

corospondent

The Coronation Fund Managers Institutional Quarterly

October 2017, Spring Edition



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is an authorised financial services provider.
7th Floor, MontClare Place, Cnr Campground & Main Roads,
Claremont 7708. PO Box 44684, Claremont 7735.
Telephone: 021 680 2000

www.coronation.com

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NOTES FROM MY INBOX

TRUTH TO POWER

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.

As we go to print, headlines could scarcely be gloomier. The barrage of bad news is unending, from nuclear threats, natural disasters, mass killings and raging corruption to alarming accounts of assaults against women in a supposedly progressive industry.

The accusations against Harvey Weinstein are depressingly familiar: powerful man harms women, finds shelter in misogynist culture of impunity. We see these dynamics play out with dispiriting regularity all over the world and also in SA. For most of history, women have not had equal access to formal structures of power. Far too often we are confronted with stories of women being objectified, stereotyped and discriminated against, and simply not having the same freedom as men.

I recently caught a glimpse of how this manifests in workplaces across the country. To commemorate Women's Month in August, Coronation held a number of events for clients and high-school learners. In SA, women have been at the forefront of the struggle for transformation. Yet the stories told by many women and girls reflected the systemic discrimination they face, the sometimes blatant but more frequently subtle sexism which is often reflected in a 'low inclusion' culture. At work, many experience prejudice and have been sidelined because they are not part of a male alliance or do not easily fit into a male-derived culture. At home, they shoulder many more unpaid hours of domestic work and care responsibility for an extended family network. What makes matters worse is that the wage gap is still painfully evident, despite how far we have come over the past 100 years. All of this has left many women disillusioned and exhausted.

I have been fortunate in my career to have found a home in an organisation like Coronation that fundamentally is premised on gender-neutral, race-neutral output. This has had a tremendous impact on my own personal growth and on my career. We remain determined to fight biases and equip all our staff (53% of us are female) with the tools to succeed, and the recent launch of the *Lean In* programme at Coronation forms part of this.



Unfortunately, all the programmes in the world will not eliminate gender discrimination and assaults against women and girls. We need more leaders – male and female – to use their power to advance gender equality and ensure power is no longer used against women.

IN THIS EDITION

This issue of *Corospondent* examines many of the deeply concerning geopolitical headlines that have dominated the news for some time. To give context and analysis, we turned to the chief foreign affairs commentator at the *Financial Times*, Gideon Rachman, for his insights. Inside is his exclusive assessment of the current crisis in Korea. A sobering read, he warns of the risk of nuclear attacks if the North Korean leader is faced with the prospect of the collapse of his regime.

While the global environment seems overcast, Europe is shakily emerging as an unexpected bright spot. Our economist Marie Antelme explores the reprieve granted to the continent after the latest round of elections, on page 9. She argues that Europe should embrace this window of opportunity for economic reform.



We know that Bitcoin is a hot topic. When a *Financial Times* headline reads, “Dimon and Fink unite on need to ‘crush’ Bitcoin”, you know that the topic has taken on supernova status. On page 6, Neville Chester dissects and destroys the investment case for the current batch of cryptocurrencies. While we remain excited about the possibilities of blockchain technology and expect a reputable digital currency soon, we do not believe one of the current contenders will survive.

There is no shortage of *true* investments in this edition, and we include analysis of the SA retail group Spar and of Airbus, the European aircraft manufacturer. Airbus has long been an unloved stock and may look like an unexpected addition to our portfolios, especially our Global Emerging Markets Equity strategy. But our extensive research shows that Airbus is trading well below our estimate of its fair value, and that the company has a long runway (yes, pun intended) of growth. As an emerging market company, we also understand the potential demand for its products outside the developed world.

We believe this homegrown perspective on emerging markets provides us with a competitive edge in investing across the globe. We see the world from a different perspective – where others may only see risk, we have successfully identified long-term opportunities over the years, as is evident from the track record of the Coronation Global Emerging Markets Equity strategy (page 36). As the world economy evolves, we believe that an allocation to emerging markets is becoming increasingly obligatory, as explained on page 18.

The latest Nobel prize in economics was recently awarded to professor Richard Thaler, whose research in behavioural economics uncovered the importance of ‘nudging’ consumers

into making better decisions for the long term. We believe the new retirement default regulations which were recently adopted in SA will provide some important nudges to help retirement savers stay on track. You can read more on page 7.

This is a bumper edition – we hope you enjoy the read. ■

Kirshni

MARKET MOVEMENTS

	3rd quarter 2017	Year to date 2017
All Share Index R	8.9%	12.6%
All Share Index \$	5.0%	13.8%
All Bond R	3.7%	7.8%
All Bond \$	0.0%	8.9%
Cash R	1.8%	5.6%
Resources Index R	17.8%	12.4%
Financial Index R	5.1%	4.0%
Industrial Index R	7.4%	17.0%
MSCI World \$	4.8%	16.0%
MSCI ACWI \$	5.2%	17.3%
MSCI EM \$	7.9%	27.8%
S&P 500	4.5%	14.2%
Nasdaq \$	6.2%	24.0%
MSCI Pacific \$	4.0%	15.7%
Dow Jones EURO Stoxx 50 \$	8.5%	25.2%

Sources: Bloomberg, IRESS



FEES SLASHED ON SOME OF OUR STRATEGIES

SAFEGUARDING COMPELLING RETURNS

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.



As part of Coronation's ongoing commitment to ensure the best outcome for clients, we continually review the charges on our products to make sure they reflect market conditions and offer compelling value to clients.

We are an active management house that aims to materially grow our clients' portfolios by outperforming the market on a consistent basis over the long term. This is evidenced by Coronation's almost 25-year track record of persistently outperforming the market. In fact, retirement funds which have been invested in Coronation's flagship balanced fund since our inception in 1993 (and there are many clients who fit this grouping) have grown in value by 3 791%, more than 1.65 times the return from a market-index portfolio.

It is in this light that we have made some bold changes to the fees in many of our top-performing strategies, which we believe will benefit our clients and safeguard compelling returns for years to come. We have cut fees by up to 15 basis points on many actively managed equity and multi-asset class strategies. This includes our successful Global Emerging Markets Equity strategy (covered on page 36), which has delivered outstanding returns since inception. All current clients have benefited from this move.

In addition, base fees on our performance fee options have reduced in line with fees on available passive solutions. We believe that this is a powerful move that offers investors only upside in terms of the costs they pay for our products and have an outsized benefit if we deliver outperformance

over the market. We only earn higher fees if and when we outperform.

PIONEERING A CHANGE TO HEDGE FUND FEES

Coronation has taken a bold step in changing the fees on our hedge funds – making us a global pioneer with this move.

Coronation has always been outside of the norm by charging a performance fee only above the risk-free cash rate (many hedge funds charge fees over zero).

Along with a reduction in the performance fee participation rate, we have taken the bold step of capping the annual performance fee on our hedge fund portfolios from 1 October 2017. This is a pioneering approach in an industry that has traditionally never put caps on fees. We have introduced an annual performance fee cap for the Coronation Presidio Long-Short Equity Hedge, Coronation Multi-Strategy Arbitrage Hedge and Coronation Granite Hedge strategies.

As you know, Coronation is an owner-managed and investment-led firm. Every decision we make is driven by the sincere desire to deliver strong investment outcomes for our clients. We have demonstrated this client centricity over the years, time and time again. The latest fee reductions should confirm this commitment. For a more detailed breakdown of the fee changes, please contact your client service fund manager. ■



THE BITCOIN BUBBLE BUT THE FUTURE OF BLOCKCHAIN IS BRIGHT

By Neville Chester

Neville is a senior member of the investment team with 20 years' investment experience. He joined Coronation in 2000 and manages Coronation's Aggressive Equity strategy.



When is a bubble not a bubble? When it is a new paradigm, of course! Throughout history, every time a bubble gathers momentum, there has always been a strong and often logical (though not always) explanation for why there was no bubble. Towards the end, the defenders become louder and more assertive against the naysayers, until it all comes crashing down.

Bitcoin was recently described by Jamie Dimon, the CEO of JP Morgan, as a “fraud”. I prefer the term used by the *Financial Times*: “mass delusion”. A fraud implies a conscious effort by a group of individuals to steal money from another, whereas what we see with Bitcoin is not that.

I would, however, categorise the raft of ‘Initial Coin Offerings’, or ICOs as they are referred to, as something more akin to fraud. Increasingly companies, in a completely unregulated fashion, are launching myriads of copycat ‘coins’ in the hopes of raising cash from gullible participants who are hoping to cash in early on the next Bitcoin.

But we are getting ahead of ourselves. Some non-millennials might be asking: what is Bitcoin? Bitcoin is a virtual currency which was launched off the back of a new advance in technology called blockchain.

The key attribute of this technology, and what makes it such a potential game changer, is that the record of ownership is contained in a distributed ledger. This allows independent verification that each Bitcoin is indeed unique and not simply a virtual copy. The way Bitcoin was constructed also ensured that there would be a limited supply of Bitcoins (21 million, if you’re interested), creating a ‘rarity’ of supply – important support for the value of any commodity.

In any debate about investing in Bitcoin, zealous promoters will argue ‘blockchain’ back at you, usually with some comments about how old-school finance is going to be undermined by blockchain in the future and why many established bankers and economists do not believe in Bitcoin because it is a competitor to their existing interests. This is unfortunately confusing two concepts. Blockchain is indeed

a revolutionary technology and it will redefine our future relationships with many financial institutions. The ability to independently verify ownership of any asset without the use of an intermediary is very powerful. This is why the biggest investors in exploring the technology of blockchain are the big financial institutions. Bitcoin, however, is just a product launched using the blockchain technology. One of thousands, in fact.

A supposed benefit of cryptocurrencies is that they are presumed to protect your assets from central banks which are printing fiat money at a rapid rate post the financial crisis. However, today there are over 1 000 cryptocurrencies in existence (including the humourlessly named Titcoin, used in the adult entertainment industry) against around 180 fiat currencies. And the list is growing every day.

Is Bitcoin a currency? A functional currency has two key attributes:

- It is a store of value.
- It is a medium of exchange.

Given the extreme volatility we have seen in Bitcoin prices, it fails the first test. It also largely fails the second, despite a number of vendors being prepared to accept it. The reality is no one is actually pricing their goods in Bitcoins; they price them in dollars or an equivalent fiat money and then accept payment via Bitcoin. This is due to the first point: the valuation of Bitcoin varies wildly from day to day.

The majority of transactions that Bitcoin is being used for are speculative trading, circumvention of capital controls in countries like China and Venezuela, and for concluding other illegal transactions. The settlement time is also prohibitively long for effective day-to-day transactions. It can take up to an hour for transactions to be confirmed as valid. This is not a realistic scenario while waiting in a queue at your favourite store.

So is Bitcoin an asset and can you invest in it? The fundamental step is to determine the value of a Bitcoin.



And here even the most messianic of Bitcoin promoters cannot come up with a fundamental basis for what the value of a Bitcoin could be.

The reason is that the basis for any valuation is ultimately a discounted cash flow of the return the asset generates. Whether valuing a government bond, a property or a company, the value of the asset is determined by the value of the cash flows the asset will ultimately generate. And Bitcoin generates nothing. It is a speculative investment in that the value of a Bitcoin is determined only by the price someone else will want to pay for it.

This is why the punters of Bitcoins and other cryptocurrencies are so fervent in spreading their message: the more people are buying it, the greater the chance of selling it for a profit. When fewer people buy it, the likelier the chance of a loss.

Without a doubt, the current situation of quantitative easing has facilitated the growth in cryptocurrency bubbles (and many other asset price bubbles).

While interest rates have been held artificially low, the cost of speculating has been very low. If you can borrow money cheaply, your opportunity cost of buying assets with no yield is low. However, as interest rates start to normalise, as in the US currently, with murmurs also growing louder from the UK and Europe, the implied cost of holding an asset that generates no yield will rise.

The future of blockchain is bright and in all likelihood, some time in the future, we will see central banks adopt and promote a virtual interchangeable version of digital currency, but one that will be stable and traceable to prevent the facilitation of criminal activity. It will not be Bitcoin. ■



RETIREMENT DEFAULT REGULATIONS

THE RULEBOOK IS CHANGING

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.



The new retirement default regulations, which took effect on 1 September, herald a new chapter for SA savers.

Many years and a great deal of consultation later, the regulations are a serious attempt to improve the level of savings by South Africans and help pension fund members make better decisions that ultimately allow them to retire comfortably. At present, it is estimated that less than 30% of individuals have enough when they retire – the new regulations aim to change this for the better. Although the interventions are rigorous, we believe they present a great combination that still allows retirement savers to retain the necessary flexibility to achieve the best possible outcomes.

In short, the new regulations introduce the following changes:

- Employer pension and provident funds are required to offer a default in-fund preservation arrangement to members who leave the company. This is a significant change from the current arrangement which forces departing employees to move their accumulated savings from these funds. Importantly, any funds remaining need

to be invested in the trustees' default solutions (in line with active members) and at the same costs. Departing employees can still withdraw their savings or transfer them to any other fund, but remain fund members until they elect another option. Trustees are obliged to offer employees counselling on retirement benefits before they make a decision. This focus on financial education and advice is a significant move.

We believe this offers a great way to plug the large leakage in the SA retirement market, and will assist individuals to save for when they will need it most.

- In defined contribution funds, trustees are required to offer a default investment portfolio to members who have not made any choice on how their savings should be invested. The investment portfolio should be “appropriate, reasonably priced, well communicated to members and offer good value for money”.

This principle-based approach to selecting default investment products is appropriate, particularly in a market like SA. Investment portfolios need to be suitable,



given the concentrated nature of the local markets, and carefully balanced against risks to deliver the best possible investment outcome. Cost cannot be the only consideration. Trustees need to consider long-term, after-fees investment outcomes to ensure the best options for their members. Most retirement savings in SA are defined contribution in nature. This means that individuals ultimately bear the risk and responsibility of ensuring they have enough to last through retirement.

As people are living longer (and therefore need more in the savings pot to afford retirement), and with more muted returns expected from asset classes over the next few decades, ensuring a solution that can meet requirements is paramount. The biggest risk here is not being able to afford to retire – essentially individuals cannot rely on low-risk asset classes or merely beta to generate the necessary outcome.

Performance fees are often cast as some sort of dark art, but if aligned with the investment value created, and if simple to understand, these fees are a powerful force for good in retirement savings. Coronation only charges performance fees when we deliver significant outperformance, and all our performance fee structures are capped and clear-cut. Accordingly, we welcome plans to formulate a new standard for performance fees (confirmed in the new regulations), which aims to simplify the methodology and

improve disclosure of these fees. We believe that this can be a powerful mechanism that allows retirement savers to benefit from the much-needed uplift in savings returns while only paying when performance is delivered.

- For retiring members, a fund is required to offer an annuity strategy, either in-fund or out-of-fund. Members cannot be automatically defaulted into a specific annuity option, but have to consent first.

This is an important development, and provides retirees with a broad pathway to assuring a sustainable income for retirement. It also ensures that individuals are provided with adequate advice when making retirement decisions. We believe that this goes a long way to ensuring individuals make the most of what they have saved and make a decision that is right for their specific circumstances.

Given the concerning state of savings in SA, more can be done to encourage and preserve retirement savings. In truth, many funds already comply with most of the new regulations, and we find that most trustees really apply their minds when considering investment options.

Still, we believe that the new measures are an important step forward to ensure that more South Africans can afford to retire comfortably. ■



EUROPE'S REPRIEVE BUT GERMANY NEEDS TO DO MORE

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.



Europe has been the big surprise this year. Reeling from the unexpected decision by the UK to leave the EU, and Donald Trump's election win in 2016, it was hard *not* to expect a populist victory in a vulnerable Europe in 2017. Many in Europe have suffered deeply during a decade of slow recovery, and economic hardship has contributed to political outrage, especially against outsiders. Concern about populism was even more pronounced because the global financial crisis, followed by the Eurozone sovereign debt and banking crises, had already triggered a crisis of confidence in the EU and its monetary union. Against this background there was very real concern that the emergence of populist political parties would be the death knell for a weakened Europe.

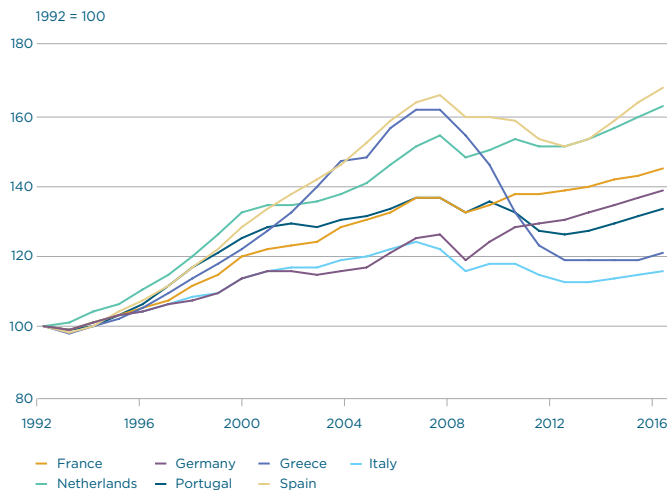
as the polls ahead of the Brexit vote and US election were so misleading, nervousness grew about an adverse outcome in at least one of the elections.

ELECTION RESULTS

The first key European country to hold elections this year was the Netherlands. It has a rather complex electoral system which allows for a broad level of representation in the Binnenhof. Coalitions are common, and it seemed unlikely that populist firebrand Geert Wilders of the Party for Freedom (PVV) would gain a ruling majority. Nonetheless, his strong views on immigration were widely telegraphed, especially since the Netherlands is traditionally one of the more tolerant EU members. Wilders' campaign called primarily for the de-Islamification of the Netherlands and more sovereign independence, "including from the EU". On the day, the PVV gained the second-most votes, but failed to attract a meaningful coalition partner.

The elections in France were perhaps the most important and least certain. Emmanuel Macron, running as an independent, campaigned for wide-ranging economic reform and a strengthening of relations with the EU. The campaign of the Republican nominee, François Fillon, was plagued by controversy. But their challenger, the established anti-EU populist Marine le Pen, remained consistently popular in the run-up to the election. Macron's victory not only secured him the presidency, but his new party, La République En Marche, gained the parliamentary majority. A resounding victory for French Europhiles, with a mandate for much-needed labour reform within France.

RELATIVE REAL GDP GROWTH



Source: IMF

In Europe, populist parties on both sides of the spectrum have been more visible, more vocal and perhaps more entrenched than in either the US or the UK. The election calendar in 2017 was also unusually packed, with each country's own populist politicians proposing various, and sometimes extreme, alternatives to the status quo. Still, most offered a common anti-immigration narrative, forcing centrists to adopt it as an electoral issue. The economic implications seemed bleak. And

It was supposed to be the most predictable election of the year that ultimately sprung the biggest surprise. The outcome in Germany confirmed that Europe has only seen a political reprieve and not resounding support for moderate politics. As expected, Chancellor Merkel won her fourth term, but there was a significant shift in underlying political dynamics. Instead of a Grand Coalition, Merkel will have to rebuild her coalition with liberal alliances. There is also now a blemish on the political landscape with a swing in



support towards the right-wing populist Alternative for Germany (AfD). Again, centrist candidates lost support due to immigration concerns.

While the electorate supported European unity, it is clear that deep divisions remain, specifically regarding immigration and fiscal union, and these are close to the surface. Nonetheless, diminished political risk, surprisingly strong European growth momentum, recovering labour markets and a supportive global context are serving a potent cocktail for Europe.

