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The Personal Investments Quarterly

Tailwinds and headwinds

CORONATION
TRUST IS EARNED™

APRIL 2021 AUTUMN EDITION

IN THIS ISSUE

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Notes from my inbox

"In the past, censorship worked by blocking the flow of information. In the twenty-first century, censorship works by flooding people with irrelevant information. In ancient times having power meant having access to data. Today having power means knowing what to ignore." – Yuval Noah Harari

By **PIETER KOEKEMOER**

Pieter is Head of Personal Investments

Nearly everyone is by now aware of the central conceit in professional wrestling: this is scripted entertainment rather than a serious sport with unknown outcomes and real winners and losers. Yet, wrestling remains a big and successful business. WWE Inc., the most prominent promotor, is a multi-billion-dollar corporation that hosts more than 450 events a year and broadcasts in 28 languages, with the potential to reach more than 800 million homes around the world. Its share price tripled over the past five years.

The key insight is that, in exchange for entertainment and escape, the audience is a willing participant in the lie. This complicity makes ever more extreme scripts possible and ensures that the whole edifice remains sustainable. If the fans revoke their consent, the system will collapse.

This phenomenon has become pervasive in our post-modern world. It sometimes feels like everything is now performance art. It is well advanced in politics, where President Vladimir Putin and ex-President Donald Trump rewrote the populist playbook, showing how to hack the media by flooding public discourse with disinformation through increasingly outrageous statements. This new style of propaganda aims to muddy the waters so that it becomes impossible to reach consensus based on the facts.

We see it in global markets too. In a world awash with liquidity, narrative-based 'investment opportunities' inspire an army of newly empowered retail investors using easily available leverage via their app-based, fee-free broking accounts to take a punt. Dogecoin, a meme-inspired crypto >

in-joke, traded 60 times higher in late-April 2021 compared to the start of the year. Multiple electric vehicle start-ups, with no revenue or product, are trading at prices consistent with double-digit global market share a few years out. Nearly 400 new equity listings were added to US markets in three months, in the strongest first quarter for deal-making since at least 1980. Three out of four of these were blank-cheque acquisition companies. We live in a world where there are many who are prepared to sell what people want to hear.

Being in on the joke does not protect you from negative consequences, though. Wrestlers still get injured and pervasive anabolic steroid use increases their risk of cardiovascular disease. Donald Trump became only the third one-term president since the Great Depression, as most Americans rejected his style of politics. High valuations supported by good stories but not by solid fundamentals will eventually lead to large losses, as illustrated by the dotcom bubble of the early-2000s.

At Coronation, we do not believe that the truth is unknowable. That is why we remain committed to improving our understanding of the fundamental drivers of value through deep and intensive proprietary research. Over time, this approach will continue to produce superior results.

FEE REDUCTIONS FOR MORE CONSERVATIVE FUNDS

We have recently introduced management fee reductions for the Coronation Strategic Income, Coronation Balanced Defensive and Coronation Capital Plus funds. These changes are aimed at making it slightly easier for more conservative investors, often retirees who are dependent on their investment portfolio to meet their living expenses, to select the fund with the most appropriate risk profile for their needs, as summarised in Figure 1. More information on the new fees are available on our website and on the respective fund fact sheets.

IN THIS EDITION

Bullish sentiment in global markets is built on the expectation of a post-Covid-19 economic boom due to a release of pent-up demand as lockdowns ease. The IMF recently upped its global growth forecast for 2021 from 5.2% to 6%. The key risks to this upbeat forecast are a stumble in vaccine rollouts and efficacy, possibly due to new virus variants; and increasing inflation concerns in response to an increase in the money supply, coupled with faster growth. Marie Antelme unpacks the latter in detail on page 10. Locally, the outlook is more subdued, but as is evident from the economic and fund commentary in this edition, much of the froth evident in pockets of the global markets is not present in local financial markets, which still offer undemanding market prices.

In three examples of recent original research, our emerging markets team makes the investment case for emerging stock exchanges (page 15), Godwill Chahwahwa unpacks the opportunities created by crunching the numbers post a change in accounting standards on page 29, and Floris Steenkamp reports on a return of business confidence in Zimbabwe and the attractive opportunity presented by Zimplats on page 33.

Finally, we lead this edition with an extract from our third annual Stewardship Report, covering our environmental, social and governance activities during 2020. If you would like to read more on this topic, the full report is available on **coronation.com**.

As always, I invite you to get in touch with us via **clientservice@coronation.com** if you require more information or if you are in any way unhappy with the quality of our delivery to you.

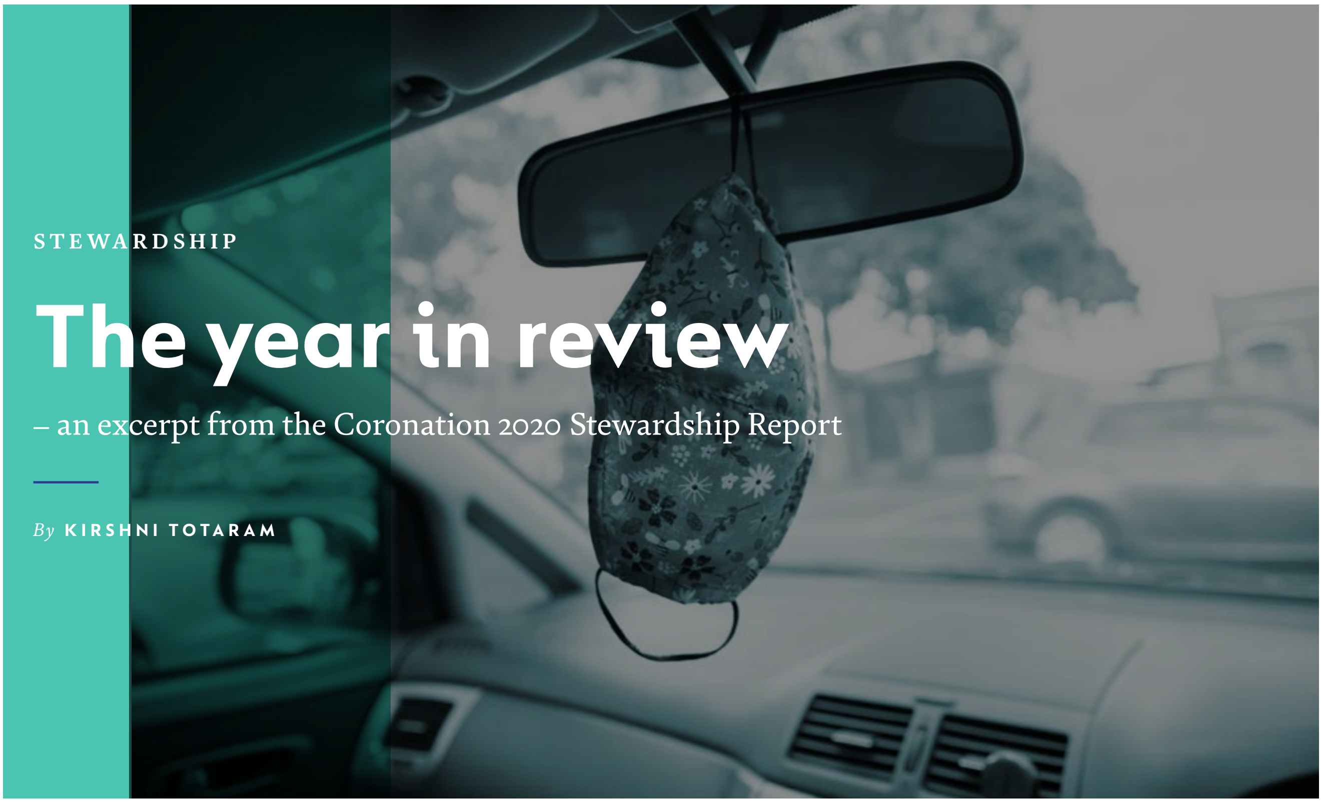
Pieter

Figure 1

RISK PROFILE

Fund	Investor need
Strategic Income	Managed exposure to income-generating assets over periods of 12 to 36 months. This is a conservative fund aiming to outperform cash and deposit accounts, with no equity exposure.
Balanced Defensive	A lower risk income-and-growth fund with typically not more than 50% exposure to growth assets (equity and property). Suitable for very cautious investors requiring a growing income from their portfolio over an extended period.
Capital Plus	A moderate risk income-and-growth fund with typically not more than 70% exposure to growth assets (equity and property). Suitable for investors requiring a growing income from their portfolio over an extended period, especially those in the first decade of retirement.

Source: Coronation



STEWARDSHIP

The year in review

– an excerpt from the Coronation 2020 Stewardship Report

By **KIRSHNI TOTARAM**

Kirshni is Global Head of Institutional Business. She joined Coronation in 2000.

ANY REVIEW OF 2020 is inevitably a review of the devastating global effect of the Covid-19 pandemic.

It placed the importance of our role as long-term stewards of our clients' capital front and centre. At its core, our stewardship responsibility requires us to focus on the long-term prospects of the companies in which we invest. We do so by considering the financial health and prospects of each company, as well as the impact that their actions have on stakeholders, the environment and broader society.

The Covid-19 crisis presented a unique challenge – while our focus remained on the long term, we needed to consider the shorter-term impact that hard economic stops would have on each of the businesses in our portfolios, and the extent to which companies had the financial resilience to survive through a period of extreme uncertainty. From a corporate perspective, survival through the crisis became the crucial measure of long-term sustainability.

The severity of the crisis required us to fully understand the implications for each of the companies in which we were invested. We performed a stock-by-stock impact analysis to ensure that we understood the risks to our clients' portfolios and were appropriately positioned to deliver long-term value to clients, in line with our stewardship responsibility.

This included understanding the financial impact on each company and the measures that they could take to protect their balance sheets. We also considered how they treated their key stakeholders, such as employees, suppliers and customers, through the crisis.

We believe that the Covid-19 crisis will, in time, become a study of how companies were forced to make difficult trade-off decisions when balancing the need for financial survival with their broader responsibilities, in the face of extreme uncertainty. Despite this shift in emphasis in 2020, we continued on our stewardship journey by increasing our depth of knowledge on key sustainability issues and expanding the range of issues that we tackled with investee companies.

This meant that, while our focus on driving good corporate governance remained a key pillar of our approach, we did not lose sight of the broader objectives of encouraging responsible environmental and social practices within our investee companies. This is reflected in the increased proportion of engagements of an environmental nature relative to prior years.

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THE RISE AND RISE OF SUSTAINABLE INVESTING

In a year that was so disrupted by lockdowns that changed the way in which we live and work, it was striking to note how the industry's focus on stewardship, environmental, social and governance (ESG) factors, and sustainable investment accelerated at an even greater rate than in prior years.

There were several contributing factors, such as a continuation of industry and regulatory efforts that preceded the pandemic. However, the pandemic itself created a heightened appreciation of the importance of sustainability.

In terms of the economic and societal impact, the crisis highlighted the role that companies could play in assisting their stakeholders through the crisis. At a more systemic level, the pandemic demonstrated the new risks and complexities that we face in such an interconnected world, with clear parallels to, for example, the global climate crisis. Covid-19 has therefore placed sustainability in even sharper focus.

In 2020, we saw signs that the industry is starting to move towards a common set of standards in its approaches to tackling sustainability-related matters. Some of the more material developments that took place include updates to stewardship codes and the increasing adoption and alignment of corporate disclosure standards. A lack of consistency in company-reported sustainability data is one of the most pressing challenges facing the industry.

ACTIVE OWNERSHIP

We continued to employ active ownership techniques by engaging robustly with investee companies on material issues, and by enforcing our rights as shareholders through proxy voting at shareholder meetings. Engagement with companies and voting at shareholder meetings are both powerful tools that we consider to be an essential part of our active management offering.

Effective engagement drives responsible corporate behaviour, which, in turn, leads to greater sustainability and, ultimately, higher long-term returns for our clients. We believe that we can have a greater impact by investing in companies that have scope for improvement in their ESG practices and exercising our influence to bring about the necessary changes.

Some of the case studies that we have included in the report show that our approach has been effective and has brought positive change to many of our investee companies.

To this end, in 2020, we held 256 material engagements with 121 companies on a range of ESG issues, with an increased focus on climate-related matters.

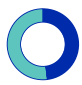
We also continued to vote in line with our proxy voting principles, and voted on 6 466 resolutions across 524 shareholder meetings. We firmly believe that active engagement that is conducted in an informed, responsible and robust manner, enables us to drive tangible, positive corporate change over the long term by improving sustainability and governance practices.

Active ownership is, therefore, a core part of our stewardship approach, which we apply consistently across the full range of investment products that we offer to our clients.

100%
Assets we engaged in client portfolios

248%
Increase in engagements on environmental matters

>360
Companies engaged regarding Covid-19



Shareholder meetings
Dissenting votes 52%
No dissenting votes 48%

DRIVING STANDARDS FOR SUSTAINABILITY REPORTING IN SOUTH AFRICA

Our ability to drive meaningful environmental change requires regular and informed engagement with the companies in our investment universe. We now expect companies to provide robust disclosures of climate risks and opportunities, so that we are able to assess how well positioned they are to manage those risks and the transition to a low-carbon economy.

Starting in the fourth quarter of 2020, we have sent letters to 89 listed South African companies to explain these issues and to urge them to adopt the Task Force on Climate-related Financial Disclosures (TCFD) recommendations as part of their reporting process.

This will be a complex, multi-year initiative; however, we are encouraged with the response that we have received thus far.

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PORTFOLIO CARBON INTENSITY VERSUS BENCHMARK

For every $1m in revenue, the number of tonnes of CO_2e[1] emitted by the underlying holding is:

SA HOUSEVIEW EQUITY	ACTIVE GLOBAL EQUITY	GLOBAL EMERGING MARKET EQUITY
305 portfolio	41 portfolio	35 portfolio
339 benchmark	155 benchmark	264 benchmark

[1] Carbon dioxide equivalent or CO_2e is the number of metric tonnes of carbon dioxide emissions with the same global warming potential as one metric tonne of another greenhouse gas

Sources: MSCI, Coronation

We will follow through on this initiative in the coming years by urging corporates to commit to this disclosure standard and implement it properly.

For companies that adopt the TCFD, we will engage with them to ensure that they have credible environmental targets and that they follow through on these targets with the correct actions and appropriate disclosure.

To align our business with the commitments we ask of our investee companies, we have formally included natural capital in our corporate value-creation activities. As the first step on this journey, we included the findings of our first operational carbon footprint analysis in our integrated report for 2020.

We will continue to use the learnings from this exercise to improve our operational efficiencies to soften and offset our impact on the environment. We are working towards formally reporting in terms of the TCFD in the next 12 months.

EXPANDING OUR GLOBAL SUSTAINABLE OFFERING

While we actively engage all our investee companies in order to drive positive change, we also recognise and respect that many investors do not wish, or are unable, to have exposure to certaintypes of companies.

In 2020, we launched the Coronation Sustainable Global Emerging Markets (GEM) Fund. This is an emerging markets equity fund that builds on our existing emerging markets capability, which has delivered significant alpha to long-term investors. The Sustainable GEM Fund is designed to meet investor demand for long-term outperformance from an actively managed portfolio of sustainable investments, using a more conservative risk budget than our existing GEM offering. This follows the 2019 launch of the Coronation Global Sustainable Equity Income Fund. Both funds exclude investments in certain companies or sectors, such as tobacco companies, companies that manufacture or distribute controversial weapons, and companies involved in the mining and extraction of thermal coal or the production of coal-based power and/or the extraction of oil from tar sands.

The Sustainable GEM and Global Sustainable Equity Income funds follow the same approach to stewardship and active engagement that we apply across our business, by actively encouraging responsible business practices by investee companies.

GOVERNANCE MATTERS

In 2020, governance matters continued to be a key focus area for our investment team, with over 60% of our investee company engagements linked to governance concerns. We continued to advocate for improvements in corporate governance across a range of issues, with board composition, executive remuneration and shareholder value being key topics of engagement.

Executive remuneration was once again a focal governance concern, with one third of our governance-related engagements linked to remuneration. We focused on important issues such as enrichment versus compensation, alignment with shareholders, and whether remuneration structures are sufficiently long term in nature and set against appropriate key performance indicators. We continued our push for the inclusion of malus and clawback mechanisms in all remuneration structures and made further progress, with a number of companies either including or committing to include these provisions in their remuneration policies.

We also addressed a variety of stock-specific concerns about shareholder value, addressing issues that ranged from business strategy, capital structure and capital allocation through to corporate actions and regulatory matters.

SOCIAL CONSIDERATIONS

The Covid-19 crisis highlighted, and in many ways exacerbated, some of the major social and political challenges facing the global community. Many of the issues that companies faced had a social dimension, given that the issues centred on protecting the health and welfare of individuals affected by the virus and the response. The sudden and brutal economic impact of lockdowns meant that many companies were forced into survival mode. These companies needed to balance their need to survive the crisis with the need to act in >

the interests of their stakeholders, such as their customers, employees and suppliers, to protect the long-term viability of their businesses. All of these decisions had very real and tangible impacts on the lives of the people that were affected by them.

We engaged extensively with our investee companies throughout the Covid-19 crisis to understand not only the financial implications that lockdown would have on their businesses, but also their operational response, including the implementation of workplace safety protocols and employee well-being initiatives.

Additional areas of focus during 2020 included engagements with companies on stock-specific issues relating to labour relations, health and safety standards, empowerment, and the management of community relations by mining companies.

KEEPING YOU INFORMED

As part of our stewardship commitment, we provide regular updates to clients on our wider stewardship activities, including our engagement and voting activities, and updates on ESG matters. We communicate the results of these activities in our client interactions, regular client reporting and through our annual stewardship report. We also work with our clients individually to ensure that we provide them with the information that they need to fulfil their stewardship objectives, as well as any regulatory reporting required.

As a Principles for Responsible Investment (PRI) signatory, we report publicly on our responsible investment activities each year. These Transparency Reports, together with the Assessment Reports, are accessible to signatories on the PRI Data portal. Our voting activities are disclosed and updated on a quarterly basis in the stewardship section of the Coronation website.

COLLABORATING WITH OTHERS

Institutional investors are now, more than ever, working collaboratively to effect positive change at investee companies. Last year, we collaborated with like-minded investors on specific company issues across the various geographies in which we invest. These collaborations covered a range of issues, including board independence, capital management, corporate activity and environmental reporting.

We continued to engage proactively with industry bodies and policymakers to ensure that we help develop an environment that improves outcomes and protects the long-term savings industry. In 2020, a significant proportion of our collaborative efforts focused on working with industry bodies to assist with understanding the impact of lockdowns on the South African economy, and to advocate for appropriate policy measures and responses.

SIGNATORIES TO MULTIPLE CODES

Coronation remains a signatory to multiple responsible investing codes, including the PRI and the Code for Responsible Investing in South Africa. In addition, we adhere to the principles denoted in the updated UK Stewardship Code. As a signatory to these codes, we work very hard to ensure that we continue to take cognisance of and champion their tenets and principles.

TOP OF THE CLASS – PRINCIPLES FOR RESPONSIBLE INVESTMENT 2020

Our annual participation in the PRI's annual reporting and assessment review is an important benchmark that enables us to assess how we compare to global best practice, and to identify areas where we can improve our process. In 2020, we achieved the highest PRI rating of A+ across all assessment categories, exceeding the median participant score across every category.

We have worked hard over the years to develop and improve our stewardship practices and are encouraged to receive recognition for the progress we have made.

THE ROAD AHEAD

There can be no doubt that stewardship and sustainable investment practices are now mainstream requirements for the investment industry across the globe. It is no longer sufficient for investment managers to consider the two dimensions of risk and return; instead, investment managers must consider the impact that companies have on their external environment and factor this into their investment decision-making and engagement processes.

At Coronation, we believe that these objectives are not mutually exclusive; instead, we view responsible corporate behaviour as entirely consistent with long-term corporate success. We also believe that our approach to active engagement with investee companies is the most effective way to drive meaningful, positive, long-term change within the corporate sector.

However, we are not naive about the challenges that the industry is facing, and will continue to face, in tackling this incredibly complex and constantly evolving space. We believe that alignment with a set of credible disclosure standards remains a critical area that the industry must get right in the coming years. We further note that the flood >

of new ESG investment products into the market highlights the need for effective product disclosure standards, such as the EU's Sustainable Finance Disclosure Regulation, to address the risk of potential 'greenwashing'.

As we have done for many years, we continue to review, interrogate and enhance our skills, understanding and processes so that we can fulfil our obligations as responsible stewards of our clients' capital to the fullest extent.

We believe that this will be integral to achieving our goal of delivering significant and sustainable long-term benefits to our clients, to our stakeholders and to the communities in which we operate. +

ECONOMIC COMMENT

Global outlook

Inflation – it's time to pay attention

By **MARIE ANTELME**

THE QUICK TAKE

History does not always repeat itself; not every crisis is the same

The macro building blocks for sustained higher inflation are in place

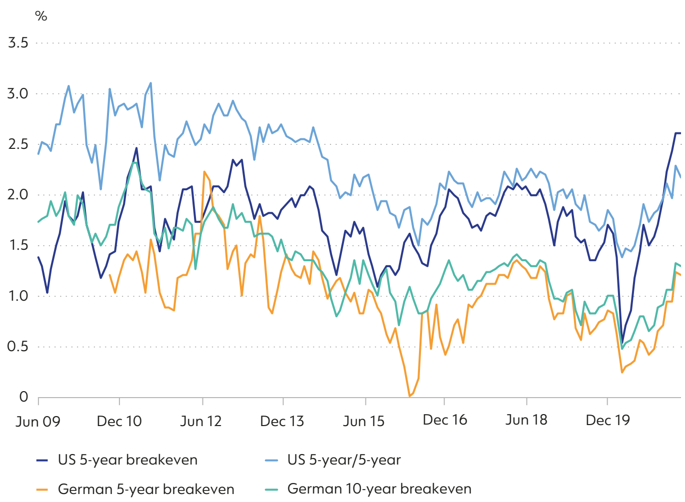
However, divergent policies, timing, measurement issues and base effects temper some of the upside risk for now

Marie is an economist with 20 years' experience in financial markets.

IN DECEMBER 2020, former Federal Reserve Governor Bill Dudley warned, "A lot of people believe that inflation in the US is dead or, if not dead, in a state of suspended animation for the foreseeable future. They could be setting themselves up for an unpleasant surprise". At the time, only a few were voicing concerns about inflation risk; after all, headline and core inflation rates were broadly below targets. Also, oil prices remained below pre-pandemic levels, output gaps were assessed to be large, and GDP and employment levels were well below their pre-pandemic norms. While stimulus was abundant, especially in developed economies, this absence of concern was informed by recent history, when the ringing warnings of inflation risk post the Global Financial Crisis (GFC) stimulus had come to naught. So, is this time different? We think so, yes.

Figure 1

'BREAKEVEN' INFLATION EXPECTATIONS (DIFFERENCE BETWEEN NOMINAL AND INFLATION LINKER YIELDS)



Source: Bloomberg

Economists broadly subscribe to one of two theories about the causes of inflation.

- Monetarists believe that prices rise when too much money chases too few goods.
- Keynesians believe that when demand exceeds an economy's ability to provide goods and services for agents' needs and wants, this pushes up the prices of those goods and services.

The two ways of thinking aren't mutually exclusive – too much money could push demand for goods and services beyond an economy's short-term capacity to produce them. If it's true, as economist Milton Friedman said, that "inflation is always and everywhere a monetary phenomenon", then it's reasonable to question whether this round of massive stimulus could raise inflation in the months ahead. Developed market inflation expectations have adjusted sharply upwards in recent weeks, as financial markets start anticipating this risk, as seen in Figure 1.

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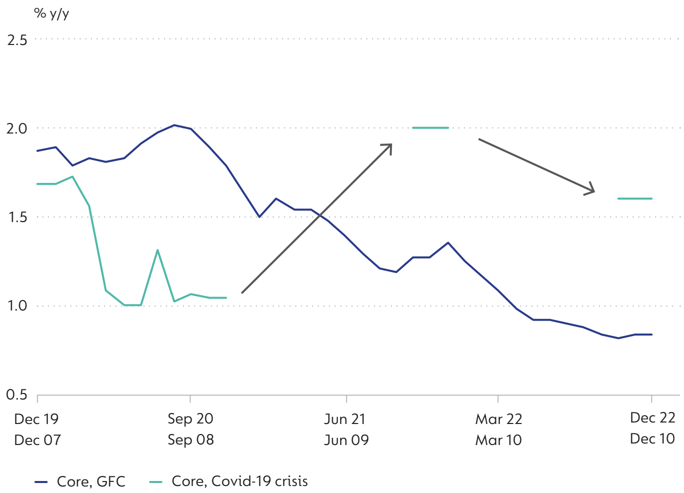
THE BUILDING BLOCKS OF INFLATION

The Covid-19 pandemic's policy and economic characteristics are different to those that accompanied the GFC. In these differences may lie the building blocks to a sustained level of higher inflation (Figure 2).

Figure 2

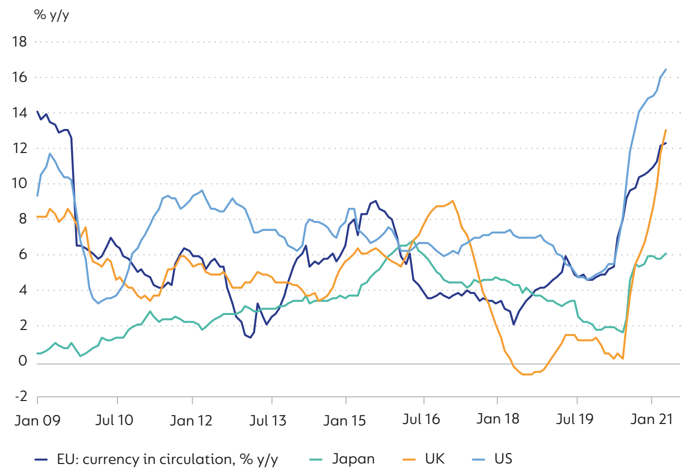
DEVELOPED MARKET CORE INFLATION IN GFC VERSUS COVID-19 CRISIS



Sources: Haver, UBS

Figure 3

NARROW MONEY SUPPLY GROWTH



Source: Haver

1. **Base effects.** First to note is that within the next few months, printed inflation in most economies will accelerate meaningfully as the decimated base of 2020 normalises. Also, oil prices have recovered strongly, and the prices of products or services that were restricted and collapsed in 2020 may even be higher than before. UBS estimates that US headline inflation will rise from 2.3% year on year (y/y) in March to 3.9% y/y by May; in the EU the increase is forecast at 1.9% y/y from 1.3%, and in the UK from 0.5% y/y to 1.9%. These largely base-related peaks will differ by region, and there is significant uncertainty about the timing and duration of this acceleration (and what additional drivers there may be). Next year, in the absence of sustained price increases elsewhere, such as the services sector, these base effects will swing back. There is some risk that this won't happen, but the dynamic is a powerful one. More on this later.

