITY STRATEGY

	Launch date	1 year	3 years	5 years	Since inception
Fund	14 Nov 14	30.95%	-	-	6.36%
Benchmark		18.78%	-	-	6.09%

Annualised, quoted in USD
Sources: Coronation, Bloomberg

After an encouraging start to 2017, global financial markets continued their strong form into the second quarter of the year, buoyed by stronger than anticipated economic news out of Europe. Whilst economic data out of the US have generally been disappointing this year, corporate profits continued to surprise on the upside, providing further stimulus to the strong momentum these markets have enjoyed over the last few quarters. Commodity prices have retreated somewhat during the second quarter, led by the oil price that disappointed despite some decisive action by OPEC to constrain supply. The gold price has also been weak.

From a political perspective, the last three months brought more uncertainty, as president Trump continued to surprise both his supporters and his political adversaries with some of his erratic actions. Much-touted healthcare reform stalled due to a lack of support from within the Republican Party, prompting a reassessment of the likelihood that his promised tax reform will be implemented in 2017. The tepid outcome



of the UK election contributed to intensified uncertainty regarding the Brexit negotiations. Despite this, the pound actually strengthened over the three months.

Towards the end of the quarter, global equity markets witnessed some extreme sector rotation prompted by a sell-side broker report advising clients to take profits in the high-flying technology sector. This correction gained momentum as an unprecedented large fine was levied on Alphabet/Google by the European Competition Commission. Over any longer time period, technology stocks have, however, outperformed all other sectors by a large margin. Energy, materials and telecommunication stocks were the laggards over the last three months. Over the last 12 months, the energy and telecommunication sectors were significant underperformers, with consumer staples a surprisingly weak spot as well. Besides technology, financial stocks did well over the last year, helped in the last quarter by a renewed focus on the benefits of deregulation in this sector in the US.

The biggest contributors to fund performance over the quarter were the alternative asset managers, which continued to rerate as the prospects for stronger short-term profitability improved with the buoyant equity markets. There was also some positive news regarding further fund raisings. Over the last 12 months, this sector contributed about 70% of the fund's outperformance, aided by the takeout offer for Fortress. This vindicated our long-held positive view on the sector, which even though it added volatility to the overall portfolio, more than compensated us in terms of superior performance.

Other notable winners over the quarter included L Brands (featured on page 16), Yum China (a small position which we exited during the quarter), American Airlines and PayPal. The airline stocks also feature highly on the 12-month contribution list, as do JD.com and Charter Communications.

Detractors over the last months included Liberty Global (following an immaterial restatement of financials due to fraudulent misrepresentation), Schaeffler (poor trading update), Urban Outfitters (very poor newsflow from conventional US retailers) and Estácio (its proposed merger with Kroton has been rejected by Brazilian competition authorities). Read more about the latter development in the following section.

We have continued to add to our exposure in some of the retailers under pressure, with L Brands now in a top-five position. We also introduced another consumer finance company, Discover Financial Services, in addition to our exposure to Capital One. We see their low ratings as an attractive investment opportunity, especially as their strong capital position affords them flexibility in terms of capital allocation, despite the recent regulatory Comprehensive Capital Analysis and Review setback for Capital One. We reduced our exposure to some of the consumer staple

names, as they continued to rerate after their sell-off towards the end of 2016. We continue to rate these companies highly in terms of quality, but have become more concerned about valuation levels.

CORONATION GLOBAL EMERGING MARKETS EQUITY STRATEGY

	Launch date	1 year	3 years	5 years	Since inception
Fund	14 Jul 08	21.79%	(2.19%)	7.17%	7.00%
Benchmark		23.75%	1.24%	4.20%	2.35%

*Annualised, quoted in USD
Sources: Coronation, Bloomberg*

The Coronation Global Emerging Markets Strategy returned 7.1% during the quarter, compared to the 6.3% of the benchmark MSCI Emerging Markets Total Return Index, representing outperformance of 0.8% for the period.

The biggest contributor to alpha for the period was JD.com, with the share up 26%. (JD.com is discussed later on in this section.) Yum China, which had previously been a detractor since being spun out from Yum! Brands, was up 44% in the quarter. Other notable contributors were 58.com (+25%), Naspers (+12%), Heineken (+15%) and Melco Resorts & Entertainment (+22%). The positive contribution from Naspers was more than offset by not owning Tencent directly, as the value of the Naspers stake in Tencent increased by even more, rising ever higher above the market value of Naspers standalone (the value of Naspers' stake in Tencent is now 35% higher than Naspers' market capitalisation).

Year to date, the largest detractor from performance has been Magnit, which has declined by 22%. In this regard, we spent the last week of June in Russia, visiting Moscow (X5 Retail Group's base), Krasnodar (home of Magnit) and St. Petersburg (Lenta's home town). We met with senior management of the three food retailers: Magnit (COO and CFO), X5 (CEO) and Lenta (CEO). In summary, our positive view on the sector and these three individual companies (which together make up 7% of the strategy) was confirmed.

In particular, our conclusion on Magnit (which at 4% of strategy is the largest position of the three) was that its current issues are of a short-term, cyclical nature as opposed to being structural. Over the past year or so, Magnit has gone from being a market darling to being almost universally disliked (with X5, it is the exact opposite) due to negative like-for-like sales, and the usual extrapolation of current experience by short-term focused market participants. We believe that Magnit management is making the right adjustments to its value proposition as well as doing the required refurbishments to keep up with a newly invigorated X5, which is increasingly moving into its markets. These changes take several quarters to reflect in results, but should eventually see a return to positive same-store sales and



contribute to maintaining its margins. In addition to this, the long-term opportunity still holds: large formal retailers will continue to take market share.

We bought three new positions during the quarter: a 1.7% position in Naver, the leading search engine in South Korea; a 1.4% position in Alibaba (although the strategy has effectively owned Alibaba since July 2014 through a position in Yahoo, with Alibaba representing 80% of its valuation); and a 0.7% position in Indiabulls Housing Finance, one of the leading housing finance companies in India. We also added to the strategy's positions in Naspers, JD.com and 58.com.

JD.com reported excellent first-quarter results in April that beat consensus by some margin. It has historically been one of the most attractive stocks in our investment universe in terms of upside to fair value, but the evolution of its business has exceeded even our expectations. After repeated losses since its initial public offering (although it has always generated decent cash from suppliers funding its working capital, even when making accounting losses), JD.com has now become profitable due to an increase in gross margins.

This has been driven by a mix effect and growth of its 3P business relative to its 1P business. Both 1P and 3P are very attractive businesses, but the 3P model has a higher margin – there is little cost involved in selling someone else's product on your established platform. As 3P becomes a larger proportion of the overall mix, JD.com's margins will continue to rise. When we first assessed JD.com in 2014, we believed it could eventually earn (operating) margins of 4% to 5% due to gross profit margin expansion and achieving sufficient scale to dilute the high fixed costs involved in rolling out a massive distribution and logistics network.