GDP growth may remain comfortably above 2% this year, and is expected to stay at about the same rate in 2018. With unemployment in Europe (currently 9.1%) at multi-year lows and further support for a tightening labour market, there may be a cyclical opportunity to integrate further, to bring Europe from an “imperfect monetary union to a true economic continent” (according to the French finance minister Bruno Le Maire). But the opportunity is more likely to be a window than a door.

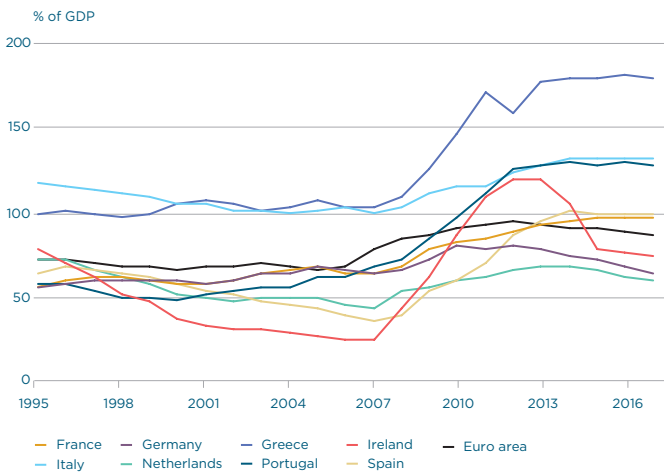
EUROPE’S OPEN FLANKS

The path to closer European integration is full of obstacles, on all flanks:

Economic flank: closer fiscal union

This is arguably the biggest risk factor for the EU. The current monetary union lacks key features crucial for long-term stability, above all greater *fiscal* union at a centralised level. Members have given up their exchange rates, but the failure to further unify their fiscal policies has weakened the union’s ability to react to shocks. Unfortunately its most powerful (and fiscally conservative) members have weakened the move towards a sufficient centralised fiscal policy. Without it, the EU remains hamstrung in tackling future challenges.

GROSS DEBT



Source: IMF

Political flank: immigration

The immigration crisis of 2015 revealed that Europe fundamentally disagrees on immigration politics, which has emerged as a poisonous and divisive political narrative.

No unified vision for Europe

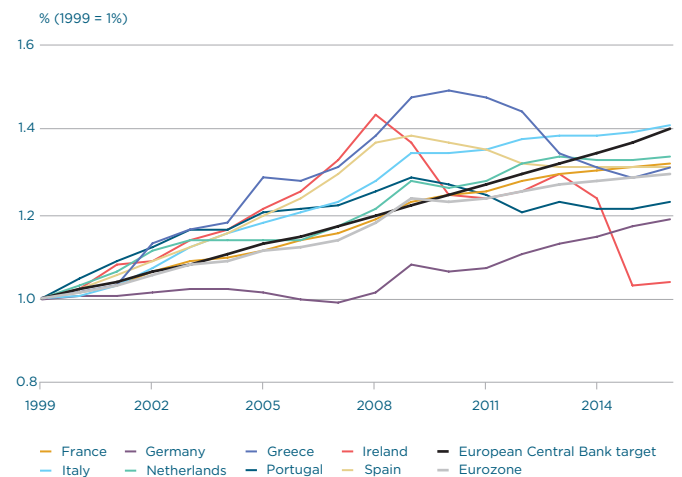
The aforementioned economic and political weaknesses are compounded by a lack of common vision. This, in turn, has led to the emergence of political alternatives in Hungary and Poland that have been moving very far away from the political centre. A new agenda needs to provide potential areas of cooperation, to ensure focus and build momentum.

CONTINENTAL DIVIDE

A first step in rebuilding the European project is recognising the deepening divisions, inequality and ongoing economic hardship following the global financial and European crises. This has undermined trust in EU institutions, threatening the broader European identity and terminating integration efforts. Countries which had to be bailed out have suffered slow and painful economic transitions. The process has deepened the North-South economic and political divisions, and reinforced the dominance of the stronger countries in institutions and policymaking. Externally, immigration, terror threats and attacks, a re-emergence of national identity and concerns about East-West geopolitical uncertainty all challenge the existing framework.

Germany, the biggest economy within the EU, has benefited enormously from conservative policies in the period between 2002 and 2009, especially in the labour market, and after that from the weaker euro. Germany is running a current account surplus at a breathtaking 8.6% of GDP (at the end of 2016), and growing at 2.1% year on year, above its estimated long-term potential. Germany has low government debt to GDP (65%) and is running a small fiscal surplus. It also has the loudest voice in EU decisionmaking.

EUROPEAN WAGE GROWTH



Source: UBS



France's position has been largely overshadowed by Germany, but regional momentum and revived hope of reform and stronger growth have boosted its GDP to 1.8% year on year. France's debt levels are high at 96% of GDP, and its deficit is persistent at -2.8%. But for the first time in years, French confidence is on firmer ground and Macron has a very real opportunity to reinvigorate the economy. Credible domestic reform will also boost France's ability to promote a reform agenda to Europe.

The so-called 'European periphery' – Ireland, Spain, Portugal and black-sheep Greece – saw their domestic financial systems buckle under massive debt burdens. In Ireland and Spain, private debt and poorly regulated banking systems were the root cause, while in Portugal and Greece profligate fiscal policy during the boom saw deficits bulge and debt rise. All suffered ballooning current account deficits as debt increased. As the crisis hit these vulnerable economies, the bailout of the banking systems led to a sharp rise in an already large stock of debt. All four sought financial assistance.

Through a painful adjustment, Ireland exited its reform programme, and has managed to recover. The other three are taking longer to recuperate. Still, economic stability in Spain has improved meaningfully, and Portugal too is on a firmer footing. In Greece, the fiscal interventions required to stabilise the sheer burden of its debt has left the economy in an almost semipermanent recession. The situation has become so dire that eight years into its reform programme and seven prime ministers later, the EU and IMF are at loggerheads about how to proceed. The IMF is advocating debt relief for Greece, while the EU, which has already lowered debt service and extended the repayment periods for Greek debt, is reluctant to do more.

THE WAY AHEAD

At this stage, France offers the best options for a new integration agenda. France's proposal, presented by Macron at the Sorbonne in late September – after the German election – stated explicitly the need for Europe to consolidate against the present threat of populism. Macron called for "the refoundation of a sovereign, united and democratic Europe". Amongst his wide-ranging proposals were a bigger EU budget to fund investment and provide a cushion against shocks, a simplified European Commission, an EU intervention force with a unified frontier police force, educational initiatives across EU institutions, funding for innovative research and an overhaul of agricultural policy. He fell short of directly proposing a European Monetary

Fund with oversight by a single finance minister, but has mooted these in the past. The importance of these proposals is twofold. France, by implementing tough reform at home is claiming its place as a significant driver of EU integration. Also, by offering a wide-ranging menu of reforms, Macron gives Europe options to choose a path forward.

Earlier this year, the European Commission released a report that called for more efficient economic structures, a financial union (including a banking union and a capital markets union), a fiscal union which will promote fiscal sustainability and stabilisation and, ultimately, a political union with democratic accountability, legitimacy and stronger institutions. The report sees these unions slowly evolving in parallel. However, it acknowledges that short-term measures need to be ambitious in order to be meaningful.

The challenge, as always, is getting it done. Of the bigger, more influential European economies, only France really has presidential commitment, with adequate domestic backing, to push the reform agenda. And that is not enough.

STRONGER TOGETHER

It is possible that economic reform in France will see a strong economic revival. President Macron has already implemented labour reform that will go a long way to addressing France's economic malaise. In doing so he is supporting regional growth, boosting confidence, reinforcing credibility and creating a platform for a new debate on European integration.

But what Europe really needs is for Germany to set aside its fiscal conservatism and take responsibility for the union and the role it plays. It needs to make a bigger economic commitment to the stability of the EU. Unfortunately, Germany's election outcome does not give much hope – despite the possibility of a more liberal, pro-Europe coalition, Germany remains fiscally conservative.

For many young Europeans, their only experience of being part of the EU has been miserable – high unemployment, fiscal constraints, poor wage growth, ongoing risk of economic crisis, banking fragility, systemic risk and external threats to their safety. There is a major risk that these voters opt out rather than integrate if nothing changes. Stronger economies may help counter the risk, but current growth will be put to the test soon: the next two years bring a host of fresh elections to the European calendar. If current growth falters, this optimism fades. ■



THE KOREAN CRISIS

ONE MISSTEP AWAY FROM CATASTROPHE

By Gideon Rachman



Gideon is the chief foreign affairs commentator at the Financial Times and a globally respected journalist. He joined the Financial Times in 2006 after a 15-year career at The Economist, which included positions as a foreign correspondent in Brussels, Washington and Bangkok.

After years of rumbling away in the background, North Korea has pushed its way to the very front of the international agenda. The North Korean regime led by Kim Jong Un is closing in on developing a nuclear missile that can hit the United States. But Donald Trump has vowed that North Korea will not be allowed to threaten the US with nuclear weapons. The US president has also repeatedly suggested that the US is prepared to take preemptive military action to prevent this from happening. Speaking at the UN, he even threatened to “totally destroy” North Korea, if it threatened the US.

Some sort of final crisis may now be in the offing. The Chinese government has compared the US and North Korea to two trains heading towards each other, at top speed. The question is whether either side is prepared to slam on the brakes.

It is highly likely that there are secret diplomatic contacts between Washington and Pyongyang – so the crisis could yet be resolved by negotiations. Alternatively, if North Korea is ultimately unwilling to freeze its nuclear programme, the US might indeed stage a military strike. But the strongest possibility is that America will ultimately decide that attacking North Korea is too dangerous – and will finally have to tolerate the North Korean nuclear threat.

The Americans know that any attack on North Korea could spark devastating retaliation against South Korea – and against US military bases in the region. North Korea probably now has more than 20 nuclear weapons – and they are dispersed in secret locations. Even if the US succeeded in ‘taking out’ all of North Korea’s nuclear weaponry, the Pyongyang regime could still launch a devastating conventional artillery attack on South Korea, whose capital, Seoul, lies just 56 km from the North Korean border. American estimates suggest that up to one million Koreans could die if war broke out on the Korean peninsula.

North Korea is such a closed society that even academic specialists struggle to interpret its behaviour. The mainstream

view is that Mr Kim’s pursuit of advanced nuclear weapons is motivated by a search for security.

The North Korean leader has seen what happened to other dictators who failed to acquire these weapons – Saddam Hussein of Iraq and Muammar Gaddafi of Libya – and concluded that only nukes can guarantee his survival. North Korea would also be devastated by American retaliation – if it was unwise enough to attack US bases in South Korea, or elsewhere.

For that reason, it seems unlikely that either side actually wants a war. But it remains possible that North Korea and the US will stumble into a war by accident. The two key leaders – Presidents Kim and Trump – are both unpredictable and given to bombastic rhetoric. The dangers that they will miscalculate each other’s actions – with catastrophic consequences – are real.

The Chinese government, North Korea’s neighbour, is critical to hopes of a peaceful solution – but faces a complex set of calculations. Mr Trump has repeatedly tried to persuade Beijing to exert more economic pressure on North Korea, threatening that the US will take unilateral military action if China fails to force Mr Kim into line. China has sought to placate Mr Trump by toughening sanctions on Pyongyang. But the Chinese also have to consider how Mr Kim might react if he is forced into a corner. The risk that the North Korean leader will use nuclear weapons first will surely rise if he is faced with the prospect of the collapse of his own regime – and his own certain death.

It is also important to be realistic. The Kim regime currently shows little interest in diplomacy, or in responding to the tentative efforts at rapprochement from the new South Korean government.

For the moment, therefore, the world will have to trust in deterrence, containment and luck to avoid a catastrophe on the Korean peninsula. ■



SPAR DUSTING ITSELF OFF

By Tumisho Motlanthe



Tumisho Motlanthe joined Coronation in 2007. A CFA charterholder, Tumisho researches SA retailers and food producers, as well as hotel and leisure companies.

Alfred Pennyworth: "Took quite a fall, didn't we, Master Bruce?"
Thomas Wayne: "And why do we fall, Bruce? So we can learn to pick ourselves up." - Batman Begins (2005)

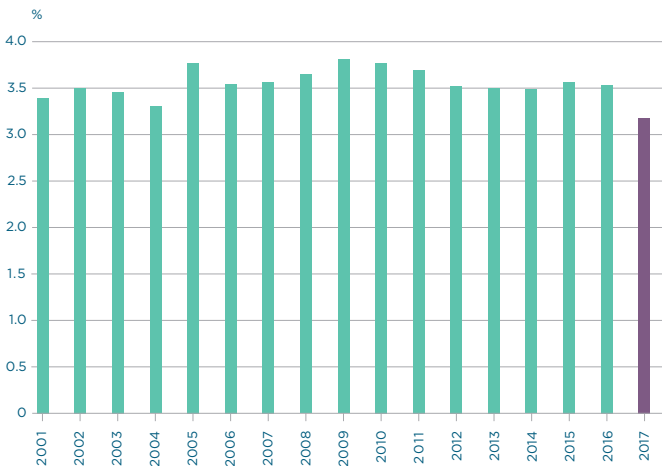
Four years ago, when we last wrote about Spar SA, the company had just turned 50 years old. Having faithfully served its communities throughout the decades, and handsomely rewarded investors since listing in 2004, the business and its share price were solid outperformers ... until about a year ago. From a high of R219, the share has tumbled nearly 25%, with the stock now having underperformed the market over the last five years.

Recent earnings have disappointed and some valid concerns are being raised around Spar as an investment. We too have wrestled with these concerns, and having concluded that the challenges are surmountable, we explain our thinking in this article.

IS PARADISE (REALLY) LOST IN SA?

In the six-month period to end-March 2017, Spar SA reported its lowest ever operating margin of 3.11%. This was a shock

SPAR SA EARNINGS BEFORE INTEREST AND TAX

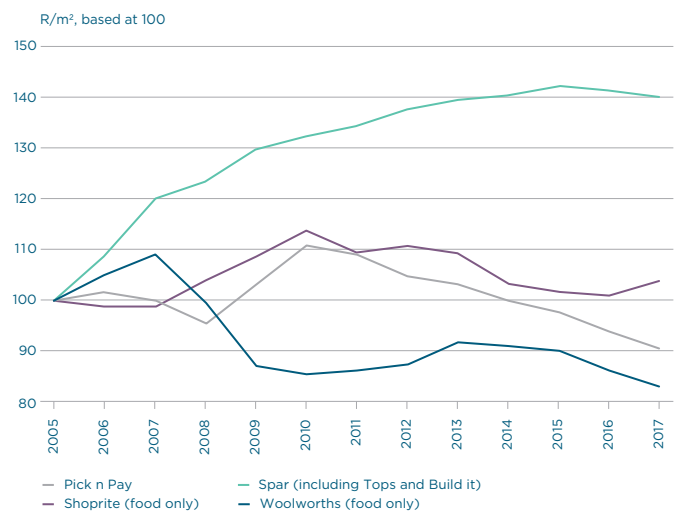


Source: Company financials

to the market and to us. Here was a business that, with metronome-like regularity, delivered 3.5% as a matter of course. While a difference of less than 0.4% may not sound like much, it is actually a 10% reduction in profitability levels - on margins that are already this thin! Compounding this was the fact that total revenue had declined in real terms, driven by a 5% decline in volumes through the retailer's distribution centres.

The following graph shows the evolution of retail space productivity in real terms, relative to 2005. What is clear is just how well Spar has managed this. Over the last two years, however, it has been declining, due to a number of reasons. First, Spar's excellent execution over many years has built a high base. Importantly, the economy is much weaker and consumers are very distressed. In addition, Spar is experiencing challenges with its business model. While the economy should recover eventually, the big fear is that Spar's model may fall down.

SA SUPERMARKETS: REAL TRADING DENSITY



Sources: Company financials, management guidance, Coronation estimates

We have spent a lot of time speaking with various people in the organisation as well as outside of it (competitors,



suppliers, franchisees), thinking through these issues and contextualising recently reported numbers against long-term history. These channel checks have provided invaluable insight into the business model. We believe the model will withstand current pressures and that the market's fears are overdone.

Some of the factors we considered are:

- **Loyalty of franchisees.** Given the current difficulties, some of Spar's independent franchisees are currently weighing up the pros and cons of staying or leaving. Though it might be tempting to exit the agreement, the costs would almost certainly outweigh the benefits:
 - Being a member is financially lucrative. Spar carries the stock burden, so franchises have become a lot more cash generative over time. Ten years ago, its creditor days (the average time a company takes to pay its creditors) were at parity with stock days (the average number of days the company holds its stock before selling it). Now, creditor days are twice as long.
 - Spar's systems and processes are easy to use, freeing up franchisees from having to deal with suppliers and investing in fleet.
 - The transparent nature of the agreement with Spar engenders trust. Franchisees can easily compare it with that of competing retailers. Spar suffered only a single defection in the last year – the agreement is evidently compelling.
 - **Limited threat of independent buying groups.** As beneficiaries of down-trading over the last few years, these retailers have managed to increase their market share. However, they are unable to effectively compete for Spar's customers in two key categories: fresh food and prepared/convenience meals. This limits their ability to entice Spar's franchisees away en masse, which lowers the risk of Spar being replaced as the wholesaler of choice.
 - **Coordination of retail strategy.** Because the agreement between Spar and its franchisees is voluntary, it is no surprise that execution varies from store to store. This has resulted in differences in what customers find on shelves and in terms of the services offered (even within the same format), and has added to the difficulty of drawing new customers into their stores. Management has now confirmed two big, compulsory initiatives for all franchisees:
 - Money market counters and kiosks are part of the SA customer experience. These provide another reason for consumers to enter the store and two additional opportunities (sending money and receiving money) for Spar to build a long-term relationship with the customer.
 - The 'My Spar Rewards' programme has to be very visible in-store. The programme is being heavily promoted after Spar historically undervalued the importance of loyalty programmes.
 - **Price perception set to improve.** Consumers wrongly view Spar as expensive, regardless of the store format. The company's previous marketing campaigns have not shouted loud enough about price. Future campaigns will see more price-focused advertising that clearly highlights how much consumers can save. Across the stores, all franchisees are now also running off a single point-of-sale system, which will allow promotions to be pushed seamlessly across the stores.
 - **Space growth.** Spar's recent store roll-out has been slowed due to the weak environment. Franchisees have grown skittish about opening stores, while new property developments have been delayed. The company still has a healthy pipeline of new sites in areas where they lack a presence, and this will come on-line in the near to medium term.
 - **Sustainable profitability.** We believe Spar's long-term profitability is higher than that reflected in today's margins. Operating costs have outgrown revenue, gross profit margins declined and volumes were negative – all simultaneously for the first time. Not the usual service we have come to expect over the years! In fact, volumes have never been negative over a full 12-month period. Pleasingly, volumes have picked up even as food inflation has come down, and there is every chance that volumes will finish the year in the black. Given Spar's largely fixed-cost base, this improvement suggests great potential for fatter margins in future. We expect 3.5% may be sustainable in the foreseeable future.
- Once the environment stabilises and starts to improve, Spar should be off to the races. We expect the business to return to at least maintaining (and even growing) its retail space productivity. Along with the normalisation of margins, the earnings recovery should be strong off what we believe is a low SA earnings base.

EUROPEAN ACQUISITIONS

In recent years, Spar bought related retail businesses in Ireland, South-West England and Switzerland. Were these European acquisitions a mistake?