2. **The nature of the crisis.** The economic impact of the Covid-19 pandemic has been more like a war or a massive natural disaster – sudden, disruptive, and devastating to lives and livelihoods. This is not the bursting of a leverage-inflated bubble, which carries long-term balance sheet damage and a painful deleveraging that weakens aggregate demand and drags on growth. Importantly, it has not damaged the financial sector; balance sheets are in reasonably good shape, and monetary and financial transmission mechanisms should be relatively intact. That's not to say regions and sectors won't feel the very adverse effects for a long time, but as the nature of the crisis has been different, so will be the nature of the recovery.

3. **The nature of the remedy.** The policy response to the pandemic is unprecedented in peacetime. Covid-19 triggered both monetary and fiscal responses aimed largely at protecting those lives and livelihoods – income support, balance sheet protection, and financial and banking sector buffers. The IMF estimates that average fiscal support in developed markets was 6% of GDP in 2020. While some of this momentum has faded, new policies in the US and Europe, combined with a more generalised concern that too-swift consolidation could push countries to a fiscal cliff (another sudden moderation in growth), will add duration to the stimulus.

   Monetary stimulus has also seen developed market central bank balance sheets expand by c.21.5% of GDP, and narrow money supply (currency in circulation) in the US is up by 16.5% y/y (Figure 3). This is in contrast to the policy response triggered by the GFC, which was mostly monetary, with liquidity provision aimed initially at protecting the very fragile financial sector, and then at stimulating growth. At the time, money supply growth peaked at 11.7% y/y in early-2009. Bank lending has also been actively encouraged, with governments guaranteeing bank loans to mitigate risk. This may support stronger demand for credit now than before.

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4. **In hindsight, inflation drivers were misdiagnosed last time around.** In the aftermath of the GFC, many commentators were concerned about the potential inflationary impact of massive liquidity provision. But nothing happened. In fact, many developed market central banks battled to raise inflation to targeted levels. In retrospect, one of the critical issues was that the increase in broad money was not met by a strong increase in demand for 'transaction' money. The money created remained in the financial system; in part because the underlying economies were weak, and in part because there was an accompanying change in the regulatory buffers required of banks, which made them unwilling or unable to lend. Combined, this meant that very little of this 'excess liquidity' or 'money creation' made its way into the traded economy. The pandemic has not shared these challenges, and, as mobility continues to normalise, it seems likely that demand for money will too. The risk of 'excessive' money creation is greater this time around. Put differently, there is more available money to drive demand for goods and services than before.

THE RISK OF 'EXCESSIVE' MONEY CREATION IS GREATER THIS TIME AROUND

5. **A faster pace of recovery.** The pandemic hit a relatively healthy global economy. While the rapidity and force of early lockdown was an unprecedented economic shock, policy intervention and the increasingly rapid vaccine rollout should lead to a swifter return to normalcy than we saw post the GFC, where balance sheet and financial damage was enduring. Many economies will see GDP at pre-pandemic levels this year (some are there already), with a lagged but steady recovery in employment. That said, the recovery is diverging – developed economies that were able to inject massive support and vaccine strategies are recovering much faster than emerging markets, which have more limited policy options and poorer vaccine strategies. In these economies, inflation risk is not absent, but more heavily concentrated in exchange rate risk.

6. **Bottlenecks and supply disruptions.** Specific to Covid-19, the impact of supply bottlenecks is already being seen in rising prices of specific goods and services. Container and freight costs have surged. Labour shortages in some countries have become an issue, with more people required to be at home (to meet caring and homeschooling needs) than before.

7. **Price normalisation** risks lie to the upside and could compound base effects. Specifically, the collapse of service sector activity saw the prices of key components of the consumer inflation basket fall sharply. These include restaurants and hotels, travel and transport, and various items related to recreation and holidays. In some instances, they have fallen by more than two standard deviations below their long-term averages. As mobility returns and people not only go back to more normal consumption of these goods, but binge a bit on pent-up demand, supply could be constrained, which would see prices rise. Services (broadly) typically carry a large weight in measured inflation, and even though the impact on CPI will be non-uniform, it may pose a considerable risk to near-term inflation outcomes.

8. **The role of expectations and policy mandates.** The Federal Reserve Board and the European Central Bank are leading central banks that have explicitly changed their mandates to actively encourage higher inflation after long periods of undershooting targets. This has increased market jitters that greater tolerance of inflation overshoots could see price acceleration run ahead of behind-the-curve central banks. This is certainly not a given, but it may affect market pricing as well as the inflation expectations of economic agents.

There are also long-term trends – not related to the pandemic – that could play into this frothier environment. Work done by Charles Goodhart and Manoj Pradhan[1] takes a detailed look at the history of falling inflation over the past 40 years and concludes that among the most important drivers of lower inflation was the impact of moderating global wage pressure. This is reflected in the emergence of China as the world's manufacturing epicentre and the rise in participation rates in developed markets, mostly by women. The withdrawal of these lower-cost workers is likely to have the opposite impact on global wages over time. In tandem, ageing workers not only don't produce, but also increase the demand for specific goods and services, which could also see specific prices rise.

The process of 'deglobalisation' has likely been accelerated by the pandemic, as countries seek to ensure that critical goods and services are produced locally, and are not subject to the uncertainty of long global supply chains and changeable geopolitical dynamics. Where onshore production is more expensive than procuring the same goods from a low-cost producer elsewhere, price pressures could emerge.

[1]Goodhart, Charles and Pradhan, Manoj. "The Great Demographic Reversal: Ageing Societies, Waning Inequality, and an Inflation Revival". August 2020

... NOT SO FAST

Despite all these emerging or potential pressures, there are still important issues of measurement and timing. Not only does the composition of various inflation measures vary, but the measurement of goods and services does too. Also, for all the listed 'macro building blocks' of inflation, recent years have shown some of these relationships to be more tenuous drivers of inflation than in the past.

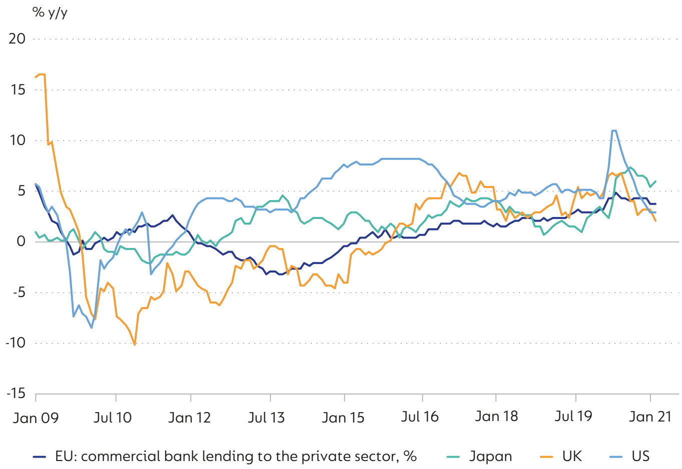
1. The relationship between broad money supply growth and inflation is historically quite weak. The degree to which strong money supply growth generates inflation depends on whether it pushes aggregate demand to be in excess of supply. For this to happen, the rate of money supply growth needs to be sustained, and accompanied by matching spending and/or loan growth. So far, this is not happening. Figure 4 shows that loan growth remains weak in recovering developed markets and the ratio of money supply to nominal GDP (money velocity) has been falling. It is possible that excess savings and rolling mobility restrictions have limited spending and loan growth, but for now this link is weak.

2. Price normalisation may not be uniform. Lockdowns produced excess demand for certain goods and services (home refurbishment, IT, work-from-home infrastructure, courier and communication services, and so on), and the prices of these items have increased. Price normalisation of recreational- and mobility-related services affected by lockdowns may rise – in some cases sharply – but these may be offset by moderating inflation elsewhere. Here, it is also worth noting that the role of rentals (and imputed[2] rent) in many countries' inflation baskets are either a strong anchor to services inflation (as in South Africa), or a possible risk, such as in the US, where the housing market has had a strong recovery. But even there, the pass-through from listed rental increases to CPI happens with a considerable lag and is not seen as an imminent threat.

3. For all the optimism about a strong global growth recovery, by region and country, recovery rates are extremely divergent. The IMF's April forecast update upgraded global GDP growth expectations for 2021 to 6.0% from 5.2%, primarily on the upward revision of developed market growth from 3.9% to 5.1%. The varying rate of vaccine rollouts and the economic cost of the 2020 lockdowns will probably see emerging markets recover more slowly, and degrees of economic scarring will vary. That said, almost without exception, expectations of labour market recoveries lag, implying ongoing labour and wage slack.

Figure 4

ADVANCED ECONOMY PRIVATE SECTOR CREDIT EXTENSION



Source: Haver

4. Expectations play a key role in price formation. Moderating expectations in the past 40 years have had a reinforcing influence on both wage- and price-setting behaviour. While markets have repriced inflation risk, expectations are not yet historically high, and certainly not what could be called 'unanchored'. While these remain reasonable, price-setting behaviour should too.

5. Finally, and importantly, there isn't a strong 'global inflation cycle'. In this note, we have discussed the broad drivers of inflation, and compared and contrasted these to the circumstances that prevailed after the GFC and may evolve as economies recover from the pandemic. But idiosyncratic factors are likely to remain critical drivers of short- to medium-term inflation. In some emerging markets (Turkey, Brazil, India), inflation is above target, and policy rates have already started to rise. That said, the repricing of US inflation risk in particular could have meaningful and material repercussions for the pricing of global assets.

IN CONCLUSION

The generalised nature of this note provides an outline of the broad contours of global inflation drivers. In the short term, base effects will dominate, and CPI is expected to accelerate into year-end. After that, the degree to which inflation persists or subsides will vary by country: where liquidity remains ample and the recovery robust,

[2] An estimate of the rent an owner would pay to rent their own property.

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prices will reflect the difference between money growth and real GDP and are more likely to remain elevated. Supply disruptions could affect pricing more in smaller economies, and those with delayed vaccine strategies may see relative prices take longer to normalise, and economic slack persist – such as South Africa and parts of Europe. We expect developed market inflation to be higher in coming years than in the post-GFC period and asset prices to adjust, but we don't think the building blocks for runaway inflation are yet in place. ✚

EMERGING MARKETS

Emerging market exchanges and the rise of retail investing

Promising long-term growth seen in emerging equity markets

By SUHAIL SULEMAN

With contributions from PAUL NEETHLING, LISA HAAKMAN, IAKOVOS MEKIOS *and* DANIE PRETORIUS

THE QUICK TAKE

- Emerging market securities exchanges have attractive business models with strong tailwinds
- These exchanges are being boosted by a surge in retail equity investors
- Declining rates and the search for yield should support emerging market exchanges over time
- Emerging market exchanges offer high revenue growth coupled with economies of scale

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

THE PAST QUARTER saw significant attention drawn to retail investors in the developed world and how their coordinated activities resulted in wild swings in the prices of heavily shorted shares. GameStop, a perennially loss-making seller of new and used video game consoles and titles, was the most prominent example of heavily shorted companies experiencing a massive spike in its share price due to a buying campaign. In emerging markets, we haven't experienced anything quite so exciting. However, the long-term trend of greater retail participation in several countries off a very low base is something we have highlighted before. We like the business models of securities exchanges, as they tend to dominate trade in their local markets and are akin to a local monopoly. If run correctly, they can build significant moats around their respective businesses and earn very high returns on capital, while generating cash that is distributed to shareholders. The primary driver of these high returns is scale, as the majority of costs are fixed in nature. As volumes increase – either through new listings or through greater turnover (liquidity) of existing listings – the incremental profits on these volumes tend to fall through to the bottom line. In our coverage list, most exchanges earn margins (measured at EBITDA[1] level to improve comparability between different exchanges) well in excess of 50%.

Figure 1

MARGIN COMPARISON OF EMERGING MARKET EXCHANGES

Exhange	EBITDA margin (FY2020)
B3 (Brazil)	80%
BMV (Mexico)	59%
Moscow Exchange (Russia)	72%
HKEX (Hong Kong)	77%
LSE (UK)	54%
CME (derivatives, US)	67%
Nasdaq (US)	55%
Xetra (equities only, Germany)	66%

Sources: Bloomberg, company reports

Figure 1 shows the margins of the four exchanges covered in this article, as well as selected peers in the developed world. Strictly speaking, one cannot compare margins between exchanges

[1] Earnings before interest rates, taxes, depreciation and amortisation

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to measure relative efficiency, because what the various exchanges offer to clients differs from jurisdiction to jurisdiction. Some offer just equities trading, whereas others may also offer derivatives and fixed-interest products. Some provide data services and security custody, both of which offer very high margins. What should be apparent, however, is that even in highly competitive jurisdictions like the US and Europe, where firms have any number of exchanges from which to choose, high profitability is the order of the day.

In this article, we highlight a few emerging market exchanges, set out why we like them and briefly touch on how retail investing is impacting their business.

BRAZIL

The original São Paulo Stock Exchange was founded in 1890. Today, B3 is the result of the 2017 merger between BM&FBovespa (derivatives and equities) and Cetip (over-the-counter [OTC] derivatives, banking instruments, liens and loans), which created a multi-asset, vertically integrated exchange. B3 is the largest cash, equities, derivatives exchange and depositary company in Latin America. The services it offers range from exchange trading, clearing and other post-trade services. Also on offer is the registration of OTC transactions, such as those evidencing vehicle and real estate loans. B3 has become a stronger business post-merger due to three factors: 1) diversification, 2) economies of scale, and 3) reduced risk of competition. As the sole exchange in Brazil, B3 enjoys a monopoly position with high barriers to entry, leading to strong underlying returns on invested capital and much-better-than-average free cash flow generation.

The current B3 CEO, Gilson Finkelsztain, joined in 2017 from Cetip when the two companies merged. He had an excellent track record at Cetip, materially outperforming BM&FBovespa's revenue and earnings-per-share growth, while simultaneously taking the company from a net debt to a net cash position. Like all exchanges, B3 is a high fixed-cost business. Consequently, its margins are materially geared toward increasing volumes on the exchange, and B3 has undertaken to share the upside on increasing volumes with customers in the form of reduced pricing. By deliberately foregoing some pricing power, they have therefore made it more difficult to be disrupted.

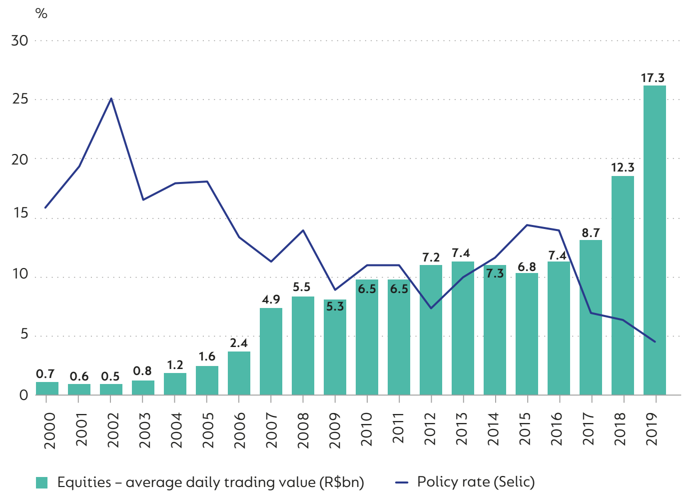
Brazil's capital markets offer significant growth potential. The country's ratio of stock market capitalisation to GDP is low while corporate leverage is at reasonable levels and should benefit from lower interest rates. Additionally, derivatives and securitisations are still in their early stages, and the proportion of equities and alternative investments in the retail and asset management industry is low.

A big historical disincentive for retail investors to be in the equity markets was the easy money that could be made in the fixed-interest market, due to Brazil's very high real interest rates. This was a throwback to the measures taken to tame inflation in 1994 after periods of on-off hyperinflation in the preceding decades. As interest rates have declined without an uptick in inflation, retail investors are being enticed into the capital markets and daily liquidity has improved (see Figure 2).

The improvement in equity market conditions has resulted in a virtuous cycle whereby more companies have come to market to raise equity, in spite of cheaper borrowing costs (see Figure 3).

Figure 2

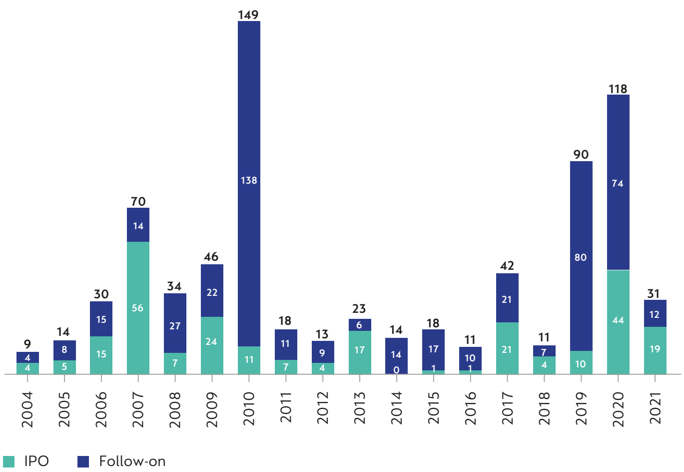
B3 ANNUAL VOLUMES VERSUS BRAZIL TARGET POLICY RATE (SELIC)



Sources: Company data, Brazil Central Bank

Figure 3

EQUITY OFFERINGS IN BRAZIL BY YEAR (%)



Source: BTG Pactual

MOSCOW EXCHANGE

The Moscow Exchange is the largest exchange in Russia and trades the full suite of products, including equities, bonds, foreign exchange, derivatives and commodities. The business has seen explosive growth in recent years for a number of reasons.

As with Brazil and other emerging markets, declining rates in Russia have led to a search for yield. Investors can no longer earn a decent yield by holding their assets in cash deposits at banking institutions, as rates in Russia have declined from a high of 17% in 2014 to just 4.5% today. The average bank deposit yields just 2.5%.

As a result, the country has seen a steady flow of assets from bank deposits to the markets, but this structural tailwind still has a long way to go. Russia's entire stock market capitalisation is RUB6 trillion ($78 billion), in contrast with bank deposits of RUB34 trillion ($444 billion).

Expressed as a percentage of GDP, which is the more meaningful metric, Russia's ratio of stock market capitalisation to GDP is only 5%, compared to over 100% in the US. Equity ownership is still extremely low in Russia, with most Russian investors holding a far greater weighting in bonds and other interest-bearing instruments relative to other countries (see Figure 4).

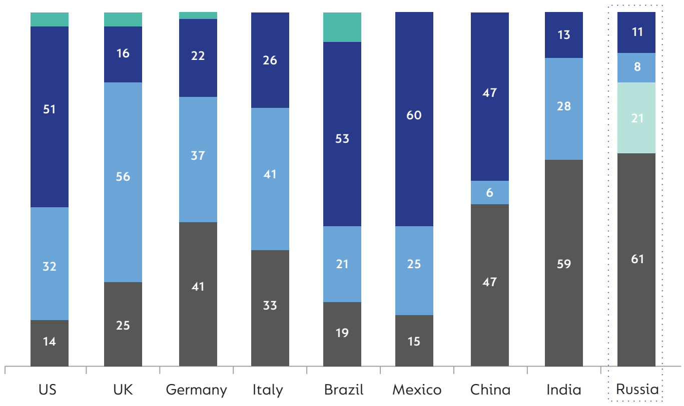
With retail trading accounts continuing to grow and rates forecast to rise by only another 50 basis points (bps), the trend of wealth flowing into equities is set to continue (see figures 5 and 6). Adding to the attraction are increased listings in Russia, with a number of companies previously only listed in London now choosing to list in Russia too. This includes the Tinkoff Group, and a number of recent IPOs in Russia, such as Fix Price and Ozon.

The market in Russia is still immature and, although the Moscow Exchange has the capability to trade a vast array of products, these products lack the critical mass to really take off and be meaningful.

We expect this to improve with time. Institutional ownership is also low, as there are few tax incentives to save in a regular manner for retirement. This may be more difficult to change, however, as asset manager fees are quite high and have not adjusted to compensate for the decline in available yields.

Figure 4

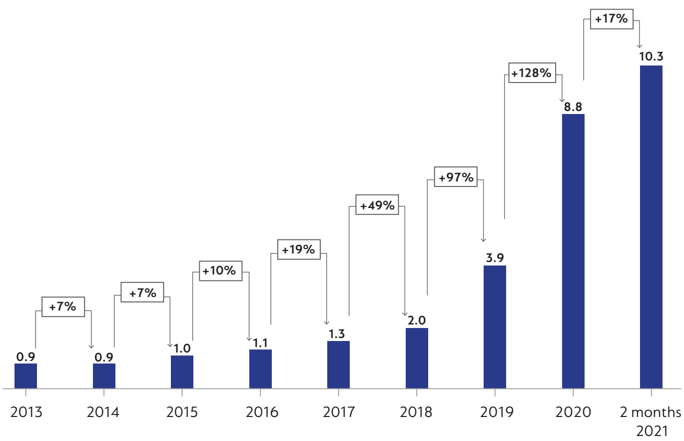
BREAKDOWN OF ASSET CLASS HELD BY COUNTRY (%)



Source: Moscow Exchange

Figure 5

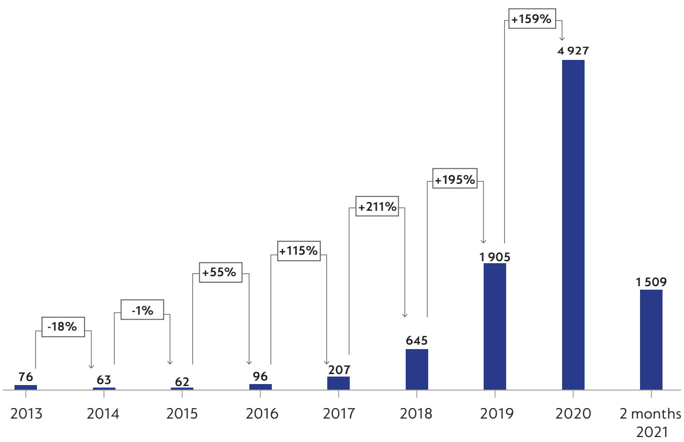
NUMBER OF UNIQUE RETAIL CLIENTS (MILLION)



Source: Moscow Exchange

Figure 6

NEW RETAIL CLIENTS (NET; '000s)



Source: Moscow Exchange

HONG KONG EXCHANGES

As with many other exchanges around the world, Hong Kong Exchanges (HKEX) has seen a significant increase in trading activity over the last six months. Average daily volume grew by 50% in 2020. And, in the first few months of 2021 to date, it is 119% higher than the comparable period in 2020. Although many of the drivers of this increase are common to other exchanges around the world, and are arguably cyclical in nature, Hong Kong benefits from structural growth and a few unique factors.

First, increased tension between China and the US, and the subsequent threat of the potential delisting of Chinese companies from US exchanges, has prompted many of these firms to seek a secondary listing in Hong Kong. This so-called 'homecoming' has bolstered Hong Kong's position as a listing venue. This is particularly prevalent with technology companies that originally listed in the US in search of higher valuations and to overcome restrictions on super-voting shares that were generally discouraged in Hong Kong. Over the past year, high-profile names, such as Alibaba, Netease and JD.com, have tapped Hong Kong for a secondary listing. While the bulk of the liquidity in these names is still concentrated in the US, the incremental impact on Hong Kong has been very positive. For example, these three stocks already comprise 14% of Hong Kong's total market capitalisation.

Secondly, greater demand for Hong Kong-listed stocks from Mainland China investors has led to a substantial increase in Southbound Stock Connect flows. Stock Connect is a mechanism by which Hong Kong enjoys mutual market access with Mainland China, enabling foreign investors to trade shares listed in Shanghai and Shenzhen, and Chinese investors to trade shares listed in Hong Kong.

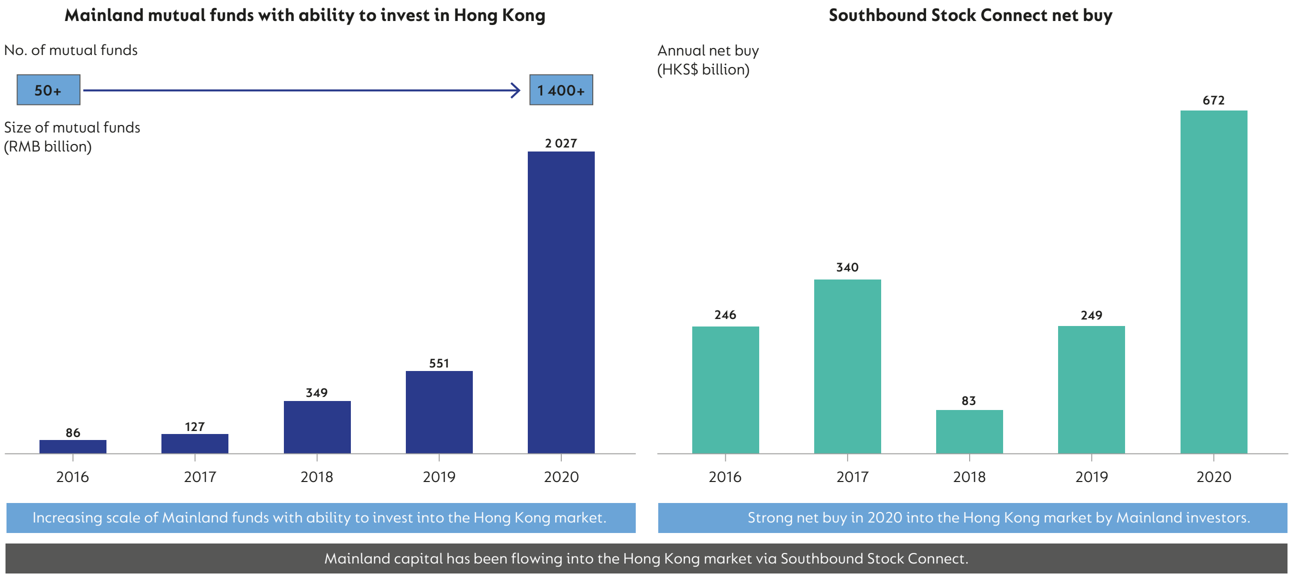
In our view, these flows represent structural rather than cyclical growth, as the number of Chinese mutual funds authorised to invest into Hong Kong has grown materially, seeing a fourfold increase between 2019 and 2020 (measured in assets under management). Southbound trading grew by 90% in 2020, and by close to 200% in the first few months of 2021, and now accounts for 30% of the volume traded in Hong Kong.

