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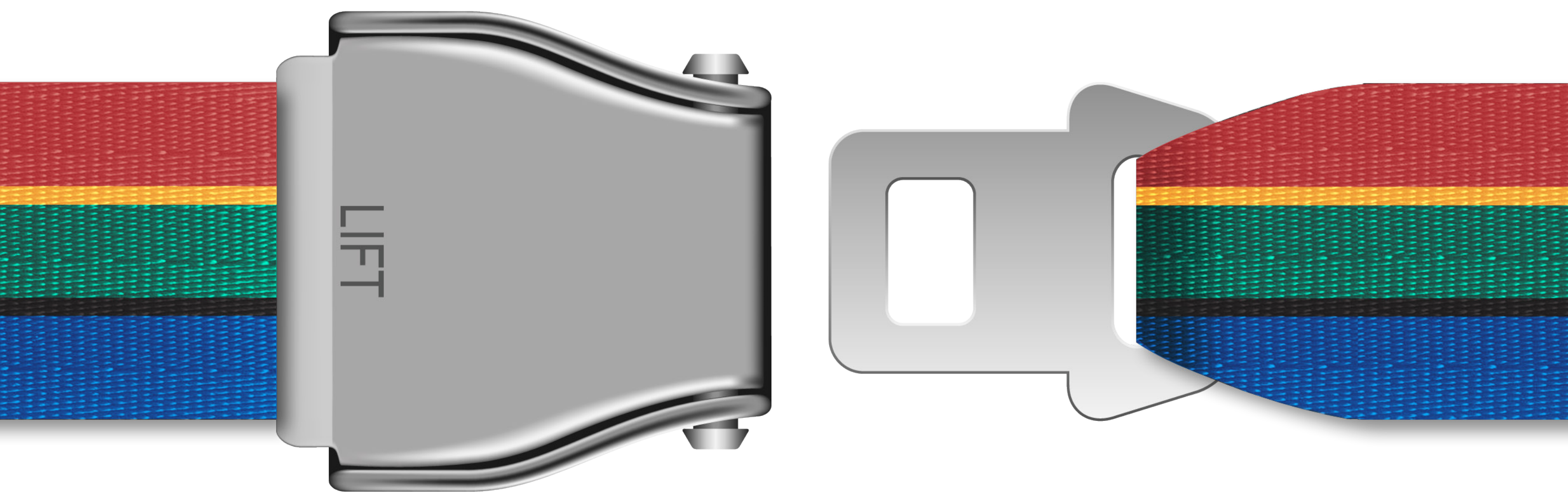

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NOTES FROM MY INBOX

TURBULENT TIMES

By Pieter Koekemoer

Pieter is head of the personal investments business. His key responsibility is to ensure exceptional client service through a combination of appropriate product, relevant market information and good client outcomes.

"You can change the weatherman, but that won't change the weather." – Attributed to SA Reserve Bank Governor Lesetja Kganyago

If this were a normal quarter-end, this report-back would have focused on a pleasing period of both absolute and relative returns across our fund range. I may have spent a paragraph on why the Top 20 Fund's year-to-date return is much better than the previous quarter's, or how the Balanced Plus Fund's recent robust performance bolstered its five-year compound growth rate. Unfortunately, this quarter was anything but normal, and we remain in a period of profound political and economic change around the world.

At home, the last few weeks have felt surreal (and not in a good way). SA again finds itself in crisis. The midnight hour cabinet reshuffle at the end of March dented confidence and triggered ratings downgrades, the effects of which will be felt for years to come. Attaining investment grade credit ratings was a significant achievement of the first democratically elected government, secured through great discipline 17 years ago. Government's commitment to fiscal discipline benefited all South Africans by lower borrowing costs, boosting economic growth and achieving greater redistribution through a progressive tax system. Recent political choices make it likely that at least some of these benefits will be lost.

In the near term, these events have most likely delivered a 'knockout blow' to the signs of economic recovery that emerged earlier this year. A deteriorating outlook has the most serious consequences for the poor, who have little defence against the economic fallout unleashed by infighting in the ruling party. A culture of corruption and patronage, dressed up in the language of radical economic transformation, will cause much harm.