As mentioned previously, the business was loss-making at the time and the lack of profits meant the market struggled to value JD.com appropriately. Investors focused on misleading short-term metrics, like quarterly gross merchandise value (the total value of all goods sold on its platform). The business has developed considerably since then and, together with the impact of the growth in its 3P business, management believes they can earn operating margins of 6% to 8%. It is this kind of profitability target that has driven the share price rally in recent weeks. Yet despite the move, we believe the share remains very undervalued – even if it only reaches the bottom end of this margin range in the long term.

As previously mentioned, the strategy also bought a new position in Alibaba, although we have held an indirect stake in Alibaba for the past three years due to owning Yahoo. Alibaba operates a consumer-to-consumer marketplace (think of eBay) and a business-to-consumer marketplace for merchants. We have historically (and still do) favoured the JD.com business model over that of Alibaba, due to the competitive advantages of the fulfilment model that JD.com

(and indeed Amazon) operates, that results in total control of the customer experience.

With time, however, whilst we continue to believe that Alibaba will lose overall market share (and JD.com will gain share), we are more convinced that Alibaba is a formidable business with a number of very promising assets besides its traditional e-commerce business. This includes its cloud business and the payments business, Alipay. In fact, the e-commerce offerings from JD.com and Alibaba are largely complementary. The strategy also continues to hold Yahoo (now renamed Altaba after the sale of the core business to Verizon) where the upside to fair value is even higher than Alibaba if tax can be minimised.

The quarter also saw the completion of the antitrust assessment process of the proposed merger between the two Brazilian education holdings Estácio and Kroton. Despite the best efforts of Kroton to propose remedies that would allay antitrust fears, the board of the antitrust authority voted against approving the merger. We had expected that, on a balance of probabilities, the merger would be approved – but had always positioned the fund for the risk of a rejection. Estácio never quite traded at the final agreed swap ratio of approximately 1.28 Kroton shares.

We maintained the strategy's overall Kroton/Estácio relative exposure at similar levels (two to two-and-a-half times Kroton weight vs Estácio weight) to when the deal was first announced. This reflected our view that in the event the merger was vetoed or approved with too many conditions, we would want to own both companies, just as we had for the 18 months prior to the merger developments, but would want a bigger position in Kroton.

Now that the deal has been rejected, the share prices had, by quarter-end, pretty much converged back to parity – which is where they were a year ago when this whole process started. We believe both businesses remain extremely attractive on a standalone basis, with over 60% upside to fair value for both.

Kroton trades on less than 11 times earnings and is a 5.2% position in the strategy, while Estácio trades on less than 10 times and represents 2.2% of the strategy. They remain the largest and second-largest players in the industry, with massive scale advantages over their smaller peers which generally only trade at marginal profitability. We also believe that Estácio is very likely to be a participant in further industry consolidation.

Overall this quarter proved to be a busy one, with team members spending a lot of time travelling to meet the management of portfolio holdings, competitors or looking for new ideas in Brazil, Russia, Hong Kong, China, Singapore, Macau and Indonesia. The weighted average upside to fair value of the strategy at the end of June was around 50%, which is broadly in line with the historical five-year average.





CORONATION GLOBAL MANAGED STRATEGY

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Nov 09	19.56%	3.62%	9.88%	9.13%
Benchmark		9.98%	3.20%	7.10%	6.76%

Annualised, quoted in USD
Sources: Coronation, Bloomberg

The MSCI All Country World Index (ACWI) returned just over 4% over the quarter, bringing the year-to-date return to 11.5% and the 12-month lagging return to an impressive 18.8%. Emerging markets outperformed their developed peers over all of these time periods, with the 12-month emerging market performance being just over 5% higher than that of the ACWI. Europe outperformed the US during the quarter as the economic news out of the region surprised on the upside. The stronger euro also contributed to the outperformance. Over the last 12 months these markets have now produced very similar returns.

Global bond yields drifted down over the quarter, but rose quite sharply after the fairly hawkish statements by European Central Bank (ECB) president Mario Draghi towards the end of June, as detailed in the Coronation Global Bond Fund commentary on page 42. This resulted in bond markets yielding small positive numbers over the three months in local currencies, with some return pick-up due to US dollar weakness. Credit continued to perform well, with improving economic news around the world.

The US dollar continued to weaken against other major currencies as investors re-evaluated the prospects for the greenback. The euro was almost 7% stronger against the US dollar, and has now strengthened by just under 10% since the end of 2016. Emerging market currencies deteriorated in line with weaker commodity prices, although some of their equity markets continued to perform well.

Global property had a strong quarter in most regions, with Europe, Singapore and Hong Kong leading the pack. The quarterly return of 3% was also positively impacted by the weak dollar. Japan produced poor returns, as did Australia, as concerns over the impact of online retail hurt the listed mall owners.

The fund performed satisfactorily over the quarter, slightly underperforming its benchmark. The three-month number of 3.7% and the year-to-date return of 10.5% are strong absolute numbers. It has outperformed its benchmark over almost all periods by a significant margin after all costs and fees, highlighting the value proposition in this medium-risk product.

The fund continues to be defensively positioned, as evidenced by its low equity exposure (relative to the 60% benchmark weighting). We believe that equity markets have started

discounting a very benign outcome to the various political and economic challenges the world faces, and as such caution is warranted. We still hold some put options to protect the equity holdings to some extent, should there be a widespread sell-off. Over the quarter we increased the fund's exposure to property, with US mall Real Estate Investment Trusts introduced for the first time after they sold off in response to poor retailer trading numbers. We believe we have invested in the best quality portfolios, which should remain relevant in a digital world. Proactive management teams will need to continue to manage these dominant shopping centres to remain attractive to consumers and tenants alike. We have reduced exposure to credit by letting some positions mature.

Given the increased uncertainty regarding the outcome of the Brexit negotiations, it came as no surprise that the UK property sector remained in the doldrums. We used this period of heightened uncertainty to add to our position in Intu Properties, making it a very material position in the fund. Intu owns a high-quality portfolio of dominant retail centres in the UK, and whilst we cannot predict which way the negotiations will settle, we do think that over time this portfolio will retain its quality and relevance to the UK consumer, even in a world of increased online retail penetration. The share is trading at a significant discount to estimated net asset value, highlighting a stock that is discounting the worst possible outcome in our assessment. It also pays out a healthy dividend, with the share maintaining a dividend yield of 5.3%.

CORONATION AFRICA FRONTIERS

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Oct 08	19.25%	(5.85%)	7.68%	9.37%
Benchmark		1.01%	0.59%	0.47%	0.54%

Annualised, quoted in USD
Sources: Coronation, Bloomberg

Over the past three months the performance of markets across Africa was strong, with the FTSE/JSE All Africa ex-SA Index gaining 11.3%, compared to the fund return of 16%.