We think the acquisitions were strategically important, and see them as a natural extension of the business, given the limited scope for big store roll-out in SA as the group protects franchisee profitability. All the European businesses work on the same model as in SA, and in fact three of them are Spar licensees in those countries. In our view, management is staying within its circle of competence,



reducing the risk of the acquisitions. Some R2.1 billion has been spent on these acquisitions and, seeing as they were acquired on price/earnings multiples of between seven times and 14 times, with good earnings growth potential, they make financial sense too.

Ireland – huge convenience opportunity

In developed markets, food retail formats are more clearly defined than what we are used to in SA, each with its own set of strengths and weaknesses. In BWG, Spar SA has acquired multiple banners (brands) which play in various formats. We estimate that 70% of group sales is in the convenience sector (think KwikSpar in SA), and BWG is the biggest player in this market in Ireland. We are excited about the very attractive fundamentals of this format:

- The convenience market looks set to take share from other formats, given rising income levels and an evolution in Irish lifestyles. DINK (dual income, no kids) households are on the rise, while elderly people living in cities increasingly demand prepared meals. These developments underpin a more stable demand, enhancing the defensiveness of the format.
- Convenience retailing is hedged against price debasement from discounters, given its different mix of products. Discounters have brought price deflation to fruit and vegetables, as well as to high-value groceries. In contrast, convenience stores specialise in home meal replacement, emergency buys and treat purchases. They also offer very high service levels, while stores are located in busy thoroughfares where discounters are not present.
- Store productivity is high given the heavy footfall through a small space, as well as the high price points of (and high margin on) goods.

In Ireland, distribution facilities are underutilised, which presents an attractive opportunity to drive volume. In SA, franchise loyalty sits between 80% and 85%, but this is far lower in Ireland (in the 60s). Franchisees also typically have more power given their size, where big players can run 50 to 200 stores, compared to only five to ten in SA. Over the last two years, loyalty has been increasing as Spar has proven its distribution expertise in Ireland, while demonstrating an ability to distribute the whole category basket.

In conjunction with our positive revenue outlook, we think margins have some way to go before reaching their true

long-term potential. While margins are around 2% today, these should get above the 2.5% level and tend towards 3%.

Switzerland – a right-sized bet

The acquisition of Spar Switzerland appears to have been a bit rushed on the back of successful purchases in Ireland and the UK. Though management knew they were buying a sub-scale business (which has a market share of only 1% versus the top two players with a combined 80%), it turns out their due diligence intelligence was poor. Profits have fallen since acquisition. Sadly, of the European acquisitions, management paid the highest multiple for this one.

What is reassuring is that Spar has managed the size of its up-front investment accordingly. Spar only acquired 60% of this business versus 80% to 100% of its UK and Irish acquisitions. Furthermore, of Spar's R2.1 billion European investment, only a third was spent on this business.

Although it has disappointed, there are some early signs of a turnaround. Spar has relocated the former head of its KwaZulu-Natal distribution centre to take charge of the Swiss business, with the help of two other SA colleagues. After months of revenue decline, Switzerland has at the time of writing completed six consecutive weeks of sales growth. The Swiss operation represents 8% of group revenue, and while it does not make any money at the moment, just getting it back to a reasonable margin level will be very positive for group earnings, while growing revenues will provide further upside.

CONCLUSION

While Spar SA looks different today than it did four years ago, its essence remains the same. Fundamentally it remains an above-average return generator and converter of earnings into cash, with stable margins. Also, its management has a good track record of allocating capital. The business has stumbled in the last year, but much of this is because of the very subdued environment.

Spar is one of those agile businesses that, when faced with adversity, will emerge wiser and stronger. Given its current valuation – it trades on 12.5 times our assessment of normal earnings while offering a 4.5% dividend yield – we like the share more than we did a year ago, and we own a lot more of it as a result. Like the dark knight himself, we expect Spar to rise, and to contribute positively to our portfolios in the process. ■



AIRBUS

HEADING FOR CRUISING ALTITUDE

By **Iakovos Mekios**

Iakovos is an analyst within Coronation's Global Emerging Markets investment unit. He joined the business in 2013 and is a CFA charterholder.



Few displays of human ingenuity and technological progress are more impressive than the commonplace sight of massive metallic tubes flying people largely safely and reliably into airports across the globe. Aircraft are complex machines that inspire awe in the observer, but when it comes to investing in companies that are involved in either building or operating them, the experience has not always been quite as rousing.

We have always approached investing in air travel with caution. Airbus was a case in point. While it has been on our radar for the last few years, its past as a state-controlled entity with low profitability, a heavy and at times poor investment rate, and governance failures had kept us on the sidelines.

The business was born in the late 1960s and is an amalgamation of various European aerospace and defence companies that were put together over time with the ultimate goal of creating a pan-European champion that would compete with its US counterparts in these strategically important industries. In its commercial aircraft division, the most significant part of its business – which now accounts for 75% of revenue, followed by defence and space with 16% and helicopters with 9% – Airbus reached technological parity with its key American competitor, Boeing, in the early 2000s.

While Airbus (then known as EADS) was listed on the Paris stock exchange in 2000, its full privatisation started in earnest in 2012 when its French, German and Spanish state-owned shareholders agreed to limit their aggregate holding to a maximum 30% of the shares outstanding. By that point, the business was an established duopolist (along with Boeing) in commercial aviation and commanded market share of some 50%.

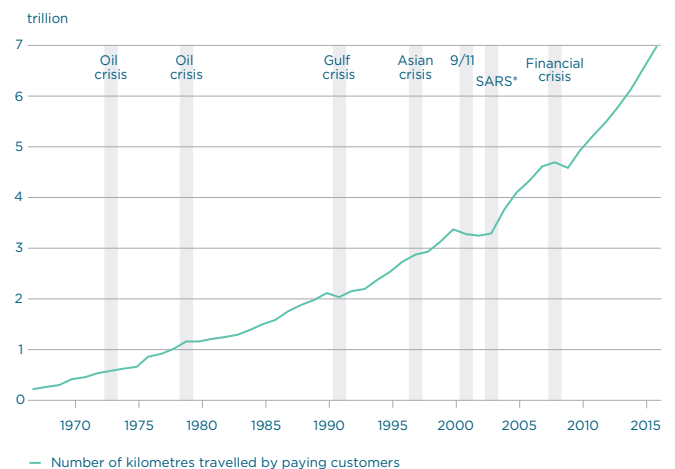
After decades of outsized investment, it was finally allowed to focus more on commercial priorities. The newly promoted management team at the time signalled this shift in mentality by taking rational decisions relating to its commercial aircraft product cycle: it decided to launch updated versions of its current programmes (known as 're-enginings' due to the application of a new, more capable engine on an aircraft

body that was only slightly updated) rather than new, clean-sheet designs. The main advantages of 're-enginings' are that they are quicker to execute, carry lower technological risk – which is mainly borne by the engine makers instead of the aircraft manufacturers – and require significantly lower capital expenditure. Still, due to the long time lag in aviation between product launch and entry into service, the impact of these decisions will only start being evident at the end of this decade and even more so in the 2020s.

SECULAR GROWTH

The most important external variable driving the Airbus commercial aircraft division's long-term revenue growth is, of course, air travel. Ever since aviation became commercialised in the 1950s, air traffic has proven to be very resilient to external shocks. Wars, aviation disasters, natural phenomena, epidemics and economic crises have only temporarily stalled the growth in the number of annual air passengers. Air travel has recovered every time and has correlated well with the growth in countries' GDP per capita (as is evident from the graph on the following page).

WORLD PASSENGER AIR TRAVEL

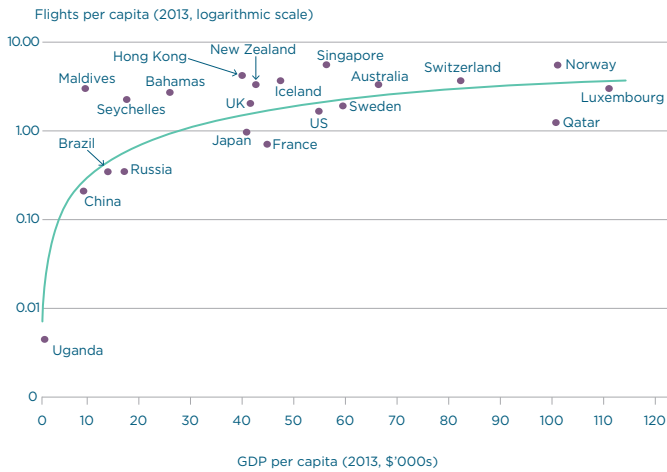


Source: Airbus



This resilience speaks to the strength of the human desire to explore the world and to maintain personal connections. In fact, it seems that the demand for travel is almost insatiable: markets such as Europe and the US have been deemed 'mature' for decades, but keep growing at a reasonable pace as air travel frequency continues to increase.

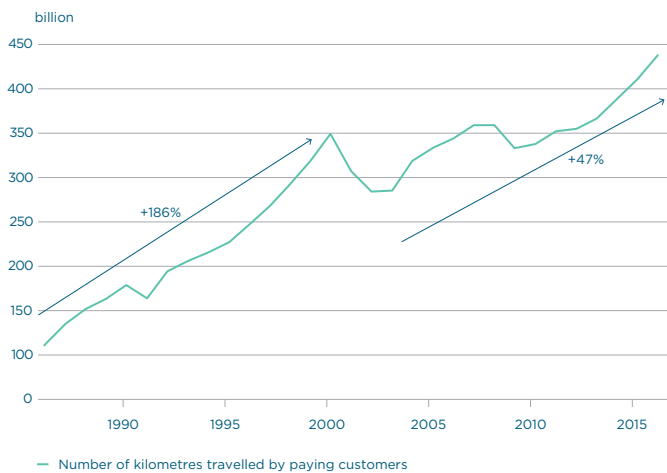
MORE MONEY, MORE FLIGHTS



Sources: International Air Transport Association, Tourism Economics 'Air Passenger Forecasts'

The best example to illustrate this is the busy North Atlantic air travel market. Unlike other categories where structural growth subsides within a couple of decades, it is hard to imagine an end to air traffic growth in this century.

PASSENGER TRAFFIC BETWEEN EUROPE AND THE US

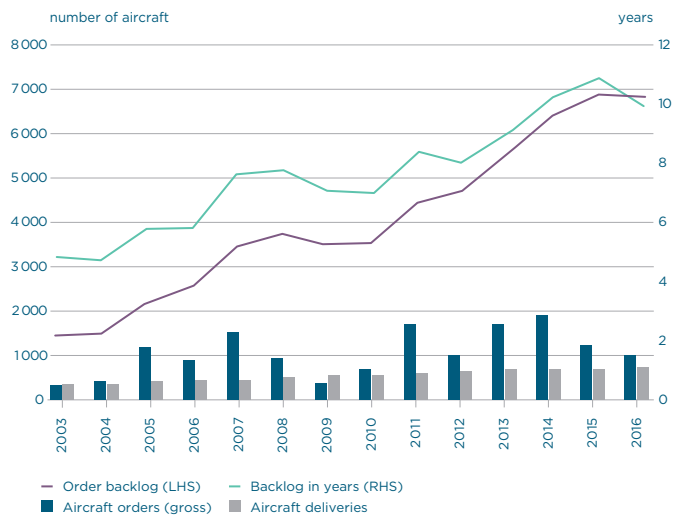


Source: Airbus

BACKLOG AND PROFITABILITY

In order to meet the global demand for aircraft, Airbus has been steadily increasing its production capacity. Backed by a very strong order backlog (worth almost 10 years of production at current production rates), the company is adding to its product suite and upgrading some of its current

AIRBUS COMMERCIAL ORDERS AND DELIVERIES



Sources: Airbus, Coronation

bestsellers. Still, its current earnings are abnormally low. This is due to the development of three new programmes, the A350, A320neo and A330neo. Airbus uses the cost accounting method to compile its financial statements, unlike Boeing which relies on 'programme accounting'. Airbus incurs the upfront launch costs of a new aircraft programme before the corresponding sales ultimately more than offset these costs over the programme's lifespan of 25 to 30 years. As the A350, A320neo and A330neo programmes mature, they will not only boost the revenue line, but also reverse the dampening effect they have on profitability and strongly improve free cash flow generation.

On top of this, the company's bottom line is currently affected by currency hedges. Its currency exposure is hedged out for many years in the future, and as a result of the weaker euro, maturing hedges have been expiring in the red. Over time, as hedges unwind, the business should benefit from any US dollar strength: the majority of its revenue is denominated in dollar, while a significant percentage of costs is linked to the euro and the British pound.

RISKS

The A400M military transport aircraft programme has been a problematic remnant from the 'old Airbus' era. The company has had to budget provisions of more than €6 billion in aggregate due to cost overruns and capability shortfalls. The resolution of the aircraft's woes depends on sensitive negotiations between Airbus management and government customers that could take longer than is currently anticipated.

Naturally, the global business cycle will affect aircraft demand (as well as military and helicopter orders), but we believe its large order backlog should insulate Airbus from sharp cyclicity. Moreover, barriers to entry are high:



new aircraft from competing manufacturers – Chinese and Russian in particular – appear at least 10 to 15 years away from becoming credible, commercial alternatives to the duopoly’s products.

Although governance has improved materially in the last few years, Airbus faces outstanding investigations on alleged past transgressions. If these were to result in fines, we believe Airbus has the balance sheet to withstand them comfortably. We take governance into account when deciding on the quality of a business and we incorporate our view into the fair value multiple we assign to the company.

VALUATION

The stock trades on 18.5 times its expected 2018 earnings, which may seem like a rich multiple to pay for a European industrial. However, we believe the current price only partially

discounts the profitability improvements that Airbus should deliver by the end of the decade, and almost completely ignores a second leg of profit uptick in 2020 to 2025 as new aircraft programmes enter maturity. Accordingly, Airbus recently became a holding in our Global Emerging Markets Equity and Global Equity (developed market) portfolios. The stock is eligible for both international strategies, as Airbus has more than 55% exposure to emerging markets, both by revenue and by its order book. This is the result of the rise of Middle Eastern carriers and the growth of the Asian middle classes, which have shifted global aviation eastward and increasingly towards emerging markets.

Commercial aircraft manufacturers are investments with very long cycles. In our view, this gives long-term investors such as ourselves an edge. We are able to look at a company’s earnings and free cash flow generation potential many years out – key to appreciate the value we believe lies in Airbus. ■



EMERGING MARKETS
FROM ‘NICE TO HAVE’ TO ‘NEED TO HAVE’

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.



Over the years, we have repeatedly made the case for a direct allocation to emerging markets, as they are under-represented in major global indices and under-researched by the world’s investors.

Through frequent crises and downswings, we encouraged investors not only to keep the faith, but also to look through the short-term news and focus on the long-term potential. At times, this may have been severely tested as currencies and commodities saw collapsing prices and political shocks wreak havoc on asset prices. We continue to emphasise that there are always investment opportunities present in emerging markets. Emerging market behaviour is far more inefficient than that of developed markets, creating ongoing mispricings from which an active, valuation-driven investor can benefit.

Since the most recent crisis, emerging markets have staged a strong and broad recovery, and the IMF now expects growth of 4.6% this year (and 4.9% in 2018) from these countries. In contrast, advanced economies are expected to expand by only 2.2% in 2017, before slowing down to 2% next year.

The road ahead will be bumpy and one should never expect that emerging market countries will not pose challenges to investors from time to time. Still, despite many daunting challenges, we do believe that the positive trajectory for these countries is growing ever clearer.

In the long run, emerging markets will continue to benefit from structural drivers that are simply not present in developed markets. With younger populations, formalising economies and vastly untapped consumption potential, emerging markets undeniably offer a higher rate of growth potential.

An example is China, where only 55% to 60% of the population has access to the internet (compared to an average of 80% in developed markets). Hundreds of millions of consumers still need to be connected, holding massive potential for many consumer and internet companies. Also, while 90% of US households own at least one vehicle, only 6% of households in the Philippines own a car and 2% in Vietnam. In China, less than a fifth of households own their own car. This should provide a strong tailwind for growth in vehicle sales in emerging markets.



Similar structural growth stories are playing out across a number of emerging market industries. A growing consumer class and a strong shift from the informal to the formal sector are benefiting many companies. These include the Russian food retail sector where national retailers continue to profit from the move away from ‘mom and pop independents’ and open-air markets to branded chains. They also include Indian private sector banks that look to benefit from both a capture in market share from the poorer run state-owned counterparts that still control 70% of the banking sector and the increase in financial services penetration of the relatively underbanked population.

Our valuation approach aims to value these businesses based on what we expect them to earn over the long term. We then look to use any short-term pressure on the share price as a buying opportunity if prices fall significantly below our estimate of intrinsic value. In addition, despite the strong run in emerging markets as a grouping over the past 18 months, we still see many companies that are trading at very attractive upside to their long-term value.

The strong supporting dynamics will drive emerging market growth for many years, and according to some projections, six of the world’s seven largest economies could be emerging markets by 2050. By then, Indonesia and Mexico are projected to be larger than Japan, Germany, the UK or France, while Turkey could overtake Italy.

EMERGING MARKETS WILL DOMINATE THE WORLD’S TOP 10 ECONOMIES IN 2050 (GDP AT PURCHASING POWER PARITY)

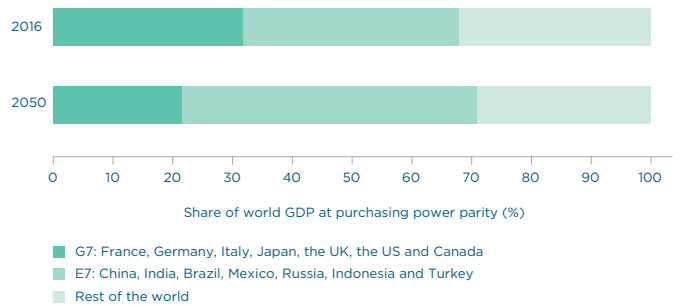
	2016	2050	
China	1	1	China
US	2	2	India
India	3	3	US
Japan	4	4	Indonesia
Germany	5	5	Brazil
Russia	6	6	Russia
Brazil	7	7	Mexico
Indonesia	8	8	Japan
UK	9	9	Germany
France	10	10	UK

■ E7 economies ■ G7 economies

Source: PricewaterhouseCoopers

Investors without emerging market exposure will fail to benefit from this massive economic shift. For those with a nervous disposition, we believe emerging markets are reaching scale and a level of maturity that bring with it a greater degree of predictability. So while the end of quantitative easing may have a negative impact on emerging markets, our base case is that emerging market economies today are far more robust and we would not expect a repeat

PROJECTED CHANGE IN WORLD GDP



Sources: IMF for 2016 estimate, PricewaterhouseCoopers projections for 2050

of the ‘Volcker Shock’ when Latin American countries lost a decade of economic growth in reaction to sharp rate hikes in the US during 1979 to 1981. This time round, emerging markets are more resilient, with record-low inflation, flexible currencies and sheer size on their side. Their economies have matured; they are structurally much stronger and able to withstand volatility.

So the question shifts from ‘why emerging markets’ to ‘where in emerging markets’. The answer may be more difficult than you think:

A top-down only approach will not necessarily help you.

The relationship between economic growth and equity returns has proven to be somewhat tenuous in emerging markets. Notwithstanding the positive economic drivers, we would emphasise that economic growth does not necessarily equal good investment returns, and in our experience, the countries with the rosier outlooks do not necessarily offer the most attractive long-term investment opportunities.

Our emphasis is on stock selection rather than top-down geographic allocation or macro themes. Our own, unique research will determine what a share is worth (its fair value), and we will only invest if we think the current price is sufficiently below this level, thereby offering a significant margin of safety. This analysis is based on our own detailed modelling of all companies in our coverage list. This includes modelling revenue, cost and margins for at least five years out.