The potential for increasingly populist, but ultimately self-defeating, policy choices in SA is echoed by global developments. The political shocks of 2016 continue to shift the ground under our feet. The new US president keeps on upsetting geopolitics, while the UK premier, Theresa May, recently triggered Article 50, bringing the UK a step closer to formally exiting the EU. Throughout the world, ordinary people are expressing their discontent with the established world order. Many developed-world citizens are simply fed up with the feeling of being left behind, which they blame on globalisation. Understandably, they want to see economic prosperity that does not only benefit a few. However, their discontent is channelled towards solutions (protectionism, anti-immigration, nationalism) that will not necessarily serve their own interests, or those of the broader society, in the long run. Reducing inequality by making everybody – including yourself – poorer, does not seem to be a sound strategy.

Against an unsettled background, this bumper edition of *Corospondent* contains our analysis of the concerning events unfolding around the world. In the lead article (page 5), Neville Chester dissects the impact of the recent developments in SA and the aftershocks that await investors and the economy. Our economist, Marie Antelme, examines the causes and economic ramifications of the rise of populism on page 8.

It is in turbulent times like these that we are continually reminded that risk is an integral and unavoidable part of life.

And the first rule of investing is to ensure that you allocate capital in a manner that will appropriately reward you for the risk you have taken. Most of us like to just talk return: it's simple and, let's face it, easier to understand. In his article (page 11), our CIO, Karl Leinberger, takes a closer look at the vital role that risk management plays in investments. This is a timely read for this new era of uncertainty.

Great investment opportunities continue to present themselves despite deteriorating politics, and as always, we continue to invest in long-term holdings that we believe will unlock value for our clients. In this issue, you will find our views on opportunities in a Russian banking behemoth (page 14) and in the local mobile telecommunication group MTN (page 16).

History has taught us, time and time again, that our ability to forecast the immediate future is limited. Our focus remains on building diversified portfolios of undervalued assets that can withstand the shocks that seem to keep coming our way. We remain steadfast in our focus and commitment to deliver investment excellence for our clients.

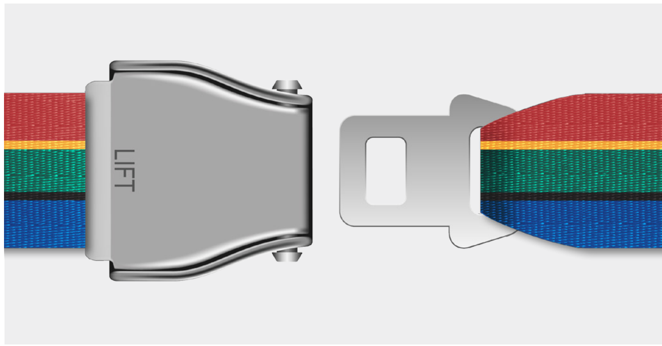
While the nature of our subject matter this quarter means that I cannot guarantee you a pleasant read, I do hope that you find our insights useful, providing you with some security and clarity in these pressured times.

As always, do not hesitate to let us know in case we have failed to live up to your expectations. ■

Pieter

MARKET MOVEMENTS

	1st quarter 2017	2016
All Share Index R	3.8%	2.6%
All Share Index $	5.9%	15.9%
All Bond R	2.5%	15.5%
All Bond $	4.6%	30.4%
Cash R	1.9%	7.4%
Resources Index R	2.7%	34.2%
Financial Index R	(1.1%)	5.4%
Industrial Index R	6.6%	(6.6%)
MSCI World $	6.4%	8.2%
MSCI ACWI $	6.9%	7.9%
MSCI EM $	11.5%	11.2%
S&P 500	6.1%	12.0%
Nasdaq $	12.1%	7.3%
MSCI Pacific $	7.0%	4.5%
Dow Jones EURO Stoxx 50 $	8.3%	0.7%



SA IN CRISIS

RADICAL ECONOMIC TRANSFORMATION WILL NOT END WELL FOR THE MAJORITY OF SOUTH AFRICANS

by Neville Chester

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

During our recent institutional roadshow, I was, for the first time in many years, fairly upbeat about our country's prospects for the year ahead. Commodity prices were up, heavy rains had resoundingly broken the drought, and both consumer and manufacturer confidence indices were rising. All of these boded well for a pick-up in economic growth. With the rand having strengthened, and inflation firmly under control and heading well below the top of the inflation target of 6%, the prospects were looking good for interest rate cuts that would further boost consumer spending power and the economy in general.