Egypt remains our largest country exposure. Although the Egyptian market was only up 4%, our investments within Egypt performed well, with the fund's largest holding, Eastern Tobacco, gaining 33% (in US dollar terms) during the quarter. Zimbabwe was up 41% with investors continuing to invest excess cash in real assets, driven to a large extent by the scarcity of dollars and concerns over the Zimbabwean bond notes that were introduced at the end of last year. However, we would caution against taking this performance at face value, given that it is impossible to repatriate funds through normal mechanisms and significant discounts are applicable to alternative repatriation methods. Kenya also performed well, with an increase of 16%, and Morocco was up 10% over the past three months. A key driver of the performance this quarter was Nigeria, which gained 26% on the back of renewed

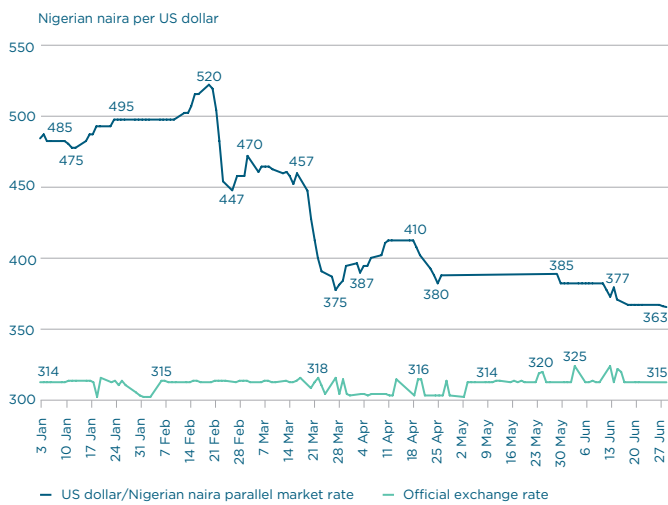


optimism following the introduction of the new currency exchange window (NAFEX) in April 2017. It is noteworthy that, compared to a year ago when three major markets in Africa had dysfunctional currency regimes (Egypt, Nigeria and Zimbabwe), today Zimbabwe is the only one remaining.

Nigeria's new window is predominantly aimed at exporters and portfolio investors who are now able to bring money into Nigeria at a more favourable exchange rate. In June, participation in the window was further liberalised by allowing banks to match trades among all of their clients – previously banks could only match foreign exchange trades within their own clients. Official reports indicate that there is decent (and improving) liquidity, with \$3 billion transacted in the first eight weeks. While this is certainly a step in the right direction, our understanding is that these volumes are still to a large extent the result of liquidity injected by the Central Bank of Nigeria (CBN). Businesses have started to report improved dollar availability; however, we understand that this too is driven more by the activity of the CBN through increased forward transactions, rather than the NAFEX window.

Until now the impact has been positive, with the parallel market rate reducing from a high of around 500 naira/US dollar in February 2016 to virtually converging with the new NAFEX rate of around 370 naira/US dollar by the end of June (see the graph below). This also contributed to Nigeria (at least temporarily) avoiding a potential downgrade out of the Frontier Markets Index by the MSCI in its semi-annual review in May. During the quarter we took the decision to value our Nigerian holdings using the new, more conservative NAFEX exchange rate. Indices such as MSCI still use the official exchange rate, which overstates the return of the index in our view.

PARALLEL MARKET SPREAD SINCE JANUARY 2017



Sources: Bloomberg, Exotix

This should increase Nigeria's oil production by at least 15%. Following all these developments, Nigeria saw renewed interest from global investors. The market was up strongly and average daily volumes doubled during the quarter. Many companies look cheap on near-term multiples, however we remain cautious. In June 2016 we saw similar optimism when the Nigerian naira was allowed to 'float freely'. However, it quickly became apparent that the new stable official exchange rate was not reflective of true supply and demand dynamics and, as a result, liquidity dried up quickly. Oil prices remain low and many companies still have large foreign currency payables, which have already resulted in a number of forced rights issues. In the banking sector, we believe that the tough economy has not yet been fully reflected in the loan impairments and we expect that a number of banks will have to raise capital at some point. Many banks have exposure to Etisalat Nigeria, which recently defaulted – a reminder of just how tough conditions in Nigeria are.

Over the longer term, we still view Nigeria as one of the most attractive markets globally and it continues to represent a sizable portion of the portfolio. Still, we remain very selective in our Nigerian exposures. In the banking sector, we own Stanbic IBTC Bank. In addition to an attractive valuation, this bank has demonstrated in the past that it is proactive in recognising nonperforming loans. We continue to avoid businesses with large dollar-denominated liabilities and prefer to hold those that should benefit from a weaker currency. One such business is Seplat Petroleum. This London-listed company is a large direct beneficiary of the reopening of the Forcados terminal and gained 42% during the quarter. We still view this as a very attractive investment opportunity, with attractive cashflow dynamics and a growing gas business, which is becoming strategically important in Nigeria due to the dependence of power plants on the gas supplied by Seplat.

We believe Nigeria's multiple exchange rates with limited transparency leaves the door open for abuse, but we are hopeful that the measures that have been put in place will eventually lead to a liberalisation of the exchange rate. In the near term, conditions in Nigeria remain tough, but from a bottom-up perspective there are a number of high-quality businesses in Nigeria at attractive valuations, which should provide attractive returns to investors willing to take a longer-term view.

CORONATION GLOBAL FRONTIERS

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Dec 14	26.93%	-	-	3.74%
Benchmark		1.01%	-	-	0.65%

Annualised, quoted in USD
Sources: Coronation, Bloomberg

Further positive news out of Nigeria was the lifting of the force majeure on the Forcados terminal in June 2017.

As in previous quarters, our return (+13.8%) differed materially from that of the MSCI Frontier Markets Index, which was up



4.4% over this period. Frontier markets that performed well during the quarter were Nigeria (+26%), Kenya (+16%), Vietnam (+11%) and Sri Lanka (+10%), while Pakistan was down 2%, Bangladesh down 2%, Kuwait down 3% and Argentina virtually flat.

At Coronation, we construct clean-slate portfolios. Among its peers, this is a big differentiator for the Global Frontiers Strategy. We believe there is more value in focusing on absolute returns rather than outperforming an index benchmark that is often poorly constructed. This is particularly true in the case of frontier markets where the MSCI Frontier Markets Index is the most widely used benchmark.

We strongly believe that you should own a stock because it is trading below its intrinsic value and not because it happens to have a large weighting in an index. For a number of companies, the very reason they are large in the index is because they are overvalued. This is clearly demonstrated by the country exposure of the fund. Argentina is now 20% of the MSCI Frontier Markets Index and Kuwait 17%, but we have no exposure to these two countries, as we currently see more value in businesses in other frontier markets. In contrast, our investments in Sri Lankan companies represent almost 14% of the fund, while the country represents less than 2% of the MSCI Frontier Markets Index.