Our proprietary company research is supported by extensive first-hand scrutiny of potential holdings, including country visits and meetings with management, competitors, industry experts and other information sources.

Active management gets you the most benefit. We believe many of the best investments in emerging markets lie beyond the largest indices.

Notwithstanding the strong long-term emerging market investment case, global equity managers remain generally structurally underweight in emerging markets. For example,



the MSCI All Country World index, the most important index for global markets, includes a much smaller emerging markets allocation than their share of global GDP would justify. This is because capital market development in these countries is not as evolved as their developed-market counterparts and many large emerging markets businesses have lower free floats than their peers in developed markets. When international investors do invest in emerging markets, it tends to be in a narrow universe of the biggest, most liquid names in the asset class.

Importantly, we do not believe the MSCI Emerging Markets Index is an appropriate reflection of all the value and investment opportunities in emerging markets. Many of the holdings in the index often are below-average businesses (particularly state-owned banks and energy groups), subject to significant state regulation. Often these companies are poor stewards of capital and exposed to cyclical earnings. We do not believe they represent the full opportunity set in emerging markets.

And just like any such index or by investing in an index fund, you would systematically own more overpriced stocks, sectors and countries and less of their underpriced counterparts. The importance of researching and selecting a portfolio of the best opportunities within emerging markets is even greater when the overall backdrop is challenging.

You want to be confident that the investments in your portfolio are able to weather the storm and, in many cases, come out stronger on the other side.

Accordingly, we build entirely clean-slate portfolios based on our assessment of the most compelling risk-adjusted investment opportunities in emerging markets. Our portfolios look very different to the index. In fact, we are comfortable taking decisive positions away from the benchmark when the investment case is compelling, as these positions are underpinned by convictions derived from our proprietary analysis.

We have identified many great businesses in fast-growing industries with small (or no) weightings in the index that have resulted in significant value creation for our clients over the years. This is evident in the performance of the Coronation Global Emerging Markets Equity strategy which has delivered an annualised return of 8.5% (in US dollars) since inception in 2008. The strategy has outperformed its benchmark (the MSCI Daily Total Return Net Emerging Markets USD) by 5.4% per annum.

Given our expectation that all asset class returns may be lower going forward, exposure to these emerging market higher-growth opportunities, provided the right companies are bought at the right price, will remain vital. ■



ZIMBABWE

RETURNS THAT SOUND TOO GOOD TO BE TRUE ...

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.



You may think that the countries with the best-performing stock markets are those whose economies are booming, and those that enjoy large foreign investment inflows and stable political environments. However, when you look at the list of the best-performing stock markets thus far in 2017, you will find that the top spots are occupied by some unlikely candidates. Markets like Argentina and Kazakhstan (both up by more than 40% year to date in US dollar) saw strong recoveries from very low bases, but the real outliers are the two countries right at the top of the list, which are there for completely the wrong reasons.

In Venezuela, the stock market gain of more than 1 000% merely reflects the currency printing and hyperinflation in the economy. The official exchange rate is not the rate at which people unofficially exchange US dollars and the stock market gains therefore largely signify the true currency devaluation.

There are parallels that can be drawn between Venezuela and the second-best performer, Zimbabwe, which is up 189% year to date (to end-September). You would think that the performance in Zimbabwe – which adopted the US dollar as its official currency – should not reflect a currency devaluation, but in reality the country has created a new form of currency printing. As a result a dollar in a bank account in Zimbabwe is no longer worth the same as a physical US dollar elsewhere.

The problem with adopting the US dollar for Zimbabwe, which imports more than it exports, is that the dollars in the economy reduce if there are not enough foreign investments or international funding to plug the gap. After adopting the US dollar in 2009, Zimbabwe experienced a few years of economic growth, with renewed interest from foreign investors. However, in addition to the severe decline in agricultural output which turned the country from a net maize exporter to a net importer over the past three decades, a number of factors more recently resulted in accelerated outflows of US dollars.

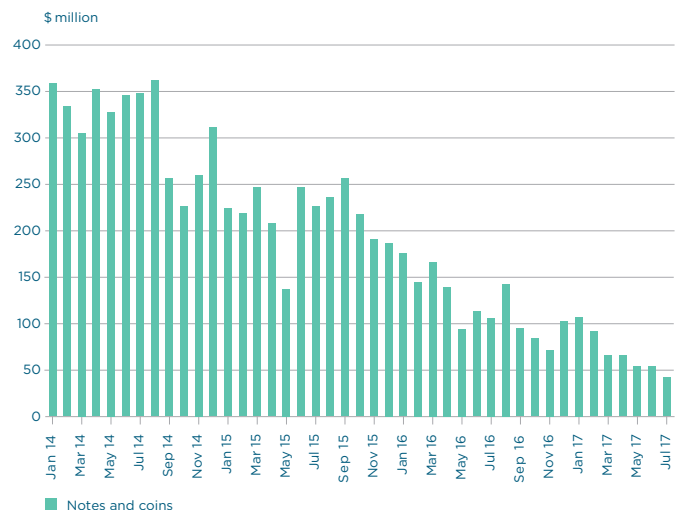
Exports declined as gold, which accounts for almost a third of Zimbabwe's exports, fell from above \$1 700 per ounce in 2012 to below \$1 100 per ounce in 2015.

As Zimbabwe's largest trading partner, the fact that SA's rand lost almost half of its value against the dollar between 2012 and 2016 has left Zimbabwe completely uncompetitive. It became much cheaper to import, hitting local businesses hard. It also meant that the US dollar value of diaspora remittances reduced, dropping by almost 18% in 2016 alone.

Net direct foreign investments slowed from \$473 million in 2014 to \$255 million in 2016, and portfolio investments also turned negative last year.

It has also become almost impossible for the country to access international funding, as these lenders are demanding significant reforms. This means that the physical US dollars in the economy are now close to being depleted, which is evident from the following graph showing the decline in currency held by the commercial banks.

NOTES AND COINS HELD BY COMMERCIAL BANKS IN ZIMBABWE



Source: Reserve Bank of Zimbabwe

The cross-border flow of dollars, particularly out of the country, has become more and more regulated, with imports of basic food products and the inputs of net exporters being prioritised, while the capital of investors is (much)

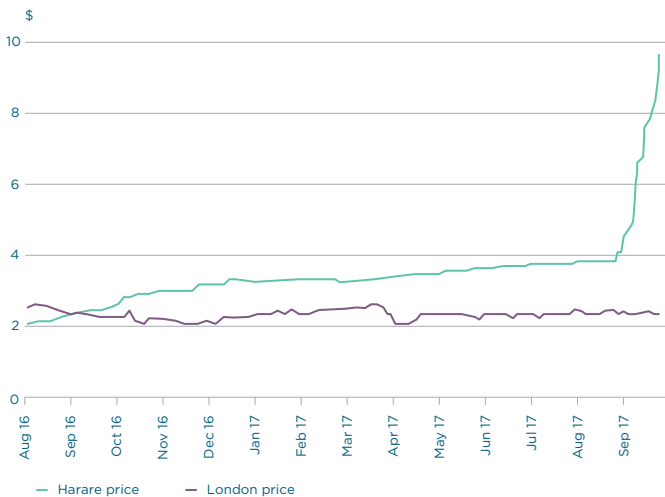


lower down on the list. This means that for all practical purposes it has become impossible for a foreign investor to repatriate funds.

In 2016 the cash shortages became so problematic that the Reserve Bank started printing the so-called ‘bond notes’, basically a new form of local currency that officially holds the same value as the US dollar. However, what started as \$10 million in bond notes injected into the market in November 2016 grew to at least \$175 million, with talk of much more to come. The combination of the US dollar shortage and the fact that foreign companies do not accept bond notes as payment for imports meant that people were quickly willing to pay more than one bond note for one US dollar. From anecdotal evidence, the premium was between 10% and 25% earlier this year, but this recently increased to around 60%. In many ways this is similar to the black market for US dollars in Venezuela.

Objective evidence that there is a large difference between a physical US dollar and an electronic dollar or bond note in Zimbabwe is the fact that the share price of Old Mutual, which is listed in both Zimbabwe and London, trades at vastly different values on the different exchanges. Many investors track this difference as an estimate of the effective currency devaluation. The following graph shows that Old Mutual’s Zimbabwean-listed shares, which traded at parity in August 2016, were almost four times more expensive than the London-listed shares at the end of September 2017. Stated differently, the Old Mutual share price in Zimbabwe needs to be impaired by 73% to reflect the same share price as the London listing.

OLD MUTUAL SHARE PRICE



Source: Bloomberg

At ATMs in Zimbabwe, people struggle to draw more than \$20 per day, and the money they do get can either be in the form of US dollars or bond notes, with the latter being much more likely. Although locally produced food products are

still priced at a level fairly similar to what they were at the beginning of the year, signs of hyperinflation are emerging, with some imported products tripling in price over the last few months.

With the hyperinflationary mid-2000s still fresh in investors’ memories, they are doing exactly what they did during that time and are using all cash trapped in Zimbabwe – either in the form of bond notes or electronically such as a bank account balance – to buy assets that store value. Property prices rise as people put their cash into real estate and companies are even reporting a jump in the sales of electronic goods.

But the most conspicuous reaction is the way people have been piling into the stock market. Locally listed Zimbabwean equity prices have seen excessive and unwarranted gains, with share prices now well above our estimates of fair value. Using these quoted prices, our African-focused portfolios showed large paper gains. However, as these gains are not realisable, we had to evaluate our valuation methodology for these companies to ensure that we do not overstate performance, and that both new investors into these funds and clients who want to withdraw funds are treated fairly. As a result we have impaired a significant portion of the value of all in-country Zimbabwean assets to account for the unwarranted gains.

ZIMBABWE INDUSTRIAL INDEX



Source: Bloomberg

The Zimbabwean exposure of our African portfolios is largely concentrated in Econet Wireless and Delta Corporation. With returns for the first nine months of this year of 243% and 212% respectively, these two companies still contributed positively to the funds’ overall returns over this period, despite the write-downs.

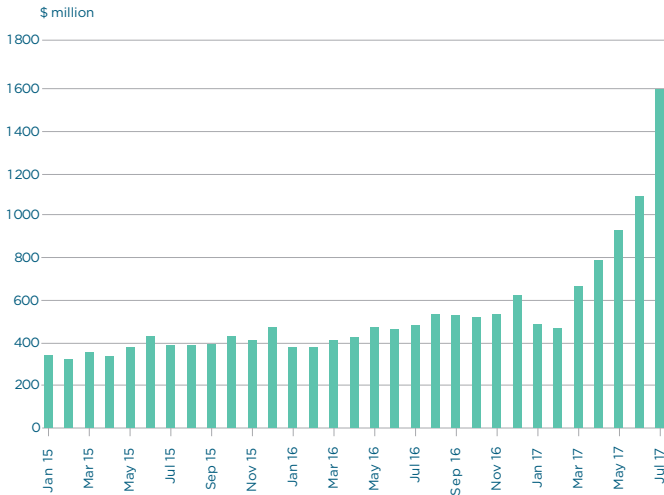
Although the operating environment in Zimbabwe is currently extremely challenging, these two high-quality businesses are entrenching their moats as the dominant players in their respective industries.



A good example is EcoCash, Econet's mobile money business. With a market share of close to 100%, this business is thriving in the current environment. Zimbabwe's cash shortages resulted in a spectacular rise in the number of transactions on its mobile money platform, as demonstrated by the graph below. This environment is

driving a massive acceleration in the adoption of mobile money technology, which has transformed this business. From simply providing an alternative option for payments a few years ago, EcoCash is now an absolutely fundamental part of the economy.

VALUE OF MOBILE TRANSACTIONS IN ZIMBABWE



Source: Reserve Bank of Zimbabwe

Africa has experienced a number of currency crises over the years. We know they do not last forever and we have seen the positive outcomes of being invested in countries like Egypt and Nigeria when their currency situations improved. We do not know when this will happen in Zimbabwe, but what we do know is that at some point something has to give. If shelves are empty and filling stations run dry, the country will be forced into significant interventions, and with its recent traumatic events still fresh in memory, this might well play out much faster this time around. The signs of hyperinflation are already clearly visible and the possibility of a watershed moment is as real as it has ever been, with increased discontent among the general public, more reports of political infighting and government's finances basically depleted.

We still view the Breadbasket of Africa as a country with immense potential and our focus is on owning the high-quality companies that will emerge from this volatile environment as stronger businesses. ■



SA ON THE BRINK

BUT WE HAVE BEEN HERE BEFORE

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.



The SA economy might grow by 0.7% this year. If we are lucky. The numbers tell us that there has been very little spending by households, whose incomes are under pressure, and no-one is investing.

The real story is more complicated. Households' incomes are stagnating because there has been no employment growth, and while inflation is more subdued, it has not compensated for a bigger tax burden. Consumers who can afford to spend have not done so because confidence has plummeted. Investment has not grown because government has an expenditure cap, and its revenues have disappointed. Companies have not invested because profitability has been poor and they, too, are worried about the economy. The latest business confidence data from the Bureau for Economic Research (BER) suggest that 65% of respondents think current conditions are unfavourable.

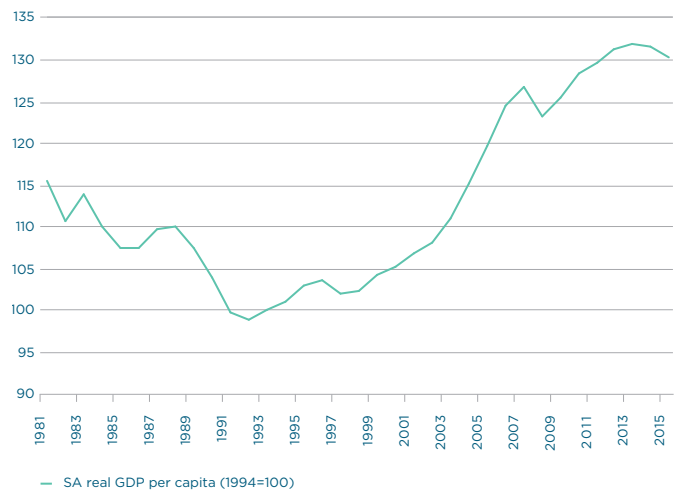
There are only three things that make economies grow: absorbing more labour (creating jobs), investing in better infrastructure (creating capacity) and combining the employed labour and better infrastructure in more productive ways (total factor productivity). These seemingly simple requirements are inherently enormously complex, and rely on an implicit fabric of socioeconomic and political stability, predictability, governance, ingenuity, education and time.

Where does government fit in? Government's job is not to make economies grow; its job is to implement policies which enable the private sector to invest in growth. These include creating and reinforcing institutions which facilitate, educate, oversee, regulate, implement and police economic and social policies. In practice, the impact of government on the economy is much more complex. Feedback loops between policies and their economic translation often have unintended or unanticipated consequences. Often, it is not even policy, but a lack of policy that can have a damaging impact on the economy. A failure of confidence can have long-lasting and far-reaching repercussions.

This gives us a framework within which to assess the way in which the economy has grown and evolved since democracy,

and a way of articulating some of the challenges we now face. The graph below is the best illustration, showing real per capita GDP since the run-up to democracy, and three distinct periods of post-democracy growth.

SA REAL GDP PER CAPITA



Source: Statistics SA

1994 - 2001

In 1994, the ANC inherited an economy that was almost bust. Per capita GDP growth had been contracting in real terms for more than a decade amid international sanctions and a collapse in private investment, with an apartheid government which scrambled to create capacity which the private sector would not. The government deficit ballooned to -7.1% of GDP in 1993, and by 1996 debt accumulated to 48.2% of GDP. Inflation surged.

The incoming government liberalised and simplified internal institutions (abolished trade boards and subsidies, etc.), opened up trade with the rest of the world, implemented a new economic framework and initiated a fiscal reform programme (which included the Medium-Term Expenditure Framework budgeting process) to ensure transparency and



improve participation. The economy benefited enormously from resurging confidence. Investment boosted productivity and potential growth estimates were revised higher to 3.6%¹.

SA PRODUCTIVITY



Source: Organisation for Economic Co-operation and Development (OECD)

Still, the period was not plain sailing ... The Tequila Crisis in 1995, as well as meltdowns in Asia (1997) and Russia (1998) all rocked SA's fragile markets and saw growth contract. With few fiscal resources and a central bank with a flexible mandate, the main policy rate surged to 21.85% in September 1998, the currency plummeted and higher inflation followed, peaking at 9.3% year on year in November of that year.

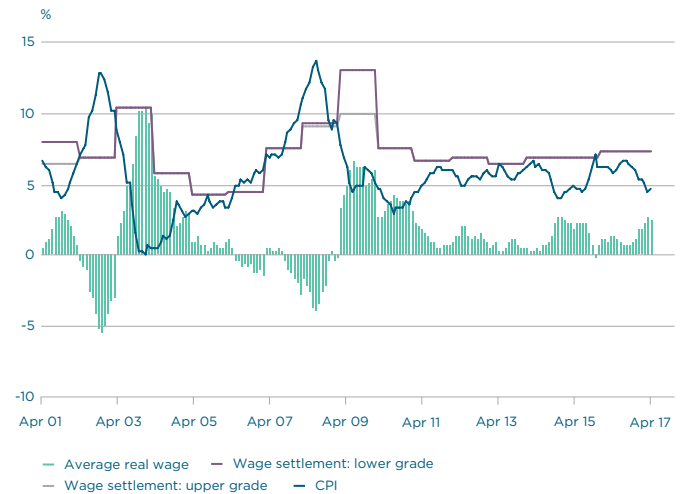
The official implementation of the inflation target from 2000 provided greater transparency and stability to monetary policy. During this time, real GDP averaged, with some volatility, at 2.9%.

2002 - 2009

The 2001/2002 currency crisis led to a spike in inflation and prompted the recently inflation-targeting central bank to raise the repo rate from 13% in September 2001 to 17% a year later. But the weaker currency boosted competitiveness and manufacturing output surged in a world where global growth was accelerating. The modern rise of China in turn raised commodity prices and was the catalyst for a multi-year boost to domestic terms of trade. As SA's growth momentum increased, job creation improved, credit was extended to a wider proportion of the populace and a combination of conservative budgeting and upside surprises to nominal GDP facilitated a healthy dose of fiscal healing. Gross government debt fell steadily from its 1996 peak to 26% of GDP in March 2009 as the primary deficit moved into surplus. Growth during this period averaged a robust 4.4%.

By 2009 government implemented textbook-true counter-cyclical fiscal policy in response to collapsing growth amid the global financial crisis. Government expenditure surged from 28.7% of GDP in 2008 to 33% by 2016 ... and then did not budge. Much of the increase went to a massive expansion of the government wage bill as the state's employment rose from 24% of total employment in 2008 to 27%. On top of hiring, civil servants were awarded large employment-adjusted real increases. The massive increase in government employment further boosted the last driver of domestic growth – an accelerated emergence of the middle class.