The financial impact on HKEX from the growth in Southbound trading is slightly less pronounced. Unlike in a domestic transaction, HKEX earns revenue on only one leg of the transaction (the Shanghai and Shenzhen exchanges earn revenue on the other side), and typically does not earn clearing revenue. Nevertheless, the flows and revenue from Stock Connect are entirely incremental to HKEX and a very attractive line of business. Like the other exchanges mentioned in this article, incremental revenue with little additional cost will tend to pass straight through to the bottom line, further bolstering profitability.

Tempering the good news, though, is the recent decision by the Hong Kong regulator to increase stamp duty on stock transactions from 10bps to 13bps, with higher transaction costs risking a

Figure 7

STRUCTURAL SHIFTS ATTRACTING SOUTHBOUND CAPITAL INTO HONG KONG



Sources: HKEX, WIND, CICC

reduction in demand for trading in Hong Kong. While this is a legitimate concern, we think it's unlikely to derail the underlying growth in the market. Hong Kong does not have a base of high-frequency algorithmic traders that would be much more sensitive to transaction costs.

MEXICO

In Mexico, Grupo BMV (Bolsa Mexicana de Valores) is the dominant securities exchange, hosting >85% of equity transactions. The company is the second-largest equities and derivatives exchange in Latin America, offering an integrated market for shares, derivatives and OTC fixed-income securities.

The equitisation story in Mexico is at an earlier stage than in some of the other emerging markets discussed here. There are only 500 000 retail stock trading accounts open, which are less than 1% of Mexico's population. In comparison, north of the border in the US, the recent equity craze among retail investors has boosted penetration to 50% of the population. Scarred by two serious financial crises in recent decades and due to low levels of GDP per capita, Mexico's financial system is substantially less developed than its northern neighbour.

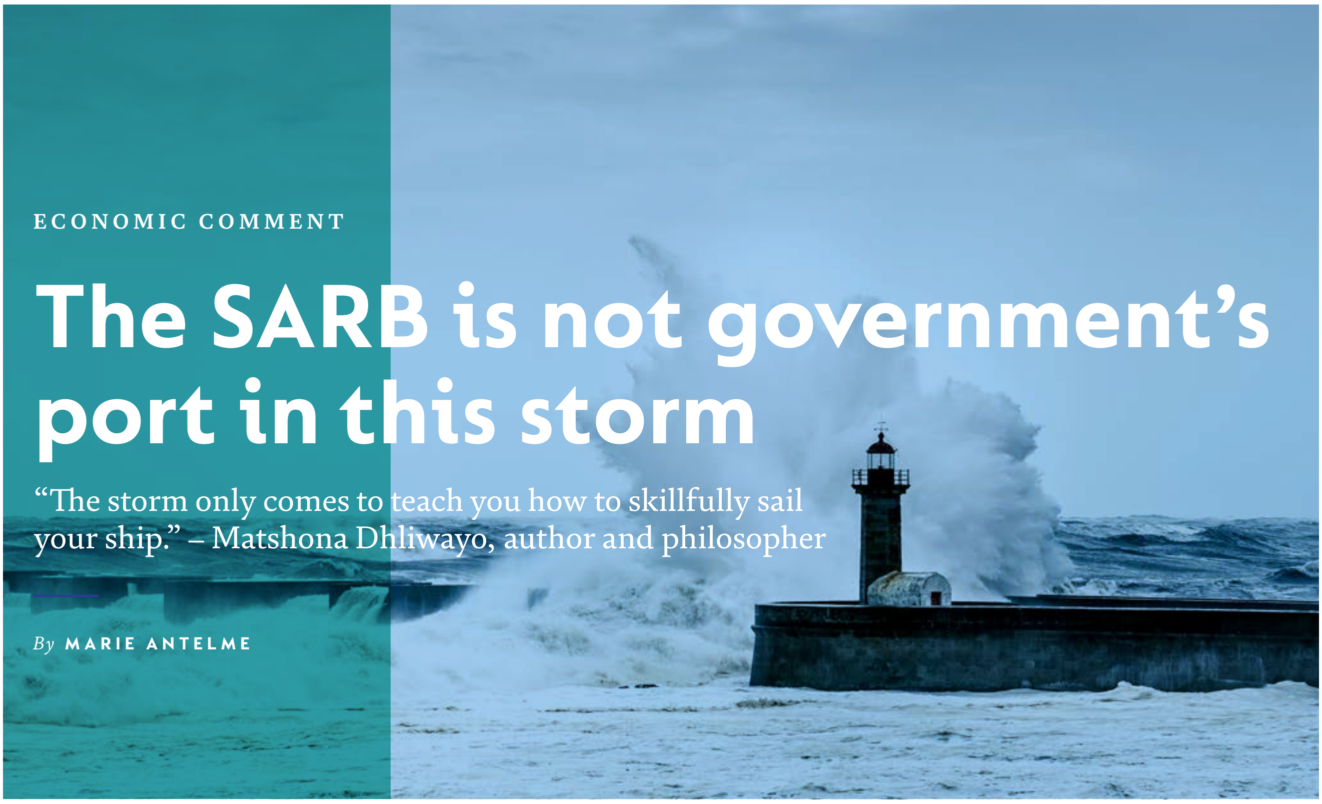
The country also lacks the types of strong innovating businesses, such as Robinhood in the US, XP in Brazil and TCS in Russia, that would foster retail investor education. However, in recent years, regulatory incentives and digitisation initiatives by banks have generated a growing trend of financial inclusion, which should promote greater retail investment participation. Grupo BMV is also promoting financial education in cooperation with high schools and universities. Currently, cash equities represent just 8% of the group's revenue mix, but their contribution has the potential to grow.

Meanwhile, the Mexican Congress recently passed a major overhaul of the country's pension system that, among other provisions, raises workers' total contributions from 6.5% to 15% of salary (with additional contributions mostly borne by employers). This is expected to raise assets held by pension funds (Afores) from 35% to 56% of GDP by 2040, which should benefit the domestic securities market. Grupo BMV will benefit on various fronts from this reform as it should support trading, clearing and custodial revenues, as well as assist capital raising by businesses over time.

Finally, like many other global peers, Grupo BMV is planning to grow sales generated from data sales. These have grown from 8% to 11% of the revenue mix in four years and management is investing further in the segment. Despite these long-term tailwinds, the market is concerned about the competitive intensity fueled by BIVA, a small challenger exchange launched in 2018, and potential regulation aimed at supporting a more competitive market.

CONCLUSION

The overall theme that should be apparent from the examples above is that the runway for long-term growth in equity markets in emerging markets is very promising. Financial systems have strong tailwinds driving higher participation in equity markets, and we expect these to persist for many years ahead. Where exchanges are trading at attractive valuations, we will invest in them selectively. ✚



ECONOMIC COMMENT

The SARB is not government's port in this storm

"The storm only comes to teach you how to skillfully sail your ship." – Matshona Dhliwayo, author and philosopher

By **MARIE ANTELME**

THE QUICK TAKE

- If unchanged, SA's government debt dynamics are unsustainable
- Stronger growth and more moderate debt service costs are needed to fix this situation
- Calls for the SARB to intervene could see lasting economic and institutional damage
- Global growth tailwinds, some local windfalls and a credible strategy could buy time to right the fiscal ship

Marie is an economist with 20 years' experience in financial markets.

IT IS WIDELY acknowledged that South Africa's fiscal position is precarious. Debt stock had more than doubled from a nadir of 26% of GDP in 2008 to 65.3% in 2019/2020. The Covid-19 crisis has pushed this to c.80%. The dynamics at play, including a now-large stock of debt, low rates of nominal growth, excessive expenditure relative to revenues and stubbornly high borrowing costs, mean that South Africa may not be able to contain the rise in debt and that the cost of servicing it will likely become overwhelming. There are active market debates about the ultimate risk of default. Assuming past trends remain unchecked, this is a very real risk.

THE SUM OF THE PARTS

Fiscal arithmetic shows that the rate at which a country accumulates debt is a function of the starting stock of debt, the nominal cost of debt relative to nominal GDP growth, and the government's primary balance, which measures non-interest expenditure allocation relative to revenue. When the starting stock of debt is low, the most important variable in stabilising debt is the primary balance.

Running surpluses here has a strong influence on debt accumulation. When the starting stock of debt is high, as it now is in South Africa, then the difference between the cost of that debt (interest) and the growth rate of GDP has the bigger influence (see the debt accumulation equation below[1]). If the cost of borrowing consistently outweighs the rate of GDP growth, deficits remain high as borrowing increases to meet the shortfall and service the debt (see Figure 1 overleaf). The influence on the stock of debt compounds, and is ultimately overpowering. In South Africa, this dynamic is already visible: debt service costs have been compounding at a rate of 12.6% over the past six years, while nominal growth has been compounding at 6.2% over the same period.

[1] $$\Delta d_t = d_{t-1} \cdot \left(\frac{i_t - g_t}{1+g_t}\right) - pb_t$$

The evolution of public debt is a function of three things: 1) the existing stock of debt (Dt: a result of past policy decisions); 2) the interplay between growth and debt service costs ((i – g) influenced by markets and past policy decisions); and 3) the primary balance (pb: directly influenced by policy decisions).

Source: JPMorgan

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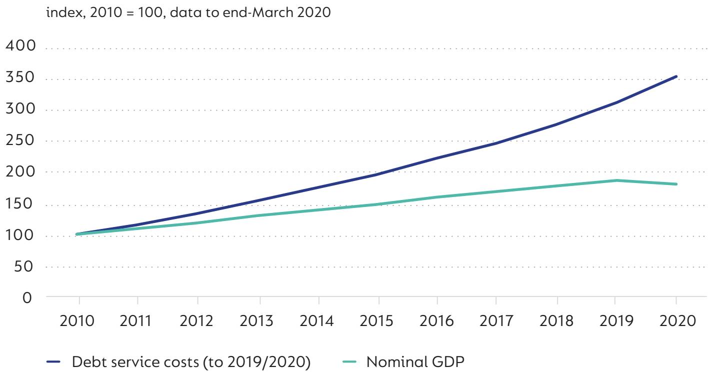
Figure 1

BORROWING COSTS AND NOMINAL GDP GROWTH



Source: National Treasury

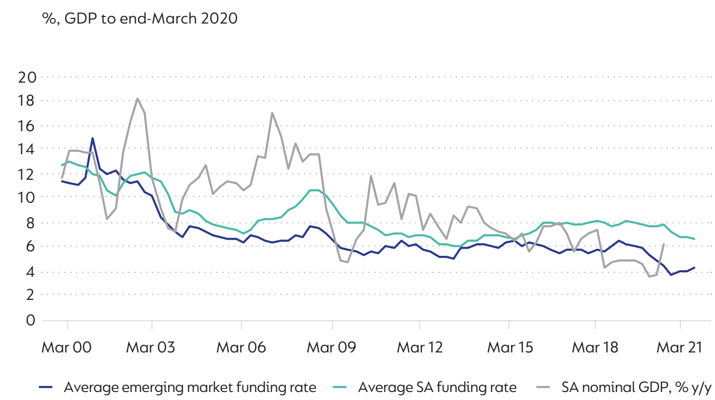
Part of the problem is that South Africa's fiscal position has been deteriorating for a long time. This isn't just a 'Covid-19' deficit and debt surge, as is the challenge in many other countries. Covid-19 just made things much worse. The drivers of fiscal deterioration come from policy choices and economic outcomes that started a decade ago. These include:

1. The deliberate expansion of government expenditure within GDP since 2007, notably on salaries and wages, education, health and security, and State-owned enterprises (SOEs).
2. An ongoing slowing in nominal growth (and revenues) since about that time, reflecting a range of factors, including the end of the global commodity boom, domestic capacity constraints (electricity), State capture and a collapse in investment – both public and private – falling productivity and a prolonged deterioration in confidence.

These combined dynamics led to persistent fiscal deficits and a relentless increase in debt stock since 2008; this was accompanied by an accelerated increase in debt service costs.

Figure 2

AVERAGE BORROWING COSTS: EMERGING MARKET BASKET VERSUS SA



Source: Emerging Advisors Group

VERY DIFFICULT TO TURN THE SHIP, BUT NOT IMPOSSIBLE

Rectifying the balance between nominal growth and borrowing costs is key to stabilising government's debt position. Firstly, it really is about growth. While scepticism is well justified based on past performance, on this front there have been some encouraging developments.

We are seeing a resurgence in global growth, trade and commodity prices. Against this backdrop, South Africa should enjoy some lingering effects from accelerating global growth, which has been the biggest driver of domestic growth for a long time[2]. As activity picks up in the second half of 2021, this potentially offers a considerable near-term lift for domestic export growth and in longer-term revenues.

There is also some evidence that the process of capacity destruction that was State capture has slowed. In part, this reflects the diligent efforts of those who have exposed the malfeasance at certain SOEs and the ensuing inquiries, and in part the fact that this process inhibits ongoing maladministration. Certainly, these issues have not been fully or effectively dealt with and the lingering cost is still with us, but the change should be less growth detractive, supporting rather than undermining confidence.

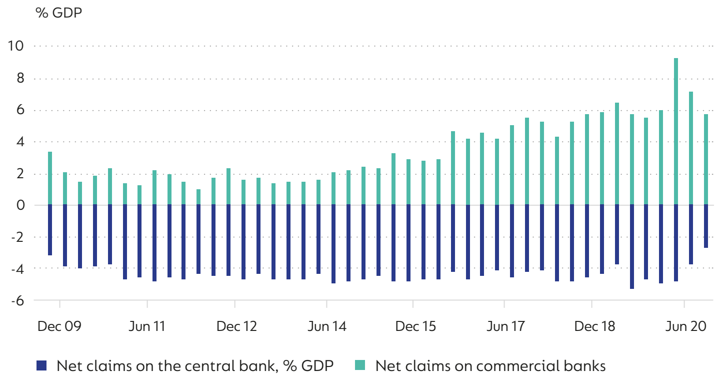
Growth and revenue outcomes have been better than expected (off a very weak forecast base), which improves the starting position. The South African Revenue Service announced a R38 billion tax overrun compared to the February Budget forecast, all equally implying a main budget deficit closer to -11% of GDP than the National Treasury's -12.3% forecast.

Fiscal consolidation – albeit slow, painful and still uncertain – is under way. Much hinges on the wage settlement for coming years and an associated legal process, but the intent signaled by last year's wage freeze and this year's commitment to future wage constraints is a significant break with past practice. There is more to be done, but it is a start. Despite these efforts, the cost of debt/growth dynamics remains under pressure, and South Africa's borrowing cost is higher than just about anywhere. Figure 2 illustrates that this has been the case for some time, in line with the deterioration in fiscal dynamics.

[2] Havermann, Roy and Edward Kerby, "Reigniting Economic Growth: Lessons from three centuries of data" ERSA Working Paper 854, 2020

Figure 3

FINANCIAL SYSTEM CLAIMS ON THE GOVERNMENT



Sources: South African Reserve Bank, Haver

NOT ALONE, YET VERY ALONE

The Covid-19 shock brought a step change to most governments' fiscal positions around the world. As the pandemic threatened lives and livelihoods, governments implemented unprecedented fiscal support to contain the social and economic fallout. A massive combination of tax, income, health and poverty support, coupled with a collapse in revenues, saw global government deficits balloon in 2020. The effects are expected to linger in coming years as policy support is withdrawn at a staggered pace, and large deficits will need to be funded.

Conventional financing options for such a large fiscal shock are limited. Governments usually have two basic ways in which to finance deficits: raising taxes, or borrowing and raising debt. However, given the sudden need for massive funding, a third, less conventional option has also become popular: central bank financing.

The official wording around these interventions is broadly consistent, although scope and design vary by country. With policy rates at or close to zero, the broad aim is for a central bank to use its balance sheet to increase demand for government debt to meet the increase in supply (and in some cases, other financial assets), providing funding, creating broader liquidity, lowering borrowing aggregate costs, and encouraging credit lending and growth.

Most developed economy central banks have implemented policies with these broad objectives. According to the IMF, 27 emerging market central banks (including South Africa) also implemented successful asset purchase programmes during 2020. Some of these interventions were short-lived, while others have been extended, facilitating lower funding costs – even for emerging markets that might be perceived as riskier credits due to high initial levels of debt and less conventional funding practices.

Unsurprisingly, there are ongoing calls for the South African Reserve Bank (SARB) to reinstate the asset purchase programme it used in mid-2020, hopefully to achieve the same effect. The SARB has provided relatively little financial support to the government through the crisis, and it seems reasonable that there is capacity to do more – especially given the successes seen elsewhere. Figure 3 shows that, while government has drawn down deposits with the central bank, the government still holds cash and other deposit buffers with the SARB.

However, it is deeply uncertain whether such an intervention could successfully and sustainably lower the cost of funding, and here's why – the countries where these programmes have achieved lower long-term interest rates share at least some common features:

1. The institutions involved are deemed credible by markets.
2. The related policies (monetary interventions and stepped-up fiscal support) are deemed to be finite. This is not seen as open-ended funding.
3. Prevailing inflation is low.
4. Generally, in emerging markets:
    a. the starting stock of debt is low, and governments are seen to have some fiscal headroom; and
    b. foreign positioning is relatively small, and the local (often State-owned) banking sector is a large owner of government debt.
5. Pre-crisis growth rates were relatively good (which means the ability to recover is implicit).

THE FACTS OF THE MATTER

What makes this challenging for South Africa is that we currently share only two of these requirements. We have low inflation and a credible central bank. As mentioned, the country's fiscal deterioration is not just a function of the impact of the pandemic; it is the accumulation of years of weak fiscal and economic performance, which means our starting position is fragile and fiscal credibility is poor. Rising yields reflect this long deterioration in sovereign risk.

This means that neither the government nor, presumably, the central bank, can commit to a 'finite' intervention – and the market knows it. Because of this, any intervention wouldn't look like a 'Covid-19 funding strategy'; it would more >

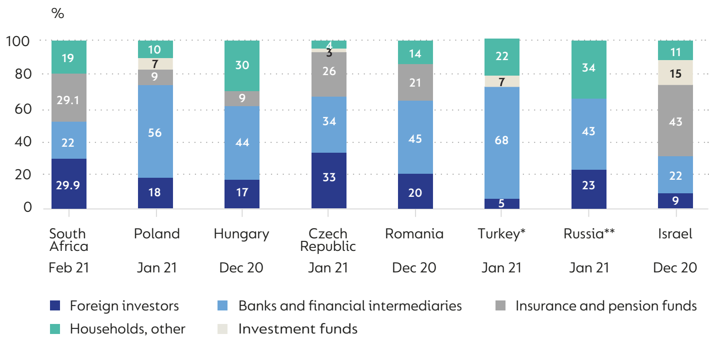
likely reflect a central bank that is funding infinite issuance by a government previously unable or unwilling to effectively manage expenditure. The SARB's important credibility would easily be lost.

As shown in Figure 4, with still-heavy foreign positioning (foreigners own 29.9% of marketable South African bonds), it seems likely that such action would cause foreign investors to divest and stay away, sharply weakening the currency.

This would severely limit future funding options and may even accelerate the political temptation to implement domestic regulatory changes which could require local funds to hold a greater proportion of government debt. The chart also shows that in other emerging markets, the often state-owned banking sectors play a larger role in funding the government.

Figure 4

OWNERSHIP DISTRIBUTION OF DOMESTIC MARKETABLE DEBT, EMERGING MARKET PEERS

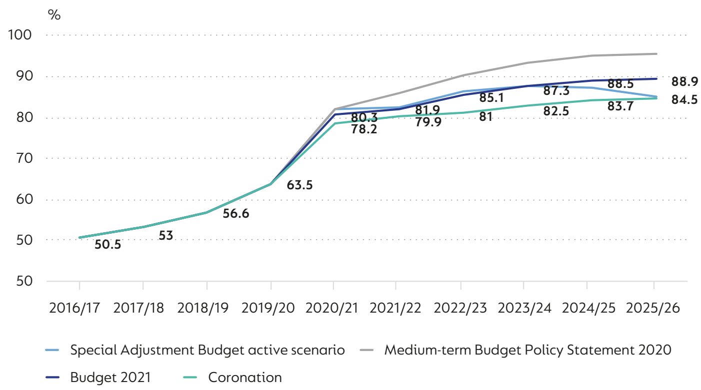


* Insurance and pension funds included in 'Households, other'
** Insurance and pension funds, investment funds included in 'Households, other'

Sources: Haver, JPMorgan

Figure 5

SOUTH AFRICA GROSS GOVERNMENT DEBT TO GDP



Sources: National Treasury, Coronation

This policy option is also unappealing from the SARB's perspective. Unlike many of the countries referenced here, policy rates in South Africa are not at a lower bound. At 3.5%, the SARB could cut further if it were deemed appropriate. With the market functioning normally – albeit at elevated yields – and the National Treasury on a comfortable cash cushion for now, there is little need to intervene to ensure financial stability – as it did in 2020.

Further, high yields are a reminder to the government of the cost of its profligacy, and the need to reform. Governor Lesetja Kganyago has said before that the SARB will not take responsibility for solving the problem of fiscal sustainability, and certainly not at the risk of its very hard-won credibility.

There are also other ways to help lower borrowing costs, including a more flexible funding strategy. Government has already lowered the average cost of borrowing in 2020 relative to the previous year (and despite spiking yields) by issuing more Treasury Bills closer to low policy rates and utilising low cost foreign loans.

This is not a feasible strategy for many emerging markets, but in South Africa's case, with a long period of prudent asset and liability management and the very long average maturity of its debt stock predominantly in local currency, it could implement this strategy comfortably for a limited period. The introduction of other financing instruments, with flexible rates and maturities that fall between the large bond issues, may also take pressure off the overall financing bill.

Until the underlying inhibitors to lower funding costs are decisively managed, investors will remain concerned about the sustainability of the fiscal position, and will price associated risk appropriately. It may well happen that markets lose faith in government's ability to service its debt in full and on time, and, in the event of a financial crisis, the SARB will have to step in.

But the only durable solution is a permanent consolidation of the deficit and a visible improvement in domestic growth outcomes. We are some way along in redirecting the ship. Growth and revenue performance for 2020/21 has been better than most expected. As shown in Figure 5, this raises the base and makes the starting position a little less onerous.

The year ahead should see strong nominal growth (possibly in excess of nominal funding costs), good revenue gains and a smaller deficit than the National Treasury is currently forecasting.

If some of this momentum is sustained, the debt trajectory will be lower, and shallower, than many expect. This is some comfort, but more needs to be done. The ship is not yet decisively on a new tack. +

BOND OUTLOOK

Economic recovery risks remain high

But SAGBs are still an attractive investment

By NISHAN MAHARAJ

THE QUICK TAKE

- Vaccines change the game, but are not a fix-all
- Economic growth hinges on public-private cooperation
- While risks abound, this is not the worst block to recovery we have seen
- SA government bonds remain attractive, given the current environment

Nishan is Head of Fixed Interest and has 17 years of investment experience.

PROGRESS IS RARELY made in a straight line and there are always bumps in the road, but ultimately, what matters is the direction you are heading in. It is now just over a year since the World Health Organisation declared Covid-19 to be a global pandemic and the world went into lockdown. The difference now, however, is that we have several viable vaccines that will help stave off serious infection, lessen the pressure on healthcare systems and, hopefully, return our lives to some version of normality. There are concerns that new variants might reduce the efficacy of vaccines; that the vaccines might not be rolled out expeditiously; and that second, third and fourth waves will delay the global recovery. Ultimately, there is light at the end of the tunnel, and it doesn't look like another train!

South Africa remains precariously placed in the global recovery due to its stretched public finances, a glacial pace of reform implementation and the leisurely rollout of its vaccination programme. Following a strong start to the year, South African government bonds (SAGBs) gave back a portion of their initial gains due to concerns that the large amount of global fiscal and monetary stimulus would stoke inflation, hence forcing a quicker normalisation in policy rates. The benchmark 10-year SAGB rallied to 8.75% by the beginning of February, but sold off by over 100 basis points (bps) by the end of the first quarter of 2021 (Q1-21), ending at 9.89%. This resulted in the All Bond Index (ALBI) returning -1.7% over the quarter, which was anchored by the underperformance of the 7- to 12-year area of the curve.

SAGB yield movements were not dissimilar to the experience in many emerging markets around the world, as a reaction to a c.80bps selloff in US 10-year yields. Conversely, South African inflation-linked bonds (ILBs) produced a return of 4.6% in Q1-21 as real yields held onto their gains since the beginning of this year. Due to March 2020 being the peak of the Covid-19 crisis in financial markets, the one-year performance of SAGBs and ILBs looks spectacular, at 17% and 16.7%, respectively.

>

RISKS PROLIFERATE; REMAIN HIGH

South Africa's Budget speech in February was an important marker on the country's recovery path. Following better-than-expected tax revenue receipts, the National Treasury presented a picture of public finances that was much better than the October 2020 Medium-Term Budget Policy Statement, but still not indicative of debt stabilisation. It was very encouraging that the tax windfall was not used to increase expenditure in other areas, but instead used to reduce the borrowing requirement over the forecast period. This resulted in a reduction in weekly nominal fixed rate issuance by c.30%, which was welcomed by markets and resulted in the relative outperformance of the 12-year+ area of the curve. However, implementation risk remains high as all the expenditure consolidation is focused on a three-year public sector wage freeze, which has already been rejected by public sector unions.

In addition, State-owned enterprises (SOEs) and local municipalities are a further risk to expenditure, given their poor health going into the Covid-19 crisis. Long-term austerity is not palatable in South Africa given the size of the expenditure adjustment needed to right the ship. To keep from sinking, South Africa needs to increase its potential growth rate by accelerating its reform process and bringing in the private sector.

There are early signs that the private sector is starting to contribute to investment, but for this to be sustained, policy needs to be transparent and stable. It is also essential that previous perpetrators of corruption are brought to justice to show that there are real consequences for malfeasance. Unfortunately, given the country's poor track record, investor confidence remains depressed, which is abundantly reflected in the elevated level of bond yields and the steepness of the yield curve.