Post a recent investment conference hosted in March, where foreign investors met a broad array of local companies, it was clear that this confidence was shared: share prices of most SA-specific companies rose as foreign investors started backing the recovery with investment into the country. The rand strengthened further and bond yields dropped to a remarkable 8.2%; remarkable, as generally global bond yields were rising, not falling. All indications were that SA was pulling itself back on track post the shake-up in December 2015 when markets were shocked by Nenegate – the firing of finance minister Nhlanhla Nene and his replacement with little-known backbencher Desmond van Rooyen.

With this improved confidence would come stronger economic growth, which drives investment, which in turn would bring with it jobs and improving financial results, which then would boost overall tax revenues.

The ANC elective conference in December 2017 was the main risk to this improved outlook, with a clear high road/low road scenario depending on which faction within the ANC would come out on top. By mid-March, it still seemed that either faction had equal odds of winning the elective conference and setting ANC policy for the next five years.

All of this was completely derailed on Thursday 30 March. In a surreal event, a midnight cabinet reshuffle was orchestrated, apparently without involving any of the senior members of the ANC national executive committee. The ANC secretary general was so shocked as to publicly state, "This reshuffle was not done in consultation with the ANC, we were given a list that was done elsewhere and then it was given to us"[1]. Ten ministers and ten deputy ministers were fired or moved to different portfolios, and a number of new members, many of whom are fairly unknown, were introduced. The main blow to the economy was the removal of both the finance minister and his deputy, despite their sterling job in staving off a ratings downgrade and delivering a properly funded budget, notwithstanding the economic challenges SA faced in the past year. They were replaced with Malusi Gigaba, previously minister of public enterprises and more recently home affairs, and Sfiso Buthelezi, a relatively unknown backbencher who was an advisor to Zuma prior to his rise to the presidency. Interestingly, two of the new appointees, Gigaba and the new minister of police, Fikile Mbalula, were both past presidents of the ANC Youth League (ANCYL).

There has been much speculation as to where the new names came from, and what the intentions of all these various ministers will be. One can read plenty about their past connections and foibles in the popular press. It is more important to deal with the factual results of these appointments and what the economic impact will be. Perhaps most telling is the response of the current president of the ANCYL to ratings downgrades following these announcements: "We are welcoming the junk status. When the economy rises again, it will be held by us." The move to junk is nothing to be welcomed, and expectations of a rising economy an example of naivety in the extreme.

THE REAL EFFECTS

Since the cabinet changes, the yield on the benchmark 10-year government bond has pushed up to 9% and the rand has fallen from its recent peak of R12.20 to the dollar to R13.80. Domestic interest rate-sensitive companies like banks and retailers have fallen by 10% to 15%. Expectations of rate cuts and a return to economic growth are disappearing and inflation is no longer going to ease as expected. Why is this the case?

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[1] *Business Day 31 March 2017*

Regardless of all the conspiracy theories doing the rounds about looming special deals for connected parties, we know that the president and new ministers are now talking about radical economic transformation. These are the kinds of words and policies used by politicians with falling ratings to try to drum up support from the electorate. While it might succeed in appeasing the electorate, the only transformation to the economy is going to be a deterioration, ultimately impacting those self-same voters the most. Slicing up a pie in different ways does not grow the pie, but is certain to cause it to shrink.

State-owned enterprises (SOEs), which have been mismanaged and have consumed billions of rands over the past decade, are likely to be topped up by a newly compliant Treasury. This alone will increase the government debt burden by billions of rands. Ratings agencies have been very wary of these institutions, given their potential to massively increase the debt burden of all South Africans. Over and above all of this, the mooted project to build six to eight nuclear reactors, with a projected cost exceeding R1 trillion, appears to be on track again. Under Gordhan, the National Treasury had been steadfastly blocking this project as unnecessary and unaffordable. Post his removal, Treasury is now supportive of it progressing, despite the fact that following demand-side measures and the two new coal-fired power stations coming on line, SA now has significant surplus power capacity. SA has gross debt to GDP levels of 51% (rising to 61% if guarantees issued to SOEs are included). If all existing SOE debt is included, it rises to 69%, and with a potential R1 trillion nuclear build, debt to GDP exceeds 90%. Should this happen, we would be in a debt trap death spiral.