SA PUBLIC SECTOR WAGE AGREEMENTS

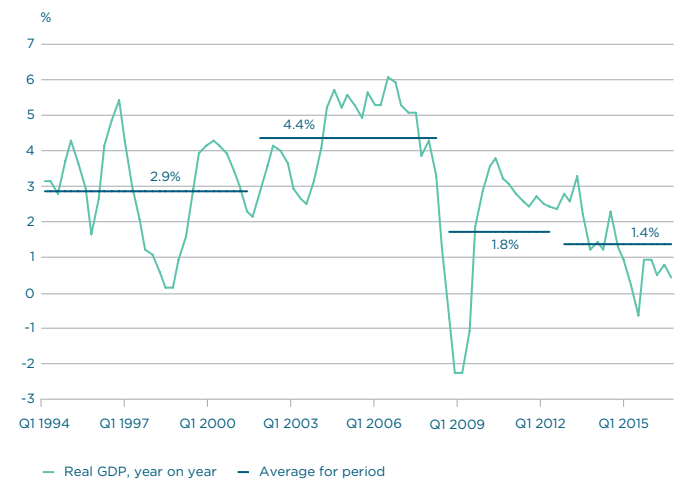


Sources: Statistics SA, National Treasury, JP Morgan, Coronation

2009 TO DATE

After an initial recovery (real GDP growth reached about 1.8%), growth has slowed steadily since 2012, averaging 1.4% since that time, but clearly slowing more recently. An absence of sustainable drivers in a weak global economy offers some

SA REAL GDP



Source: Statistics SA

¹ N. Ehlers, L. Mboji and M. Smal, "The pace of potential output growth in the South African economy", South African Reserve Bank Working Paper, Research Department, March 2013.



explanation, as do idiosyncratic domestic events, including a rise in strike activity in 2012 to 2014, a crisis in electricity provision and the drought in 2015/2016. Still, the malaise has persisted even as these factors subsided.

A closer look at the data offers some clues: both household spending and overall capital expenditure have contributed less than before. Households have been under pressure from slow employment growth, spikes in inflation and a growing tax burden. Businesses have scaled down investment in capacity because global growth has been poor, compounded by a weak domestic economy. The most distressing reality though is that confidence levels of both businesses and consumers have tumbled to levels not seen since the early 1990s.

Businesses specifically have cited political uncertainty as a key constraint on investment in the BER's business confidence survey. Households think future domestic economic conditions will be worse than today. This combination of low employment growth and poor capacity expansion (in SA's case, this has fallen below capital replacement) has led to lower productivity and a significant deterioration in our estimated potential growth rate. The latest SA Reserve Bank assessment calculates this at about 1.1% for this year.

SA has few levers to pull to generate higher growth: the 'democratic dividend' is certainly a thing of our past; a helpful upswing in global GDP will help, but the kind of boost from terms of trade which facilitated employment and investment before is unlikely in a world of high leverage and excess capacity. SA's own middle class could help, but only if employment, education and confidence improve. In

short, we have no low-hanging fruit. Growth from here will require focus, commitment and a meeting of minds that are currently very far apart.

Much hinges on the political outcome of the ANC elective conference in December. There is a huge amount of guesswork, branch counting and slate speculation about the combination of candidates who may be elected to the National Executive Committee, and importantly, the 'Top Six'. I honestly do not know what the outcome will be. I do know that a continuation of the status quo - the blatant theft, state capture without recourse and utter incompetence at strategic state institutions - is likely to reinforce the domestic constraints on growth. With this comes lower credit ratings, a weaker currency, probably higher interest rates and certainly fewer fiscal options as government finances continue to deteriorate. Still, assuming that this is the only outcome may be risky. Much has changed - the exposure of graft may constrain future fraud and public awareness makes legal recourse more likely.

SA has been on the brink before. Maybe the challenge is bigger and the rot more ingrained. Maybe not.

Importantly, there are people willing to do the 'right' thing, possibly even with their branch vote. A small shift in the leadership outcome could make a great deal of difference to key institutions, strategic ministries and regulators. Perhaps most important of all, some indication that politics in SA have shifted will reopen communication between the private sector and government, lifting very depressed confidence and opening the door, even just a crack, for better growth outcomes than seem possible now. ■



BOND OUTLOOK

AN EERIE FEELING OF STABILITY

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 performance of many fixed-income asset classes over the last quarter has masked increasing divergence in longer-term market expectations, resulting from heightened levels of uncertainty. Uncertainty is a familiar bedfellow of investors, and increased uncertainty historically manifests itself in asset prices. SA finds itself at the arduous intersect of extraordinary global and local uncertainty. Globally, the direction of monetary policy, the impact of unwinding quantitative easing and increasing political disruptions continue to obscure the macro picture. Locally, the outcome of the governing party's leadership race and more importantly, its effect on policy implementation, remain crucial for the struggling local economy. Despite all of this, SA assets have continued to defy the gravity of local fundamentals.

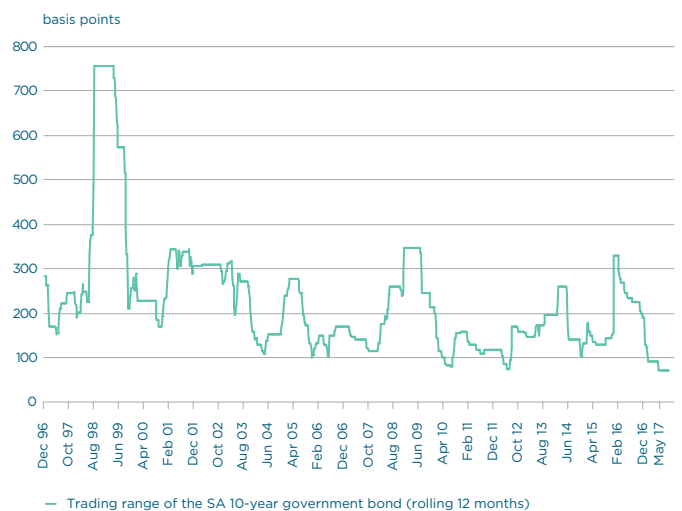
This past quarter saw the All Bond Index (ALBI) gain 3.7%. Its returns for the year to date and over a rolling one-year period, at 7.8% and 8.2% respectively, are both well above cash. While the yield of the long-term section (12 years and longer) of the ALBI is well above 9.5%, it has been the three-to-seven-year area of the bond curve that provided the best performance year to date and over 12 months. The shorter end of the bond curve has been anchored by expectations of a lower repo rate, which was eventually cut in July.

In addition, strong emerging market bonds have buoyed local bonds. Over the previous quarter, the ALBI's performance in dollar (-0.6%) was behind that of the JP Morgan Emerging Markets Bond Index (+2.4%). Still, the ALBI's performance year to date (+7.8%) is in line with emerging markets (+8.8%). Over a rolling one-year period, the ALBI (+9.1%) is far ahead of the emerging market index (+4.2%). SA's high yield relative to its emerging market peers has helped attract foreign capital and prevented any material widening in yields (capital loss), thus far.

The SA 10-year benchmark bond started the quarter just above 8.8%, touched a low point of 8.4%, but spent the majority of the quarter between 8.5% and 8.6%. Despite the elevated levels of uncertainty, bond yields have not been volatile. Over the last year, the benchmark bond's trading

range (the difference between the highest and lowest traded yield) has narrowed steadily to below 100 basis points – the lowest level in the last 20 years. This hardly seems to reflect a high level of uncertainty.

SUBDUED VOLATILITY



Sources: IRESS, Coronation

There are a few interlinked reasons that explain these low levels of volatility in the local bond market. First, it is important to distinguish between volatility and uncertainty. Volatility occurs when uncertainty suddenly materialises in definitive actions that impact asset prices. Since the Nenegate crisis, there has been an increase in uncertainty, but not an increase in definitive policy actions that have had an actual impact on underlying asset prices. Also, the market holds very different views on the implications of possible policy actions, providing very little guidance as to how asset prices should/could behave.

To us, the major concern is that the prolonged lack of definitive policy actions will further undermine a lacklustre economy, eventually triggering a stark reaction from the market. At the moment, the current subdued volatility is feeding an underlying complacency about possible market



outcomes. Over the last year, low levels of volatility have allowed investors to safely earn the yields offered by local bonds. But stability begets instability – investors extrapolate current stability and expect that things will always remain fine. The slightest unexpected negative event may then trigger an overreaction, and the ultimate outcome may be much more dangerous. There is only one way to protect our investors against this risk: by only investing if the underlying assets are cheap enough to withstand any short-term deterioration in fundamentals and/or volatility.

So, are SA bonds cheap enough? One way of determining the fair value of SA government bonds is by doing a calculation (demonstrated below) featuring the global risk-free rate (US 10-year bond rate), the inflation premium required when investing in local assets (the difference between expected SA and US inflation) and the riskiness of SA as a borrower (SA's credit default spread).

All inputs used in the following calculation come directly from the valuations implied by the markets. For instance, the 10-year US and SA inflation rates are implied by the 10-year nominal and inflation-linked bonds.

SA BONDS: CHEAP OR EXPENSIVE?

As at 29 September 2017

US 10-year bond		2.33%
US 10-year implied inflation	minus	1.85%
SA 10-year implied inflation	plus	6.08%
SA credit spread	plus	2.39%
SA 10-year fair value	=	8.95%
SA 10-year current trading level		8.55%
Difference between the fair value and its current level		(0.40%)

Conclusion: the SA 10-year bond is 0.4% more expensive than our estimate of its fair value.

Sources: IRESS, Coronation

It is evident that SA government bonds are expensive relative to their fair value. One could argue that market expectations for SA inflation are too high and should be closer to between 5.2% and 5.5%, but similarly, the current level of the US 10-year bond probably should also be higher (perhaps 2.8% to 3%), given the impending unwinding of the US quantitative easing programme. Also, the absolute level of the SA credit spread may require extra scrutiny: the current level could be more reflective of the global 'risk-on' environment, and not SA's precarious fiscal situation.

The key takeaway remains that SA government bonds are somewhere between fair value and expensive. In the short term, the global backdrop remains supportive, with growth pushing higher, inflation heating up (but contained) and global yields remaining complacent. However, local

valuations do not offer any margin of safety against bad news. It is therefore difficult to justify a long/overweight duration position in the SA 10-year bond yields.

So why are SA 10-year bond yields continuing to trade at more expensive levels?

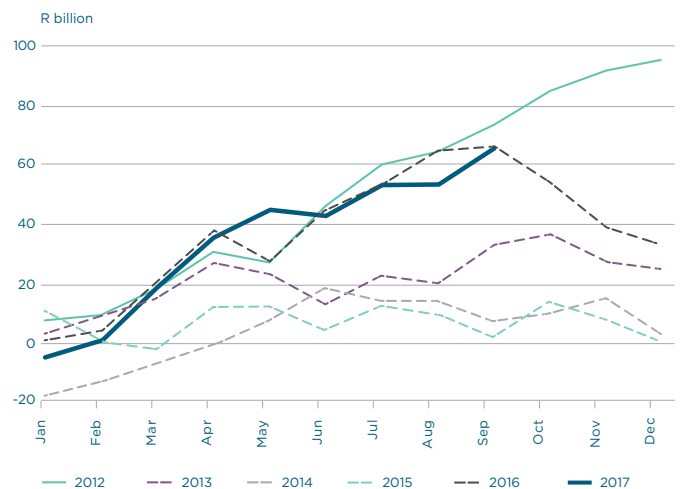
To start with, the market expects more interest rate cuts. Consumer inflation has moved lower and is expected to remain well behaved over the next two years. Meanwhile, the faltering economy is growing well below its potential, which has lowered both the SA Reserve Bank's and the markets' expectations of short-term rates in the first half of the year.

Following the SA Reserve Bank's repo rate cut in July, the market expects the repo rate to move lower by another 0.5% over the next six to nine months. This has enhanced the attractiveness of SA bonds relative to cash and acted as a strong anchor for the bond market, keeping the upside on yields well contained. There has, however, been a much larger force keeping SA bond yields trading at expensive levels.

Foreign inflows into the local bond market have been substantial this year, at approximately R70 billion. This ferocious buying spree is almost on par with the pace of accumulation seen in 2012 when SA was included in the Citigroup World Government Bond Index (WGBI). But in 2012, the outlook for the economy was much better. In addition, SA's credit metrics were much healthier and among the strongest of its emerging market counterparts, whereas now SA is staring down the abyss of subinvestment grade.

SA is currently benefiting from a flow of capital towards emerging market bonds. The market expects that global inflation will undershoot targets in the shorter term, that the unwinding of quantitative easing will not have much of

INFLOWS INTO SA BOND MARKET



Source: JSE



an impact and that developed market bonds will remain well behaved. Unfortunately, all of these assumptions are based on shorter-term outcomes that can dissipate quickly. Market expectations for US rate hikes are still materially below what the Federal Reserve (Fed) is guiding - to such an extent that the current market pricing of the long-term Fed target rate is 1% below the Fed's own guidance (1.75% versus 2.75%). Investors are buying emerging market (and SA) bonds because they offer much higher yields, but the underlying assumptions about US yields are either very stretched or at risk of being too optimistic.

Also, consider that if SA were to be downgraded to below investment grade, it could result in the mandated selling of R120 billion to R150 billion worth of SA government bonds by passive trackers of the Citigroup WGBI. It is quite difficult to see the current pace of inflows continuing to contain yields if that event were to occur - especially in light of the fact that the SA government also needs to fund itself to the tune of R180 billion to R190 billion every year. Foreign inflows need not reverse, but just abate, for

the yields of SA government bonds to succumb to the supply dynamics.

The underlying mix of factors driving the current level of yields in the SA bond market is concerning. Low volatility has increased complacency, supported by aggressive short-term inflows into the bond market. This has created an eerie feeling of stability despite a steadily deteriorating local backdrop. Meanwhile, the international environment is becoming less friendly for carry trades. Yet investors continue to revel in delusions fuelled by the accommodative global monetary policies of yesteryear.

Local bonds are at levels deemed to be on the expensive side of fair value, and do not offer a sufficient margin of safety if one of the short-term supportive factors should fall away, or the economy suffer a further deterioration. We remain cautious in our approach to investing in the local bond market. Only when bond yields are cheaper than fair value and offer an adequate buffer against expected adverse volatility will we look to deploy capital meaningfully into the asset class. ■



SA PORTFOLIO UPDATE

PERFORMANCE OF OUR SA INVESTMENT STRATEGIES

Our portfolios performed very well over the quarter, supported by healthy returns from most major asset classes.

The JSE had a good quarter, with the FTSE/JSE Capped All Share Index returning +8.4% (9.4% over a rolling 12-month period).

Locally, the headlines continue to be dominated by the political backdrop, which remains volatile. The political and policy uncertainty has wreaked havoc on business and consumer sentiment, with SA business confidence slumping to a 32-year low. This has filtered through to a weak and deteriorating economic growth outlook.

While markets have been remarkably benign, we caution that global risks remain elevated, given the state of political disruption around the world. We remain overweight global equities, and emerging markets in particular, although we have been taking profits into strength.

SPECIALIST EQUITY STRATEGIES

	Launch date	1 year	5 years	Since inception
Houseview Equity	Oct 93	5.00%	13.36%	17.47%
Benchmark		9.39%	12.54%	14.82%
Aggressive Equity	Feb 02	8.50%	12.48%	17.99%
Benchmark		9.39%	12.54%	15.28%

Annualised
Sources: Coronation, IRESS

Equity market returns were driven by a strong performance from the resources sector (+17.8%) and outsized returns from some of the large industrial sector constituents such as Naspers (+15%) and Richemont (+15%), which masked the poor performance of many SA-focused domestic shares. The financial sector lagged the overall market over the quarter.

Against this backdrop, our large holdings in Anglo American (+41%), Exxaro (+35%) and Glencore (+27%) continued to perform strongly and have been the major contributors to

our portfolios' outperformance this quarter. The original investment cases for these specific holdings are playing out. They all remain significant holdings as valuations are still supportive, but we have used share price strength to reduce the respective position sizes.

Our portfolios remain skewed towards stocks with large offshore earnings exposure (Naspers, British American Tobacco, MTN, UK-listed property holdings and Steinhoff). We believe the valuations of these businesses are extremely attractive.

We also continue to maintain reasonable exposure to resources based on our assessment of their long-term value.

We continue to find attractive investment opportunities in defensive, high-quality SA-focused businesses of which the share prices have de-rated significantly. We have bought broadly in names including Spar (as featured on page 13), Netcare and Curro. These businesses are well managed, cash generative and should be fairly resilient in tough economic conditions.

These purchases were funded predominantly by a reduction in our Naspers holding. This has certainly not been an easy call to make. The Naspers investment case remains compelling; Tencent is a phenomenal business and is at the core of a rapidly growing Chinese internet economy, with numerous opportunities to further monetise its massive user base. As an example, we believe that Tencent's move into payments and financial services creates a market opportunity several times the size of its current gaming business. Naspers currently trades at an almost 30% discount to its Tencent stake alone – in our view, a complete pricing anomaly.

Furthermore, we have been very encouraged by the steps Naspers management has taken to streamline the rest of the business's portfolio. Although Naspers remains the largest single position across our equity portfolios, we felt the holding's absolute size had grown too large for our clean-slate portfolios and had created stock-specific risk for investors in absolute terms.



BALANCED STRATEGIES

	Launch date	1 year	5 years	Since inception
Global Houseview	Oct 93	8.98%	14.05%	16.48%
Peer median		7.31%	12.19%	15.11%
Managed	May 96	10.65%	14.55%	16.93%
Peer median		7.31%	12.19%	13.98%

Annualised
Sources: Coronation, IRESS

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

Global equities delivered another strong performance over the quarter, with prospects for synchronised global economic growth more than offsetting a multitude of concerns (which we discuss in other parts of this publication). The MSCI All Country World Index returned 5.2% in US dollars for the quarter (+18.7% over a rolling 12 months), while emerging markets continued their strong rally, returning 8% for the quarter (+22.9% over a rolling 12 months).

Our large weighting in global and, in particular, emerging market equities, significantly added to the portfolios' performance this quarter, with the Coronation Global Emerging Markets Equity strategy (a top five holding across our global balanced strategies) outperforming the index by 7.5% over the quarter and by 6.5% for the 12-month period.

From an asset allocation point of view, we remain overweight equities in our balanced portfolios. We have used the proceeds from our reduction in global equities (as mentioned earlier) to gradually increase our domestic equity exposure on further weakness in the rand and local equity markets.

We also maintained very low exposure to fixed rate bonds, which had a neutral impact on the portfolios' return over the quarter. However, our credit portfolio delivered a strong performance over the period. After going through a period of remarkably low appetite for credit locally, we have seen a spike in demand for new credit, which has driven spreads lower.

Our property exposure did not contribute to performance over this period but remains a compelling opportunity. With very attractive distribution yields and potential for significant capital growth in the years ahead, we are very confident that these holdings will be an important part of the future growth of the portfolios. We have continued to add to our exposure to Intu, the UK retail property fund, where we can earn a dividend return in excess of 6%, with potential growth to come from rental growth driven by improved shopping centre performance.

ABSOLUTE RETURN STRATEGIES

	Launch date	1 year	5 years	Since inception
Domestic Absolute	Apr 02	6.92%	8.75%	15.16%
CPI		4.66%	5.45%	5.84%
Inflation Plus	Oct 09	8.37%	9.86%	11.12%
CPI		4.66%	5.45%	5.20%
Global Absolute	Aug 99	7.88%	11.54%	15.91%
CPI		4.66%	5.45%	6.12%

Annualised
Sources: Coronation, IRESS

The absolute return portfolios all have dual mandates of beating inflation by a certain target while also protecting capital. In light of the lower return world, we have made slight adjustments to the targets for the various funds, and we have extended the capital protection period from 12 months to 18 months (for more detail, please refer to page 35). While our absolute return strategies have delivered strong positive real returns over all longer-term periods, beating inflation plus the required target over 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.