In fact, one of our best-performing investments is Hemas Holdings, which is not even in the index. Hemas is a family-controlled Sri Lankan conglomerate with a high-quality fast-moving consumer goods business, a market-leading pharmaceutical distribution business and a portfolio of hospitals on the island. When the current CEO was appointed in 2013, he was specifically tasked with transforming the business into a professional outfit. Today, the business is run with a strong focus on shareholder returns and value is starting to be unlocked. While not in the index, it is a business we find very attractive and it accounts for more than 4% of the portfolio. The value of owning a business like this is evident in the fact that the company's share price was up 38% during the quarter and up 66% since we first invested in this business in June 2016.

During the past three months, a number of countries have been affected by MSCI's review of its Frontier Markets Index. As announced last year, Pakistan was moved from the Frontier Markets Index to the Emerging Markets Index. Overnight, Pakistan went from 9% of the index to zero. Whether or not a business is included in the Frontier Markets Index does not change our view on the company and we continue to hold the businesses in Pakistan which we find attractive.

For two countries in the Frontier Markets Index it was what was not decided that impacted investor sentiment. The decision on whether Nigeria should be removed from the index was delayed until November. This was largely as a

result of the introduction of the new NAFEX exchange window. On the other side of the spectrum, the decision on whether to upgrade Argentina from 'frontier' to 'emerging' was delayed until June 2018. This disappointed investors, who expected an upgrade, and some of the large-cap stocks in Argentina came under pressure.

In our view, these announcements have virtually no impact on the underlying fundamentals of businesses and the investor reaction is an example of the inefficiencies that can exist in financial markets. Frontier markets in particular are more susceptible to this as they are often less researched, illiquid and more volatile. We believe this presents unique opportunities for bottom-up, valuation-driven investors willing to take a long-term view.

CORONATION GLOBAL BOND

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Oct 09	4.61%	1.42%	2.55%	3.55%
Benchmark		(2.18%)	(0.77%)	(0.06%)	1.22%

*Annualised, quoted in USD
Sources: Coronation, Bloomberg*

The fund performed strongly during the second quarter, up 3.3% against a return of 2.6% for the Bloomberg Barclays Global Aggregate Bond Index over the same period. The second quarter saw central banks in many developed countries begin to discuss the eventual unwinding of unconventional monetary policies. The US Federal Reserve (Fed) chose to look past the recent softer economic data and hiked the Fed Funds rate again in June, whilst robust growth in Europe will have reinforced the ECB's view that temporary factors have been responsible for the weakness in inflation. Bond yields in most developed markets rose slightly, while a sustained appetite for risk allowed higher-yielding markets to continue to outperform. Movements in foreign exchange markets were, however, the dominant factor in total returns, with the trade-weighted US Dollar Index weakening by 4.7% during the second quarter.

US economic data consistently disappointed in the second quarter, challenging the more optimistic view portrayed in sentiment surveys. Markets reacted to the softer data and the lack of tax and infrastructure plans from the new administration by pricing out the Trump rally that followed the US election. Softer US inflation added to concerns that US activity may be stalling and helped US 10-year yields fall from 2.4% to as low as 2.1%. The Federal Open Market Committee (FOMC) disregarded the weakness and raised the Fed Funds rate by a further 0.25% (to a range of 1% to 1.25%) mid-June.

The hawkish Fed combined with a more dovish market flattened the yield curve with two-year yields rising 0.13%, (1.25% to 1.38%), while 30-year yields fell 0.17% (3% to



2.83%). Breakeven rates of inflation also narrowed (10-year from 1.98% to 1.73%) as inflation fell short of expectations. The softer oil price (down 9%) merely added to the negative sentiment towards Treasury Inflation Protected Securities. The fund reduced duration during June, reversing the position that had been taken in the first quarter, when yields were 35 basis points higher.

German bond yields traded sideways for most of the quarter, with much of the attention focused on the French election and banking issues on the European periphery. At the ECB meeting on 8 June, there was no change in rates or movement in its asset purchase programme. The ECB revised its outlook for growth marginally higher, but lowered its forecast for inflation, which was above that of the market. However, ECB president Mario Draghi's speech at end-June in Portugal significantly changed the narrative. He indicated that increasingly robust data and the view that deflationary risks have abated are raising the prospect of a much earlier end to unconventional stimulus than the market had anticipated. Rates were anticipated to remain on hold until the asset purchase programme was wound down from €60 billion per month to zero, which was expected to happen during 2018. Since the speech, the market has moved to price in a rate rise during the course of 2018. Longer-dated yields also moved higher, ending the quarter at 0.46%. After quarter-end, yields have breached the previous range high of 0.5%, threatening a more substantive sell-off. The fund unwound its position in French government bonds after bonds outperformed post the election of Emmanuel Macron as president.

If the outlook for the UK was not opaque enough, the decision by the prime minister to hold early elections in the hope of consolidating her mandate has backfired and delivered her a wafer-thin majority via a problematic coalition. The UK's cards at the Brexit negotiating table do not look like a winning hand.

While other central banks may be discussing unwinding quantitative easing, the Bank of Japan (BOJ) remains committed to its current framework and its price-stability target of 2%. The BOJ now owns around 44% of all outstanding government bonds via its asset purchase programme, which raises interesting questions about how losses will impact on confidence when yields eventually rise.

Emerging markets maintained their relative strong performance as investors continued to seek out yield. The Emerging Market Bond Index spread rallied to 3.15% in May, but ended the quarter unchanged at 3.3%. In SA the finance minister was fired at the end of March, leading to heightened economic uncertainty. In April, president Erdoğan's authoritarian regime in Turkey secured a narrow victory in a referendum granting him greater powers.

Brazilian bonds suffered a setback in May after its president became embroiled in corruption charges, potentially derailing important reforms. The fund remains active within emerging markets, adding exposure to Brazil in May after the market fell sharply. The fund reduced its exposure to SA government bonds around the same time and shortened its exposure after the Mexican curve flattened. The fund also increased its exposure to Egypt via Treasury Bills during May.

Corporate bonds continued to perform strongly, with investment-grade credit outperforming government bonds by about 1% during the quarter, taking the year-to-date outperformance to around 1.5%. Rising government bond yields and reductions in central bank purchases remain a key test for the market, and we remain cautious of valuations. The fund reduced its exposure to SA dollar-denominated bonds and to MTN as the bonds were seen as vulnerable to ratings downgrades.

Within foreign exchange markets, the US dollar has continued to disappoint, with its weakness extending beyond interest rate differentials. The euro performed particularly well, up 7% over the quarter as economic data surprised on the upside and speculation that the ECB will begin to tighten monetary conditions led many investors to reduce their underweight positions. The yen briefly rallied as equities suffered rare bouts of weakness, but ultimately the decision by the BOJ to hold bond yields at close to zero means that the yen is vulnerable as global yields rise. Emerging market currencies experienced mixed fortunes as the Turkish, Mexican and SA currencies all strengthened against the US dollar, while the Brazilian real, Russian rouble and Argentine peso all weakened. The fund has reduced some of its emerging market exposure (Mexico, Turkey and SA) and has begun to add to its US dollar position. The fund switched its Swedish exposure into euros during April to reduce its vulnerability to a squeeze in the euro. The fund remains underweight the yen.