The reaction of two of the global ratings agencies to these changes has been swift and brutal. Our foreign debt ratings have been slashed to subinvestment grade (junk), with immediate impact on the cost of our funding. This is not something only affecting the arcane world of finance, but also has real punitive effects on every South African. As the cost of funding our debt goes up, it takes away valuable resources that could be used to fund social services, healthcare and education. It also results in a decline in the value of existing SA bonds, impacting millions of pensioners. We expect the remaining ratings agency (Moody's) to cut our foreign debt rating in the next few months. Meanwhile, SA debt has already been ejected from the JP Morgan Investment Grade Index. The biggest risk is still outstanding, however. Only one of the ratings agencies (Fitch) has moved our local currency debt rating to junk. Should another ratings agency cut this rating to junk, we will be ejected from the Barclays Global Aggregate Bond Index, resulting in the forced sale of approximately $5 billion of SA bonds. Should Moody's and Standard & Poor's downgrade our local currency bonds to junk status, we will be ejected from the Citi World Government Bond Index, triggering the forced sale of some $9 billion of our bonds. (At current exchange rates, this represents a cumulative outflow of R193 billion from the bond market.)

Do not hold your breath for any BRICS-friendly ratings agency to make an iota of a difference. As Warren Buffett famously said, never ask a barber whether you need a haircut. Similarly, global investors will not be swayed by the biased views of such an agency.

After Gordhan was reappointed as finance minister following the shock of Nenegate, corporate SA rallied around the National Treasury to deliver work streams to prevent a ratings downgrade and to drive economic growth through targeted investments in small businesses and various programmes designed to assist in alleviating service delivery and poverty. By and large, these initiatives were successful, certainly in managing the ratings agencies and in the establishment of a R1 billion fund to support SME development. Without a doubt these initiatives were instrumental in staving off the downgrade. As the Treasury shifts its focus to providing more funding to SOEs, including the unaffordable nuclear build, and amid its stated support for radical economic transformation, these initiatives are likely to stagnate and ultimately will be undone.

Given that the foreseeable outcomes of the radical cabinet changes, pushed through against the wishes of many senior ANC members, are all negative, why has the market reaction not been as negative as when Nene was fired? It is not obvious, but a couple of possibilities exist. Firstly, the sell-off after Nenegate proved a great buying opportunity as the market swung from despair to hope when Gordhan took control of the Treasury. Bonds and domestic shares, which were hardest hit, generated some of the best returns in 2016 as the market started to believe in the SA economic recovery story. There is definitely an element of hope playing out in markets currently where investors are buying these same assets in the hope that fiscal discipline is not going to be lost.

Secondly, as mentioned, the first quarter of 2017 was showing promising signs of recovery and many foreign investors were encouraged by a nascent economic turnaround. They may be viewing this sell-off as an opportunity to invest, not realising the significance of the change in our fiscal trajectory. All the major political surprises globally in 2016 have generally been buying opportunities, with UK and US equity markets rallying hard after their own political shocks. While South Africans are aware of how significant a blocking role the National Treasury and the incumbent finance minister had in the SA government, this is not common knowledge elsewhere.

Finally, one can only assume it is the 'frog in the pot' syndrome. According to the classic analogy, a frog thrown into a pot of boiling water will jump out in fright, saving itself, but if you put it in a pot of cold water and slowly turn up the heat, it will eventually die, not noticing the more subtle change in temperature until it is too late. Having been

through a similar event before and having heard constant threats of Gordhan's removal – have we all just become complacent to what is now, hot water?

One cannot overstate just how significant the change at the National Treasury is for SA. Since the dawn of democracy in SA, it has been a steadying force, applying fiscal conservatism as a guard against wasteful and profligate spending. The Public Finance Management Act is an important piece of legislation that required the finance ministry to have a final say in all major projects approved by other departments. Investors and all South Africans relied on the prudent actions of a well-respected finance team to control expenditure across government. If you look at countries around the world where radical government changes (led by populist parties with no fiscal restraint) have played out, the end game has been pretty predictable. Rampant growth in debt was followed by rampant printing of money and, ultimately, currency crises and defaults. While Zimbabwe is the obvious example, we have seen the same across many Latin American countries like Venezuela, Bolivia and Argentina. This is playing with fire, and it does not end well for the economy and the people.

PORTFOLIO IMPLICATIONS

We have for some time been managing our strategies with a high allocation to offshore assets. Most of our asset allocation strategies with mandates to invest offshore are at their maximum regulatory or mandated levels. Within our domestic equity allocation we have more recently had a high weighting to companies with earnings outside of SA or driven by dollar-based revenue lines (such as mining stocks).