Where it used to be possible to generate reasonable real returns in the interest-bearing portion of a multi-asset class portfolio, it is simply no longer possible. Real returns of only 1% or 2% in cash and bonds have become the norm. Therefore, to meet our inflation targets and preserve capital over shorter time periods, we have reviewed the mandates of our absolute return strategies and will be discussing these amendments with clients directly. We have kept our exposure to risk assets in the respective strategies high as we feel these assets still offer good value. We are concerned that global interest rates will normalise at some point and will place upward pressure on yields in the emerging world too. The bond portion of the portfolios therefore has a very low duration, protecting the fund against capital losses that will be incurred in case interest rates do rise. We are also concerned by the state of government finances and prefer corporate to government bonds.

While the rand proved remarkably resilient for most of the quarter, it weakened materially in September on deteriorating SA sentiment. The rand ended the quarter down 3.6% against the US dollar and almost 7% against the euro. As such, we believe our offshore allocation of close to 25% (where applicable) remains appropriate given the benefits of diversification and the value in the underlying offshore assets. In this uncertain world, our objective remains to build diversified portfolios that can absorb unanticipated shocks. We will remain focused on valuation and will seek to take advantage of attractive opportunities that the market may present, and in so doing generate inflation-beating returns for our investors over the long term. ■



A DECADE OF DISTORTION THE GRIM LEGACY OF THE FINANCIAL CRISIS

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.



INVESTOR COMPLACENCY

As we approach the 10th anniversary of the global financial crisis, there is again much to worry about. In one word, complacency is the biggest investment risk at present. Over the past ten years, new risks have appeared – more specifically in the areas of volatility and liquidity. Quantitative easing has created the delusion of permanent liquidity, as well as encouraged the mispricing of risk. Pretty much every asset class is currently making new highs, supported by a range of positive factors. The strongest of these supports is the steadily improving rate of global growth (albeit to levels well below those prevailing in the last decade before the crash), coupled with inflation remaining subdued. Investors have concluded that the combination of these factors will be positive for corporate earnings. Additionally, this is within an environment in which monetary policy remains very accommodative. Although central banks wish to 'normalise' monetary policy, the fear of a policy error is holding them back from implementing the process any faster than 'extremely gradually'. Essentially, investment markets are currently in a positive virtuous circle.

As mentioned, global inflation remains low, despite improving growth. In the US, the country at the top end of developed market inflation, the core inflation index is increasing at an annual rate of only 1.4%. This is well below the Federal Reserve's (Fed) inflation target of 2%. In Europe, the core inflation rate is currently 1.2% – again well below the 2% target set by the European Central Bank (ECB). In Japan, inflation is running at a mere 0.5%. Even in emerging markets, inflation presents no meaningful pressure, with the Bloomberg inflation index for emerging markets currently at 3.4%. The net result is that, despite the intention to normalise monetary policies, central banks continue to expand their balance sheets to support growth in the developed nations. Research suggests that, over the past 12 months, the sum of the ECB, Fed and Bank of Japan balance sheets has grown by 11.4%.

The combination of improving global growth, moderate inflation and supportive central bank policy has therefore

provided a positive backdrop for global equity markets this year. And barring a shocking turn of events in North Korea (as discussed on page 12), that same positive combination seems likely to continue to support equity markets in coming months.

Given the prevailing investor complacency, equity valuations need to be monitored carefully. It can be argued that global equity markets trade at reasonable valuations, with price earnings ratios for the MSCI World, MSCI Europe, Australasia and Far East, and MSCI Emerging Markets indices trading at 16.4, 14.5 and 12.6 times forward earnings respectively. Put another way, earnings yields of 6.1%, 6.9% and 7.9% on these equity markets respectively still seem quite competitive relative to prevailing government bond yields. To give this context, for example, the real yield on 10-year inflation-indexed US Treasuries is trading at only 0.3%. Real yields in Europe and Japan actually remain negative.

THE GREAT UNWINDING

This relatively benign interest rate environment for developed market nations should give emerging market central banks latitude to ease monetary policy on a discretionary basis in response to country-specific inflation trends. To illustrate this, in August we saw rate cuts in India, Indonesia and Colombia, while rate cuts are expected soon for Brazil, Hungary and Russia. The weakness of the US dollar this year has also given emerging market central banks more latitude to opt for easier monetary policy where appropriate.

There are of course several sources of economic uncertainty beyond the North Korean issue. The disruptive force of Hurricane Harvey is likely to add volatility to US economic data in coming months – at a time when the country has to grapple with the ongoing potential for a government shutdown. There is also concern that China's negative credit impulse could slow growth in coming months. Still, recent Chinese data have been notably resilient, with the official Purchasing Managers' Index strengthening to a solid 51.7 in August, which is the second-highest reading for the year.



On the current state of complacency, it should be recalled that a decade ago, subprime problems were thought to be contained, global stock markets were scaling record highs, negative interest rates were unimaginable and barely anyone had put the words 'quantitative' and 'easing' together. However, this state of Nirvana met its demise soon after, and quantitative easing has been a feature of the economic and investing landscape ever since. Therefore, despite the current sanguine approach from investors, the Fed's announcement that it will begin rolling back quantitative easing should be seen as a defining moment in the post-crisis era. That said, many investors remain dismissive about its implications.

ARTIFICIALLY LOW COST OF CAPITAL

A further point that investors should not overlook is the fact that borrowing costs for companies are at record lows. It must, however, be pointed out that the overall borrowing cost for companies is depressed largely because of historically low government bond yields. Credit spreads – the difference in yield between a treasury bond and a company bond – are still some way from their tightest levels of prior cycles. For instance, credit spreads for US investment-grade companies are currently around 135 basis points (bps). They were actually well below this level in 2007 and in 1997. Meanwhile, European investment-grade spreads now trade at about double their 2007 level of near 60 bps. The conclusion of this is to remind investors that the corporate sector is not necessarily mispricing risk; it is the whole interest rate curve that is distorted by ongoing central bank interference.

In addition to the distortions caused by the prevailing (artificially low) cost of capital, there is a broader societal theme that worries us. Ageing populations, global sourcing of goods and services, and technical innovations are widening gaps in income, job opportunities, living standards and ideology. Secular headwinds continue to disrupt the lifestyles of many people around the world. The symptom of this is the loss of middle-class jobs, wages and benefits, and therefore prospects for a more secure and prosperous future. It is this erosion of the middle class that has triggered a backlash against the status quo – be that against global trade, capitalism, the financial sector or political leaders.

HIGHER TAXES, FEWER SERVICES

Unfortunately, the dearth of well-paying jobs, resulting wage stagnation and the loss of faith in the future will intensify over the next decade as technology increasingly eliminates or automates tasks – including in the labour-intensive service sector. The real worry is that while job anxiety, frustration and loss of confidence are likely to increase populist pressures to protect jobs, incomes and living standards, governments will have limited ability to respond. This is due to the fact that a growing share of

public sector revenue will be absorbed by the pension and healthcare needs of ageing populations and an inevitable rise in debt service costs.

Of course, this gradual unwinding of the social order has been partially masked over the past decade by distortions set in motion by well-intended central bank monetary manipulation. Implemented as an emergency measure to prevent the deep 2008 to 2009 recession from spiralling into a self-feeding deflationary contraction, central bank bond buying has caused, in addition to investor complacency, public sector complacency that fed excessive spending and overregulation. Inevitably, over the next decade, a widening gap between public sector income and spending will lead to higher taxes – for fewer services.

If the distortion of borrowing costs had been short-lived, for say, two to three years, the impact of 'normalising' interest rates (and central bank balance sheets) would have been limited in scope and duration. Instead, the protracted suppression of interest rates has had an excessive impact on public spending, borrowing and debt service costs.

Since the Fed became a major buyer of new debt issued by the US Treasury, spending has been unconstrained over the past 10 years and US federal debt has doubled, from \$10 trillion to \$20 trillion. Fed intervention not only reduced the cost of new deficit spending, it also significantly lowered the cost of rolling over maturing debt. Hence, while the total debt doubled over the past decade, the annual cost of servicing the US federal debt has stayed nearly flat.

AN UNSUSTAINABLE 'NEW NORMAL'

In our opinion, this situation is ultimately unsustainable. As the Fed (soon to be followed slowly by the Bank of England and the ECB) steadily reduces bond buying, a slow but steady normalisation of interest rates will begin. In 2007, the US paid an average of 5% on its \$9 trillion federal debt. This year, the US is paying only 2.28% on its \$20 trillion debt. A doubling of the debt is masked by cutting the interest rate in half. As interest rates slowly normalise over the next five to seven years, so too will the cost of servicing a further relentless rise in the total US federal debt. If, for example, the average interest rate paid on debt rises to 2.4% next year, 3% in 2020, and 4% by 2024, the annual cost of servicing the US debt will double. Simply put, during the next presidential term (from 2021 to 2024) the president and Congress must spend an additional \$80 billion to \$100 billion each year – not on schools, healthcare, defence or Social Security, but to pay the rising cost of servicing the federal debt. The majority of Americans do not yet seem to appreciate the gravity of the debt service problem set to explode in the next decade.

There are of course those commentators who believe that we are today in a 'new normal' – and that there is an implicit



guarantee that interest rates will remain extremely low for many years to come. In our opinion, it will be unwise to indefinitely suspend sound economic thinking. Investment trends do always revert to normal with time. The current level of developed market interest rates is abnormal – and will not endure in perpetuity.

As long-term investors we just do not know how the current set of uncertainties will play out. Investors must therefore

give thought to how to navigate the challenges that lie ahead. Not least of these challenges is the fact that most (known) asset classes are highly priced due to excess liquidity and investor complacency. Setting risk tolerance guidelines is one of the steps when it comes to exposure to risk investments. Within risk investments, finding underpriced investments is rare. The focus is therefore more than ever on identifying stocks that can produce real earnings growth on a sustainable basis. ■



ADJUSTED TARGETED RETURNS FOR OUR ABSOLUTE RETURN MANDATES

For some years now, we have cautioned that returns from SA assets in the coming decade will be lower than in the past era.

This has implications for the expected returns delivered by various investment products – and confirms the importance of generating alpha (active return) through stock selection and asset allocation.

It is clear that we are living in a much more volatile environment, with tougher economic conditions. We believe this represents a risk that asset prices may not deliver the same significant real returns as they have done in the past. This is already evident in the recent three-year returns from local equities, which have performed largely in line with inflation (as at end-September).

Given lower expected returns from the relevant asset classes, we believe the real return targets of our absolute return strategies should be adjusted to reflect this reality and to manage the expectations and behaviour of savers accordingly. The effective changes are indicated in the following table.

ADJUSTED TARGETED RETURNS

Strategy	New performance target
Global Absolute	CPI + 5% p.a. (gross of fees and taxes) over a rolling 3-year period
Domestic Absolute	CPI + 4% p.a. (gross of fees and taxes) over a rolling 3-year period
Inflation Plus	CPI + 3% p.a. (gross of fees and taxes) over a rolling 3-year period
Medical Absolute	CPI + 3% p.a. (gross of fees and taxes) over a rolling 3-year period
Absolute Bond	CPI + 2% p.a. (gross of fees and taxes) over a rolling 12-month period

Source: Coronation

It is important to highlight that these adjustments will not have any impact on how we manage these strategies. In fact, there is a keen awareness of the need to produce as much risk-adjusted returns as available and possible. Active management with integrated risk management will help achieve the best outcome for savers. But we must all be aware of the new environment in which we find ourselves. ■



CORONATION GLOBAL EMERGING MARKETS EQUITY

INCEPTION DATE

14 July 2008

PORTFOLIO MANAGERS

Gavin Joubert and Suhail Suleman. Gavin is head of Coronation's Global Emerging Markets investment unit with 20 years' investment experience. Suhail is a portfolio manager within the investment unit with 15 years' investment experience.

OVERVIEW

Coronation Global Emerging Markets Equity is an actively managed equity strategy that invests in what we consider to be the best investment opportunities in emerging markets. It aims to deliver long-term capital growth through a focused equity portfolio of securities that we believe offers the most compelling risk-adjusted returns. Our long-term objective is to outperform the MSCI Emerging Markets Index by 3% to 4% per annum over five years and more.

We leverage off our 24 years' experience of managing money in an emerging market like SA, which we believe has been crucial in framing our thinking about managing emerging market portfolios. It has provided a key competitive edge relative to global peers.

PORTFOLIO CONSTRUCTION

We are long-term, valuation-based investors. The fair value of a company represents a crucial anchor for our portfolio actions. This strict valuation discipline is exactly the same approach we have used successfully in SA for almost a quarter of a century.

Research

We conduct our own research to determine what a share is worth, and only invest if it trades at a sufficient margin below this level. Our estimate of the fair value of a share is based on our own detailed modelling, including of a company's normalised revenue, cost and margins for at least five years out. Setting our own assumptions allows us to avoid anchoring off 'consensus expectations' and sell-side recommendations.

Our proprietary company research is supported by extensive first-hand scrutiny of potential holdings, including country visits and meetings with management, competitors, industry experts and other information sources. Our coverage list comprises around 200 shares that we have filtered down from the broader number of companies listed on emerging market exchanges. As long-term investors, environmental, social and governance criteria are fully integrated into any investment case to understand the long-term sustainability of a business.

Putting the portfolio together

In constructing our portfolios, we pay no attention to the emerging market indices. Our portfolios are constructed

TOP 10 HOLDINGS

Holding	% strategy
Naspers Limited	7.6%
Kroton Educacional SA	5.0%
JD.com Inc ADR	4.7%
Magnit OJSC-SPON	3.9%
58.com Inc ADR	3.7%
Heineken NV	3.5%
Porsche Automobil HLDG-PR	3.4%
Baidu Inc ADR	3.4%
AIA Group Ltd	3.2%
Sberbank of Russia	3.1%

Source: Coronation

GEOGRAPHIC EXPOSURE

Country	% strategy
China	16.9%
SA	14.1%
Brazil	13.3%
India	10.8%
Russian Federation	10.0%
US	7.5%
Netherlands	5.8%
Germany	3.4%
Hong Kong	3.2%
France	3.0%

Source: Coronation



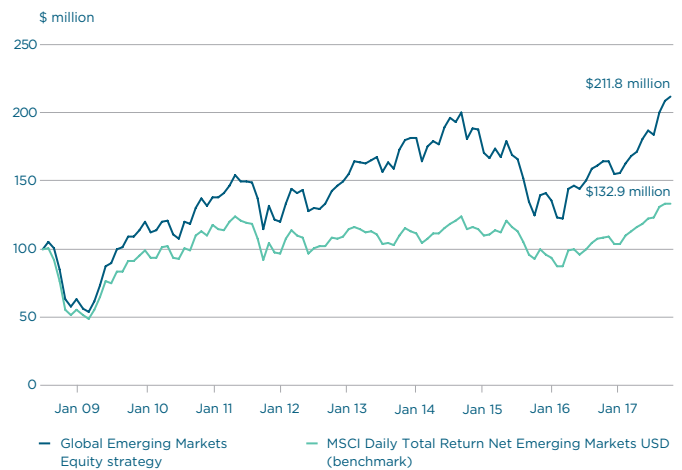
on a completely clean slate and bottom-up basis based on the stocks we believe offer the best risk-adjusted value. Our portfolios are fairly concentrated (50 to 60 stocks) and reflect our high-conviction ideas prominently, but we are not buy and hold investors. If a share reaches fair value in a short period and we believe that the fair value remains correct, we will sell the share. Our portfolios will often have stocks that do not feature in many other funds around the world. Risk is controlled by only owning stocks that trade well below fair value, and our portfolios are constructed with no excessive exposure to any one country, industry or other single identifiable factor that could have an unexpected and outsized impact on portfolio returns.

Some of our key current holdings are stocks that are exposed to the Chinese e-commerce and internet sector, Brazilian tertiary education and Russian food retail.

COMPELLING TRACK RECORD

The Coronation Global Emerging Markets Equity strategy has delivered an annualised return of 8.5% (in US dollar)

GROWTH OF \$100 MILLION INVESTMENT



The performance shown is gross of fees

Source: Coronation

since inception in 2008. The strategy has outperformed its benchmark (MSCI Daily Total Return Net Emerging Markets USD) by 5.4% per annum. ■



INTERNATIONAL PORTFOLIO UPDATE

CORONATION GLOBAL EQUITY FUND OF FUNDS

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Jul 00	17.93%	8.38%	12.57%	6.68%
Benchmark		18.65%	8.23%	11.57%	4.67%

Annualised, quoted in USD
Sources: Coronation, Bloomberg

The fund advanced 5.8% over the quarter against its benchmark (MSCI All Country World Index) return of 5.2%, bringing the rolling 12-month performance to 17.9% against the 18.7% returned by the index.

Europe was again the best-performing region this quarter, rising 6.5% (in US dollar terms). Asia ex-Japan delivered the weakest return, rising 3.7% (in US dollar terms). Japan returned 4.0% (in US dollar terms) and North America rose 4.7%. Emerging markets advanced 7.0% (in US dollar terms). The fund continues to be overweight North America, underweight Europe and Japan, and has maintained its overweight position in emerging markets.

Among the global sectors, energy (+8.2%), materials (+8.3%) and information technology (+8.2%) generated the best returns. The worst-performing sectors were consumer staples (-0.9%), real estate (+1.3%) and utilities (+2.3%). On a look-through basis, the fund was positively impacted by its overweight position in information technology and underweight position in utilities and telecommunications. Its overweight position in consumer discretionary detracted from performance.

Three underlying managers were largely responsible for the fund's performance over the quarter. Contrarius Global Equity had an excellent three months, advancing 11.1%. This was largely a result of having a significant overweight position in energy stocks which benefited from the oil price rise of 12%.

Coronation Global Emerging Markets Equity (as featured on page 36) also contributed strongly to the fund's overall

outperformance for the quarter. Despite already strong returns in emerging markets, the fund delivered alpha of 7% as its Brazilian education stocks, Kroton and Estácio, rose substantially on solid growth numbers and potential future merger and acquisition plans. Chinese internet-related stocks such as Baidu, 58.com and Naspers (Tencent) also weighed in with good performances.

Likewise, Conatus Global Equity enjoyed strong gains from its emerging market exposure (for example, Tencent) and internet stock holdings (for example, Facebook). The underlying manager also benefited from PayPal, which is being supported by the continued shift to e-commerce; Ferrari, which is expanding its product offering; and Adidas, which continues to take market share in the US sports apparel market.

Three underlying managers that did not perform over the period were Maverick Capital, Vulcan Value Fund and Tremblant Capital. Maverick lagged the index due to a large overweight to US healthcare, a sector at the centre of huge political debate and which did not advance as much as the overall index.

Vulcan was also hurt by an overweight to healthcare. Tremblant did see positive contributions from its internet holdings such as Baidu and Netflix, but exposure to media names such as Viacom and CBS more than offset those gains, causing the underperformance over the quarter.

Satisfactory global growth and favourable liquidity would indicate that equity markets may have further to run in the near term. We have previously noted that US equities appear expensive when viewed against measures such as the Shiller price earnings ratio, but relative to other asset classes, equities in other parts of the world do still seem reasonably attractive.

Rising geopolitical tensions are a cause for concern and there may be some volatility ahead as world leaders negotiate their way around North Korea, Iran, Brexit and other pressing issues.



CORONATION GLOBAL EQUITY STRATEGY

	Launch date	1 year	3 years	5 years	Since inception
Fund	14 Nov 14	23.17%	-	-	7.48%
Benchmark		18.65%	-	-	7.39%

Annualised, quoted in USD
Sources: Coronation, Bloomberg

The strategy marginally underperformed its benchmark over the quarter, but is materially ahead year to date, as well as over the 12-month and two-year periods. The two-year absolute performance number of 21.4% per annum is particularly gratifying against the benchmark return of 15.3% per annum. Since inception, the strategy has delivered marginally positive alpha.