Last quarter, we highlighted that there was a growing sense that central banks were about to embark on unwinding the exceptionally accommodative policies that have been in place for many years. In the last month, we have seen policymakers say as much, and the Bank for International Settlements has called upon policymakers to take advantage of growth tailwinds to build greater economic resilience. The fund remains underweight duration and has scaled back its exposure to assets deemed most vulnerable to policy normalisation. The global economy may still have its vulnerabilities, but there is a growing realisation that the time of ultra loose policy is running out, and its extension risks exacerbating potentially damaging side effects in areas such as housing and consumer debt. Normalisation, to whatever that level may turn out to be, will be gradual but the greater fool theory of investing may soon be tested. ■



INSTITUTIONAL FUND PERFORMANCE

PORTFOLIOS ^A	FEES ^B	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	4.99%	6.95%	14.32%	12.07%	15.63%	3 569.23%	16.38%
Median of the Peer Group*			3.30%	6.47%	12.49%	10.00%	14.14%	2 664.23%	15.00%
Alpha			1.69%	0.48%	1.83%	2.07%	1.49%	905.01%	1.38%
Managed	G	May-96	8.17%	7.04%	14.94%	12.85%	16.11%	2 587.93%	16.82%
Median of the Peer Group*			3.30%	6.47%	12.49%	10.00%	14.14%	1 457.34%	13.85%
Alpha			4.87%	0.57%	2.45%	2.85%	1.97%	1 130.60%	2.97%
DOMESTIC BALANCED									
Domestic Houseview	G	Jan-98	3.86%	5.09%	11.82%	11.37%	16.33%	1 666.25%	15.86%
Domestic Balanced Benchmark			2.60%	5.57%	10.67%	9.73%	13.30%	1 034.04%	13.26%
Alpha			1.26%	(0.49%)	1.15%	1.64%	3.04%	632.21%	2.60%
SPECIALIST EQUITY									
Houseview Equity	G	Oct-93	2.11%	3.03%	13.78%	12.08%	18.02%	4 395.29%	17.38%
Houseview Equity Benchmark			1.35%	3.57%	12.30%	9.76%	14.90%	2 445.01%	14.60%
Alpha			0.77%	(0.54%)	1.48%	2.32%	3.12%	1 950.28%	2.78%
Aggressive Equity	G	Feb-02	7.69%	2.63%	12.66%	11.98%	17.86%	1 151.27%	17.81%
Aggressive Equity Benchmark			1.35%	3.57%	12.30%	9.76%	14.90%	756.60%	14.95%
Alpha			6.35%	(0.94%)	0.36%	2.22%	2.95%	394.67%	2.86%
Core Equity	G	Mar-04	2.21%	3.51%	13.74%	12.54%	-	888.02%	18.74%
FTSE/JSE Shareholder Weighted Index			0.28%	4.79%	12.89%	10.32%	-	687.02%	16.73%
Alpha			1.93%	(1.28%)	0.86%	2.22%	-	201.00%	2.01%
SPECIALIST FIXED INTEREST									
Strategic Cash	G	Sep-06	8.79%	7.96%	7.26%	8.17%	-	134.61%	8.19%
Short Term Fixed Interest 3 Month Index			7.25%	6.56%	6.00%	7.00%	-	110.61%	7.12%
Alpha			1.54%	1.40%	1.26%	1.17%	-	24.00%	1.07%
Active Bond	G	Jul-00	9.02%	7.92%	7.93%	9.50%	10.59%	539.01%	11.53%
BEASSA All Bond Index			7.93%	7.12%	6.61%	8.40%	9.63%	454.77%	10.60%
Alpha			1.09%	0.81%	1.32%	1.10%	0.96%	84.24%	0.92%
Strategic Bond	G	Jan-08	8.82%	8.00%	8.13%	-	-	144.99%	9.89%
BEASSA All Bond Index			7.93%	7.12%	6.61%	-	-	114.88%	8.38%
Alpha			0.90%	0.89%	1.52%	-	-	30.11%	1.51%
Absolute Bond	G	Mar-03	8.36%	7.82%	8.15%	10.55%	-	317.19%	10.48%
CPI			5.10%	5.37%	5.65%	6.16%	-	122.70%	5.74%
Alpha			3.27%	2.46%	2.50%	4.39%	-	194.49%	4.73%
Flexible Fixed Income	G	Jul-10	9.60%	8.60%	8.94%	-	-	95.79%	10.07%
BEASSA All Bond Index			7.93%	7.12%	6.61%	-	-	75.68%	8.38%
Alpha			1.67%	1.48%	2.33%	-	-	20.11%	1.69%
Short Term Fixed Interest 3 Month Index			7.25%	6.56%	6.00%	-	-	49.44%	5.91%
Alpha			2.35%	2.04%	2.95%	-	-	46.35%	4.17%
Medical Aid Cash	G	Dec-05	8.78%	7.93%	7.12%	8.11%	-	145.36%	8.06%
Short Term Fixed Interest 3 Month Index			7.25%	6.56%	6.00%	7.00%	-	121.68%	7.11%
Alpha			1.54%	1.37%	1.12%	1.11%	-	23.68%	0.94%
INFLATION-LINKED BENCHMARK									
Global Absolute	G	Aug-99	4.87%	6.24%	11.63%	10.88%	14.97%	1 294.83%	15.85%
CPI			5.10%	5.37%	5.65%	6.16%	5.83%	192.69%	6.18%
Alpha			(0.23%)	0.87%	5.97%	4.72%	9.15%	1 102.14%	9.67%
Domestic Absolute	G	Apr-02	4.98%	4.52%	8.84%	9.88%	14.86%	756.48%	15.12%
CPI			5.10%	5.37%	5.65%	6.16%	5.83%	139.99%	5.91%
Alpha			(0.12%)	(0.85%)	3.19%	3.72%	9.03%	616.49%	9.21%
Inflation Plus	G	Oct-09	5.84%	7.02%	9.93%	-	-	123.03%	10.90%
CPI			5.10%	5.37%	5.65%	-	-	49.30%	5.31%
Alpha			0.74%	1.65%	4.28%	-	-	73.74%	5.60%
Medical Absolute	G	May-04	4.63%	4.84%	8.42%	9.64%	-	401.40%	13.03%
CPI			5.10%	5.37%	5.65%	6.16%	-	110.47%	5.81%
Alpha			(0.46%)	(0.52%)	2.77%	3.48%	-	290.93%	7.21%