In early 2016, we bought a lot of domestic shares as their prices fell in excess of 30% post Nenegate. As the year progressed and these shares did well and the rand strengthened, we felt that the return opportunity was once again more favourable, outside of the purely domestic shares. Given that the moves following the recent cabinet shake-up have not been as extreme, and the fact that we think the long-term changes in fiscal strategy are far less benign, we are not inclined to increase our purely domestic weighting.

Bonds, both globally and locally, have not looked attractive on a risk-return basis since the global financial crisis. We have avoided global bonds and, other than some tactical buying post Nenegate, we have generally avoided local bonds as well, due to our assessment that the yields did not offer sufficient return for the risk involved. We have preferred property instead where yields were as attractive, and well-managed companies are able to grow distributions in line or ahead of inflation. We have not been tempted to buy domestic bonds as yet given our concerns over the likelihood of our debt burden rising significantly and necessitating further debt issuance outside of the long-term projections of the budget office.

Our funds have performed well in volatile times, and the first quarter of 2017 has not been different. We have built portfolios based on a careful assessment of maximising returns at an acceptable level of risk. Still, this is cold comfort for the millions of South Africans facing a much bleaker future today as result of a stagnating economy and the reduced resources available for meeting social services. ■

FUELLED BY FEAR

THE RISE IN POPULISM AND ITS ECONOMIC IMPACT

By Marie Antelme

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

Brexit, the recent election of Donald Trump as US president and the upsurge in Eurosceptic parties over recent years are widely deemed indicative of a rise in 'populism'. This umbrella term is hard to define: the representation of a populist political 'left' and the policies it is likely to implement will be different from a populist 'right'. Another challenge is distinguishing between politics that may give rise to dangerous isolationist and divisive policies, and a more moderate representation of the interests of vulnerable groups. Using the term carelessly risks ignoring some of the nastier characteristics that have accompanied truly populist politics in the past. More often than not, political parties representing minority interests – the economically excluded or downtrodden, and a range of interests in-between – are labelled populist when this may not necessarily be the case.

WHAT IS POPULISM?

We have all read headlines in the past months about the politics of anger, but beneath the anger is always fear. Having established that there is no single definition of populism, and no common ideology that defines populist politics, it helps to distinguish between the ends of the spectrum and identify a number of common traits.

In today's language, 'leftist' political populism would likely see lower- and middle-income voters stand against a wealthy, politically powerful and economically influential elite – movements akin to the labour movements of the past. 'Rightist' populism is more likely to see the same groups uniting against an elite accused of protecting or supporting outsiders – movements characterised by anti-immigrant, racially resentful politics. This is an 'us and them' kind of politics, which holds the politically influential elite to ransom for a range of grievances, with a particular focus on foreigners or minorities. In both cases, the people most likely to vote for a populist party or candidate tend to be economically vulnerable – those who are older, have experienced job losses or income stagnation, or feel they face a threat to their social or national identity, survival, livelihood or personal wellbeing.

There are other shared characteristics, aside from a broad division of the population into 'the people' and 'the elites'. Populist movements tend to show fierce antagonism towards intellectuals (today's 'liberal elite'), favouring instinct over education. They champion polarising, divisive views and generally display contempt for the judiciary, and possibly also for the military and other political powers (such as government intelligence). Protectionist trade policies tend to feature, along with a willingness to implement capital controls and nationalise assets. There is usually also a strong intolerance of a free press.

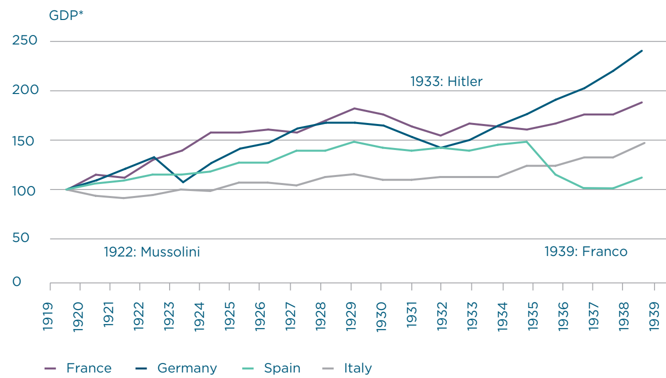
POLITICS WITH A LIVELY PAST

Populist 'uprisings' are not uncommon – especially in the US. During the late 19th century, the farmers and labourers who constituted the People's Party in the US (also known as the Populist Party, or simply The Populists) united against capitalist interests perceived to be driving inequality. The party called for the nationalisation of essential economic infrastructure – notably the railways – and was very critical of private banking.