Coronation Global Equity will soon celebrate its three-year anniversary, and while the first year of its existence proved to be a very tough initiation period, we are confident of deploying our consistent philosophy of focusing on the longer term with success into the future.

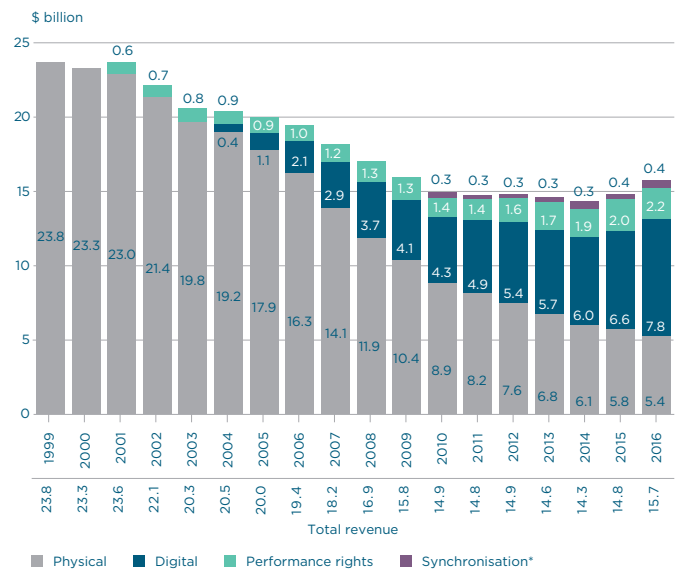
The most notable contributor to performance over the past quarter was our position in Estácio, the second largest tertiary education operator in Brazil, which is explored on page 40.

The two positions that hurt performance most over the three months were L Brands (as featured in our July 2017 issue) and the investment holding company Pershing Square Holdings, actively managed by the activist fund manager Bill Ackman. It contains a portfolio of blue-chip US companies which are trading at significant discounts. We continued to add to both positions as we remain convinced of their long-term investment merits. TripAdvisor was another disappointment over the 12-month period, but in this case we sold out of our holding in light of another change in company strategy and continued (in our opinion) poor operational execution by management. Our holdings in the retail pharmacy networks in the US and the UK also disappointed. While we are closely monitoring Amazon's intentions and ambitions in this space, we remain holders of these stocks for now.

One of the new names introduced into the portfolio over the last three months warrants additional commentary. The French media group Vivendi caught our eye when we started analysing its record label business, Universal Music Group (UMG). The last two decades have been extremely tough for music owners as the methodology for selling music kept evolving in a digital age. But while monetisation has decreased substantially due to piracy, among other reasons, consumption has continued to rise. We have seen a decided turn in fortunes for the industry over the last few years (see the accompanying graph). Subscription

services are growing handsomely in the developed world, and we believe that, given time, this industry will relive its former glory days. UMG is the largest of three significant global players and owns the most comprehensive music catalogue, which we believe is underappreciated within the wider Vivendi group. The group holds other media and communication assets like pay-TV, telephony and more recently, advertising agencies. It is controlled by a successful, if somewhat contentious, French industrialist family led by Vincent Bolloré. Although we would have preferred to own the music assets directly, we think Vivendi's unique corporate structure and controversial family control have given us the opportunity to buy the position at what we believe is an attractive entry price.

GLOBAL RECORDED MUSIC INDUSTRY REVENUES



*The licence to synchronise music with visual media (film, TV, advertisements and video games).

Source: International Federation of the Phonographic Industry (IFPI)

CORONATION GLOBAL EMERGING MARKETS EQUITY STRATEGY

	Launch date	1 year	3 years	5 years	Since inception
Fund	14 Jul 08	28.93%	5.38%	8.26%	8.48%
Benchmark		22.46%	5.03%	4.21%	3.13%

Annualised, quoted in USD
Sources: Coronation, Bloomberg

The strategy returned 15.4% for the quarter, which was 7.5% ahead of the benchmark return of 7.9%. The one- and two-year performance figures are also strongly positive in both absolute and relative terms, recording 6.5% alpha over one year and 10.9% alpha per annum over two years. While this short-term performance is pleasing – particularly after a tough period from late 2014 to late 2015 – it is the long-term performance that matters and what we believe best illustrates the alpha-generating ability of the strategy.



In this regard, the strategy's five-year outperformance is 4.1% per annum, the seven-year outperformance 4.4% per annum and since inception (now over nine years ago) outperformance is 5.4% per annum.

The biggest contributors to the strategy's outperformance over the quarter were the two Brazilian education stocks, Kroton and Estácio. Their attempted merger was blocked just before the end of the previous quarter, which resulted in a sharp share price decline for Estácio in particular. Given our view that both Kroton and Estácio remained very attractive on a standalone basis, our combined holding in these two stocks remained close to 8.5% of strategy.

During the quarter, Estácio's share price more than doubled, while Kroton's was up 35%. Some appreciation in the Brazilian real added to the local currency return generated by the two stocks, and collectively they contributed 3.5% to alpha over the quarter. Estácio outperformed Kroton as its results for the second quarter were well ahead of expectations and investors reappraised the longer-term outlook for the business's margins. Historically, Estácio's operating margins have been less than half of Kroton's – mid-teen margins for Estácio versus low 30s for Kroton. This large difference in profitability is partly why Estácio carried a lower rating than Kroton and one of the reasons why Kroton wanted to buy Estácio.

This margin gap has already started to close and we believe Estácio can narrow this gap even further, which brings down the multiple quickly as one looks further out – although Kroton's scale advantage will mean that Estácio's operations are unlikely to ever reach Kroton's margin on a sustainable level. While we reduced the strategy's Estácio position over the past few months, we believe it remains attractive. Today just over 7% of the strategy is invested in the Brazilian education stocks, with Kroton being a 5.0% position and Estácio a 2.2% position.

The Chinese internet stocks 58.com and Baidu were the next biggest contributors. The former was up 43% (contributing 1.2% to alpha), while the latter was up a more modest 38% and contributed 66 basis points (bps) to alpha. In Baidu's case, the struggles of last year, which resulted in the cleanup of its advertiser base, seem to have largely passed, while profitability has improved significantly. This has led to an increase in earnings per share of 70% year on year in the second quarter.

For the last 18 months, the big concerns with 58.com have centred on its property business. The company is the leading player in advertising existing home sales and as the Chinese government clamped down on the property market to prevent an asset bubble, investors sold out of 58.com. This created a buying opportunity for us. The results released for the second quarter saw the company beating its own previous guidance by almost 10%, with revenue growth of 33% (for the half year).

More critically, there are signs of significantly improved profitability as 58.com went from making losses in the first half of last year to now earning operating margins of 14%. The property business has held up well in spite of the issues in the broader market. This is not unexpected as it is more akin to a membership service for estate agents than an online estate agent which tries to earn commissions on sales, an inherently more cyclical business. Despite the sharp move in the share price, we believe 58.com remains very undervalued. It has largely dominant positions and several years of high revenue growth ahead in all its key verticals (online blue-collar jobs, online housing and general online classifieds), while the reduced investment needs and natural operating leverage that comes with higher revenue can see margins expand substantially from current levels.

The Russian stocks Sberbank (+37%, 66 bps contribution to alpha), Magnit (+20%, 51bps contribution) and X5 Retail Group (+29%, 39 bps contribution) also came through strongly over the period. Brilliance China Automotive was up 32% for the quarter, bringing the one-year return to 117%. We had been consistently reducing our holding into strength and sold out of the position during the quarter as it reached our fair value.

There were two new buys in the strategy – Noah Holdings (0.6% of strategy) and Airbus (3.0% of strategy). Noah is a wealth and asset manager with tremendous growth potential in what is still a very fragmented market in China. The ranks of the wealthy in China have surged over the last two decades, but their savings and investment holdings remain relatively unsophisticated. This is a tremendous market opportunity for Noah, and with the founders still involved in the business (and being material shareholders), we believe they have the operational capability to be successful. Noah also generates high returns on capital (c. 20%) and is very cash generative (free cash flow conversion of c. 90%). Today Noah trades on around 12 times forward earnings (excluding cash), which we believe is very attractive for what is a high-quality business.

Airbus earns around 55% of revenue from emerging markets, and the share of its order book (future confirmed orders by airlines) from emerging market airlines is 60% and rising. A look across Airbus's product portfolio shows all their major designs are well beyond the development phase and, as the A350 production ramps up, operating margins can reach double digits within the next few years. We believe the share offers substantial upside to fair value. The company is in effect part of a global oligopoly (Airbus and Boeing together have 90% market share) in a structurally growing category (global air travel) with very visible earnings and free cash flow growth over the next five years. For a detailed investment case, refer to page 16.

During the quarter, the team undertook several trips, including to China and India, where we met with various



companies we own or are interested in purchasing for the strategy. The big moves in share prices have seen us reduce, or sell out from, positions that are approaching fair value and reinvest in either new ideas (like Airbus or Noah), or buy additional exposure to some stocks that we believe are very attractive but have lagged in recent months (such as Magnit). The overall upside of the portfolio – our assessment of fair value versus current share prices – is around 40%.

CORONATION GLOBAL MANAGED STRATEGY

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Nov 09	14.81%	6.15%	9.44%	9.28%
Benchmark		10.31%	5.47%	6.80%	7.04%

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

The fund marginally underperformed its benchmark over the quarter, but is ahead of it over most longer time periods. The since-inception number of 9.3% per annum is particularly gratifying compared to the benchmark return of 7.0% per annum, and the one-year number of 14.8% is strong both in absolute terms and against the benchmark (10.3%).

While our stock picking did not result in positive alpha over the quarter, our credit positions performed well ahead of the overall bond market. Our property holdings lagged somewhat, but our gold positions contributed positively. Over the last 12 months, our equity selection was very good, offset by low exposure to this well-performing asset class. Property and credit selections both performed very well over the last year, offset to some extent by a disappointing outcome from our merger and arbitrage bucket (primarily the Rite Aid position). These trends are also true for the five-year attribution, although the property outperformance was only marginally positive.

The most notable contributor to equity performance over the past quarter was our position in Estácio (as discussed in the Global Equity Strategy commentary on page 39). The two equity positions that hurt performance the most over the three months were L Brands and Pershing Square Holdings (featured on page 39).

We entered the last quarter of the year maintaining relatively low exposure to equities, and probably our lowest exposure to credit in the last five years. We have increased our property holdings slightly, both in the US and in Europe (after quarter end). We remain cautious on the outlook for global equities, and have continued to roll some of our equity hedges. We remain very negative on the outlook for global bonds as we are seeing more signs of inflation creeping back into the US economic system.

CORONATION AFRICA FRONTIERS

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Oct 08	17.73%	(6.79%)	4.45%	9.31%
Benchmark		1.15%	0.68%	0.52%	0.56%

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

Over the past three months, the performance of markets across Africa continued to be strong. The strategy delivered a gross return of 1.8% for the quarter, compared to its benchmark (3 Month USD Libor + 5%) return of 1.6%, and the FTSE/JSE All Africa ex-SA 30 Index, which was up 3.9%. Year to date, the strategy has returned 24.6% and since inception the strategy has delivered 9.3% per annum.

The strategy's performance would have been even stronger were it not for a write-down of our Zimbabwean assets (which we discuss in more detail on page 21). This was offset by a strong underlying asset price performance in our other markets. Egypt, which continues to be our largest country exposure, saw strong gains (+6.5% for the quarter) as the government's economic reform agenda continues to play out. Morocco (+3.4%) and Kenya (+7.4%) were also strong over the period. The solid performance in Kenya came during a quarter when the Supreme Court nullified the results of its August presidential elections, a first on the continent. The revote is currently planned for the end of October, and in the interim economic activity has slowed, although thankfully, there has been no repeat of the 2007 violence. After a standout second quarter in Nigeria (+26.6%), the country gave back some of the gains and ended down 3.9% for the three-month period. Foreign interest in Nigeria remains strong although at this point it is fixed income rather than equity investors who are most bullish.

The Zimbabwean stock market index was up 113.5% in US dollars over the quarter. Unfortunately, this was less about company fundamentals and more to do with the deteriorating conditions in Zimbabwe. At the end of July, we impaired the valuation of our in-country Zimbabwean exposure by 30%. At that stage, we were comfortable using the Old Mutual dual-pricing discount as a reference for the impairment, as the discount between physical dollar and electronic dollar and bond notes persisted. Since then, the currency discount has opened up even further, while locally listed Zimbabwean equity prices have seen excessive and unwarranted gains. This is a result of locals looking to hold physical assets rather than electronic dollar. As a reminder, it remains practically impossible for us to repatriate funds out of the country.

African markets continue to present opportunity, but challenges are to be expected. In the past year, three currency markets have been extremely testing: Egypt,





Nigeria and Zimbabwe. As an African company, we are accustomed to managing money amid ongoing currency shocks. This has helped us become disciplined investors who can cut through the noise and focus on the long term. Indeed, our exposure to Egypt and Nigeria has delivered positive outcomes for the patient investor. In both markets, the strategy achieved significant gains after currency markets started to normalise.

CORONATION GLOBAL FRONTIERS

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Dec 14	23.13%	-	-	4.40%
Benchmark		1.15%	-	-	0.71%

Annualised, quoted in USD
Sources: Coronation, Bloomberg

Over the past three months, the strategy delivered a gross return of 2.8% compared to the benchmark (3 Month USD Libor + 3.5%) return of 1.2%. As in previous quarters, our return differs materially from that of the MSCI Frontier Markets Index, which was up 8.3% over this period. Year to date, the strategy is up 23.1% and since inception the fund has returned 4.4% per annum.

The write-down of our Zimbabwean assets (as discussed in the Africa Frontiers commentary) had a material impact, but was offset by strong underlying asset price performance in our other markets. Of the large MSCI constituents, Kuwait (+17.8%), Argentina (+9.5%), Vietnam (+6.1%) and Morocco (+2.4%) were all strong. Kuwait benefited from market participants anticipating the country's inclusion into the FTSE Russell Emerging Markets Index. Notable laggards were Sri Lanka (-6.1%), Nigeria (-3.2%) and Pakistan (-15.8%). Over the quarter, Pakistan suffered from negative news headlines, including the resignation of its prime minister, the removal of both its central bank governor and the chairman of its market regulator, the indictment of the finance minister and the announcement of a US regulatory fine on the largest bank in the country, Habib Bank. The sell-down has resulted in a number of very interesting opportunities in select Pakistani stocks.

CORONATION GLOBAL BOND

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Oct 09	3.52%	2.73%	1.93%	3.64%
Benchmark		(1.26%)	1.10%	(0.30%)	1.40%

Annualised, quoted in USD
Sources: Coronation, Bloomberg

Stronger growth and modest inflationary pressures helped most government bond markets to perform well this quarter,

while continued low volatility encouraged investors to seek out higher yielding assets, which boosted emerging and credit markets. The US dollar remained weak during July and August before finding support during the month of September. The fund returned 1.63% for the quarter, against a return of 1.76% from the Barclays Global Aggregate Bond Index over the same period.

US economic activity data surprised on the upside during the quarter, having disappointed in the preceding three months. Inflation meanwhile continued to undershoot expectations. It is, however, worth pointing out that economic activity in the next few months may well be affected by the two large hurricanes that recently struck the southeastern US region. Yields on US Treasuries fell across the curve (with 10-year yields falling as low as 2.01% in early September) as markets priced out less than a single 0.25% move in the Federal Funds rate for the next 18 months.

Following more hawkish comments from Federal Open Market Committee members, markets retraced and 10-year yields closed the quarter broadly unchanged at 2.33%. The current trading range of 0.6% on US 10-year bonds is the lowest since 1965. After a series of weak CPI figures, breakeven rates are relatively low and the fund increased its exposure to five-year Treasury Inflation-Protected Securities as inflationary pressures are expected to re-emerge in the coming months. The fund also reduced the duration of its US holdings in early September after the market priced out any movement in rates.

The US Federal Reserve (Fed) announced its intention to begin to unwind its balance sheet, starting in October, by \$10 billion a month (\$6 billion Treasuries, \$4 billion Mortgage-backed Securities) and increasing by the same magnitude each three months until the total sum is \$50 billion a month. At this pace, the taper should take three to four years to achieve. The Fed's near-term dot plot chart was unchanged at the September meeting, but the long-term target fell from 3% to 2.8%, suggesting the committee's longer-term view of inflation and growth has fallen, with the implication that the output gap may be tighter than perceived.

In early September, Stanley Fischer, the current vice chair of the Fed, announced he would step down this October. This means that four of the seven Fed board positions are now open, with Janet Yellen's chair position coming up for renewal in February 2018. Fed policy could therefore look very different in 2018, depending on how much weight new members (and a possible new chairperson) place on the current outlook for inflation. The European Central Bank left its policy setting unchanged at its September meeting. The disinflationary effects of the stronger euro were noted and forecasts for CPI lowered. The governing council indicated it may recalibrate its quantitative easing programme in October, with the current €60 billion a month programme likely to reduce by around €5 billion a month during 2018.



The focus for investors in the UK remains the progress of Brexit negotiations. While prime minister May's speech in Florence maintained that no deal is better than a bad deal, she did for the first time propose a transitional period and accepted that the UK would need to honour its financial commitments. The price tag associated with those commitments does, however, remain as uncertain and controversial as the process itself. UK inflation has continued to feel the effects of the post-Brexit weakness in pound sterling. The softer Brexit stance, combined with more hawkish CPI-inspired comments from the Bank of England members, had the effect of propelling the currency back above 1.35 to the US dollar - its highest level since Brexit. The fund used the recovery in the currency to reduce its exposure.

In Japan, prime minister Abe's LDP party called a snap election for 22 October in the hope of strengthening support for his hardline policy on North Korea. Opposition parties have decided to merge to fight the election, and their rising popularity has introduced a degree of political uncertainty into the market. In recent months, economic activity has surprised to the upside, labour markets remain tight and capital investment has picked up. Any suggestion that the Bank of Japan could deviate from its current strong commitment to a 2% price stability target would likely trigger a much stronger yen. The fund has reduced its long-standing underweight position in yen as economic fundamentals appear to be improving and it remains a currency likely to rally in the advent that risk aversion returns to markets.

The majority of local currency emerging market bonds continued to outperform US Treasuries, with strong returns from Brazil, Russia, Indonesia and SA. A modest appreciation in emerging market currencies helped boost dollar returns further, although there was more dispersion within foreign currency than bond returns. The fund sold its holdings in Brazil after yields recovered strongly from the May selloff. The fund bought back into longer-dated SA government bonds after the yield curve steepened. The fund retained its Mexican exposure but hedged out its currency exposure and switched some fixed rate exposure into inflation-linked assets during July. The fund retains a holding in short-dated Egyptian Treasury bills and Argentinian currency forwards, but unwound its holdings in Turkey as the currency strengthened.

The Emerging Markets Bond Index spread fell from 328 bps to 307 bps during the quarter as investors continued to support hard currency emerging market debt. Issuers have been keen to tap into this demand, with the largest deal (\$12.5 billion) coming from the government of Saudi Arabia. Sovereign issues also came from the likes of Ukraine, Russia, Turkey, Colombia, Bahrain, Iraq and Azerbaijan, to name a few. Of the \$500 billion of new emerging market debt issues in the third quarter, only 17% (\$84 billion) were by governments, while 45% came from financial institutions, with Chinese renminbi issuance now accounting for 44% of total issuance versus only 29% in US dollars.