PORTFOLIOS ^A	FEES ^B	LAUNCH DATE	1 YEAR	3 YEARS	5 YEARS	10 YEARS	15 YEARS	CUM SINCE LAUNCH [†]	ANN SINCE LAUNCH [†]
HEDGE FUNDS									
Coronation Presidio Hedge Fund	N	Oct-05	0.23%	6.02%	15.17%	15.21%		472.07%	16.00%
Cash			6.77%	6.16%	5.65%	6.63%		115.89%	6.77%
Alpha			(6.54%)	(0.14%)	9.52%	8.59%		356.18%	9.23%
Coronation Multi-Strategy Arbitrage Hedge Fund	N	Jul-03	24.70%	12.39%	11.34%	11.94%		454.53%	13.02%
Cash			6.77%	6.16%	5.65%	6.63%		155.32%	6.92%
Alpha			17.93%	6.23%	5.70%	5.31%		299.20%	6.09%
Coronation Granite Hedge Fund	N	Oct-02	9.85%	8.23%	7.97%	9.23%		314.37%	10.12%
Cash			6.77%	6.16%	5.65%	6.63%		179.26%	7.21%
Alpha			3.07%	2.07%	2.33%	2.60%		135.11%	2.91%
OFFSHORE FUNDS^C									
Coronation Global Equity FoF (US\$)	G	Jul-00	20.22%	5.55%	12.79%	6.25%	9.92%	187.89%	6.42%
Coronation Global Equity FoFs Benchmark			18.78%	5.69%	11.92%	4.52%	7.76%	108.85%	4.43%
Alpha			1.44%	(0.13%)	0.88%	1.73%	2.16%	79.04%	1.99%
Coronation Global Managed (US\$)	G	Nov-09	19.56%	3.62%	9.88%	-	-	95.44%	9.13%
Coronation Global Managed Benchmark			9.98%	3.20%	7.10%	-	-	65.12%	6.76%
Alpha			9.58%	0.42%	2.78%	-	-	30.32%	2.37%
Global Capital Plus (US\$)	G	Sep-09	9.26%	2.45%	6.26%	-	-	60.39%	6.22%
Global Capital Plus Benchmark			1.01%	(2.76%)	(0.76%)	-	-	(7.18%)	(0.95%)
Alpha			8.24%	5.21%	7.01%	-	-	67.56%	7.16%
Global Bond (US\$)	G	Oct-09	4.61%	1.42%	2.55%	-	-	31.03%	3.55%
Global Bond Benchmark			(2.18%)	(0.77%)	(0.06%)	-	-	9.83%	1.22%
Alpha			6.79%	2.19%	2.60%	-	-	21.20%	2.33%
Coronation Global Strategic Income	G	Jan-12	2.87%	1.81%	3.10%	-	-	21.36%	3.58%
110% of 3 Month USD Libor			1.11%	0.65%	0.52%	-	-	2.89%	0.52%
Alpha			1.76%	1.16%	2.58%	-	-	18.46%	3.06%
Global Emerging Markets Equity Strategy	G	Jul-08	21.79%	(2.19%)	7.17%	-	-	83.45%	7.00%
Coronation Global Emerging Markets Equity Benchmark			23.75%	1.24%	4.20%	-	-	23.14%	2.35%
Alpha			(1.96%)	(3.43%)	2.97%	-	-	60.31%	4.65%
Coronation All Africa Strategy	G	Aug-08	21.73%	(6.05%)	6.54%	-	-	100.36%	8.11%
3 Month USD Libor			1.01%	0.59%	0.47%	-	-	5.32%	0.58%
Alpha			20.71%	(6.64%)	6.07%	-	-	95.03%	7.52%
Coronation Africa Frontiers Strategy	G	Oct-08	19.25%	(5.85%)	7.68%	-	-	118.98%	9.37%
3 Month USD Libor			1.01%	0.59%	0.47%	-	-	4.80%	0.54%
Alpha			18.24%	(6.44%)	7.21%	-	-	114.18%	8.83%
Coronation Global Frontiers	G	Dec-14	26.93%	-	-	-	-	9.96%	3.74%
3 Month USD Libor			1.01%	-	-	-	-	1.68%	0.65%
Alpha			25.92%	-	-	-	-	8.28%	3.09%
Coronation Global Equity Strategy	G	Nov-14	30.95%	-	-	-	-	17.88%	6.36%
MSCI All Country World Net US\$			18.78%	-	-	-	-	17.06%	6.09%
Alpha			12.17%	-	-	-	-	0.82%	0.28%

¹ Figures quoted in US\$ as at 30 June 2017.

^A Figures are quoted from the Independent Retirement Fund Survey as at 30 June 2017.

^B 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.

^C 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.

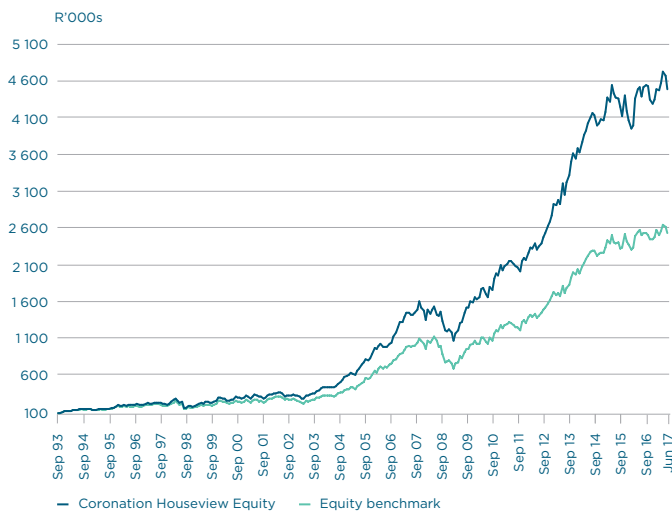


LONG-TERM INVESTMENT TRACK RECORD

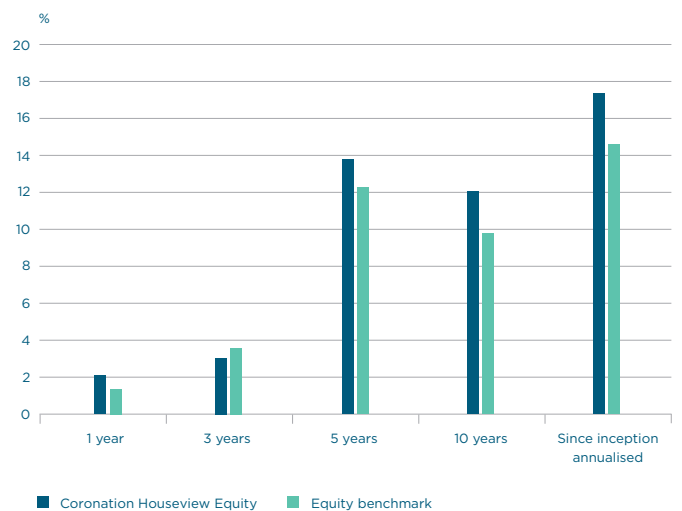
CORONATION HOUSEVIEW EQUITY RETURNS VS EQUITY BENCHMARK

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%
4 years 6 months to 30 June 2017	11.18%	9.59%	1.60%
ANNUALISED TO 30 JUNE 2017			
1 year	2.11%	1.35%	0.77%
3 years	3.03%	3.57%	(0.54%)
5 years	13.78%	12.30%	1.48%
10 years	12.08%	9.76%	2.32%
Since inception in October 1993 annualised	17.38%	14.60%	2.78%
Average outperformance per 5-year return			2.96%
Number of 5-year periods outperformed			20.00
Number of 5-year periods underperformed			-

CUMULATIVE PERFORMANCE



ANNUALISED RETURNS TO 30 JUNE 2017



An investment of R100 000 in Coronation Houseview Equity on 1 October 1993 would have grown to **R4 495 294** by 30 June 2017. By comparison, the returns generated by the Equity Benchmark over the same period would have grown a similar investment to **R2 545 013**.