INFLATION IS THE KEY NEEDLE IN THE DIAL

The positive showing in the February Budget should have resulted in an extensive rally and flattening in the South African bond curve. However, due to the selloff in global rates, this was cut short and reversed. In January 2021, short-term inflation expectations in the US, as reflected by market-implied breakeven inflation expectations (the difference between US nominal and ILB yields), moved materially above 2%, peaking at 4% for one-year forward inflation and 2.5% for five-year forward inflation.

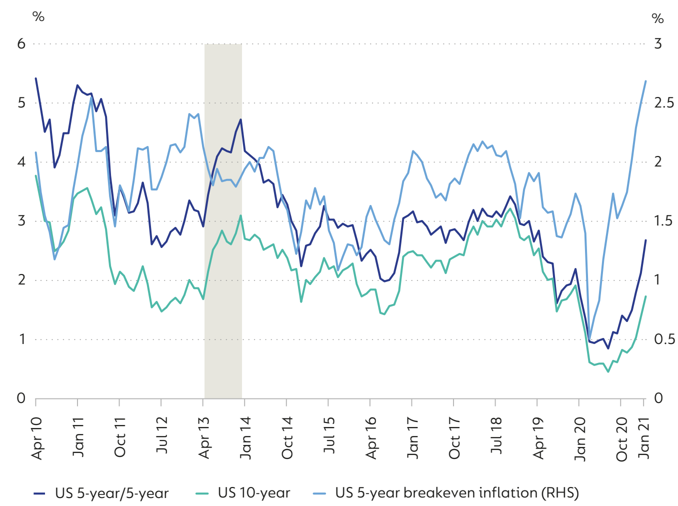
Now, across all maturities, this sits at around 2.3% to 2.5%, which means that the market expects inflation in the US to average above the 2% average inflation target set by the Federal Reserve Board (the Fed). This change in inflation expectations was driven by the Fed's change to average inflation targeting (rather than aiming to keep it at a target point); the unprecedented level of monetary policy stimulus (zero base rates and the bond-buying programme); and increased fiscal stimulus (approval of the Biden $1.9 trillion support package and the proposal for a further $2.2 trillion infrastructure spending package). The question facing investors is whether this repricing is sufficient and if emerging markets can stomach these higher levels of US rates.

During 2013, financial markets experienced a similar magnitude of re-pricing in global bond yields, which propelled emerging market and South African bond yields materially higher. The reason for this was that, fundamentally, emerging markets and South Africa were much more vulnerable to capital and portfolio flows, given their large external funding requirements (reflected by the current account deficit), foreign ownership/involvement in local emerging economy bond markets was high, inflation was uncomfortably high, and valuations were full, if not expensive.

The shaded area in Figure 1 denotes the 2013 taper tantrum that started in March of that year when the then-Fed chairman, Ben Bernanke, first signaled the intent to start the tapering of asset purchases. At the time, inflation expectations were around 2%, which was the Fed's target. US 10-year yields sold off 120bps and US five-year rates in five-years' time (5y5y yields – a proxy for forward expectations of interest rates) rose 150bps. Since January of this year, US 10-year yields have sold off 80bps, 5y5y yields have risen 110bps and inflation expectations have gone up 50bps.

Figure 1

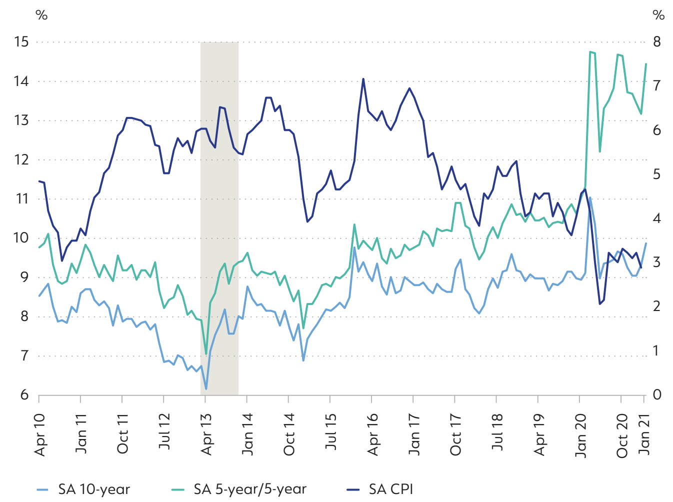
US RATES AND INFLATION EXPECTATIONS



Sources: Bloomberg, Coronation

Figure 2

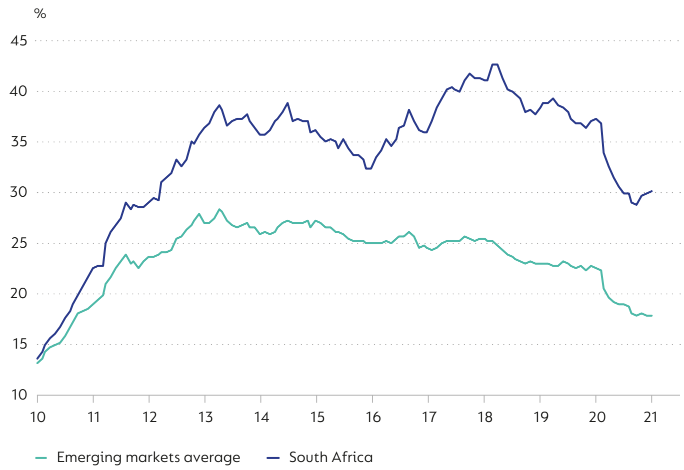
SA RATES AND ACTUAL INFLATION



Sources: Bloomberg, Coronation

Figure 3

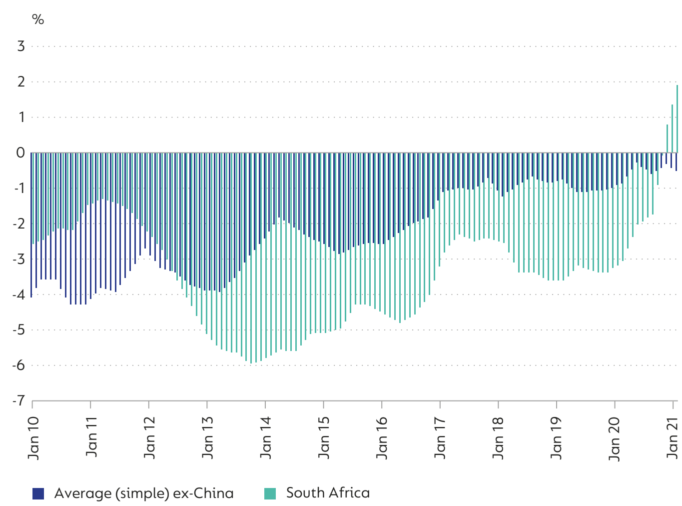
FOREIGN OWNERSHIP OF SA AND EMERGING MARKET BOND MARKETS



Sources: Bloomberg, Coronation

Figure 4

EMERGING MARKETS AND SA CURRENT ACCOUNT



Sources: Bloomberg, Coronation

This recent move has come despite the Fed recommitting to keep rates at zero until 2024 and to make no move on the tapering of bond purchases. The Fed's commitment to keep rates at zero and average inflation around 2% means that current expectations that are priced into the market are fair. The US 5y5y currently trades at 2.6%, which implies that if real policy rates in the US are kept between 0% and 0.5%, average inflation in the US will be 2% to 2.1%, which is in line with the Fed's current mandate.

In South Africa, during the last taper tantrum, yields were materially lower (6.8% in the 10-year area as of March 2013), the yield curve was relatively flat (5y5y rates were trading 100bps above the 10-year area) and local inflation was already at 6%. This time around, yields are close to 10%, the curve is materially steeper (5y5y rates are 400bps above the 10-year) and inflation is at 3% (see Figure 2). In addition to this, South Africa's current account is in surplus (against a 6% deficit in 2013) and foreign ownership of the local bond market is sub-30% (versus above 40% in 2013) – see figures 3 and 4. This suggests that not only are valuations materially more attractive, providing a larger buffer, but also that the need for external funding of the deficits is much lower.

NAVIGATING CHOPPY WATERS

The conclusion from this analysis is that South Africa is specifically much better placed from an economic cycle and valuation perspective compared to the 2013 taper tantrum. US rates have had a significant re-price, and although the absolute level of 10-year rates remains quite low, the forward-looking expectations built into those rates suggest that (barring any surprise shocks) they are adequately priced. SAGBs still trade relatively cheaply, given that they still trade at multiples of cash and are among the highest yields in the emerging markets universe (both from a real and nominal perspective). The yield curve remains steep and their embedded risk premium remains high, due to the underlying fiscal risks. Although fiscal risks remain elevated, recent policy actions by the National Treasury and government have managed to buy us more time to right the ship, which makes the yields on offer even more ripe.

ILBs provide diversity to a portfolio, given their low long-term correlation to nominal bonds (c.50%), and offer protection against higher-than-expected inflation, given that their outstanding principal grows in line with inflation. In Figure 5 overleaf, we show various maturities of ILBs, together with their real yields, what the equivalent nominal yield is at 5% inflation, what the equivalent nominal bond of the same maturity trades at, and the breakeven to cash. Despite the longer maturity of ILBs trading at high real yields, these yields are not attractive >

compared to fixed-rate nominal bonds and have a low breakeven to cash because of their high modified duration (capital placed at risk to interest rate movements), making them an unattractive investment. However, the short-dated ILB (four years) provides an attractive opportunity, given its greater than 100bps yield pick-up relative to its equivalent nominal bond and, hence, its higher breakeven to cash. We view this as an attractive opportunity to invest in an instrument that provides diversity and an attractive yield pick-up.

Credit spreads (Figure 6) in South Africa are back to levels seen pre-Covid-19. This suggests that credit fundamentals are as sound, if not better, post the pandemic fall-out. Unfortunately, this is not the case and the contraction we have seen recently in credit spreads just mimics the global phenomenon of credit spread compression. Global corporate issuance levels are higher than they have ever been, but any yield pick-up is being swallowed up since government bond yields are at zero and central banks are even buying corporate bonds in the secondary market. Locally, the situation is very different, as government bond yields remain elevated (above corporate bonds even), there is no buying of corporate bonds by the central bank and net issuance of corporate debt is declining as companies have pulled back on new investment activities. This reduced net issuance, combined with the large amount of liquidity, is the major reason for the compression of credit spreads. Underlying fundamentals remain negative, as bank credit loss ratios (Figure 7) are elevated, suggesting underlying stress in lending books and, hence, corporate South Africa. As bottom-up, valuation-driven investors, we do not believe that the current levels of credit spreads offer sufficient compensation for the underlying risk and we would avoid corporate exposure at current spread levels.

FINDING THE BALANCE

South Africa remains in a delicate balancing act. In the short term, inflation will remain under control and growth will pick up, supporting a cyclically better economic outcome. However, the fiscal accounts are problematic, given the high levels of debt. While the cyclically better economic outcomes have provided some breathing room, there needs to be an acceleration in growth-enhancing reforms, more emphasis on reviving private sector confidence to encourage investment and no deviation from current expenditure plans. The recent move higher in developed market bond yields has sparked concerns about a replay of the 2013 taper tantrum; however, South African bond valuations are much more generous now, with a much-reduced external funding requirement.

We view SAGBs as an attractive investment opportunity and would still advocate an overweight position relative to benchmark for a bond fund. In addition, we would also allocate to four-year ILBs and steer clear of corporate credit spreads at current levels. +

Figure 5

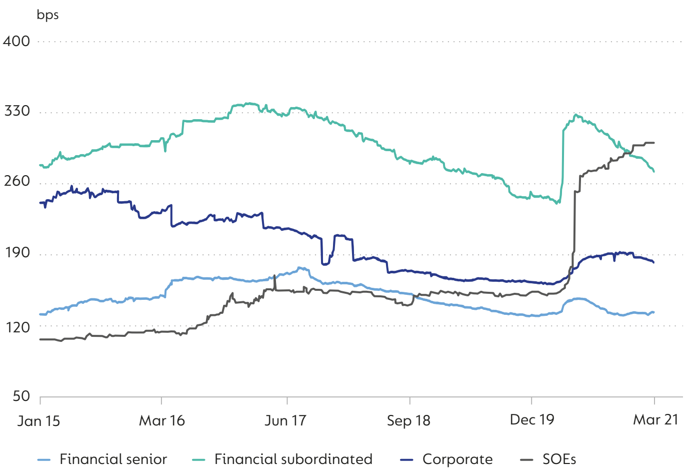
INFLATION-LINKED BOND BREAKEVEN RATES

	Real yield	Nominal yield @ 5% inflation	Equivalent nominal bond yield	Breakeven to 5.5% cash
4-year ILB	2.39%	7.51%	6.33%	55bps
8-year ILB	3.47%	8.64%	8.90%	43bps
17-year ILB	4.29%	9.50%	11.21%	30bps
25-year ILB	4.32%	9.54%	11.27%	24bps

Sources: Bloomberg, Coronation

Figure 6

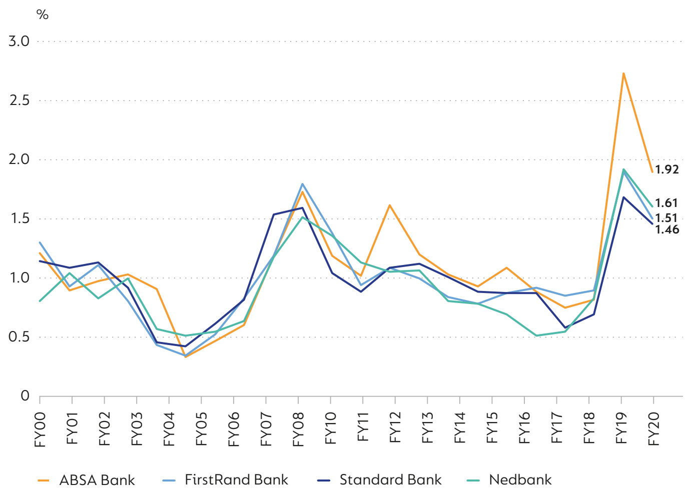
FLOATING RATE CREDIT SPREADS



Sources: Coronation, Standard Bank and Bloomberg

Figure 7

CREDIT LOSS RATIO



Sources: Coronation, Standard Bank and Bloomberg

INSIGHTS

IFRS 16: Applying our proprietary research

New accounting standard adds complexity, but also presents a competitive advantage

By **GODWILL CHAHWAHWA**

THE QUICK TAKE

IFRS 16 aims to bring accounting comparability between companies that choose to lease assets and those that opt to borrow and buy their assets.

The Standard introduces complexity and significant judgement in the determination of the lease liabilities and right-of-use assets. This can impact reported earnings materially.

This complexity provides a competitive advantage to those investors for whom detailed financial analysis is an integral component of the valuation process.

Godwill is an investment analyst with 16 years' investment experience.

WHAT IS IFRS 16?

International Financial Reporting Standard (IRFS) 16 is an accounting standard that came into effect from 1 January 2019 and sets out the principles for the recognition, measurement, presentation and disclosure of leases. It replaces International Accounting Standard (IAS) 17 under which leases were categorised based on whether the lease substantially transferred all the risks and rewards incidental to ownership (i.e. finance lease) or did not (i.e. operating lease). The accounting treatment of operating leases differed significantly from that of finance leases, with operating leases only bringing in an operating lease charge through the income statement, while finance leases required the inclusion of both the assets acquired and the liabilities incurred on the balance sheet.

IFRS 16 harmonises the accounting treatment of all leases[1] by removing the differentiation between operating and finance leases. The Standard requires that for all leases, a right-of-use asset and a corresponding lease liability are raised on the lessee's balance sheet at lease inception, and that subsequent to this, a depreciation charge on the right-of-use asset and an interest expense on the lease liability are recognised annually through the income statement. Figures 1 and 2 overleaf summarise the differences in accounting treatment for leases under IAS 17 and IFRS 16 for a sample 10-year lease, escalating at 6% p.a.

WHY THE NEED FOR IFRS 16?

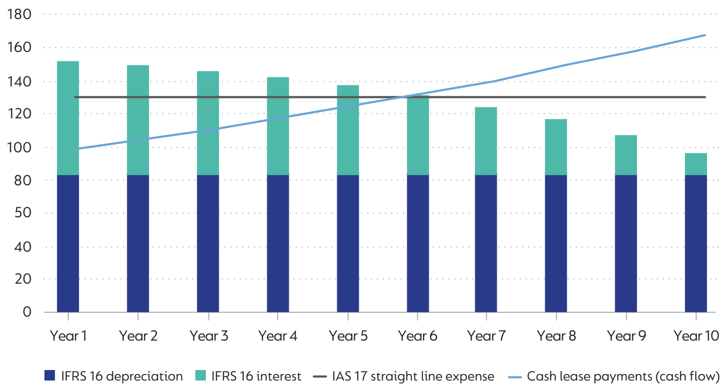
Under IAS 17, an airline (A) opting to purchase its aeroplane fleet would reflect a large balance sheet incorporating the acquired aeroplanes as assets as well as the debt incurred to pay for them as a liability. If a second airline (B) opted to lease their aeroplanes, its balance sheet would not reflect either the asset or liability associated with its aeroplane commitments, but would simply show the annual lease charge in its income statement.

This gave rise to significant off-balance sheet liabilities for airline B, which made direct comparability of these two airlines' financial reports very difficult. Often, the analysis of asset-heavy companies required an estimation of these liabilities using the >

[1] IFRS 16 excludes leases of biological assets (agriculture), leases to explore mineral resources, service concession arrangements, licences of intellectual property, and lessee rights under licensing agreements for intangible items like films, patents and copyrights.

Figure 1

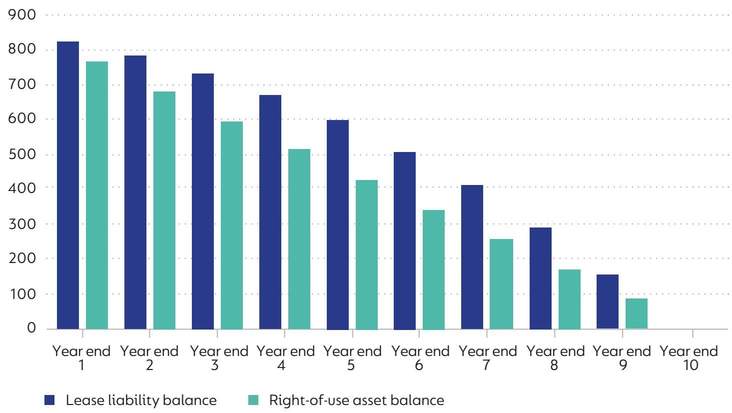
IFRS 16 INCOME STATEMENT EXPENSES



Source: Coronation

Figure 2

IFRS 16 BALANCE SHEET IMPACT



Source: Coronation

additional disclosure notes to the financial statements to adjust their balance sheets and derive a more comprehensive view of their underlying leverage.

IFRS 16 tries to address these challenges by bringing onto the balance sheet the right-of-use asset associated with the leased assets, as well as capitalising the obligation to make lease payments into a lease liability. While the Standard is applicable to all organisations with leases, it is most relevant for asset-heavy industries like airlines, shipping and transport, where the underlying leased/owned assets are the main drivers of the business model and earnings.

Unfortunately, there are some unintended consequences arising from the Standard. We believe it misrepresents the financial position of asset-light business models and can distort the earnings bases of some (but not all) companies. The retail sector, while traditionally an asset-light model, tends to have significant exposure to property leases and is therefore also materially impacted by the new Standard.

WHAT ARE THE MAIN CONSIDERATIONS WHEN APPROACHING IFRS 16?

Complexity. The Standard introduces significant complexity for both the compilers and users of financial statements. For companies drafting financials, all contracts that qualify as leases have to be identified; then all the detailed information on all their leases (the lease term, expiry, renewal/termination options, escalations, implied interest rate and so on – think of a retailer with >2 000 stores) has to be collated as inputs that are used to derive the present value of lease liabilities and right-of-use assets.

Each lease is assessed for impairment annually and an adjustment is made to the right-of-use asset. In an effort to reduce this operational complexity, the Standard allows for the exclusion of low-value (<$5 000) and short-term (<12 months) leases.

From an investor perspective, the complexity comes in understanding the impact of IFRS 16 on the reported financial statements over the lifespan of a business. To contextualise this, Figure 3 overleaf shows the differences between the IFRS 16 total charges (depreciation + interest) and an IAS 17 straight-line lease expense for a business made up of a portfolio of 10-year leases during three phases, namely rapid growth, stable and declining.

Our observations include the following:

- *IFRS 16 increases the divergence of the total income statement charge (depreciation + interest) from actual cash lease payments made, particularly at the start and end of a lease*. This has important implications for our assessment of the quality of earnings reported by a company. A company whose reported earnings closely mirror cash generated is of higher quality and better able to support dividends and capital expenditure than one where cash generated is significantly lower than reported earnings.

- *The maturity of the lease portfolio determines the extent of IFRS 16's impact on income statements.* A business at the early points of its lease profile will suffer a more significant hit to earnings as a result of the much higher IFRS 16 charges than one that is either closer to the middle (where IFRS 16 charges closely resemble cash lease payments) or at the end (where IFRS 16 lease charges are lower than cash lease payments made).

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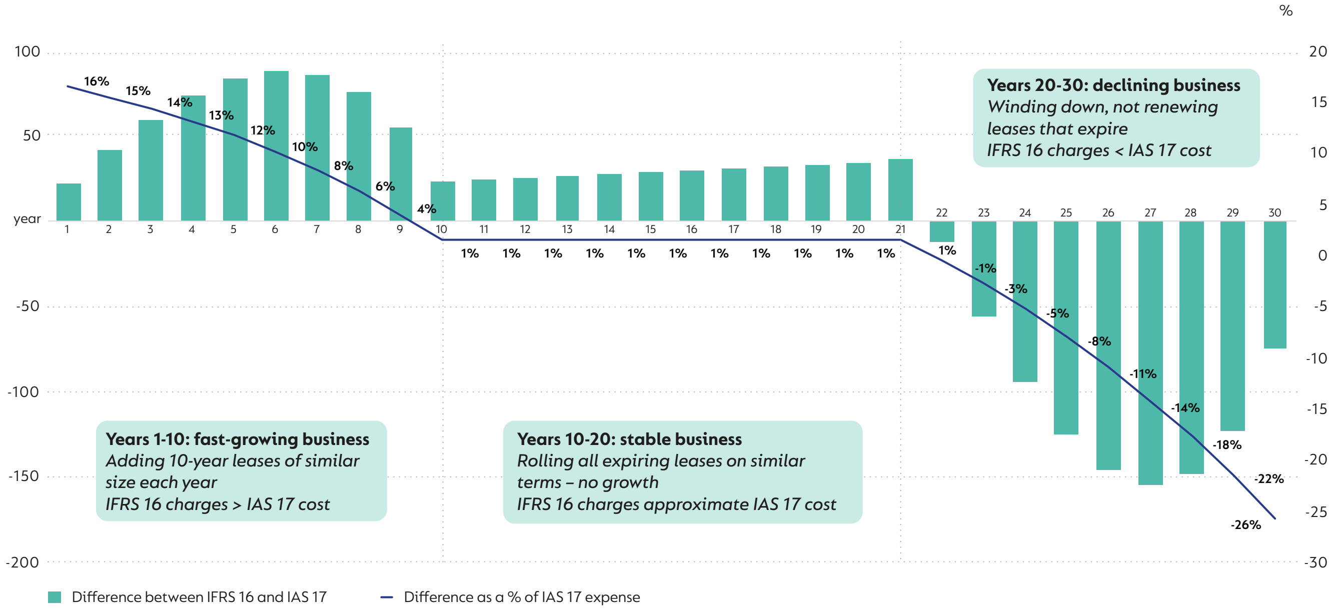
Figure 3

IFRS 16 VERSUS IAS 17 EXPENSES FOR GROWING, STABLE AND DECLINING BUSINESSES



Source: Coronation

- *A company's growth rate in the lease portfolio influences IFRS 16's impact on earnings*. For example, a retailer showing strong space growth will have more of its property lease portfolio in the early stages of the leases and will therefore incur a higher IFRS 16 total expense relative to cash operating lease charges. The opposite is true for a retailer that is in the process of shrinking its space. This can result in financials showing a growing business with declining earnings and a shrinking business with increasing earnings.

- *The lease term is an important driver for IFRS 16 liabilities*. Companies with very long lease profiles will incur a larger IFRS 16 lease liability at inception. The divergence between IFRS 16 and cash lease payments will be larger and will have a greater negative impact on reported earnings, particularly early in the lease term. A company motivated to show strong near-term earnings growth may, therefore, enter into shorter-term leases, even when this may be commercially detrimental to the long-term prospects of the business.

- *Renewal assumptions are an important input into the calculation of lease liabilities*. This is an important area of judgement by management teams that can significantly impact the quantum of lease liabilities recognised. A company taking a conservative view on lease renewals by bringing all likely renewals into account will show higher lease liabilities, and vice versa.

- *Any impairment of the right-of-use asset will drive a lower right-of-use asset depreciation charge going forward*. This would result in a higher level of reported operating earnings in future years than would otherwise have been reported.

- *Variable/turnover leases*. Where a lease has a variable component that cannot be determined in advance, the variable costs associated with the lease are excluded from the IFRS 16 calculations and expensed directly to the income statement each year. Globally, retail rents are moving in varying degrees from fixed to variable rents (for example, turnover and footfall) due to the pressure that physical retail is experiencing from the move to online retail. An increasingly larger part of these leases will therefore be excluded from the IFRS 16 calculation over time.

- *Impact*. IFRS 16 has a greater impact on companies operating in a high inflation environment relative to those operating in a low inflation environment.

THE IMPACT ON FINANCIAL RATIOS

It is therefore clear that IFRS 16 income statement expenses can vary materially from the underlying cash lease payments and this has the potential to distort reported earnings relative to underlying cash flows. When it comes to presentation and disclosure in the financial statements, IFRS 16 introduces significant changes to financial ratios >

Figure 4

IFRS 16 IMPACT ON FINANCIAL RATIOS

Accounting measure	Direction of change	Drivers of the change
EBITDA*	↑	Removal of the operating lease charge
Depreciation charge	↑	Inclusion of the right-of-use asset depreciation
EBIT	↑	Right-of-use asset depreciation < operating lease charge
Interest expense	↑	Inclusion of the lease liability interest cost
Profit before tax/profit after tax	↓	IFRS 16 depreciation + interest > operating lease charge (IAS 17)
Net asset value	↓	Right-of-use asset often less than liability due to amortisation methods
Net debt	↑	Inclusion of the lease liabilities
Cash flow statement (net)	↔	Net cash generated remains unchanged; disclosures change as below
> Operating cash flows	↑	Only the interest component of the lease charge is included
> Financing cash flows	↑	The capital portion of the lease charge is included

■ Negative impact on cash flow statement/balance sheet/cash flows ■ Positive

* Earnings before interest, taxes, depreciation and amortisation

Source: Coronation

– an important consideration when reviewing the long-term performance of a business.