Corporate bonds posted another quarter of strong returns, with the broad credit indices outperforming government bonds by around 1%. Credit spreads continued to tighten, shrugging off a brief bout of volatility in August on the back of concerns over North Korea and central bank tapering. While longer-dated instruments performed best, it was more a function of their high duration, as short-dated spreads also rallied and returns across the rating spectrum were not dissimilar.

The fund bought back into MTN, added exposure to National Grid via an inflation-linked issue and added to existing holdings in Intu and Cromwell convertibles. The fund also invested in Investec PLC's new subordinated deal and reduced its exposure to the firm's senior debt. The fund's holding of BR Malls was tendered for and we sold its holdings of JP Morgan and Citigroup subordinated debt.

The fund remains underweight duration, predominately via low duration positions in Europe and its lack of exposure to Japanese bonds. The fund also remains relatively defensively positioned within corporate bond markets where spreads appear tight. The consequences of an upcoming taper of asset purchases by central banks remain unclear and as a result the fund scaled back its exposure to emerging markets. We would be surprised if volatility within markets can remain as low as it has, and this argues for greater risk premiums going forward. After a poor performance since the beginning of the year, the US dollar has ceased falling and the fund has now moved back to an overweight position, as we expect the currency to perform better as monetary conditions tighten by more than current markets expectations. ■



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	8.98%	8.72%	14.05%	12.35%	16.40%	3 791.74%	16.48%
Median of the Peer Group*			7.31%	8.24%	12.19%	10.23%	14.86%	2 826.48%	15.11%
Alpha			1.67%	0.49%	1.86%	2.13%	1.54%	965.26%	1.38%
Managed	G	May-96	10.65%	9.19%	14.55%	13.15%	16.88%	2 750.12%	16.93%
Median of the Peer Group*			7.31%	8.24%	12.19%	10.23%	14.86%	1 547.70%	13.98%
Alpha			3.33%	0.95%	2.36%	2.92%	2.02%	1 202.42%	2.95%
DOMESTIC BALANCED									
Domestic Houseview	G	Jan-98	6.09%	7.12%	11.59%	11.48%	17.12%	1 756.72%	15.94%
Domestic Balanced Benchmark			6.41%	7.17%	10.44%	9.85%	14.14%	1 090.73%	13.36%
Alpha			(0.32%)	(0.04%)	1.16%	1.63%	2.99%	665.99%	2.58%
SPECIALIST EQUITY									
Houseview Equity	G	Oct-93	5.00%	6.00%	13.36%	12.24%	19.35%	4 670.29%	17.47%
Houseview Equity Benchmark			9.39%	7.13%	12.54%	10.01%	16.24%	2 658.53%	14.82%
Alpha			(4.39%)	(1.13%)	0.82%	2.23%	3.11%	2 011.75%	2.65%
Aggressive Equity	G	Feb-02	8.50%	6.14%	12.48%	12.12%	19.08%	1 234.89%	17.99%
Aggressive Equity Benchmark			9.39%	7.13%	12.54%	10.01%	16.24%	828.46%	15.28%
Alpha			(0.89%)	(0.99%)	(0.05%)	2.11%	2.84%	406.43%	2.70%
Core Equity	G	Mar-04	8.24%	6.54%	13.55%	12.79%	-	964.00%	19.02%
FTSE/JSE Shareholder Weighted Index			7.00%	7.37%	12.84%	10.61%	-	742.33%	16.99%
Alpha			1.24%	(0.82%)	0.71%	2.19%	-	221.67%	2.03%
SPECIALIST FIXED INTEREST									
Strategic Cash	G	Sep-06	8.82%	8.14%	7.39%	8.14%	-	139.76%	8.21%
Short Term Fixed Interest 3 Month Index			7.21%	6.67%	6.08%	6.94%	-	114.27%	7.12%
Alpha			1.62%	1.47%	1.31%	1.21%	-	25.49%	1.09%
Active Bond	G	Jul-00	8.85%	8.49%	7.56%	9.54%	10.56%	563.11%	11.59%
BEASSA All Bond Index			8.20%	7.63%	6.34%	8.44%	9.63%	475.19%	10.67%
Alpha			0.65%	0.87%	1.22%	1.10%	0.93%	87.92%	0.92%
Strategic Bond	G	Jan-08	8.61%	8.48%	7.71%	-	-	153.89%	10.03%
BEASSA All Bond Index			8.20%	7.63%	6.34%	-	-	122.79%	8.56%
Alpha			0.41%	0.86%	1.37%	-	-	31.11%	1.47%
Absolute Bond	G	Mar-03	9.44%	8.54%	7.97%	10.65%	-	331.64%	10.55%
CPI			4.66%	5.12%	5.45%	5.99%	-	123.77%	5.68%
Alpha			4.78%	3.42%	2.52%	4.67%	-	207.88%	4.87%
Flexible Fixed Income	G	Jul-10	9.59%	9.06%	8.46%	-	-	102.46%	10.22%
BEASSA All Bond Index			8.20%	7.63%	6.34%	-	-	82.14%	8.62%
Alpha			1.39%	1.43%	2.12%	-	-	20.32%	1.60%
Short Term Fixed Interest 3 Month Index			7.21%	6.67%	6.08%	-	-	52.03%	5.95%
Alpha			2.38%	2.39%	2.37%	-	-	50.43%	4.27%
Medical Aid Cash	G	Dec-05	8.78%	8.10%	7.24%	8.07%	-	150.60%	8.07%
Short Term Fixed Interest 3 Month Index			7.21%	6.67%	6.08%	6.94%	-	125.53%	7.11%
Alpha			1.57%	1.43%	1.16%	1.14%	-	25.07%	0.96%
INFLATION-LINKED BENCHMARK									
Global Absolute	G	Aug-99	7.88%	7.59%	11.54%	11.21%	15.38%	1 361.85%	15.91%
CPI			4.66%	5.12%	5.45%	5.99%	5.69%	194.10%	6.12%
Alpha			3.22%	2.47%	6.09%	5.22%	9.69%	1 167.75%	9.79%
Domestic Absolute	G	Apr-02	6.92%	5.76%	8.75%	10.01%	15.15%	791.45%	15.16%
CPI			4.66%	5.12%	5.45%	5.99%	5.69%	141.15%	5.84%
Alpha			2.26%	0.64%	3.31%	4.03%	9.46%	650.30%	9.32%
Inflation Plus	G	Oct-09	8.37%	8.01%	9.86%	-	-	132.52%	11.12%
CPI			4.66%	5.12%	5.45%	-	-	50.02%	5.20%
Alpha			3.71%	2.89%	4.41%	-	-	82.50%	5.92%
Medical Absolute	G	May-04	6.27%	5.79%	8.22%	9.74%	-	418.36%	13.05%
CPI			4.66%	5.12%	5.45%	5.99%	-	111.48%	5.74%
Alpha			1.61%	0.67%	2.77%	3.76%	-	306.88%	7.31%



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 Oct-17 [‡]	(0.83%)	6.89%	13.55%	14.69%	-	484.68%	15.85%
Cash			6.74%	6.26%	5.74%	6.56%	-	119.40%	6.77%
Alpha			(7.57%)	0.64%	7.81%	8.14%	-	365.28%	9.09%
Coronation Multi-Strategy Arbitrage Hedge Fund	N	Jul-03 Oct-17 [‡]	13.26%	11.24%	10.02%	11.31%	-	437.83%	12.53%
Cash			6.74%	6.26%	5.74%	6.56%	-	159.48%	6.92%
Alpha			6.52%	4.98%	4.28%	4.75%	-	278.35%	5.61%
Coronation Granite Hedge Fund	N	Oct-02 Oct-17 [‡]	10.58%	8.59%	8.09%	9.27%	10.14%	325.83%	10.14%
Cash			6.74%	6.26%	5.74%	6.56%	7.20%	183.80%	7.20%
Alpha			3.84%	2.33%	2.35%	2.71%	2.94%	142.03%	2.94%
OFFSHORE FUNDS¹									
Coronation Global Equity FoF (US\$)	G	Jul-00	17.93%	8.38%	12.57%	6.55%	11.38%	205.05%	6.68%
Coronation Global Equity FoFs Benchmark			18.65%	8.23%	11.57%	4.79%	9.59%	119.67%	4.67%
Alpha			(0.71%)	0.15%	1.00%	1.76%	1.79%	85.39%	2.01%
Coronation Global Managed (US\$)	G	Nov-09	14.81%	6.15%	9.44%	-	-	101.83%	9.28%
Coronation Global Managed Benchmark			10.31%	5.47%	6.80%	-	-	71.42%	7.04%
Alpha			4.50%	0.68%	2.64%	-	-	30.41%	2.23%
Global Capital Plus (US\$)	G	Sep-09	6.74%	3.61%	5.34%	-	-	62.53%	6.19%
Global Capital Plus Benchmark			1.15%	(1.36%)	(0.87%)	-	-	(6.86%)	(0.88%)
Alpha			5.59%	4.97%	6.21%	-	-	69.39%	7.07%
Global Bond (US\$)	G	Oct-09	3.52%	2.73%	1.93%	-	-	33.16%	3.64%
Global Bond Benchmark			(1.26%)	1.10%	(0.30%)	-	-	11.76%	1.40%
Alpha			4.78%	1.63%	2.23%	-	-	21.40%	2.24%
Coronation Global Strategic Income	G	Jan-12	1.96%	1.95%	2.76%	-	-	21.83%	3.49%
110% of 3 Month USD Libor			1.26%	0.75%	0.57%	-	-	3.28%	0.56%
Alpha			0.70%	1.20%	2.19%	-	-	18.55%	2.93%
Global Emerging Markets Equity Strategy	G	Jul-08	28.93%	5.38%	8.26%	-	-	111.77%	8.48%
Coronation Global Emerging Markets Equity Benchmark			22.46%	5.03%	4.21%	-	-	32.86%	3.13%
Alpha			6.47%	0.35%	4.06%	-	-	78.91%	5.35%
Coronation All Africa Strategy	G	Aug-08	15.97%	(6.02%)	3.64%	-	-	104.21%	8.10%
3 Month USD Libor			1.15%	0.68%	0.52%	-	-	5.68%	0.60%
Alpha			14.82%	(6.71%)	3.13%	-	-	98.53%	7.50%
Coronation Africa Frontiers Strategy	G	Oct-08	17.73%	(6.79%)	4.45%	-	-	122.85%	9.31%
3 Month USD Libor			1.15%	0.68%	0.52%	-	-	5.15%	0.56%
Alpha			16.58%	(7.47%)	3.94%	-	-	117.70%	8.75%
Coronation Global Frontiers	G	Dec-14	23.13%	-	-	-	-	12.98%	4.40%
3 Month USD Libor			1.15%	-	-	-	-	2.03%	0.71%
Alpha			21.98%	-	-	-	-	10.95%	3.69%
Coronation Global Equity Strategy	G	Nov-14	23.17%	-	-	-	-	23.40%	7.48%
MSCI All Country World Net US\$			18.65%	-	-	-	-	23.13%	7.39%
Alpha			4.52%	-	-	-	-	0.27%	0.08%

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

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

² G = Gross, N = Net

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

[‡] CIS launch date

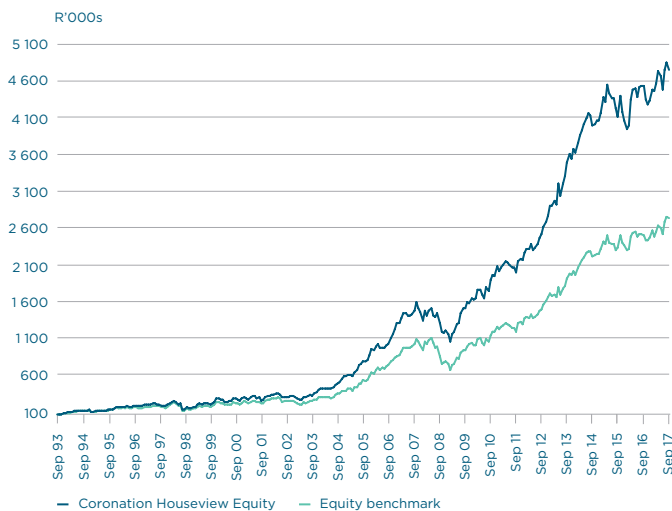


LONG-TERM INVESTMENT TRACK RECORD

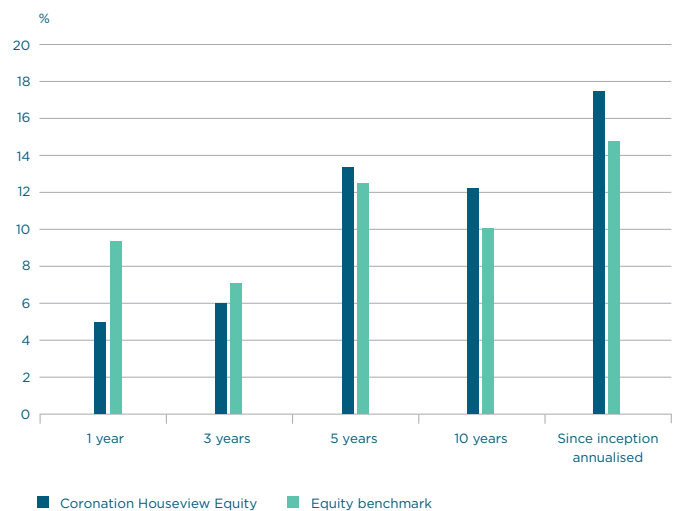
CORONATION HOUSEVIEW EQUITY RETURNS VS EQUITY BENCHMARK

5-YEAR ANNUALISED RETURNS	CORONATION HOUSEVIEW EQUITY	EQUITY BENCHMARK	ALPHA
1998	8.15%	6.49%	1.66%
1999	14.23%	10.91%	3.33%
2000	10.93%	7.52%	3.41%
2001	10.95%	9.38%	1.57%
2002	9.46%	7.80%	1.66%
2003	18.02%	13.78%	4.24%
2004	14.12%	9.63%	4.49%
2005	23.35%	18.94%	4.41%
2006	28.38%	23.66%	4.72%
2007	33.79%	29.55%	4.24%
2008	23.36%	19.73%	3.63%
2009	22.23%	20.67%	1.56%
2010	18.55%	15.73%	2.82%
2011	11.58%	8.73%	2.85%
2012	13.39%	10.10%	3.29%
2013	24.37%	20.21%	4.16%
2014	19.39%	16.08%	3.31%
2015	14.05%	13.14%	0.91%
2016	14.77%	13.33%	1.44%
4 years 9 months to 30 September 2017	11.96%	10.93%	1.03%
ANNUALISED TO 30 SEPTEMBER 2017			
1 year	5.00%	9.39%	(4.39%)
3 years	6.00%	7.13%	(1.13%)
5 years	13.36%	12.54%	0.82%
10 years	12.24%	10.01%	2.23%
Since inception in October 1993 annualised	17.47%	14.82%	2.65%
Average outperformance per 5-year return			2.94%
Number of 5-year periods outperformed			20.00
Number of 5-year periods underperformed			-

CUMULATIVE PERFORMANCE



ANNUALISED RETURNS TO 30 SEPTEMBER 2017



An investment of R100 000 in Coronation Houseview Equity on 1 October 1993 would have grown to **R4 770 288** by 30 September 2017. By comparison, the returns generated by the Equity Benchmark over the same period would have grown a similar investment to **R2 758 533**.

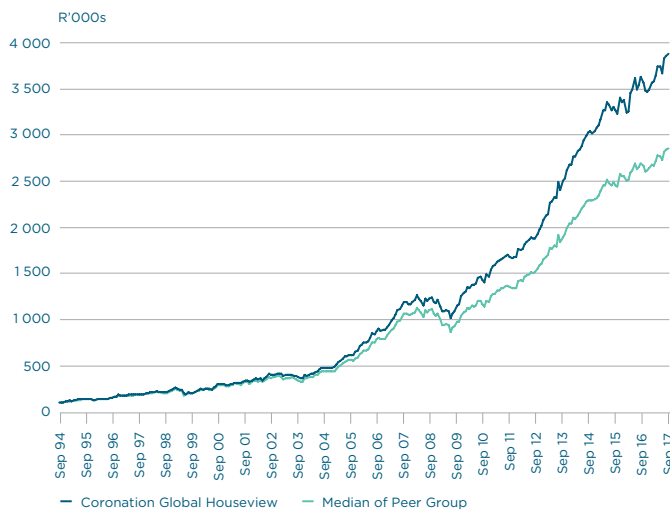


CORONATION GLOBAL HOUSEVIEW (BALANCED) RETURNS VS MEDIAN OF PEER GROUP*

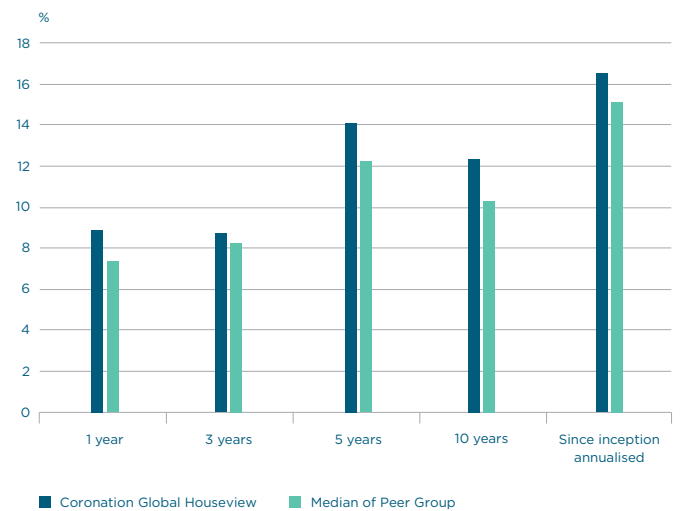


5-YEAR ANNUALISED RETURNS	CORONATION GLOBAL HOUSEVIEW	MEDIAN OF PEER GROUP*	ALPHA
1998	11.21%	11.26%	(0.04%)
1999	16.36%	15.54%	0.82%
2000	13.82%	13.17%	0.65%
2001	16.54%	15.02%	1.52%
2002	12.74%	12.05%	0.69%
2003	17.67%	15.96%	1.71%
2004	14.35%	13.30%	1.05%
2005	19.58%	18.16%	1.42%
2006	20.74%	19.53%	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 9 months to 30 September 2017	13.29%	11.48%	1.81%
ANNUALISED TO 30 SEPTEMBER 2017			
1 year	8.98%	7.31%	1.67%
3 years	8.72%	8.24%	0.49%
5 years	14.05%	12.19%	1.86%
10 years	12.35%	10.23%	2.13%
Since inception in October 1993 annualised	16.48%	15.11%	1.38%
Average outperformance per 5-year return			1.50%
Number of 5-year periods outperformed			19.00
Number of 5-year periods underperformed			1.00

CUMULATIVE PERFORMANCE



ANNUALISED RETURNS TO 30 SEPTEMBER 2017



An investment of R100 000 in Coronation Global Houseview on 1 October 1993 would have grown to **R3 891 741** by 30 September 2017. By comparison, the Median return of Global Large Managers over the same period would have grown a similar investment to **R2 861 209**.

* 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.



The same thread joins us, South Africa.

We're privileged to manage the long-term savings of millions of South Africans.

As a company that has been committed to the growth of the country since 1993, we're as much invested in South Africans as they are in us.



CORONATION
TRUST IS EARNED™

Coronation is an authorised financial services provider and approved manager of collective investment schemes. Trust is Earned™.