Over time, the People's Party joined other labour movements, and in 1896 endorsed a Democratic candidate, who swept to victory through the People's Party's constituencies. Having lost its independent identity with this endorsement, the party never really recovered. However, a number of US presidents who have followed have favoured 'populist' policies as part of their election platform – most recently (and visibly) president Trump.

By the early 20th century, a new wave of populism emerged in Europe, which became more intense during the mid-war period, undoubtedly fuelled by the economics of post-World War I Europe, the Great Depression and the trade wars that coincided at the time. The political climate was characterised by nationalism in France and Francisco Franco's Spain, fascism in Italy and Nazism in Germany, especially between the two world wars as 'rightist' populism fuelled the rise of the National Socialist German Workers' Party under Adolf Hitler.

EUROPE: GDP BETWEEN THE WORLD WARS



*1919 = 100

Source: New Maddison Project Database

THE MODERN HISTORY

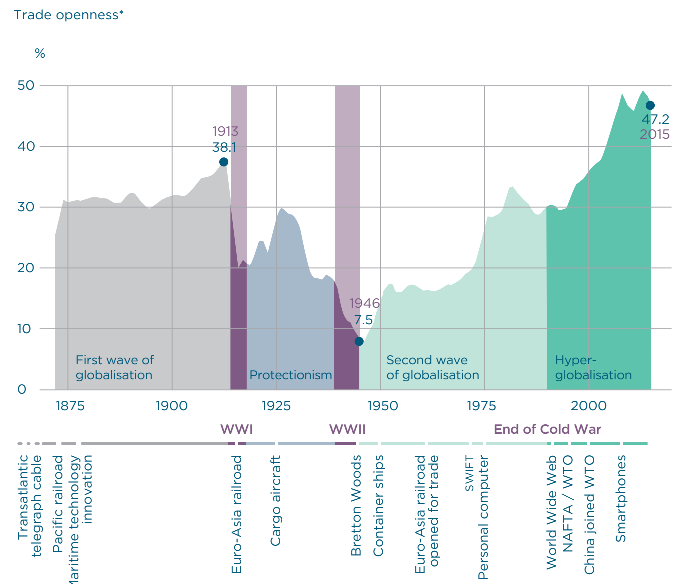
After World War II, populism faded with the careful, deliberate integration of social and political policies by Western governments of the time. In fact, the past 40 years or so have been an anomaly, with very little populist political activity globally (outside of Latin America) and almost no populist activity in developed economies.

Most notably, in the aftermath of World War II, the US, UK and European governments consciously implemented a strategy to ensure that economic development was strong and integrated enough to prevent such a war from ever happening again. For these countries, this meant that domestic policy initially focused on creating jobs and getting people employed. The success of this combined effort was the 'golden era' of growth in the 1950s and 1960s, when employment (primarily through union jobs in manufacturing) ensured rising wages, healthy gains in output and advancements in technology. But the economics were not all good: full employment led to rising wages, which fuelled inflation.

During this time, foreign policy – especially trade policy – actively promoted more open, integrated systems. Globalisation re-accelerated after the war, with the Bretton Woods agreement committing 44 countries to an integrated, gold-linked currency system that facilitated trade convertibility and established the US dollar as a reserve currency. The International Monetary Fund (IMF) and the World Bank were established in 1945; the IMF to monitor foreign exchange movements and facilitate reserve lending (trade), and the World Bank to aid war-torn countries' rehabilitation. Technological advancement helped the world become more accessible, as container ships improved the speed and cost at which goods could be moved. In an effort to form the International Trade Organisation (the precursor of the World Trade Organisation), 23 nations signed a General Agreement on Tariffs and Trade in 1947.

These programmes were initially very successful. However, by the mid-1970s, high inflation led to somewhat of a revolt by the creditors within Western economies – the investors, banks and wealthier households. With the election of Margaret Thatcher as British prime minister in 1979 and Ronald Reagan as US president in 1980, there came a shift in economic policy focus – both leaders actively pursued policies to lower inflation and break trade unionism, benefiting the wealthy more than the indebted workers. ("Low-priced Asian manufacturers cost less. Unions are bad!")