Figure 4 summarises some key ratios and how they would be impacted. It is instructive to note that while the cash flow statement disclosure requires the cash lease payments to be split between the interest component (disclosed under operating cash flows) and the capital portion (disclosed under financing cash flows), the underlying cash generated by the business remains unchanged.

HOW DO WE, AS INVESTORS, RESPOND TO THIS COMPLEXITY?

IFRS 16 harmonises the accounting treatment of leases. It successfully brings on balance sheet those lease liabilities that otherwise would have clouded the comparability between companies in similar industries taking different decisions to either acquire or lease their assets, a situation most relevant for asset-heavy business models.

The Standard brings meaningful complexity and has the potential to materially distort the earnings base for some companies. We do not think that the market is making the necessary adjustments to IFRS 16 earnings to get back to cash rentals, a number that more correctly reflects the annual cost of the underlying leases (particularly in a higher inflation country). We make this adjustment for every company where the impact is material. At Coronation, we embrace complexities such as these as part of our culture of deep proprietary research to identify mispriced opportunities. +

INVESTMENT ANALYSIS

Zimbabwe and the investment case for Zimplats

"Your perception may not be my reality." – Aporva Kala, author and philosopher

By **FLORIS STEENKAMP**

THE QUICK TAKE

- Business confidence in Zimbabwe is at its highest level in years
- Improving currency stability is at the heart of this nascent recovery
- The challenge is to alter perception anchored in a very bleak recent history
- Zimplats is a world-class miner with considerable upside

Floris is an investment analyst with six years of investment industry experience.

SHARE PRICES IN Zimbabwe doubled in the first three months of 2021. Historically, strong share price performances in Zimbabwe have been a negative sign, usually driven by investors buying equities as a store of value when there were serious currency concerns. For the first time in years, we believe that this performance is, instead, largely driven by fundamentals.

The country, once known as the Breadbasket of Africa, became the textbook example of how economic and political policies can ruin an economy. The general perception is that of a country where money printing and hyperinflation is the norm, where indigenisation destroyed property rights and where foreign investors never get their money back. In summary, the perception is that Zimbabwe is uninvestable.

Over the past few months, we have spent a lot of time talking to businesses in Zimbabwe. These conversations highlighted the gap between perception and reality. Firstly, they emphasised how Zimbabwe has completely disappeared off the radar of international investors. Many companies mentioned that no other investors had spoken to them recently – some had not spoken to investors in almost two years.

Secondly, there have been dramatic changes in the country over the past year. While we are not saying that the issues in Zimbabwe have been resolved, we think that people underestimate the significance of these developments and we suspect that the international investment community is completely unaware that management teams in Zimbabwe are the most upbeat they've been in years.

The currency situation saw the biggest improvement. In June 2020, a weekly foreign exchange auction was introduced, and the difficult decision was taken to allow the currency to devalue to a level that more closely (although not completely) reflects demand and supply dynamics. Figure 1 overleaf shows that the official and parallel rates stabilised, the gap between the two rates narrowed and it is our understanding that transaction volumes in the parallel market had declined meaningfully.

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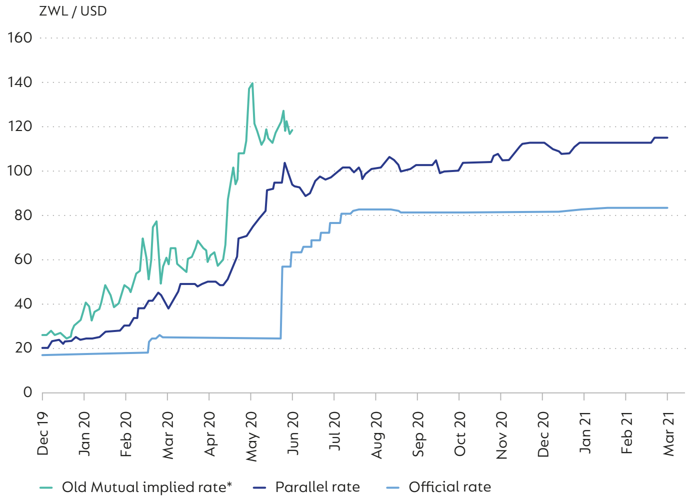
Figure 1

ZIMBABWE EXCHANGE RATES (SINCE JAN 2020)



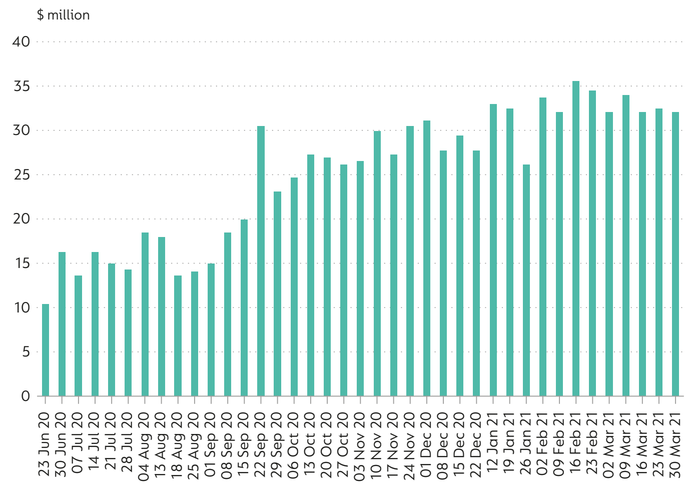
* The exchange rate implied by comparing the Old Mutual share price on the London and Zimbabwe stock exchanges.

Sources: Bloomberg, Coronation estimates

The new system was initially met with scepticism and criticism when the auctions coincided with the suspension of dual-listed shares. Businesses were allowed the freedom to trade in US dollars, but a portion of these dollars had to be converted to local currency. However, investor confidence in the currency prior to the auctions was very low, and a concerted effort was required. Thus far, this has been more successful than what we could have hoped for. Figure 2 shows that volumes continued to improve over the past nine months, with over $1 billion traded since the auctions began – a quantum that was unimaginable a year ago. Transparency has improved, with the Reserve Bank disclosing the highest and lowest accepted bids and, more recently, even publishing a list of 788 entities that were allocated more than $100 000 since the auctions started.

Figure 2

VALUE TRADED IN MAIN AUCTIONS



Source: Zimbabwe Reserve Bank

A SUPPORTIVE ENVIRONMENT

Liquidity is the best we have seen in years. We regularly receive US dollars from the auctions and have received even larger amounts from the interbank market. Over the past year, foreign investors found it much easier to repatriate funds from Zimbabwe than to repatriate money from Nigeria. However, liquidity is still low, and this is still far from being a free-floating currency. Therefore, we continue to apply a liquidity discount in our funds – valuing the shares listed in Zimbabwe at levels well below the official prices. If we valued these assets at the quoted prices, the net asset value of the Coronation Africa Frontiers Fund would have been almost 7% higher at the end of March 2021. We strongly believe that our current approach protects the interests of both new and existing clients, and, should the liquidity situation continue to improve, we will reconsider this discount and realise some of this latent value for investors in the Fund.

The stability of the currency has brought stability to the economy. Month-on-month inflation has dropped to low single digits and it has suddenly become much easier for businesses to plan. For the first time in years, companies in Zimbabwe are telling us that they are confident enough to start investing and expand capacity.

Our recent meeting with Zimbabwe's Minister of Finance highlighted that the country has become much more investor friendly. It was also clear that the positive developments we are seeing today are the result of a plan that was started three years ago. Zimbabwe is on track to run a current account surplus for the third year in a row and they have started to repay small amounts to international lenders – the first step in restoring Zimbabwe's ability to access international funding.

The government is showing a lot of discipline in resisting the temptation to print large amounts of money and in addressing the fuel and maize subsidies. The benefit of removing the fuel subsidy was not just the saving on each litre of fuel consumed, but also a large reduction in the total fuel consumed as market-related prices stopped cross-border smuggling, where people bought fuel cheaply in Zimbabwe and sold it at higher prices in neighbouring countries.

Even some factors outside of Zimbabwe's control turned from headwinds into tailwinds. Prices of key exports such as gold and platinum group metals (PGMs) declined between 2012 and 2018, but have seen a strong recovery recently. The severe drought in 2018/2019 not only impacted agriculture, but the low water levels of the Kariba Dam also had a big impact on electricity generation. The drought has >

ended and it looks like Zimbabwe will produce enough maize to meet the country's demand this year – a spectacular turnaround from the past decade where production only met about half of the demand.

What is particularly positive is that agricultural output is not only improving as a result of better rainfall, but also because of better planning. Similarly, the increase in precious metal exports is not just because of higher prices, but is also due to policy changes that encourage investments in the mining sector.

We are really excited about the investment opportunities that arise when share prices reflect overly pessimistic perceptions. Zimplats, which is currently the largest holding in our Africa Frontiers strategy, is a case in point.

A REAL GEM

Zimplats is a Zimbabwean PGM mine and is a subsidiary of Impala Platinum, one of the largest PGM producers in the world. Zimplats is a world-class mine: it is a shallow, mechanised mine that is low on the cost curve (see Figure 3), has a predictable production profile and has sufficient reserves to last for almost 40 years. In addition, the company operates in an industry with supportive fundamentals. Demand is well supported as more stringent emissions regulations force vehicle manufacturers to increase PGM loadings, while years of low capex across the industry means that there is not a lot of new supply coming online over the next few years.

The company has a fortress balance sheet, with a net cash balance of $226 million as at December 2020. This is more than 10% of the company's current market capitalisation and, given where PGM prices are currently, we believe this cash balance has grown substantially in the first few months of 2021. Importantly, most of the cash is held outside Zimbabwe.

Our investment in Zimplats has done incredibly well for our clients, with the share price tripling over the past two years. However, we don't believe the company is expensive simply because the share price has increased. The company still trades on a very attractive multiple – Zimplats trades on a forward price-to-earnings ratio of just three times and has a double-digit dividend yield. Even more appealing is the fact that these multiples do not capture the expansion plans announced by the company recently (see Figure 4).

What we like about the expansion is that this is a low-cost, low-risk investment, which will have a meaningful positive impact on earnings over time. We estimate that this investment will increase annual production by approximately 30% from 2023, and at current commodity prices, we estimate that the payback period on this investment will be less than two years.

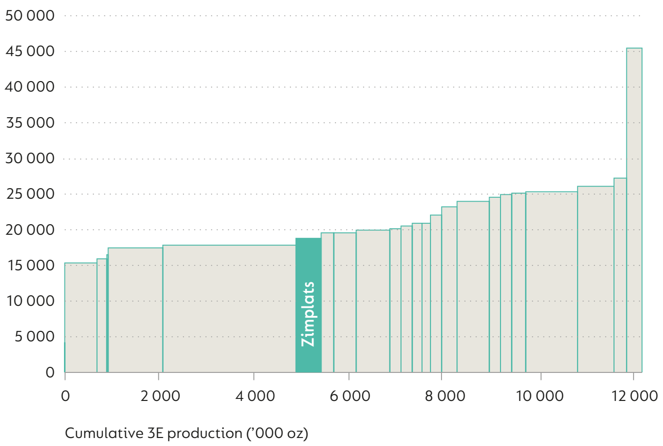
FUNDAMENTALS TRUMP SENTIMENT

In our view, the main reason why Zimplats trades on much lower multiples compared to its peers is the fact that this is a Zimbabwean business (see Figure 4).

We think there is a general lack of understanding on how much property rights have improved over the past few years. In 2018, the government started to address indigenisation laws, but the 51% local ownership requirement remained in place for platinum and diamond companies. In late 2020, this requirement for platinum and diamonds was >

Figure 3

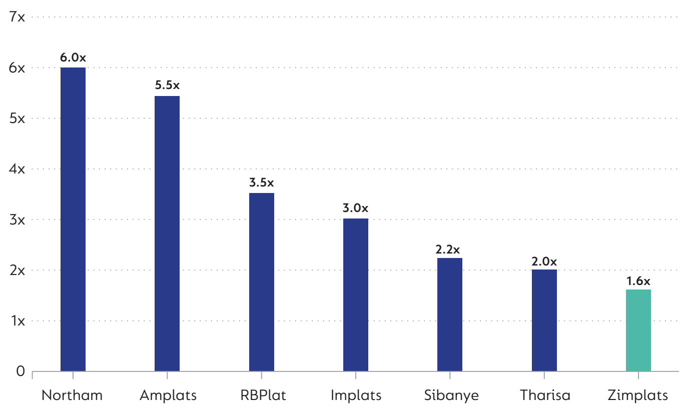
PGM COST CURVE: 2021 CASH COST ZAR/3E OZ (INCLUDING CAPEX)



Source: RMB Morgan Stanley

Figure 4

ENTERPRISE VALUE / EBITDA* MULTIPLES (2021)



* Earnings before interest, taxes, depreciation and amortisation
Source: Renaissance Capital, as at 17 March 2021

also removed. Another significant milestone for Zimplats was when its special mining lease was converted to a normal mining lease in 2018. This now gives it the right to mine for the full life of the mine, and also simplifies and reduces its tax burden. These developments are consistent with the message from other Zimbabwean miners, who report that the government has become much more pragmatic, resulting in a more predictable policy environment that enables mining companies to invest in the country.

A big concern for foreign investors looking at Zimbabwe is the value of the currency and currency repatriation. In this regard, Zimplats is completely different from other local businesses. It is an exporter that generates real US dollars. This puts the business in a strong position in a country where hard currency is in high demand. The government simply cannot afford for production to halt at a mine like Zimplats and has therefore been supportive in ensuring that mines can continue with their operations.

Another important point for equity investors is that Zimplats is listed on the Australian Stock Exchange (ASX). In contrast to shares listed within Zimbabwe, which has historically exposed investors to repatriation issues, shares on the ASX do not have this problem.

We know that Zimbabwe has seen several false dawns. Many difficult hurdles still need to be overcome before funding from organisations like the IMF becomes a possibility. We also know that it is not impossible that the government will try to access a larger portion of the hard currency generated by this business.

However, one of the most important things we try to do as stewards of our clients' capital, is to try and price risk appropriately. When we look at Zimplats, we believe that investors are blinded by their negative perceptions of Zimbabwe, and, as a result, the company trades on a valuation that offers a very compelling risk-reward profile to the long-term investor. +

MARKET REVIEW

Confidence in recovery gains momentum

THE COVID-19 PANDEMIC continued to impact markets. Despite severe second and third waves in many parts of the world, markets delivered a strong first-quarter performance. Investors are anticipating a return to more normal economic activity as vaccine rollout strategies gain momentum.

Virus mutations, vaccine efficacy and the duration of immunity remain risks to markets that have already priced in a recovery. The MSCI All Country World Index returned 4.6% for the first quarter of 2021 (Q1-21) after returning 16.3% during 2020. The S&P 500 Index returned 6.2% in US dollars for Q1-21. In Europe, the Euro Stoxx 50 rose +6.3%, despite stringent lockdowns across large parts of the continent.

Emerging markets (MSCI Emerging Markets +2.3%) underperformed their developed market counterparts (+4.9% as measured by the MSCI World Index). Within emerging markets, Turkey was a notable underperformer (-20.4% in US dollars), as President Erdoğan replaced the country's central bank governor (again). This affront to central bank independence resulted in a weakening of the currency and rising bond yields. Herd immunity for emerging markets will generally come later than for their developed market peers, taking place in 2022 or 2023. Affordability, access to vaccines, and effective procurement and distribution strategies are all headwinds. South Africa, similarly, has had a slow start to vaccine distribution, with vaccine timelines being extended. Effectively leveraging all available resources across the private and public sector will be critical to achieving the herd immunity required for economic normalisation.

Global bond yields rose as confidence in an economic recovery gained steam. Pent-up demand from consumers sitting on high levels of savings, buoyed by economic stimulus and lockdown restrictions, brings inflation risk. The Barclays Global Aggregate Bond Index declined -4.5% in US dollars in Q1-21. In South Africa, the All Bond Index declined -1.7% in Q1-21. The rand remained steady against the US dollar (-0.6% in Q1-21). Resource shares delivered 18.7% for Q1-21, followed by industrials (+13.0%) and then financials (+3.8%).

The JSE All Share Index was up strongly (+13.1%) for the quarter and 55.6% since its March lows a year ago.

Key performance indicators and fund performance

AS AT 31 MARCH 2021

		QTD	YTD	1 YEAR	3 YEARS	5 YEARS	10 YEARS	15 YEARS	20 YEARS
INTERNATIONAL INDICES [USD]									
Global Equity	MSCI ACWI	4.6%	4.6%	54.6%	12.1%	13.2%	9.1%	7.0%	7.1%
	MSCI WORLD	4.9%	4.9%	54.0%	12.8%	13.4%	9.9%	7.2%	7.0%
	MSCI GEM	2.3%	2.3%	58.4%	6.5%	12.1%	3.7%	5.9%	10.0%
	S&P 500	6.2%	6.2%	56.4%	16.8%	16.3%	13.9%	10.0%	8.5%
Global Property	Global Property (FTSE EPRA/NAREIT Developed Index)	6.1%	6.1%	35.9%	6.1%	4.8%	6.6%	4.7%	8.7%
Global Bonds	Barclays Global Bond Aggregate	(4.5%)	(4.5%)	4.7%	2.8%	2.7%	2.2%	3.8%	4.6%
US Cash	3 Month Libor	0.1%	0.1%	0.3%	1.7%	1.5%	0.9%	1.5%	1.7%
SPOT RATES AND COMMODITY PRICES									
Exchange Rates	Rand Dollar exchange rate	14.7	14.7	17.9	11.8	14.7	6.8	6.1	8.0
	Rand Dollar % change	(0.6%)	(0.6%)	20.8%	(7.2%)	(0.2%)	(7.5%)	(5.7%)	(3.0%)
	Rand Euro exchange rate	18.0	18.0	19.7	14.6	16.7	9.6	7.5	7.0
	Rand Pound exchange rate	20.1	20.1	22.2	16.6	21.1	10.8	10.6	11.4
Select Commodities	Gold price (USD)	1 891.1	1 891.1	1 609.0	1 323.9	1 237.0	1 439.0	582.0	257.7
	Oil price (USD barrel)	51.8	51.8	26.4	69.4	40.3	117.4	66.2	24.7
SOUTH AFRICAN INDICES [ZAR]									
SA Equity	ALSI (J203T)	13.1%	13.1%	54.0%	9.7%	8.2%	10.9%	11.4%	14.5%
	CAPI (J303T)	12.8%	12.8%	55.6%	8.7%	7.5%	10.7%	11.5%	-
	Capped SWIX (J433)	12.6%	12.6%	54.2%	4.3%	4.4%	-	-	-
	Resources Index (J258)	18.7%	18.7%	92.5%	30.5%	23.4%	5.6%	8.0%	12.2%
	Industrial Index (J257)	13.0%	13.0%	38.2%	7.3%	5.5%	13.8%	14.4%	16.5%
	Financials Index ex property	2.9%	2.9%	38.7%	(5.6%)	1.4%	10.1%	8.9%	-
SA Property	Africa All Property Index (J803T)	8.1%	8.1%	34.2%	(13.9%)	(10.6%)	3.6%	-	-
SA Bonds	BEASSA (TR) All Bond Index	(1.7%)	(1.7%)	17.0%	5.5%	8.7%	8.2%	7.9%	9.6%
SA Cash	Short Term Fixed Interest 3 Month Cash Rate	0.8%	0.8%	4.0%	5.9%	6.4%	6.0%	6.9%	7.5%
SA Inflation	Inflation	1.7%	1.7%	3.2%	4.0%	4.4%	5.0%	5.6%	5.6%

	QTD	YTD	1 YEAR	3 YEARS	5 YEARS	10 YEARS	15 YEARS	20 YEARS	SINCE LAUNCH
DOMESTIC FUNDS (PERFORMANCE IN ZAR)									
Coronation Top 20 Fund	14.3%	14,3%	56.7%	10.4%	9.2%	11.0%	12.8%	17.0%	17.3%
ASISA Mean of South African Equity General	12.2%	12.2%	49.1%	5.9%	4.9%	8.3%	8.9%	13.8%	13.4%
Coronation Market Plus Fund**	9.8%	9.8%	45.3%	9.4%	7.3%	10.9%	11.3%	-	15.0%
ASISA Mean of South African Multi-Asset Flexible	8.49%	8.5%	33.8%	6.1%	4.7%	9.3%	9.1%	-	10.9%
Coronation Balanced Plus Fund	8.9%	8.9%	40.1%	9.0%	6.9%	10.4%	11.0%	13.9%	14.1%
ASISA Mean of South African Multi-Asset High Equity	7.4%	7.4%	30.7%	7.3%	5.5%	8.6%	8.6%	12.4%	12.1%
Coronation Capital Plus Fund	6.0%	6,0%	28,8%	7,3%	5,7%	8,2%	9.0%	-	11.4%
ASISA Mean of South African Multi-Asset Medium Equity	5.5%	5.5%	24.3%	7.1%	5.5%	7.9%	7.8%	-	10.7%
Coronation Balanced Defensive Fund	4.6%	4.6%	23.1%	7.9%	6.5%	9.1%	-	-	9.3%
ASISA Mean of South African Multi-Asset Low Equity	3.5%	3.5%	17.2%	6.6%	5.7%	7.7%	-	-	7.5%
Coronation Strategic Income Fund	0.8%	0.8%	9.1%	6.3%	7.3%	8.2%	8.4%	-	9.8%
ASISA Mean of South African Multi-Asset Income	1.0%	1.0%	8.6%	6.8%	7.4%	7.0%	7.4%	-	8.8%
INTERNATIONAL FUNDS (PERFORMANCE IN USD)									
Coronation Global Equity Select Fund	6.2%	6.2%	56.6%	12.4%	12.9%	-	-	-	8.8%
Coronation Optimum Growth Fund	(1.2%)	(1.2%)	39.5%	8.6%	10.9%	7.5%	5.9%	10.3%	9,9%
Coronation Global Managed Fund	2.8%	2.8%	34.6%	7.5%	7.9%	6.6%	-	-	6.9%
Coronation Global Capital Plus Fund	1.2%	1.2%	15.9%	4.8%	4.5%	3.6%	-	-	4.2%
Coronation Global Strategic Income Fund	0.4%	0.4%	6.4%	2.1%	2.0%	-	-	-	2.4%

* All ASISA averages exclude Coronation funds in that category.

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

Meaningful periods

Not listed here, but included in the following commentaries – Coronation Equity Fund: highest annual return: 62.5% (Aug 2004 - Jul 2005); lowest annual return -28.7% (Mar 2008 - Feb 2009) and Global Emerging Markets Fund: highest annual return 106.2% (Mar 2009 - Feb 2010); lowest annual return -33.6% (Sep 2014 - Aug 2015).
Rest of funds' details available on pages 56 and 58.

Figures as at 31 March 2021; for detailed fund performance, refer to pages 56 - 59.

FUND UPDATE

Coronation Balanced Plus and Coronation Equity funds

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

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

Sarah-Jane is a portfolio manager with 16 years of industry experience.

BOTH FUNDS HAD a good first quarter. The Balanced Plus Fund returned 8.9%, benefiting from both value-adding asset allocation decisions and alpha generated within the domestic and global equity building blocks. The Equity Fund returned 12.3%. Both funds have performed well against their peer groups over all meaningful time periods.

Given the considerable strength in global markets, we reduced the holding in global equities to a neutral level in Balanced Plus. We remain cautious on global bonds, given the low yields at which they continue to trade, high levels of government indebtedness and the risk of inflation.

The Equity Fund's allocation to global equities has benefited the portfolio over time, bolstering returns and improving risk management. Key contributions to portfolio performance in the first quarter of the year (Q1-21) came from investments in Covid-19 casualties. These businesses saw a meaningful decline in their share prices during 2020, as the pandemic hit their near-term earnings potential. This provided an opportunity to build stakes at prices below our assessment of fair value. We expect the revenues of these Covid-19 casualties to recover strongly into 2022, as developed markets achieve herd immunity and economic activity normalises. Examples include Trip.com, MakeMyTrip and Melco Resorts & Entertainment (Melco), all of which contributed positively in Q1-21. The Fund built a considerable holding in Melco in the latter half of 2020, as travel restrictions between Mainland China and Macau left Melco's casinos empty. Melco's balance sheet was sufficiently strong to withstand the near-term earnings pressure. Costs were restructured to minimise cash losses. Despite these headwinds, our views on the long-term fundamentals of this business are unchanged. The Chinese consumer is in rude health, as evidenced by Mainland luxury spend, and consumers' desire to visit these assets is undiminished. We expect a strong recovery, as restrictions continue to be eased. In addition, the casinos are highly cash generative, which should drive rapid deleveraging. Despite the strong run in global markets, we continue to see opportunities such as these for stock picking.

After a marked deterioration in South Africa's fiscal metrics during 2020, Q1-21 brought improved news flow. The current account delivered a healthy surplus, backed by mining cash flows and a robust agricultural sector. Tax collection efforts exceeded expectations. The February Budget was encouraging, with a commitment to rein in expenditure, specifically the public sector wage bill that has compounded at a rate above inflation for many years. Implementation of the Budget plans will require a sustained commitment to austerity. Much-needed >

economic growth is frustrated by load shedding, policy uncertainty and a lack of investor confidence. While the projected debt-to-GDP ratio has come in lower than expected, it remains high, and the risk of a debt trap is not immaterial. This tenuous situation is reflected in South African government bonds yielding returns well above cash. We see better value at the long end of the curve, where lower bond prices offer more protection against restructuring. The Balanced Plus Fund is slightly underweight fixed-rate government bonds, striking a balance between the attractive returns and risk.

Having increased exposure to local equities during the third quarter of 2020, we took profits in Q1-21, given the strong run. Despite the selling, the Balanced Plus Fund remains overweight South African equities, given the breadth and attraction of the value on offer. The funds both benefited from large holdings in resources. We continue to hold considerable exposure to rand-hedge names that remain attractive for various stock-specific reasons. Major holdings include Naspers (+17%), British American Tobacco (+4.9%), Quilter (+5.5%), Bidcorp (+8.7%), Textainer (+45.1%) and Aspen (+15.1%).