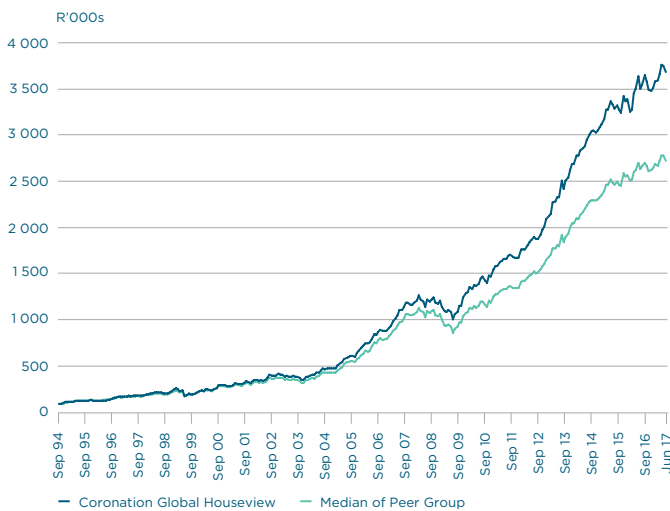


CORONATION GLOBAL HOUSEVIEW (BALANCED) RETURNS VS MEDIAN OF PEER GROUP*

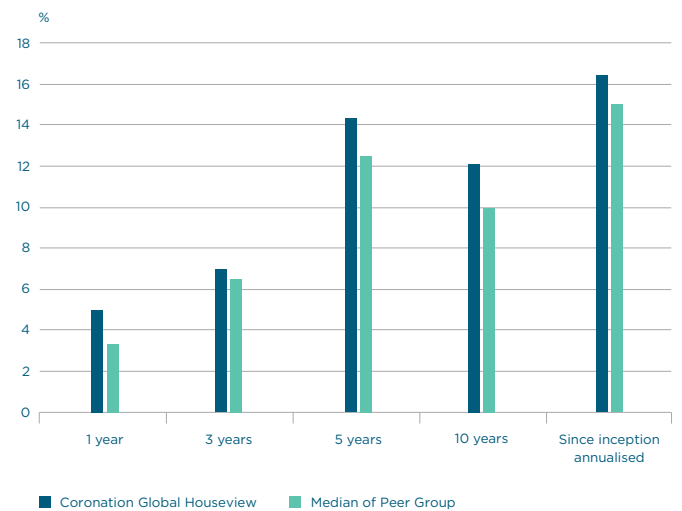


5-YEAR ANNUALISED RETURNS	CORONATION GLOBAL HOUSEVIEW	MEDIAN OF PEER GROUP*	ALPHA
1998	11.21%	11.26%	(0.04%)
1999	16.36%	15.54%	0.82%
2000	13.82%	13.17%	0.65%
2001	16.54%	15.02%	1.52%
2002	12.74%	12.05%	0.69%
2003	17.67%	15.96%	1.71%
2004	14.35%	13.30%	1.05%
2005	19.58%	18.16%	1.42%
2006	20.74%	19.53%	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%
4 years 6 months to 30 June 2017	12.60%	10.87%	1.73%
ANNUALISED TO 30 JUNE 2017			
1 year	4.99%	3.30%	1.69%
3 years	6.95%	6.47%	0.48%
5 years	14.32%	12.49%	1.83%
10 years	12.07%	10.00%	2.07%
Since inception in October 1993 annualised	16.38%	15.00%	1.38%
Average outperformance per 5-year return			1.49%
Number of 5-year periods outperformed			19.00
Number of 5-year periods underperformed			1.00

CUMULATIVE PERFORMANCE



ANNUALISED RETURNS TO 30 JUNE 2017



An investment of R100 000 in Coronation Global Balanced on 1 October 1993 would have grown to **R3 669 233** by 30 June 2017. By comparison, the Median return of Global Large Managers over the same period would have grown a similar investment to **R2 722 247**.

* 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.