GLOBALISATION CYCLES THROUGH HISTORY



* Calculated as exports + imports as a % of GDP for 17 economies, aggregated using GDP-PPP weights. 3-year moving average.

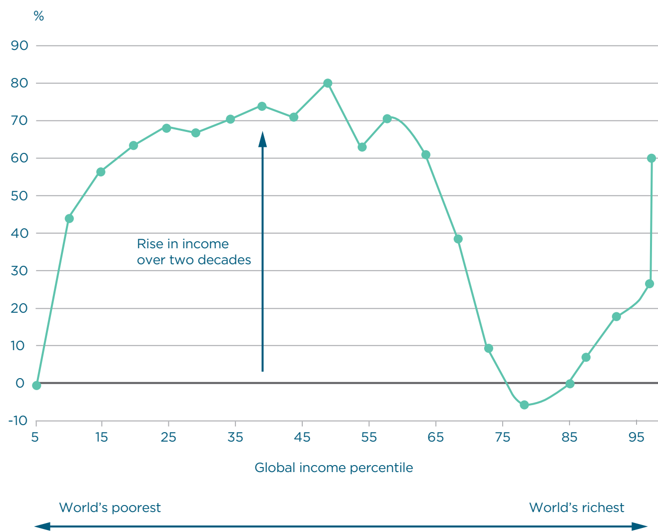
Sources: Barclays, National Bureau of Economic Research macrohistory database

Since the late 1970s, economic policy in developed Western economies has been dominated by a move to inflation-fighting monetary policy, a prolonged trend of falling interest rates and the disintegration of trade union movements. Globalisation also picked up pace, with Asia opening to trade and a visible acceleration in trade agreements. Overall, the period was very good for 'creditors' but bad for households with debt, mostly in the middle classes. The process has also been reinforcing: as 'creditors' have benefited, their political preferences have been reflected in the elected leaders of most Western countries.

This has left many voters disenfranchised. A well-known study by economist Branko Milanovic introduced the so-called 'Elephant Chart', an insightful snapshot of the impact this process has had on global incomes. Between 1988 and 2008, the combination of lower inflation (and interest rates) and trade openness led to an increase in real incomes for almost everyone in the world ... except the middle classes of the West. For these people – many of whom are male, middle-income earners and perhaps less educated in the post-war industrial era – income remained almost unchanged for 30 years.

The acceleration in credit growth from the early 2000s enabled these households to live beyond their stagnant means and to accumulate wealth as housing and other asset prices boomed. The market crash in 2009 – and in particular, the housing market collapse and spike in unemployment in the US and, to a lesser degree, the UK – was devastating. Despite the best efforts of economic policy, income was lost. So too were wealth and social identity, while fear crept in.

CHANGE IN REAL INCOME BETWEEN 1988 AND 2008



Source: Global Inequality: A New Approach for the Age of Globalisation, *Branko Milanovic*

While covering the history behind the rise in modern populist politics across a broad spectrum, it bears remembering that the circumstances affecting individual countries differ. So too do the issues that are fuelling current voter unhappiness. In the US, Trump's standpoint is somewhat of a mixture of populist policies, as he takes his cue from both the 'leftist' Rust Belt and 'rightist' anti-Mexican/anti-Chinese sentiment. In the UK, France and the Netherlands, lost wealth, stagnant incomes, immigration and the oppressive weight of governmental fiscal burdens – especially in the EU, where economic health differs so widely by country – are all aggravating factors.

In SA, the turning political tide bears worrying characteristics of other populist regimes, which are all increasingly visible: the antagonism towards intellectuals, xenophobia, challenges to a free press, interference with institutions and the judiciary, a rejection of conservative Western economic policies, demands to capture or nationalise private assets and an 'us' versus 'them' rhetoric.

WHAT IS NEXT?

History has not judged populist governments kindly – and with good reason. In many cases, populist policies were initially successful: growth accelerated and government spending fuelled investment. But excesses were hard to fund and reign in. Skyrocketing inflation and currency collapse have tended to be the catalysts for populist regimes' downfalls, but the rehabilitation of fiscal and external accounts, and the rebuilding of institutions, take time – and come at great economic cost.