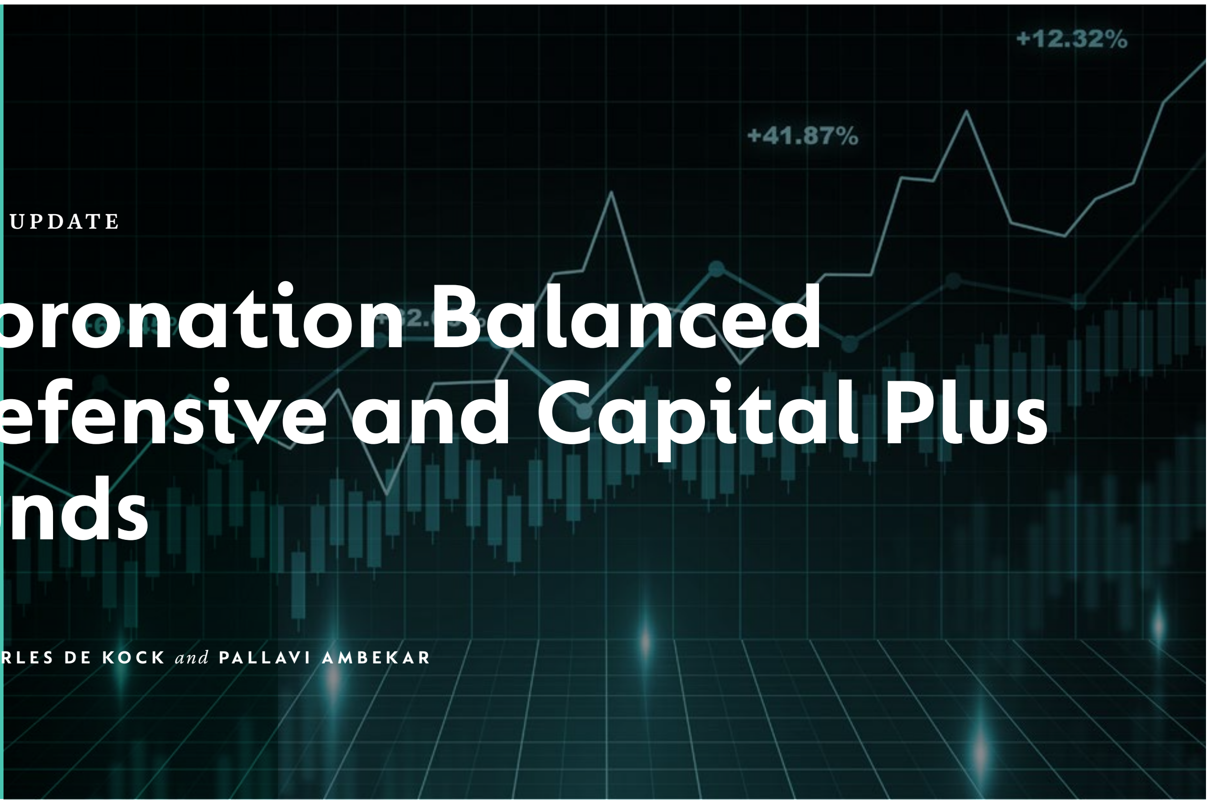
Within South African equities, the funds reduced the extent of the domestic underweight during 2020, given the move in valuations. Despite reduced medium-term prospects, domestic shares offer attractive upside to fair value. In keeping with the second half of 2020, earnings results from domestic shares have exceeded our expectations in Q1-21. We believe exciting stock-picking opportunities exist, as strong players use the crisis to become even stronger. This was evident in the results of a business such as Shoprite (+12.2% for Q1-21), which delivered strong topline growth and resilient gross profit margins despite economic headwinds.

South African banks have navigated the crisis well. Books appear well provided as borrowers resume debt repayments and low interest rates improve affordability. Capital ratios remain healthy and future earnings should be well supported, given the level of provisioning. Despite sector earnings roughly halving over 2020, Standard Bank and FirstRand returned to paying dividends. The outlook for advances growth is muted, given constrained economic growth. Slow vaccine rollout and possible retrenchments pose additional risks to economic recovery. Life insurers were forced to take additional Covid-19 provisions as a second wave drove a spike in mortality. Still, as with the banks, life insurer balance sheets remain well capitalised. Sanlam, Momentum Metropolitan Holdings and Old Mutual declared dividends. Momentum Metropolitan (+12.1%) remains an attractive investment, trading at a meaningful discount to embedded value. While additional Covid-19 provisions detracted from results, we believe management's actions are delivering underlying operational improvements. Despite the selloff in property shares, we have not built up the position, given concerns over the long-term outlook for rentals and weak balance sheets.

Within the resources sector, the funds benefited from overweight positions in the diversified miners and underweight holdings in gold. Anglo American and Glencore rose 22% and 24%, respectively. Resource shares remain a meaningful part of equity exposure despite their outperformance. Our investment thesis is unchanged – undemanding valuations, solid free cash flow and tight markets. Commodity demand is expected to remain robust, given Asian resilience and a recovery in the rest of the world. Joe Biden's presidency should strengthen the US's commitment to transitioning away from fossil fuels. Battery metals have an important role to play in decarbonising the world's energy mix, and we expect copper and cobalt to be particularly tight as this shift accelerates. Glencore (+24%) should be a key beneficiary.

The platinum group metals holdings in the portfolio (Northam +22.8% for Q1-21 and Impala Platinum +40.7% for Q1-21) performed well. Metal prices remain high given growing demand, supply disruptions and a decade of underinvestment. We have trimmed the positions but remain invested, given anticipated high levels of cash return.

Equity markets have rebounded strongly off the lows of a year ago. While we have trimmed equity exposure in Balanced Plus, we remain overweight and continue to see exciting investment opportunities for stock pickers. We believe that these positions will deliver compelling returns for clients in the coming years. +



FUND UPDATE

Coronation Balanced Defensive and Capital Plus funds

By **CHARLES DE KOCK** and **PALLAVI AMBEKAR**

Charles co-manages the Absolute Return funds with Pallavi Ambekar and has 34 years of investment experience.

Pallavi co-manages the Absolute Return funds with Charles de Kock and has 16 years of investment experience.

BALANCED DEFENSIVE AND Capital Plus have had a successful start to 2021, delivering one-year returns of 29% and 23% net of fees, respectively. The strong showing over the last 12 months to end-March has lifted the funds' medium-term performance, resulting in respective returns of 6.5% and 5.7% over the five-year period. While still slightly behind the benchmark return, this is comfortably ahead of CPI.

Risk assets have had a significant rebound off a very low base this time last year, and have been the main contributor to the funds' performance. We used the Covid-19 selloff to judiciously step up our risk asset exposure within the funds, starting with global and emerging market equities, and followed by South African equities. For the quarter, both global and local equity asset classes delivered good alpha over and above robust underlying market performances.

In the local equity market, we saw compelling long-term valuations across many counters, even after incorporating severe near-term earnings cuts due to Covid-19 and a slow path to earnings normalisation. While this gave us the confidence to increase our local equity exposure, we were very selective in the counters we bought. Our focus was on building positions in businesses that not only offered a large margin of safety, but also had robust balance sheets and the ability to generate good cash flows. Given these criteria, we did not add to our domestic property exposure, as we found better risk-adjusted return potential in equities.

Consider Quilter, one of the largest integrated wealth managers in the UK and a share we have been buying. The UK is an attractive wealth management market due to increasing regulatory compliance burdens on advisers and a growing defined contribution market. Quilter is well placed within this market, with an integrated value chain from a large, owned adviser force and a well-invested platform offering its own, as well as third-party, asset management solutions. The business is shareholder friendly and trades on 13 times our assessment of normal earnings.

There are still many uncertainties and risks as to how the world will emerge from the Covid-19 crisis. However, large amounts of stimulus, relatively low interest rates and the lifting of lockdowns will all lead to a positive backdrop of increased economic activity. With this in mind, we still see attractive investment opportunities in equity markets, with our bottom-up valuations indicating healthy inflation-beating potential returns over the next three years. >

Given the strength of market performance, we have trimmed some equity exposure in the first quarter of this year, but still maintain an allocation of 55% in Capital Plus and 40% in Balanced Defensive to local and global equities. There are tail risks to this expected economic recovery, and, as the funds also have a capital protection mandate, we have increased our protection on our equity exposure by buying local and global equity puts.

Our overall risk asset exposure is prudently balanced, with exposure to South African fixed-income instruments of 44% in Balanced Defensive and 35% in Capital Plus. The Budget presented by the National Treasury in February was broadly better than expected, with higher tax receipts and conservative expenditure allocation. Government still has a high and increasing debt burden, and a combination of growth initiatives and continued fiscal constraint will be necessary to keep this in check. Many investors are sceptical that this can be delivered, and hence our far-dated domestic bond yields continue to trade at a premium to other emerging markets. We have exposure to these attractive yielding South African government bonds but are also managing risk by spreading exposure across corporate and inflation-linked bonds. Both funds' fixed-income carve-out outperformed the All Bond Index over the quarter.

While the overall fund returns over the past 12 months have been pleasing, we would not expect a repeat of this strong performance. The past year has demonstrated the value that can be added by employing active asset and instrument selection to take advantage of investment opportunities. We think our current asset selection can still deliver on the CPI +3%/4% mandates over the medium term, with a sensible mix of growth and income assets to meet both the return and capital protection mandates of the funds. +

FUND UPDATE

Coronation Market Plus and Top 20 funds

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

Neville is a senior portfolio manager with 23 years of investment experience.

Nicholas is an equity analyst with 11 years of investment experience.

THE FUNDS HAD a good start to the year, with Market Plus delivering a return of 9.8% for the first quarter (Q1-21) and Top 20 returning 14.3% against the benchmark return of 12.8%. This marks the first 12-month period since the collapse of most markets due to the Covid-19 crisis. It also explains why the funds' 12-month returns are so strong, at 45.3% and 56.7%, respectively. Market Plus is well ahead of the benchmark return of 35.5% over this period, showing how many of the active allocation and investment decisions made during this tumultuous period have paid off.

For the quarter, the funds benefited from overweight positions in the diversified miners and platinum group metal (PGM) stocks, while domestic shares detracted.

Commodity prices (with the exception of gold) had a strong quarter. Iron ore was well supported as Chinese infrastructure spend remains strong, the rest of world's steel demand rebounds and Vale's production continues to ramp up slowly.

Increasing awareness is being brought to battery metals (primarily copper, nickel, lithium and cobalt) and their role in assisting the world to decarbonise. This theme has been enhanced by the Joe Biden presidency in the US. President Biden is likely to recommit the US as a global leader in transitioning economies away from fossil fuels. We expect persistent deficits in the latter half of the decade, particularly in copper and cobalt. Anglo American and Glencore are well positioned for this scenario. We exited BHP Billiton after a strong run in its share price and concerns around the longer-term sustainability of iron ore prices.

We think Exxaro's capital allocation track record exceeds its reputation. This was further demonstrated by a well-timed sale of non-core Tronox, with most of the proceeds being returned to shareholders via buybacks and a special dividend. We expect further capital returns should the sale processes at Exxaro Coal Central and Leeuwpan conclude successfully. Including ordinary dividends, Exxaro would then have returned c.25% of its market cap to shareholders in a 12-month window.

PGMs performed well this quarter on the back of a strong PGM basket price, led by rhodium. A decade of underinvestment cannot be remedied quickly. Companies have started to announce expansion projects, but these will take time to land.

Demand for the metals remains robust on increasing PGM loadings in the autocatalyst industry. The supply issues at Norilsk Nickel, the world's largest palladium producer, while temporary, will further tighten the market.

>

We think gold shares look increasingly attractive. Government balance sheets around the world are becoming more stressed as debt is piled on to support the global recovery from Covid-19-induced economic stress. The global printing presses are running hot. For example, 25% of dollars in circulation were issued in the last year. As a centuries-old store of value, gold should thrive in these conditions where fiat money is being debased. However, it seems all the action is taking place in new (untested) stores of value, such as cryptocurrencies. We see upside risk to the gold price, while most of the equities are pricing in a gold price well below spot. We initiated a new position in AngloGold.

Our domestic stance is little changed. After strong share price performance, we sold out of Woolworths as the market accepted the company would no longer put additional funding into its Australian operations. Our domestic holdings are centred around the food retailers (Shoprite and Spar), banks (Standard Bank and Nedbank) and the life insurers (Sanlam and Momentum Metropolitan). While we are encouraged by recent ANC National Executive Committee announcements that suggest continued progress by President Ramaphosa, our defensive stance is informed by the slow pace of delivery, poor electricity availability, the lagging pace of the vaccine rollout, and worries that consumer stress will pick up rather than decrease this year. More importantly, we feel valuations of the rand hedges that happen to be listed here are very compelling.

Both Aspen and Bidcorp (a new position) should be beneficiaries of global vaccine rollouts. Johnson & Johnson's likely approval for Aspen to fill and finish its Covid-19 vaccine at its Port Elizabeth facility highlights the quality of Aspen's manufacturing facilities. It should aid the company's ambition to boost manufacturing earnings before interest rates, taxes, depreciation and amortisation (EBITDA) by R1.5 billion.

Regarding Bidcorp, after each Covid-19 wave, we see how people are desperate to resume their normal lives by dining out and socialising in public venues. With the vaccine rollout in developed markets going at a reasonable pace, we think Bidcorp's earnings will bounce back nicely. It is a very well-managed business and should have merger and acquisition opportunities through which to pick up players hurt by the crisis. We expect it will be a strong compounder in hard currency.

We sold out of our MTN position. Management is doing a good job executing the business's operational turnaround and asset disposal programme to drive up returns on equity. Unfortunately, it cannot escape the fact that 40% of its EBITDA comes from Nigeria. Covid-19 has exacerbated a tough macroeconomic backdrop going into the pandemic. A low oil price, difficulty repatriating foreign exchange and a regulator hell-bent on shaking MTN down on a regular basis saw us conclude that there is better risk-adjusted opportunity in the new positions we have initiated.

We see good value in the asset management space. The UK wealth market should benefit from a secular shift away from defined benefit retirement solutions to defined contribution retirement solutions (which increases the need for financial advice). Quilter remains extremely well placed to capitalise on this shift. We ascribe three reasons to Quilter's low current rating:

1. a fairly recent spin-off that wasn't well covered by the market;
2. Brexit fears; and
3. Quilter re-platforming its retail advised platform to a new technology provider.

All three of these factors are largely in the rearview mirror, and we expect strong net flows to drive a re-rating in its share price. We also initiated a position in asset manager Ninety One, which has built strong investment franchises in a number of territories over time. Despite good fund performance, which should aid future flows, the share trades on a compelling rating (10 times our assessment of normal earnings and a 7% dividend yield).

In the case of Market Plus, the key driver of the returns for Q1-21 has been an overweight position in equities and very good alpha generated within the equity portfolio. We have been steadily reducing this overweight position into the very strong markets, especially the offshore component, where markets have been exceptionally robust and valuations are starting to look stretched. We have not reduced the domestic equity allocation as much, as we continue to see significant value in the domestic market.

Within Market Plus's domestic equity allocation, our positive alpha has continued to be driven by a meaningful position in resources shares. In Q1-21, in particular, our holdings of the PGM shares and Exxaro made a big contribution to the Fund's return. All the PGM shares have reported financial results, and all showed prodigious cash generation and de-gearing. With a general commitment to maintaining a disciplined approach to investing new capital, the majority of this cash is being returned to shareholders.

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Our investment in Royal Bafokeng Platinum was a standout in this regard, declaring an enormous maiden dividend. After many years of supporting this mine through equity and bond raises, it is a fantastic conclusion to see it generating meaningful returns, having created jobs, having a positive impact on the surrounding communities and now returning cash to shareholders.

The other driver of our alpha in this period was our holding in Naspers. While historically the share price has just tracked its main underlying holding, Tencent, it significantly outperformed in Q1-21, driven by the announced share repurchases being conducted by Prosus as a means to reduce the substantial discount at which Naspers trades to its underlying holdings.

Market Plus is still underweight pure domestic South African businesses, though we continue to add to the high-quality names that we think can continue to grow in a tough domestic environment.

We added to a couple of smaller industrial businesses, such as KAP and Metair, and Alexander Forbes, a financial services business that should still benefit from higher market levels, even though formal employed numbers are down.

Our offshore equity holdings are more overweight emerging markets than developed markets. The investment thesis that the rampant printing of US dollars will result in a weaker dollar and much stronger economic growth for the more industrialised emerging markets still holds. While global emerging markets were a beneficiary of this last year, we have seen a small reversal this year as the dollar has stabilised as the yields on longer-dated US bonds have ticked up. We don't expect this to last long, and still believe the relative valuation gap justifies a much bigger investment in the emerging market universe.

Our stance not to hold any global government bonds has paid off nicely. The big kick-up in yields on US government bonds saw that sector deliver the first meaningful negative quarter in many years. The expectation of a strong return to growth, coupled with high commodity prices, exacerbated by supply chain issues, should all lead to much higher inflation. The market is starting to price some of this in. We still think the risk is further to the downside and continue to avoid any meaningful holding in global bonds.

We have supplemented our holding in gold by adding a position in the platinum exchange-traded fund. While we held some last year, we had sold out when the rand price spiked in 2020. With the rand strength and an earlier pullback in platinum prices, we have added a small position, as we believe the metal is likely to head into deficits as the pace at which platinum substitutes the more expensive palladium gathers steam.

We have added to our holdings of South African government bonds. Finance Minister Mboweni delivered a second solid, and as fiscally conservative as the trying times allow, Budget for the year ahead. We have seen better revenue collection as well, reducing the projected overall deficits for the years ahead.

With much more conservative forecasts by the National Treasury team, we expect these baseline numbers to be beaten in the period ahead. Continued good metal prices and agricultural conditions will see better revenue outcomes for the year ahead. This makes the potential debt burden more sustainable, and our significant outlier yields on bonds that much more attractive. Inflation continues to be well controlled, meaning the real yields on government bonds are very attractive for long-term savers.

Finally, we have added some small property positions, being very careful to ensure exposure only to quality properties with strong enough balance sheets to ride out the uncertain times ahead. In the short term, they have delivered a nice bounce-back, although they are still trading on very deeply discounted levels.

We remain encouraged by the risk-adjusted opportunities we see and the potential upside within the funds. The current upside remains high relative to history and suggests compelling future returns from the portfolios. ✚

FUND UPDATE

Coronation Strategic Income Fund

By **NISHAN MAHARAJ** *and* **MAURO LONGANO**

Nishan is Head of Fixed Interest and has 17 years of investment experience.

Mauro is Head of Fixed Interest Research and a portfolio manager and has nine years of investment industry experience.

THE FUND RETURNED 0.75% in the first quarter of 2021 (Q1-21), bringing its total return to 9.1% for the 12-month period. This return is ahead of cash (4%) and its benchmark (4.4%).

In the US, the Federal Reserve Board (the Fed) left the funding rate range unchanged at 0.00%-0.25% and maintained the current asset purchasing programme pace and size. The Fed reiterated its stance that improvement in employment and inflation, and reaching its target ranges are necessary precursors of interest rate hikes. US headline inflation accelerated to 1.7% year on year (y/y) in February, from 1.4% y/y in January. Upward inflation pressure came from increases in energy costs and medical care service prices. Prices for food, vehicles and apparel were slightly lower than January's reading. Core inflation moderated slightly to 1.3% y/y in February from 1.4% y/y in January.

In emerging markets, China's headline inflation contracted by 0.2% y/y in February from a contraction of 0.3% y/y in January. This deflation is on the back of falling meat prices, along with a drop in transport, apparel and utility costs. Elsewhere in emerging markets, the rollout of the vaccine in 2021 has been slow, but is expected to contribute to further recovery in economic activity in the latter part of the year. Monetary policy settings have become more mixed, with some emerging market central banks signalling broad accommodation, while Russia, Turkey and Brazil's central banks all raised interest rates in March.

The rand was relatively unchanged over Q1-21, despite broader emerging market currency weakness, ending at $1/R14.78. The onset of the second wave of Covid-19 in many parts of the world and increased developed market bond yields weighed on sentiment. However, underlying economic data continued to suggest better-than-previously-expected global growth outcomes. In South Africa, specifically, this has led to slightly improved expectations, supporting the currency outperformance over February. The Fund maintains its healthy exposure to offshore assets. When valuations are stretched, it will hedge/unhedge portions of its exposure back into rands/dollars by selling/buying JSE-traded currency futures (US dollars, UK pounds and euros). These instruments are used to adjust the Fund's exposure synthetically, allowing it to maintain its core holdings in offshore assets.

South African headline inflation slowed to 2.9% y/y in February from 3.2% y/y in January. The decline came from a moderation in food prices and a decrease in medical insurance costs. Core inflation fell more sharply, from January's 3.3% y/y to 2.6% y/y in February. Inflation pressure in the economy remains

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benign, and both core and headline inflation are anticipated to remain close to the 4.5% mid-point of the inflation target range.

At the end of March, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 5.83% (three-year) and 7.08% (five-year), much higher than the close at the end of the previous quarter. This was in large part driven by a repricing in global rate expectations, following the selloff in developed market bonds. Shorter-dated NCDs have been pulled lower due to significant interest rate cuts, a recovery in bond yields and a tightening of credit spreads. Short-dated fixed-rate NCDs continue to hold appeal due to the inherent protection offered by their yields and our expectations of a lower repo rate. In addition, NCDs have the added benefit of being liquid, thus aligning the Fund's liquidity with the needs of its investors. The Fund continues to hold decent exposure to these instruments (fewer floating than fixed), but we will remain cautious and selective when increasing exposure.

South Africa remains in a delicate balancing act. In the short term, inflation will remain under control and growth will pick up, supporting a cyclically better economic outcome. However, the fiscal accounts are problematic, given the high levels of debt. While the cyclically better economic outcomes have provided some breathing room, there needs to be an acceleration in growth-enhancing reforms, more emphasis on reviving private-sector confidence to encourage investment and no deviation from current expenditure plans.

The recent move higher in developed market bond yields has sparked concerns of a replay of the 2013 taper tantrum. However, local bond valuations are much more generous now, with a much-reduced external funding requirement. We view South African government bonds as an attractive investment opportunity and would still advocate an overweight position relative to the benchmark for a bond fund. In addition, we would also allocate to four-year inflation-linked bonds and steer clear of corporate credit spreads at current levels.

The local listed property sector was up 6.4% over the quarter, bringing its 12-month return to 34.4%. Listed property has been the largest drag on the Fund's performance. The balance sheet concerns coming out of the crisis have subsided somewhat as companies have managed to introduce dividend payout ratios, withhold dividends in some cases and sell assets. Going forward, operational performance will remain in the spotlight as an indicator of the pace and depth of the sector's recovery. We believe that one must remain cautious, given the high levels of uncertainty around the strength and durability of the local recovery. However, certain counters are showing value, given their unique capital structures and earnings potential. These counters remain a core holding within the Fund.

The FTSE/JSE Preference Share Index was up 2.1% over the quarter, bringing its 12-month return to 30.1%. Preference shares offer a steady dividend yield linked to the prime rate, and depending on the risk profile of the issuer, currently yield between 8% and 10% (subject to a 20% Dividends Tax, depending on the investor entity). The change in capital structure requirements mandated by Basel III will discourage banks from issuing preference shares, which will limit availability. In addition, most of the bank-related preference shares trade at a discount, which enhances their attractiveness for holders from a total return perspective and increases the likelihood of bank buybacks. Despite attractive valuations, this asset class will continue to dissipate, given the lack of new issuance and because of its associated risks being classified as eligible loss-absorbing capital (only senior to equity). The Fund maintains select exposure to certain high-quality corporate preference shares, but will not actively look to increase its holdings.

We remain vigilant of the risks emanating from the dislocations between stretched valuations and the local economy's underlying fundamentals. However, we believe that the Fund's current positioning correctly reflects appropriate levels of caution. The Fund's gross-of-fees yield of 6.52% remains attractive relative to its duration risk. We continue to believe that this yield is an adequate proxy for expected Fund performance over the next 12 months.

As is evident, we remain cautious in our management of the Fund. We continue to invest only in assets and instruments that we believe have the correct risk and term premium to limit investor downside and enhance yield. +

FUND UPDATE

Global Equity Select, Global Managed and Global Capital Plus

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

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

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

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

EQUITY MARKETS POSTED solid gains in the first quarter of 2021, returning 4.6%, and now sit well above pre-Covid-19 levels. While we don't spend any time trying to predict short-term market moves, recent volatility (both up and down) and violent 'factor rotations' have whipsawed many investors and provided a real-life stress test of equity portfolios. For a team that strives for continual learning and acknowledges that there is always room for improvement, portfolio results, both recently and over more meaningful periods, show a strategy that is forging ahead and making solid progress. For the quarter, Global Equity Select gained 6.2%, Global Managed gained 3.1% compared to 0.9% for its benchmark, and Global Capital Plus gained 1.2% compared to 0% for its benchmark.

The funds have held a position in Porsche for many years, during which time it has performed broadly in line with the market. In January, we revisited the investment case for Porsche, whose primary asset is a 53% holding in VW common stock. The key conclusions were:

a) VW is not as bad a business as the market would have you think. It was trading on seven times earnings, which is one third of the market multiple, despite growing its market cap four times in 20 years and earnings by 8% p.a. for over 10 years and delivering an expected return on capital employed of 10%-13%.
b) Porsche did not deserve to be trading at a further 35% discount to the value of its stake in VW.
c) Earnings are of a reasonable quality, with the business converting 70%-90% of earnings into free cash flow (FCF), implying that Porsche was trading north of a 20% FCF yield on a look-through basis.
d) The transition to electric vehicles is more of an opportunity than a threat to VW. The company ended 2020 with a battery electric vehicles market share of 11% already, which is rapidly growing and is on track to exceed its 13%-14% share of traditional internal combustion engine vehicles.
e) Any form of sum-of-the-parts analysis, which more accurately valued VW's luxury brands (which include Lamborghini, Bugatti, Bentley and Porsche itself), showed that VW (and therefore Porsche) were massively undervalued.
f) The balance sheet is again solid, with year-end net cash coming in at €28 billion.

Our financial forecasts implied that the stock was worth double where it was trading and could generate an internal rate of return above 20% p.a. Very unusually, we didn't have long to wait for some of this discount to narrow, as Porsche appreciated by c.60% over the rest of the quarter. It was a top contributor to fund returns.