Civil Engineer. Machinist. Desktop Publisher. Engineering Technician. Excavating Machine Operator. Upholsterer. Visual Designer. Health Practitioner. Gaming Service Worker. Deburring Machine Operator. Maintenance Equipment Operator. Maintenance Worker. Data Processing Equipment Repairer. Transportation Worker. Crossing Guard. Grip. Veterinary Assistant. Laboratory Animal Caretaker. Travel Guide. Mail Machine Operator. Head Nurse. Fraud Investigator. Healthcare Practitioner. Data Entry Operator. Legal Secretary. Urban Planner. City Planning Assistant. Graphic Designer. Automotive Master Mechanic. Bicycle Repairer. Internist. Irradiated-Fuel Handler. Extruding Machine Operator. Exhibit Designer. Bindery Machine Operator. Metal Moulding Operator. Automotive Specialty Technician. Bill and Account Collector. Health Educator. Vending Machine Servicer. Brickmason. Boiler Operator. Machine Feeder. Cultural Studies Teacher. Avionics Technician. Maintenance and Repair Worker. Radio Mechanic. Heating and Air Conditioning Mechanic. Event Planner. Account Manager. Benefits Specialist. Credit Checkers Clerk. Bindery Worker. Fibre Product Cutting Machine Operator. Waitress. Environmental Engineering Technician. General Manager. General Practitioner. Surveying and Mapping Technician. Explosives Expert. Motorboat Mechanic. Travel Clerk. Vice President of Human Resources. Equal Opportunity Representative. Financial Manager. Fire-Prevention Engineer. Geoscientist. Grinding Machine Operator. Hand Sewer. Extraction Worker. Government Property Inspector. Credit Analyst. Environmental Scientist. Farmworker. Financial Examiner. Landscaper. Web Developer. Biologist. Customer Service Representative. Custom Tailor. Fast Food Cook. Manufacturing Sales Representative. Surveyor. Farm Equipment Mechanic. Gas Processing Plant Operator. Petrol Attendant. Law Clerk. Marcom Manager. English Language Teacher. Gas Compressor Operator. Usher. Weapons Specialists. Dry-Cleaning Worker. Primary School Teacher. Veterinarian. Executive Secretary. First-Line Supervisor. Manager of Landscaping. Lawn Service and Groundskeeping Worker. Financial Specialist. Motion Picture Projectionist. Fabric Mender. Film Laboratory Technician. Freight and Material Mover. Geographer. Geologist. Hazardous Materials Removal Worker. Mapping Technician. Motorboat Operator. Motorcycle Mechanic. Movers. Nutritionist. Typesetting Machine Operator. Valve Repairer. Regulator Repairer. Radio Operator. Legal Support Worker. Moulder. Psychiatrist. Rail Transportation Worker. Boilermaker. Healthcare Support Worker. Curator. Fashion Model. File Clerk. Firefighter. Gas Distribution Plant Operator. Geography Teacher. Glass Cutting Machine Operator. Grounds Maintenance Worker. Mining Machine Operator. Fashion Designer. Furniture Finisher. Gauger. Gluing Machine Operator. Biophysicist. Heating Equipment Operator. Claims Adjuster. Chief Technology Officer. Domestic Worker. Moulding and Casting Worker. Zoologist. Wildlife Biologist. Environmental Science Technician. Office Clerk. Writer. Author. Designer. Dental Hygienist. Diagnostic Medical Sonographer. Auxiliary Equipment Operator. Dental Assistant. Environmental Science Teacher. Gaming Dealer. Mining Engineer. Geological Engineer. Database Manager. Decorator. Entertainment Attendant. Extruding and Drawing Machine Operator. Fish Game Warden. Manager Tactical Operations. Transport Security Administrator. Auditor. Occupational Health Safety Technician. Marine Cargo Inspector. Metal-Refining Furnace Operator. Milling Machine Operator. Psychiatric Assistant. User Experience Manager. Occupational Therapist Assistant. Truck Driver. Radiologic Technologist. Civil Engineering Technician. Public Relations Specialist. Watch Repairer. Public Health Social Worker. Choreographer. Manicurist. Supervisor of Customer Service Transportation Equipment Painter. Veterinary Technician. Administrative Law Judge. Administrative Services Manager. Advertising Manager. Promotions Manager. Court Reporter. Oil and Gas Operator. Online Marketing Analyst. Psychology Teacher. Radar Technician. Lawyer. Adjustment Clerk. Credit Authoriser. Bookbinder. Video Editor. Battery Repairer. Biological Science Teacher. Boat Builder and Shipwright. Punching Machine Setter. Biological Scientist. Cutting Machine Operator. CSI Dentist. Detective. Graduate Teaching Assistant. Jeweller. Washing Equipment Operator. Auditor. Crushing Grinding Machine Operator. Metal Pourer and Caster. Public Transportation Inspector. General Education Development Teacher. General Farmworker. Government Service Executive. Office and Administrative Support Worker. Travel Agent. Umpire and Referee. Etcher and Engraver. Financial Analyst. Financial Services Sales Agent. Credit Checker. Administrative Support Supervisor. Automatic Teller Machine Servicer. Engineering Manager. Furnace Operator. Surgeon. Waiter. Waste Treatment Plant Operator. Environmental Engineer. Farmer. Health Specialties Teacher. Farm Labour Contractor. Freight Agent. Gaming Manager. Gas Appliance Repairer. Gas Plant Operator. Polisher. Market Research Analyst. Millwright. Rail Car Repairer. Typesetter. Woodworking Machine Setter. Machine Tool Operator. Farm and Home Management Adviser. Fire Inspector. Hand Trimmer. Interpreter. Translator. Judge. Model Maker. Entertainer and Performer. Job Printer. Communications Director. Purchasing Agent. Surgical Technologist. Audio and Video Equipment Technician. Brake Machine Setter. Gaming Supervisor. Makeup Artist. Supervisor of Police. Survey Researcher. Woodworking Machine Operator. Mail Clerk. Purchasing Manager. Manufactured Building Installer. Meter Mechanic. Lawn Service Manager. Environmental Compliance Inspector. Fence Erector. Fire Investigator. Landscape Artist. Fabric Pressers. Heat Treating Equipment Operator. Nursery School Teacher. Metal Worker. Creative Writer. Dancer. Manager. Motor Vehicle Inspector. Office Machine and Cash Register Servicer. Offset Lithographic Press Operator. Atmospheric and Space Scientist. Claims Examiner. Glazier. Health Technologist. Management Analyst. Marine Oiler. Office Machine Operator. Transportation Equipment Maintenance. Underground Mining Welder. Maintenance Supervisor. Radiation Therapist. Transportation Manager. Radiologic Technologist and Technician. Audiovisual Collections Specialist. Automotive Body Repairer. Automotive Mechanic. Bailiff. Baker. Dental Laboratory Technician. Manager of Food Preparation. Occupational Therapist. Barber. Psychologist. Brazing Machine Operator. Court Clerk. Lay-Out Worker. Marine Engineer. Occupational Health Safety Specialist. Tree Trimmer. Accountant. Advertising Sales Agent. Assistant Bartender. Psychiatric Technician. Brazier. Obstetrician. Oil Service Unit Operator. Public Relations Manager. Civil Drafter. Criminal Investigator. Craft Artist. Cutting Machine Operator. Actor. Engraver. Biomedical Engineer. Crane and Tower Operator. Glass Blower. Machine Operator. Biochemist. Biophysicist. Director. Lathe Operator. Pump Operators. Surveying Technician. Vice President of Marketing. Vocational Education Teacher. Automotive Glass Installer. Bookkeeper. Engineering Teacher. Freight Inspector. Funeral Attendant. Gaming Surveillance Officer. Hand Presser. Funeral Director. Health Services Manager. Jewellery Model. Mould Makers. Law Enforcement Teacher. Machinery Maintenance. Moulding Machine Operator. Webmaster. Welder. Biological Technician. Fibreglass Laminator and Fabricator. Gaming Cage Worker. Microbiologist. Mixing and Blending Machine Operator. Motor Vehicle Operator. Nursing Instructor. Radiologic Technician. Utility Meter Reader. Automotive Technician. Aviation Inspector. Courier. Epidemiologist. Etcher. Geological Data Technician. Geological Sample Test Technician. Hairdresser. Cosmetologist. Landscape Architect. Marine Architect. Military Officer. Mine Cutting Machine Operator. Radio and Television Announcer. Transportation Inspector. Word Processor. Aerospace Engineer. Bartender. Database Administrator. Piano Tuner. Audiologist. Actuary. Manager of Air Crew. Phlebotomist. Butler. Walker. Crew Captain. Mystery Shopper. Meteorologist. Consultant. Strategist. Blogger. Botanist. Doctor. Production Manager. Photographer. Swimmer. Taxi Driver. Art Director. Business Director. Banker. Independent Financial Adviser. Librarian. Receptionist.



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