Another contributor for the quarter and last 12 months was Schwab, the largest e-broker in the US, with $6.9 trillion in client assets ($4 trillion before the TD Ameritrade acquisition discussed below) in a market of $45 trillion retail assets.

It provides brokerage, custodian, advice and asset management services. In 2019, Schwab earned about 60% of revenue from interest on client cash held on its balance sheet in high-quality assets, just under a third from fees on client assets invested in various asset classes and the remainder from commissions.

In late-2019, Schwab cut its trading commissions to zero, and the US e-brokers subsequently sold off, given the near-term impact on industry revenues. Soon after, Schwab made an offer to buy its largest competitor, TD Ameritrade.

In the first quarter of 2020, interest rates declined and markets plummeted, causing Schwab to drop over 35%. Our view was that the market was not discounting the propensity for clients to increase their cash balances during a market selloff (which would provide a buffer to the interest rate impact, as net interest income is dependent on both the cash balances and the rate), nor the likelihood of an increase in yields.

Moreover, sufficient value was not being ascribed to the synergies of the Ameritrade deal ($1.9 billion cost synergies on a base of $5.9 billion in revenue for Ameritrade in 2019, the ability to bring more of Ameritrade's cash onto its balance sheet and the ability to cross-sell more of Schwab's more comprehensive services to Ameritrade clients).

In hindsight, the commission fee cut was a masterstroke from Schwab, allowing it to acquire a competitor, TD Ameritrade, at a discounted price.

More recently, interest rates have started to increase and conviction around Schwab's synergy delivery has increased. The stock has doubled from levels seen in April to September last year.

We have written about our cable holdings, Charter Communications and Altice USA, in previous commentaries. Both were detractors in the first quarter. However, both are top contributors over more meaningful time periods (three to five years).

This is often how it goes for long-term investors – we believe it's highly unusual for stocks to go up in a straight line; periods of underperformance are almost inevitable in the hunt for long-term outperformance and an investment thesis is likely to be tested many times over a multi-year holding period.

Cable's primary product, the provision of high-speed broadband internet in the US, took centre stage in 2020 as large parts of the population were forced to work, learn and entertain themselves at home and online virtually overnight. Both companies performed strongly, with Charter growing its internet subscriber base by 9% and Altice by 4% on a year-over-year basis.

Both stocks have since taken a breather due to several factors, none of which we are particularly concerned about.

First, we acknowledge that there was likely some pull forward of subscriber growth into 2020 and that these results are unlikely to be repeated in 2021. Secondly, there has been increased noise from mobile operators launching 5G home broadband plans. And lastly, the Biden administration has made announcements relevant to cable.

Addressing the first point, we have a strong conviction that demand for high-speed internet will continue to increase as data consumption grows rapidly each year. This structural tailwind is supplemented in the nearer term by various stimulus measures that will directly assist lower-income households with their monthly broadband bills, and cable continues to be the internet provider of choice.

Charter's average broadband subscriber now consumes 700GB of data per month (on a per-home basis), and this continues to grow. Capacity-constrained mobile networks, where the average unlimited user consumes 10GB-15GB per month, are unable to compete, in our view.

Lastly, Biden's infrastructure plan should provide growth opportunities for cable in previously unserved rural areas, while we view the risk of price regulation as low. Higher US corporate tax rates are factored into our forecasts.

We find the valuations of our cable holdings extremely attractive, both in relative and absolute terms, and we continue to expect strong growth in FCF over the coming years, based on healthy revenue growth, steadily expanding margins and capex declining to normalised levels. Both also have excellent, shareholder-friendly management teams, as evidenced by Altice repurchasing a massive 25% of shares outstanding over the course of 2020.

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PORTFOLIO POSITIONING: GLOBAL MANAGED

At quarter-end, the Fund was positioned with just under 72% in growth, or risk, assets comprised of:

- 56% effective equity
- 4.5% in property
- 4.5% in infrastructure
- 2.5% in convertible instruments
- 4% in high-yield credit.

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

- 7% in commodities
- 2% in inflation-linked bonds
- 5% in hedged equity
- 14% in investment-grade fixed income (primarily 9% in short-dated Treasury bills and 3% in corporate credit).

PORTFOLIO POSITIONING: GLOBAL CAPITAL PLUS

At quarter-end, the Fund was positioned with 46% in growth, or risk, assets comprised of:

- 27% effective equity
- 5% in property
- 4% in infrastructure
- 2.5% in convertible instruments
- 7.5% in high-yield credit.

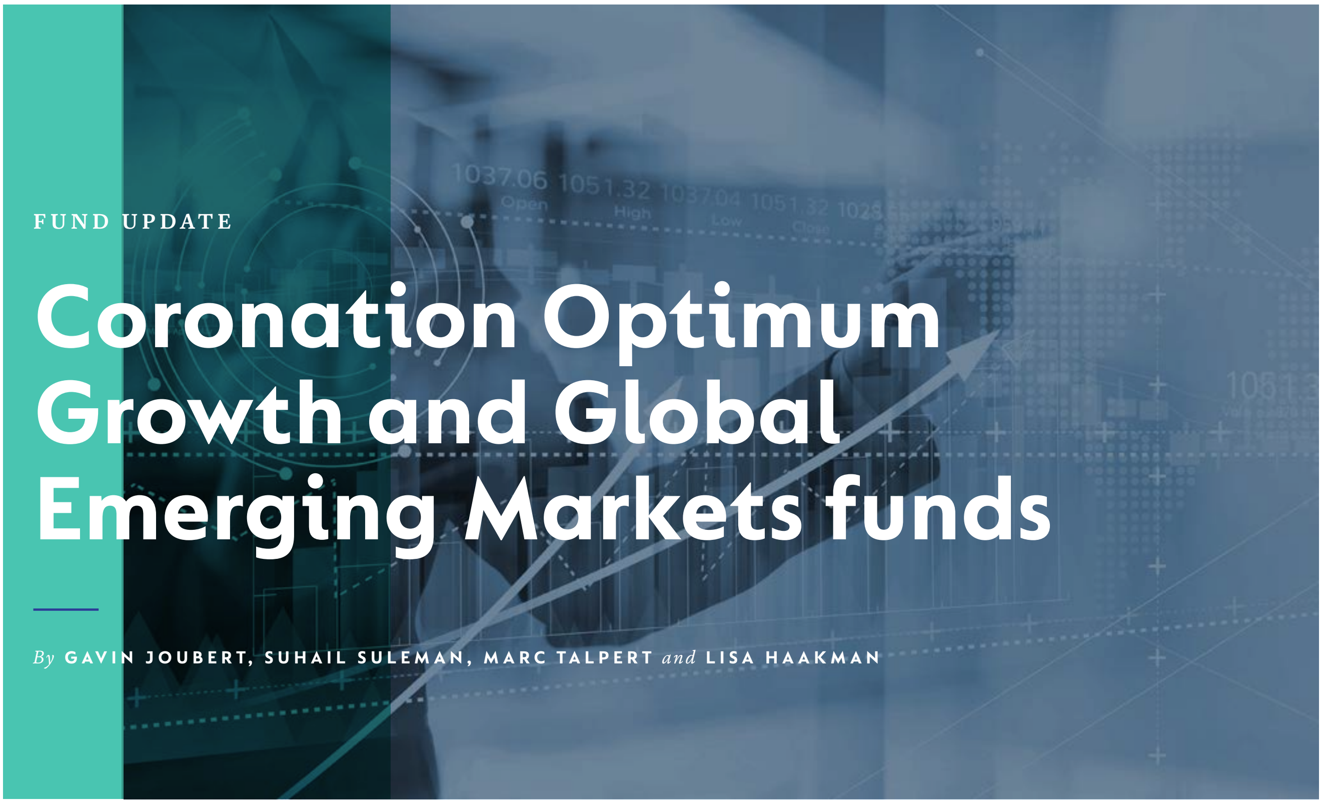
The remaining 54% of the Fund is invested in either more stable assets or diversifying assets, which we think have lower correlation to equities:

- 7% in commodities
- 2% in inflation-linked bonds
- 7.5% in absolute return/hedged equity positions
- 37.5% in investment-grade fixed income (primarily 16% in short-dated Treasury bills and 19% in investment-grade corporate credit).

TO CONCLUDE

As we wrote last quarter, we still see ample opportunities for stock pickers, and we continue to hold balanced portfolios of competitively advantaged businesses.

Thank you for your continued support and interest in the funds.✚



FUND UPDATE

Coronation Optimum Growth and Global Emerging Markets funds

By **GAVIN JOUBERT, SUHAIL SULEMAN, MARC TALPERT** *and* **LISA HAAKMAN**

Gavin is Head of Global Emerging Markets and has 20 years of investment experience.

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

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

Lisa is a global emerging markets portfolio manager with 14 years of investment experience.

OPTIMUM GROWTH DECLINED 0.6% in the first quarter of 2021 (Q1-21), yet we believe that the collection of assets held by the Fund still offers compelling, long-term, risk-adjusted returns with which to deliver on its goal of compounding capital well ahead of inflation. Over the past five years, the Fund has generated a positive rand return of 11.1% p.a. over 10 years, a return of 16.2% p.a. and since inception over 20 years ago, 14.3% p.a.

The Coronation Global Emerging Markets Fund returned 2.4% in Q1-21, 0.1% ahead of the benchmark MSCI Emerging Markets (Net) Total Return Index. Over the last 12 months, the Fund has returned 64.1%, 5.8% ahead of the benchmark's return. The very high absolute returns from both the Fund and the benchmark should be seen in the context of the market selloff during March 2020, the early stages of the Covid-19 pandemic, from which the markets subsequently recovered very strongly. Over two years, the Fund has outperformed the benchmark by 4.8% p.a., over five years by 1.7% p.a. and over 10 years by 1.6% p.a. Finally, since inception, the Fund has returned 6.9% p.a., which is 2.4% p.a. ahead of its benchmark. We are pleased with this level of outperformance and continue to believe that focusing on higher-quality undervalued assets, and being disciplined in buying them at an attractive margin of safety (and selling them when they are expensive), will generate outperformance for our investors over meaningful long-term periods of time.

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OPTIMUM GROWTH

The largest positive contributors to the performance of Optimum Growth in the quarter were Naspers (+15%; 0.49% positive impact on Fund performance), Alphabet (+20%; 0.45% positive impact) and Tencent Music Entertainment (+10%; 0.35% positive impact).

The Fund incurred unrealised losses on a collection of put option and short index positions that provided valuable protection historically, but detracted from performance this quarter due to a buoyant market. Collectively, these put options and short index positions had a 0.7% negative impact during the quarter; however, they continue to provide the Fund with protection should there be a market selloff. Outside of this, the other notable negative detractors were Unity Software (-34%; 0.38% negative impact on Fund performance), our physical gold position (-9%; 0.34% negative impact) and the London Stock Exchange Group (0.28% negative impact).

Optimum Growth ended the quarter with 77.8% net equity exposure, roughly 5% higher than at the end of December 2020, as we found compelling equity opportunities. Notable buys/increases in position sizes during the quarter were Nintendo, Porsche and Vinci.

Nintendo is a gaming company founded in 1889 as a Japanese playing card business, but moved into video games in 1977. It has a long history of releasing successful video game titles, and it owns leading franchises such as Super Mario, The Legend of Zelda, Animal Crossing and Pokémon. Nintendo creates both the games and the hardware on which these games are played, which have often driven innovation in the gaming hardware space. The company is obsessed with quality and, as such, has been slower than its peers in monetising its world-class intellectual property (IP). This provides Nintendo with a significant opportunity, and there have been some positive indicators that the business will take advantage of this opportunity.

The business's new CEO (since 2018) appears more flexible and willing to open monetisation avenues compared to his predecessors, and this approach is evidenced by the company's more aggressive moves into film, theme parks and mobile games – all-important monetisation touchpoints for its IP. We believe the business is underearning versus its long-term potential and currently trades on 17 times our estimate of 2022 earnings, which should continue to grow at a high single-digit rate and is further supported by an approximately 3% dividend yield.

Porsche is a holding company, with its major assets being its 53% ownership in carmaker, VW, common stock. VW is the second-largest auto manufacturer globally and owns brands such as VW, Audi, Porsche and Lamborghini. We are positive on VW's underlying business, with a key element of the investment case being the business's transition from an internal combustion engine auto manufacturer to an electric engine auto manufacturer.

Management is confident that in this transition, notwithstanding huge investments ($86 billion between now and 2025), electric vehicle sales growing in the mix will not be dilutionary to margins. Based on our financial year 2022 estimates of free cash flow (FCF), VW is trading on an approximate 8% FCF yield. Porsche is then trading at a 24% discount to its shareholding in VW, which we don't believe is fundamentally justified.

Vinci is one of the world's largest concessionaires and construction contracting companies. It owns irreplaceable, high-quality toll roads (with a non-commuter focus), with high visibility due to the long-term nature of the concession contracts. The business also operates a collection of airports, which are currently under pressure due to the travel disruption caused by Covid-19, but which we believe are still attractive assets that should rebound and be supported by the continuing structural growth trend of leisure travel. Finally, Vinci has a highly efficient and risk-control-obsessed building contracting business that contributes 80% of group revenue but 24% of net income.

More recently, the company acquired a business that gives it exposure to renewal energy concessions, which are expected to grow rapidly in the future. Due to the nature of its customer contracts, Vinci is a business that should deliver highly visible earnings and FCF, driving healthy double-digit total shareholder returns in hard currency, which is attractive, especially considering the inflation-linked nature of earnings.

Our negative view on global bonds remained unchanged, as a large portion of developed market sovereign bonds offers negative yields to maturity, with the follow-on effect that most corporate bonds also offer yields that do not compensate for the risk undertaken. Only 1% of the Fund is invested in bonds, which is largely made up of a 0.51 % position in L Brands (owner of Victoria's Secret) corporate bonds.

The Fund also has c.1.85% invested in global property – largely Vonovia (German residential). Lastly, the Fund has a physical gold position of >

3.4%, a 1% holding in AngloGold Ashanti and a 0.8% holding in Barrick Gold Corp, the largest gold miner globally. The gold price is down approximately 13% in US dollars year to date, but we continue to hold the position for its diversifying properties in what we characterise as a low-visibility world.

The balance of the Fund is invested in cash, primarily offshore. As has been the case for many years, the bulk of the Fund (over 90%) is invested offshore, with very little exposure to South Africa.

The markets remain volatile as the Covid-19 pandemic continues to cause disruption around the world, with various governments responding in different ways; with some achieving rapid success in their vaccination drives while others falter. This will potentially result in a world where the paths to normalisation worldwide are quite different, which can continue to create a disruptive operating environment for many businesses.

However, the pandemic will only end when the world is vaccinated at an individual country level, and thus, notwithstanding real issues surrounding equitable access to vaccines, there is hope that access will improve in the coming months. This future scenario, however, still has many unknowns associated with it, creating an environment characterised by uncertainty and disruption.

As the outlook for the future remains uncertain and hard to predict, we take comfort in the fact that the Fund holds a collection of businesses that we feel are attractively priced and can operate in what we deem a highly complex and fast-changing environment. Also, because the Fund is a multi-asset flexible fund, we have access to additional tools to take advantage of dislocations in the market, with the increased equity exposure being an example.

As vaccines roll out across the world (with initial real-world data indicating they are working well to reduce the hospitalisation and fatality risks associated with Covid-19), there is reason to be optimistic that the devastating effects of the pandemic are closer to ending.

However, there remains uncertainty as to when the entire world will reach a level of vaccination that allows life to return to normal. However, against this backdrop, we remain positive on the Fund's outlook, which has been built bottom-up, with a collection of attractively priced assets providing diversification in order to achieve the best risk-adjusted returns going forward.

GLOBAL EMERGING MARKETS

The biggest contributor to outperformance (alpha) in the quarter was the Naspers and Prosus combined position, which returned an effective 13% in the period. Naspers and Prosus are owned in preference to owning Tencent outright, due to the discount at which Naspers trades to the look-through value of its stake in Prosus and the onward discount at which Prosus trades to the value of its stake in Tencent.

At the beginning of the year, these discounts effectively allowed a Naspers shareholder to own Tencent at an approximate 40% discount to the value of its Tencent stake alone, with all other assets valued at zero. During the quarter, the discount narrowed a few percentage points (Naspers outperformed Tencent by about 8%), and this, coupled with the overweight position, contributed close to 1% of alpha alone. Not holding Tencent directly cost 0.3% of alpha, resulting in a net alpha contribution of 0.7% overall. Management of Naspers and Prosus has undertaken to unlock this discount over time and is heavily incentivised to do so.

Another significant contributor was a member of the Tencent family – Tencent Music Entertainment (TME; 57% held by Tencent). TME rose by 65% from the start of the quarter to 23 March, but then declined precipitously over the next three days and did little thereafter, ending only 6.5% higher. The proximate cause for this decline was the massive unwind in many stocks caught up in the much-publicised Archegos fiasco. TME was a 2.4% position at the start of the quarter, and we sold regularly as the share price increased until, at one point in March, the position size was down to 1.3% of the Fund as a result of the sales.

In our view, there was no significant change in the underlying value of the business after the share price sold off, so we bought back sufficient stock during the tumult to leave the position size at quarter-end almost unchanged at 2.3% of Fund. The realised return from TME for the Fund was almost double the reported 6.5% price appreciation and the overall alpha contribution amounted to 0.7%.

Brazilian retailer CBD also contributed, in a positive example of value unlock by management. At the turn of the year, the Fund held a 2.0% position in CBD, whose ADRs[1] were priced at $14.30. This was over a third lower than the share price at the start of 2020.

[1] American Depositary Receipt – when a company with a listing in one country has a secondary listing in America to make it easier for people to invest, particularly if it's difficult for foreigners to invest in the local listing.

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Although part of this was driven by the decline in the currency, this was one of the few food retailers under our coverage to see such marked share price weakness, particularly when one considers that food retailers faced among the least business disruption worldwide as 'essential service providers', and much of the spending that would otherwise have taken place in restaurants and bars migrated toward them. CBD's management team, with whom we have engaged extensively over the years, announced and carried out a plan to separate the business into its two constituent parts in order to realise better value for the underlying parts of the business.

This separation was announced last year, but only came to fruition in early March after the business received all the requisite regulatory and shareholder approvals. At this point, CBD spun out its lucrative cash-and-carry business, Assai, to shareholders, with the core supermarket and hypermarket business remaining in the original CBD. The spin-off was possible since the businesses had very separate management and supply chain structures, and their underlying drivers differ significantly.

The original CBD remains have rallied significantly off the post-spin-off ADR price, and this, coupled with appreciation in the Assai ADR price, has seen the combined value increase by 31.5% to $18.83. The combined alpha from CBD/Assai during the quarter came to 0.8%. We have retained both constituent stocks in the Fund, although the CBD position was trimmed in response to the share price moves.

The last two significant contributors to alpha were Naver and China Literature. Naver returned close to 24% in the quarter, while China Literature returned 26%. They each contributed around 0.4% to alpha. In the case of Naver, our conviction levels have increased significantly due to market developments. Naver is the number two ecommerce player in Korea. The number one player, Coupang, came to market in an IPO that was heavily oversubscribed and beyond valuation metrics that made sense to own in the Fund after it jumped 40% on its first day of trading. The additional information gleaned during the IPO process on the market opportunity, coupled with better disclosure by Naver, resulted in us increasing both our estimate of fair value and the overall conviction in the investment case.

As an example, Naver disclosed that its ecommerce gross merchandise value already amounted to $25 billion in 2020, and it has targeted a 30% market share by 2025, which would comfortably establish the business as a strong number two player, if achieved, in what will likely be a two-to-three player market. South Korea has the highest ecommerce penetration in the world (30%-32% estimate), a function of its high degree of urbanisation and technologically savvy population. As a result, its ecommerce market is already the fifth largest, despite the country being the 12th-largest economy overall.

On the negative side, the biggest detractor was Magnit, down 12% for a -0.4% contribution to alpha. This was in spite of decent 2020 results for both the company and X5, its main competitor and the largest player in Russian food retail (also held in the Fund). As expected, traffic declined significantly in stores during the year, but a 15% like-for-like increase in average basket size allowed like-for-like sales to increase by 8% in Magnit's mature stores, far in excess of inflation. Great cash generation allowed Magnit to reduce its debt burden in absolute terms, and the improvement in profitability saw leverage decline to 1.1 times net debt to earnings before interest, taxes, depreciation and amortisation (EBITDA). Magnit trades on 13.5 times forward earnings and offers an 8.5% dividend yield, which in both absolute and relative terms is very attractive.

The other material detractor (-0.4%) was New Oriental Education, which declined 25% in the quarter. In an almost carbon copy reaction to previous regulatory intervention in 2018 (which allowed us to buy New Oriental after a 40% share price decline), various levels of the Chinese government (both national and regional level) enacted rules aimed at curbing abuse by smaller tuition providers.

The trigger for the intervention was the news that many small providers, having taken tuition payments upfront, then went out of business, leaving parents with no recourse to the funds paid in advance. The regulatory authorities now require money to be suitably deposited at a bank, with parents ranking as secured creditors. Additional changes include restrictions on sales and marketing, as well as tighter approval processes for awarding business licences. These changes should all benefit the established credible players, such as New Oriental, as they raise barriers to entry and make it more difficult for smaller, sub-scale players to use temporary cash flows to stay afloat.

We added to New Oriental on the price decline and also bought TAL Education into the Fund. TAL is another leading tuition provider that we owned many years ago but sold out as it reached fair value. We have long wanted to own it again,

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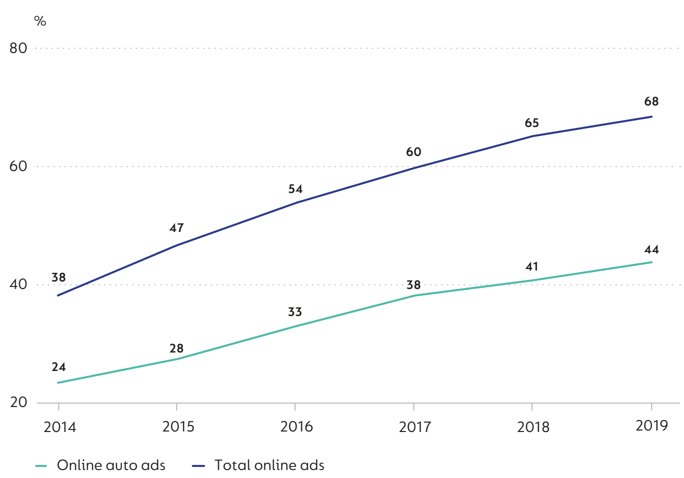
as the business has executed incredibly well in the intervening years, but it had always been too expensive. The share price declined from $90 to $50 between mid-February and late-March, which provided a good buying opportunity. TAL differs from New Oriental in that it is focused on small class offerings or one-on-one tuition, and predominantly covers maths and science. This compares to New Oriental, which offers larger classes and a wider variety of subjects, particularly English.

Additionally, TAL has expanded more aggressively into the online space than its peers and has achieved a double-digit market share. The promotional spend to get there has affected its profitability, a situation we expect to reverse over time. The different operating models of the two businesses allow them both to take market share without necessarily coming into direct competition with each other.

Other than TAL, there were four small new buys. The first of these, Autohome (0.9% position), is the leading online destination for automotive information in China. The site is a 'one-stop shop' that helps users to research, buy and sell cars. Users can also access finance and insurance through the site, thereby covering the full value chain. Purchasing an automobile is an infrequent event for most users, and it typically requires significant groundwork in order to navigate through the multitude of options available. A specialist auto site with independent reviews offers greater value to consumers than general sites and/or those with predominantly sponsored content.

Figure 1

AUTO AD ONLINE PENETRATION VERSUS OVERALL AD ONLINE PENETRATION IN CHINA



Sources: iResearch, eMarketer, HSBC estimates

Like most internet portals, the feedback loop between a large number of users or traffic creates an ecosystem of greater value than what the competition offers and raises barriers to entry for competing sites. With 62 million monthly active users, Autohome is larger than the next three largest apps combined. The site makes money through advertising, generating leads for dealers, providing demand data (colours, models, etc.) to manufacturers, and matching buyers and sellers of used cars. Additional commission is also earned by facilitating financing and insurance for vehicle purchases.

The tailwinds for growth for Autohome are very strong. In addition to rising income levels, there are the twin benefits of low vehicle penetration and low online advertising penetration in automobiles relative to other sectors (see Figure 1). The used car market is also relatively new (the existing vehicle fleet in the country is not particularly old), and this will change over time. Autohome is capital light and generates returns on invested capital above 35%. Due to the very-high cash conversion (>100% of earnings converted to cash), Autohome has almost a third of its market cap in cash and trades at 16 times forward earnings, excluding this cash. The company also benefits from having Ping An as an anchor shareholder (45%), as Ping An brings strong strategic skills and significant network benefits from its large customer base.

The second new buy, AngloGold Ashanti (0.5% position), is the first gold miner we have owned in the Fund. This is the most attractive of the major emerging market gold miners in our view (if one excludes the marginal ones) and trades on eight times forward earnings and a spot FCF yield of almost 5%.

Aside from the standalone attractiveness of the stock from a valuation perspective, we believe it brings something different to the portfolio due to the role of gold as a hedge against elevated valuations, something we had become concerned about early in the quarter, but which is less of an issue now in the subsequent market pullback. We also bought small positions in XP Inc. (0.4%), a highly innovative Brazilian wealth manager and investment bank, and Xiabuxiabu Catering (0.3%), which operates Hot Pot restaurants across China.

Finally, due to continued share price strength and reaching of our estimate of fair value, we sold the small remaining positions in Hong Kong Exchanges and Midea Group (a Chinese appliance maker). Each was a 0.4% position at the beginning of the year. ✚

Domestic flagship fund range

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

INVESTOR NEED

	INCOME ONLY	INCOME AND GROWTH		LONG-TERM CAPITAL GROWTH	
FUND	**STRATEGIC INCOME** Cash†	**BALANCED DEFENSIVE** Inflation†	**CAPITAL PLUS** Inflation†	**BALANCED PLUS** Composite benchmark† (equities, bonds and cash)	**TOP 20** FTSE/JSE C-SWIX†
FUND DESCRIPTION	Conservative asset allocation across the yielding asset classes. Ideal for investors looking for an intelligent alternative to cash or bank deposits over periods from 12 to 36 months.	A lower risk alternative to Capital Plus for investors requiring a growing regular income. The Fund holds fewer growth assets and more income assets than Capital Plus and has a risk budget that is in line with the typical income-and-growth portfolio.	Focused on providing a growing regular income. The Fund has a higher risk budget than the typical income-and-growth fund, making it ideal for investors in retirement seeking to draw an income from their capital over an extended period of time.	Best investment view across all asset classes. Ideal for pre-retirement savers, as it is managed in line with the investment restrictions that apply to pension funds. If you are not saving within a retirement vehicle, consider Market Plus, the unconstrained version of this mandate.	A concentrated portfolio of 15-20 shares selected from the entire JSE, compared to the average equity fund holding 40-60 shares. The Fund requires a longer investment time horizon and is an ideal building block for investors who wish to blend their equity exposure across a number of funds. Investors who prefer to own just one equity fund may consider the more broadly diversified Coronation Equity Fund.
INCOME VS GROWTH ASSETS[1] ● INCOME ● GROWTH	96.1% 3.9%	55.4% 44.6%	40.7% 59.3%	25.2% 74.8%	0.0% 100.0%
LAUNCH DATE	Jul 2001	Feb 2007	Jul 2001	Apr 1996	Oct 2000
ANNUAL RETURN[2] (Since launch)	9.8% 7.5%†	9.3% 5.7%†	11.4% 5.6%†	14.1% 13.0%†	17.3% 13.5%†
QUARTILE RANK (Since launch)	1st	1st	1st	1st	1st
ANNUAL RETURN (Last 10 years)	8.2% 6.0%†	9.1% 5.0%†	8.2% 5.0%†	10.4% 11.2%†	11.0% 10.5%†
STANDARD DEVIATION (Last 10 years)	2.2% 0.3%†	5.6% 1.3%†	7.1% 1.3%†	9.6% 8.8%†	14.2% 13.9%†
FUND HIGHLIGHTS	The Fund remains the top-performing fund in its category since launch in 2001 and outperformed cash by 2.3% over this period.	Outperformed inflation by 3.6% p.a. (after fees) since launch, while producing positive returns over 12 months more than 99% of the time.	The Fund remains the top-performing fund in its category since launch in 2001 and outperformed inflation by 5.8% p.a. (after fees) over this period.	No. 1 balanced fund in South Africa since launch in 1996, outperforming its average competitor by 2.0% p.a. Outperformed inflation by on average 8.0% p.a. since launch and outperformed the ALSI on average by 1.0% p.a. (since launch).	The Fund added 3.7% p.a. to the return of the market. This means that R100 000 invested in Top 20 at launch in October 2000 grew to more than R2.6 million by end-March 2021. The Fund is a top quartile performer since launch.

[1] *Income versus growth assets as at 31 March 2021. Growth assets defined as equities, listed property and commodities (excluding gold).*

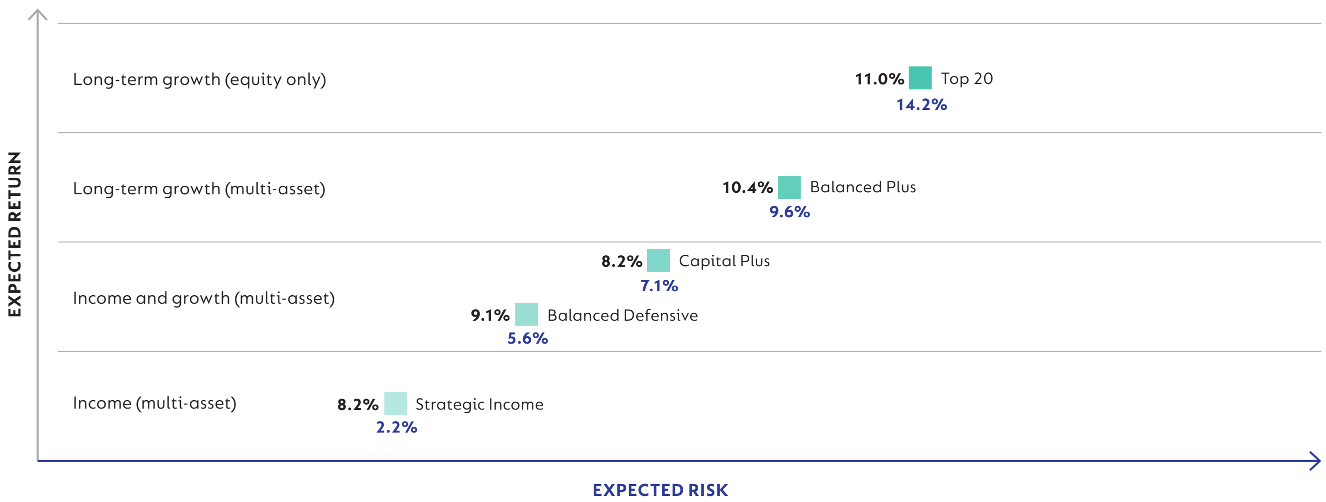
[2] *Highest annual return*
Balanced Defensive: 23.1% (Apr 2020 - Mar 2021); Balanced Plus: 49.3% (Aug 2004 - Jul 2005); Capital Plus: 33.8% (Aug 2004 - Jul 2005); Strategic Income: 18.7% (Nov 2002 - Oct 2003); Top 20: 68.9% (May 2005 - Apr 2006)

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

Figures are quoted from Morningstar as at 31 March 2021 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

RISK VERSUS RETURN

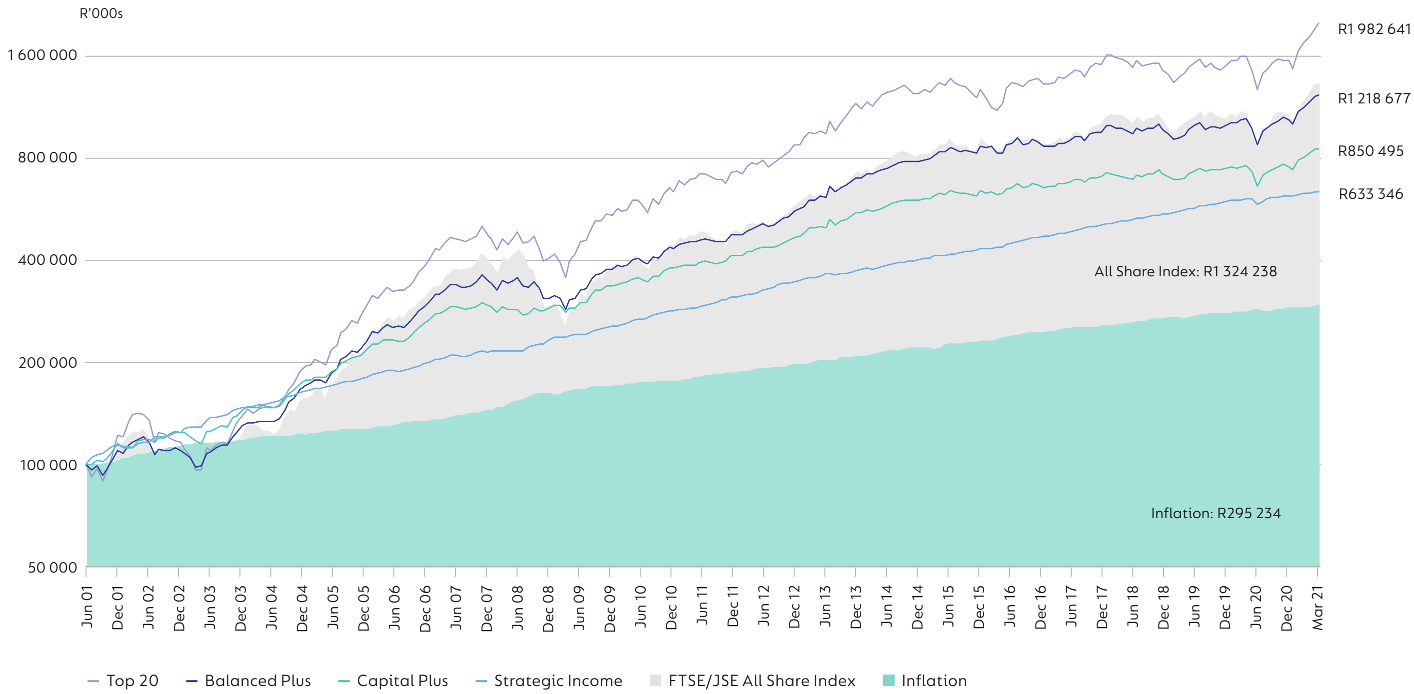
10-year annualised return and risk (standard deviation) quoted as at 31 March 2021.
Figures quoted in ZAR after all income reinvested and all costs deducted.



Source: Morningstar

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

Value of R100 000 invested in Coronation's domestic flagship funds since inception of Capital Plus on 2 July 2001 as at 31 March 2021. All income reinvested for funds; FTSE/JSE All Share Index is on a total return basis. Balanced Defensive is excluded as it was only launched on 1 February 2007.



Source: Morningstar

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International flagship fund range

INVESTOR NEED

	DEPOSIT ALTERNATIVE	CAPITAL PRESERVATION	LONG-TERM CAPITAL GROWTH (MULTI-ASSET)		LONG-TERM CAPITAL GROWTH (EQUITY ONLY)
FUND[1]	**GLOBAL STRATEGIC USD INCOME** US dollar cash (3 Month Libor)†	**GLOBAL CAPITAL PLUS** US dollar cash (3 Month Libor)†	**GLOBAL MANAGED** Composite (equities and bonds)†	**OPTIMUM GROWTH** Composite: 35% JSE CAPI, 15% ALBI, 35% MSCI ACWI, 15% BGBA	**GLOBAL EQUITY SELECT** MSCI All Country World Index
FUND DESCRIPTION	An intelligent alternative to dollar-denominated bank deposits over periods of 12 months or longer.	A low-risk global balanced fund reflecting our best long-term global investment view moderated for investors with smaller risk budgets. We offer both hedged and houseview currency classes of this fund. In the case of the former, the Fund aims to preserve capital in the class currency over any 12-month period.	A global balanced fund reflecting our best long-term global investment view for investors seeking to evaluate outcomes in hard currency terms. Will invest in different asset classes and geographies, with a bias towards growth assets in general and equities in particular.	The aim of the Fund is to maximise long-term investment growth by investing in a range of opportunities available in public asset markets from both South Africa and around the world. Our intent is to provide competitive after-inflation returns measured in rand over all five-year periods.	The Fund aims to give investors access to the best opportunities in global equity markets. The Fund is biased to developed markets and actively seeks out attractively valued shares to maximise long-term growth. Our intent is to outperform the global equity benchmark over all periods of five years and longer.
INCOME VS GROWTH ASSETS[2] ● INCOME ● GROWTH	96.7% 3.3%	55.3% 44.7%	24.5% 75.5%	13.4% 86.6%	0.0% 100.0%
LAUNCH DATE OF OLDEST FUND	Dec 2011	Nov 2008	Oct 2009	Mar 1999	Jan 2015
ANNUAL RETURN[3] (Since launch)	2.4% 0.9%†	5.1% 0.8%†	7.1% 7.5%†	9.9% 7.3%	7.4% 9.7%
QUARTILE RANK (Since launch)	–	1st	1st	1st	2nd
ANNUAL RETURN[3] (Last 5 years)	2.0% 1.5%	4.4% 1.5%	7.8% 9.2%	10.9% 9.5%	12.6% 13.2%
ANNUAL RETURN[3] (Last 10 years)	–	3.1% 0.9%	6.4% 7.0%	7.5% 4.8%	- -
QUARTILE RANK (Last 5 years)	–	1st	2nd	1st	1st
FUND HIGHLIGHTS	Outperformed US dollar cash by 1.4% p.a. (after fees) since launch in December 2011.	The Fund has outperformed US dollar cash by 4.3% p.a. (after fees) since launch in 2008.	No. 1 global multi-asset high-equity fund in South Africa since launch in October 2009.	The Fund has out-performed the composite benchmark since launch and was a top quartile performer in the Worldwide MA Flexible category since launch in 1999.	The Fund continues to seek attractively valued shares to maximise long-term growth.

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

2 *Income versus growth assets as at 31 March 2021 (for US dollar funds). Growth assets defined as equities, listed property and commodities (excluding gold).*

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

Highest annual return
Global Strategic USD Income: 7.1% (Jan 2012 - Dec 2012); Global Capital Plus [ZAR] Feeder: 31.4% (Mar 2009 - Feb 2010); Global Managed [ZAR] Feeder: 34.8% (Apr 2020 - Mar 2021); Global Equity Select: 56.6% (Apr 2020 - Mar 2021); Optimum Growth [ZAR]: 72.8% (Mar 2009 - Feb 2010)

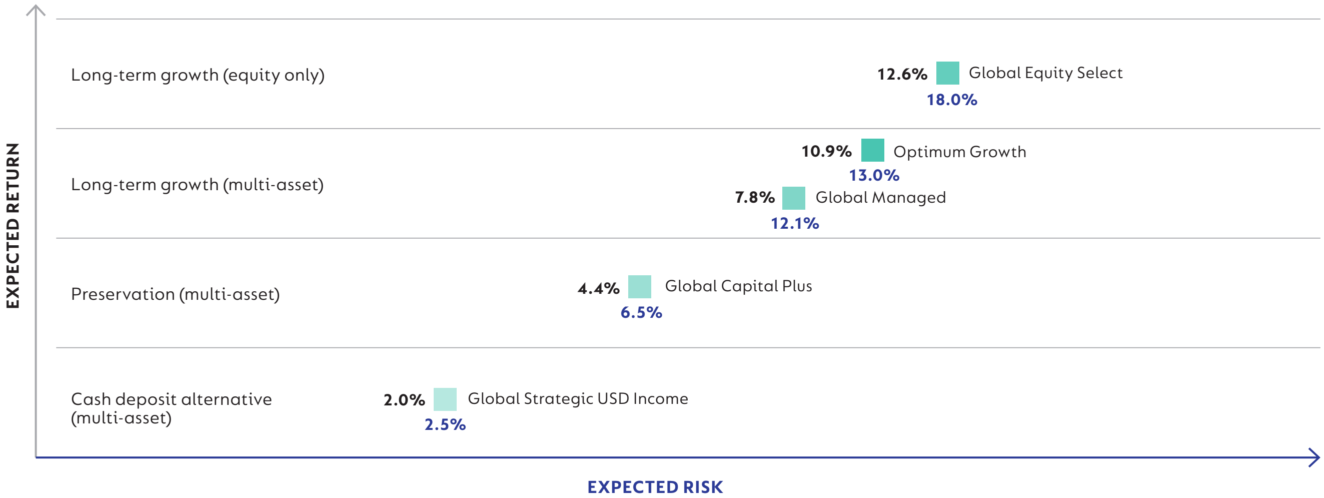
Lowest annual return
Global Strategic USD Income: -2.0% (Apr 2019 - Mar 2020); Global Capital Plus [ZAR] Feeder: -7.0% (Mar 2015 - Feb 2016); Global Managed [ZAR] Feeder: -14.9% (Mar 2015 - Feb 2016); Global Equity Select: -21.9 % (Mar 2015 - Feb 2016); Optimum Growth [ZAR]: 49.2% (Dec 2007 - Nov 2008)

Figures are quoted from Morningstar as at 31 March 2021 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

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

RISK VERSUS RETURN

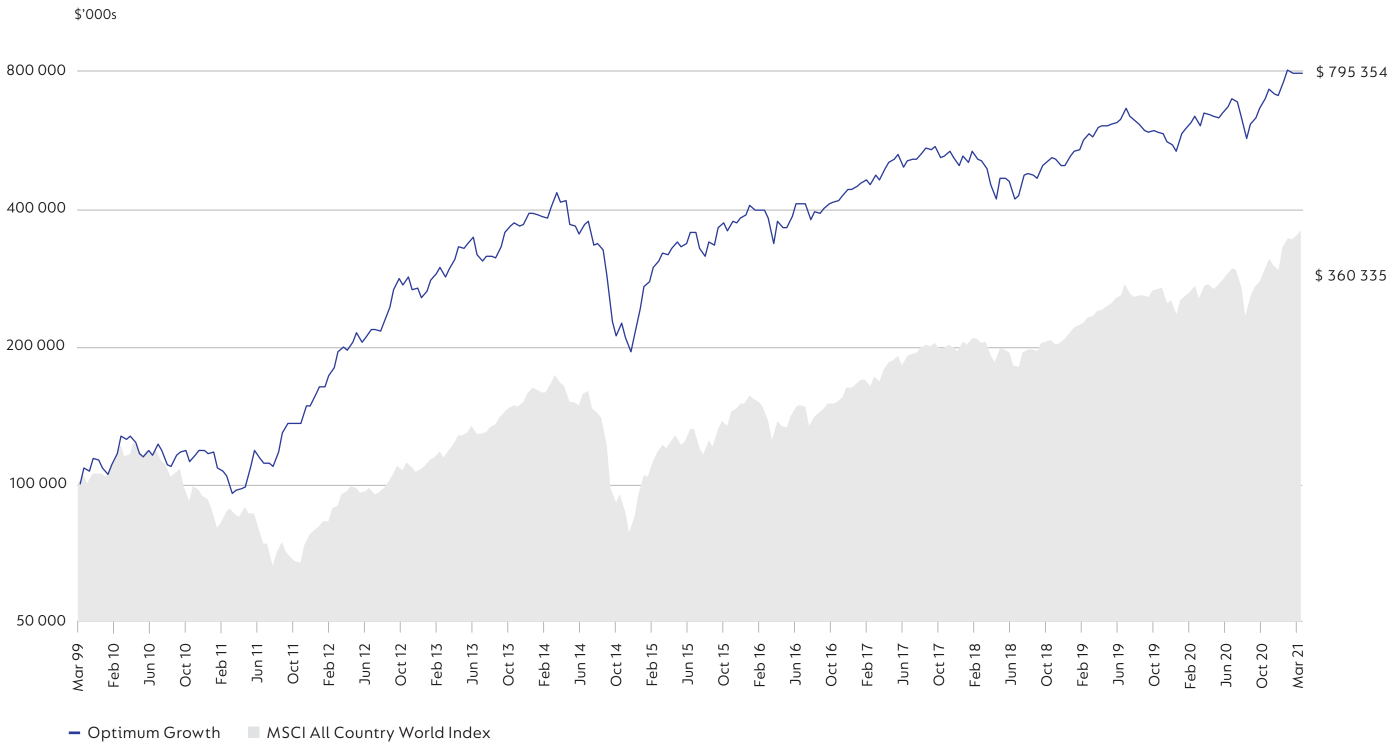
5-year annualised return and risk (standard deviation) quoted as at 31 March 2021. Figures quoted in USD (for the oldest fund) after all income reinvested and all costs deducted.



Source: Morningstar

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

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



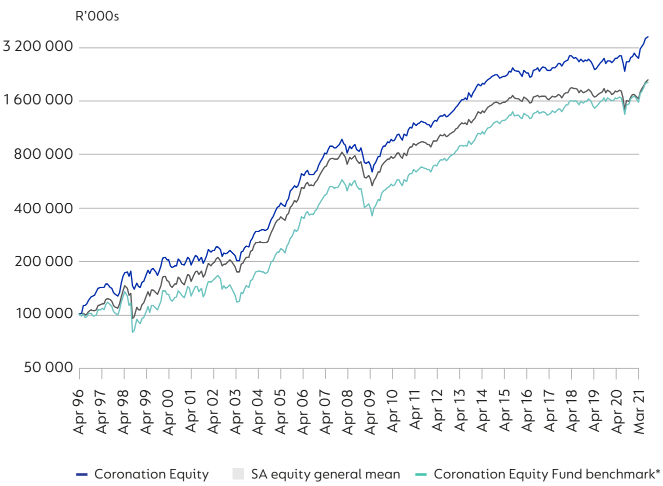
Source: Morningstar

Long-term investment track record

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

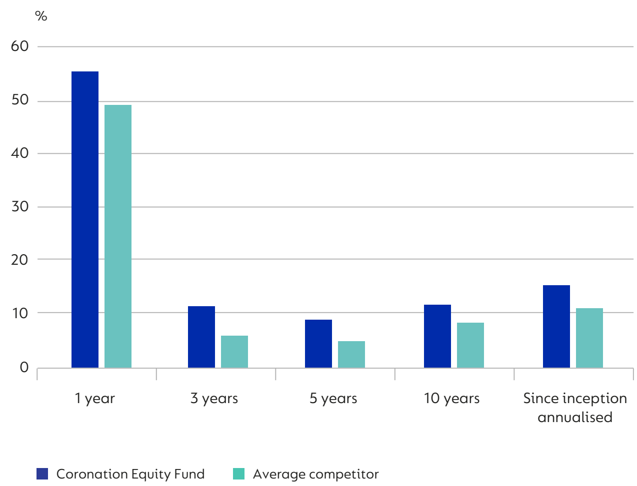
10-YEAR ANNUALISED RETURNS	CORONATION EQUITY	AVERAGE COMPETITOR	OUTPERFORMANCE OF AVERAGE COMPETITOR
2006	19.38%	17.09%	2.30%
2007	21.45%	19.23%	2.22%
2008	17.62%	18.47%	(0.84%)
2009	16.53%	16.68%	(0.15%)
2010	19.59%	19.14%	0.45%
2011	18.03%	16.98%	1.05%
2012	21.12%	18.94%	2.19%
2013	21.60%	18.68%	2.92%
2014	18.44%	16.32%	2.12%
2015	14.86%	12.62%	2.24%
2016	11.95%	9.54%	2.41%
2017	11.99%	8.90%	3.09%
2018	12.77%	10.54%	2.23%
2019	11.35%	8.71%	2.63%
2020	10.48%	7.10%	3.38%
9 years 3 months to March 2021	12.51%	8.89%	3.63%
ANNUALISED TO 31 MARCH 2021	**CORONATION EQUITY**	**AVERAGE COMPETITOR**	**OUTPERFORMANCE**
1 year	55.40%	49.14%	6.26%
3 years	11.46%	5.96%	5.49%
5 years	9.07%	4.91%	4.16%
10 years	11.75%	8.43%	3.32%
Since inception in April 1996 annualised	15.45%	11.22%	4.23%
Average outperformance per 10-year return			1.99%
Number of 10-year periods outperformed			14.00
Number of 10-year periods underperformed			2.00

CUMULATIVE PERFORMANCE



Source: Morningstar

ANNUALISED RETURNS TO 31 MARCH 2021



Source: Morningstar

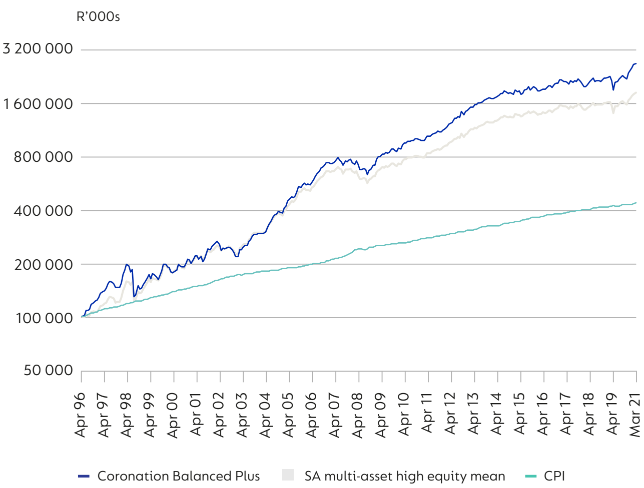
An investment of R100 000 in Coronation Equity on 15 April 1996 would have grown to **R3 589 494** by 31 March 2021. By comparison, the returns generated by the Fund's benchmark over the same period would have grown a similar investment to **R1 999 131**, while the South African equity general sector would have grown a similar investment to **R2 060 943**.

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

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

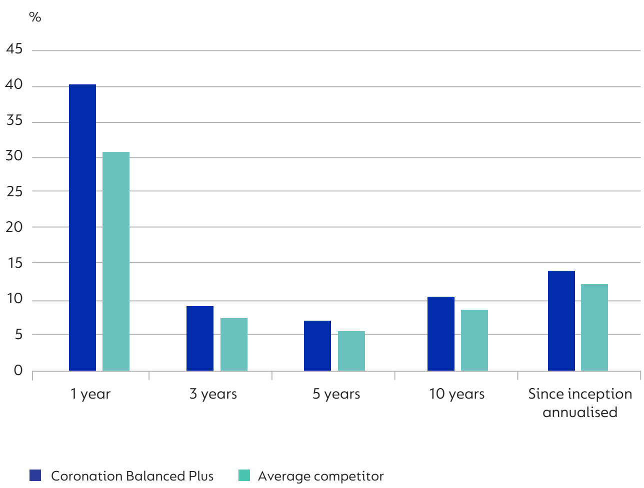
10-YEAR ANNUALISED RETURNS	CORONATION BALANCED PLUS	INFLATION	REAL RETURN
2006	18.33%	6.47%	11.86%
2007	17.81%	6.59%	11.22%
2008	16.96%	6.87%	10.09%
2009	15.69%	6.75%	8.94%
2010	17.20%	6.28%	10.93%
2011	15.78%	6.24%	9.54%
2012	17.85%	5.76%	12.09%
2013	18.63%	5.90%	12.73%
2014	16.58%	6.00%	10.57%
2015	14.01%	6.12%	7.89%
2016	11.08%	6.30%	4.77%
2017	11.04%	5.92%	5.12%
2018	11.26%	5.34%	5.92%
2019	10.30%	5.11%	5.19%
2020	9.66%	5.07%	4.58%
9 years 3 months to March 2021	10.71%	5.01%	5.70%
ANNUALISED TO 31 MARCH 2021	**CORONATION BALANCED PLUS**	**AVERAGE COMPETITOR**	**OUTPERFORMANCE**
1 year	40.10%	30.66%	9.44%
3 years	9.04%	7.28%	1.76%
5 years	6.95%	5.53%	1.42%
10 years	10.44%	8.55%	1.89%
Since inception in April 1996 annualised	14.10%	12.11%	1.99%
Average 10-year real return			8.75%
Number of 10-year periods where the real return is >10%			7.00
Number of 10-year periods where the real return is 5% - 10%			7.00
Number of 10-year periods where the real return is 0% - 5%			2.00

CUMULATIVE PERFORMANCE



Source: Morningstar

ANNUALISED RETURNS TO 31 MARCH 2021



Source: Morningstar

An investment of R100 000 in Coronation Balanced Plus on 15 April 1996 would have grown to **R2 676 374** by 31 March 2021. By comparison, the South African multi-asset high-equity sector over the same period would have grown a similar investment to **R1 837 626**.

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