The experience of countries such as Chile in the 1970s and Peru in the 1980s is instructive. Both countries had experienced a period of economic hardship. The promise of radical economic change to an impoverished electorate saw the election of (two different kinds of) populist candidates in Salvador Allende in Chile and Alan García in Peru. Economic reform achieved under IMF programmes, limited as it was, created sufficient economic headroom for both leaders to implement highly expansionary economic agendas focused on the redistribution of income and the restructuring of the economy. In both cases, conservative policies were actively rejected. Among the economic justifications was a consensus that fiscal risk was exaggerated, or even unfounded. Although successful at first – employment and wages rose, inflation moderated and economic growth accelerated – bottlenecks ultimately emerged as domestic demand expanded rapidly, and import demand with it, putting pressure on reserves. Inflation, exchange controls and deteriorating fiscal balances led to shortages over time, and ultimately, to unstable politics and economic collapse.

SA may well be at risk of repeating some of these mistakes. Certainly, recent changes in key policymakers and the reiteration of the ruling party's commitment to 'radical economic transformation' echoes the party mandates of Chile and Peru to a degree. How this commitment translates into policy changes and a new economic agenda remains to be seen, but any large-scale utilisation of state funds on unaffordable infrastructure may well precipitate an increasingly unsustainable fiscal (and external) position.

Globally, the biggest challenge for the world today is not the immediate economic impact of Brexit, or the future of the US under a Trump administration. Rather, it is the realisation that the neoliberal order that has dominated economic and political policy agendas over the past 70 years is at best under threat, and at worst breaking down. In some cases, policy reviews may not be a bad thing.

Countries with ageing populations (like the US and many European countries) need a pragmatic, agreed policy on immigration. In Europe, failure to agree on fiscal and banking integration has hamstrung the finely crafted union. In the UK, discontent over service delivery, economic stagnation and liberal immigration policies require all these issues to be re-examined. More broadly, the failure of economies to grow inclusively after the global financial crisis might necessitate a review of crisis-related legislation.

Importantly, the demands of populist electorates in the US, Brexiteers in the UK and Eurosceptics across Europe need to be considered and addressed by mainstream parties. The problem is that these parties may find it difficult to address the institutional and economic issues that have fuelled the rise in populism in the first place. Finding the right kind of jobs – with sufficient pay – in a world of integrated supply chains and disruptive technologies, while providing effective social support as populations age, sounds impossible. But failure to do so will further threaten moderate political legitimacy.

Arguably, Europe is in the most challenging position here. Both the US and UK have political and economic levers to pull, which Europe does not. It is easier for the US and the UK to replace their leadership within an election cycle, should economic outcomes disappoint. This may result in a more moderate (but still protectionist), nationalistic approach to domestic policies than we have seen. It will not fix the problem, but it could ultimately affect the process. In Europe, the reform process – in fact, almost any process – is hampered by unequal economies, and the disintermediation of politics and fiscal policy.

Unless there is an adequate response by moderate governments, macroeconomic performance improves and the fear that is fuelled by loss of income abates, the populists will continue to gain ground. While the initial response of markets and even economies may be positive, history suggests that poorly coordinated policies in a multipolar world are not good for growth, and may have severe unintended consequences. ■

RISK

THE NUMBER YOU NEVER SEE

By Karl Leinberger

Karl was appointed CIO in 2008. He joined Coronation in 2000 as an equity analyst and was made head of research in 2005. He manages the Coronation Houseview portfolios.

"Competition can be pretty intense when your competitors play like they can never get hurt." – Seth Klarman

"Our predictors may be good at predicting the ordinary, but not the irregular, and this is where they ultimately fail … What matters is not how often you are right but how large your cumulative errors are. And these cumulative errors depend largely on the big surprises, the big opportunities." – Nassim Taleb

The primary objective in investing is to deliver the best risk-adjusted returns possible. Since return and risk are two sides of the same coin, an interrogation of one without a full understanding of the other is meaningless (and dangerous).

Return is, of course, the easy one. We all know what returns any given security, portfolio or fund manager has delivered in the past. Although future returns are a guess (albeit an educated one), historic returns are fact.

Risk is another story. Winston Churchill once described Russia as a riddle, wrapped in a mystery, inside an enigma. He could so easily have been speaking on the topic of risk. I say this because:

- Opinions differ on what risk is.
- Measuring it presents some challenges.
- In contrast to return, risk remains an opinion as much after the event (ex-post) as it was before (ex-ante).

WHAT IS RISK?

In financial theory, risk is typically defined as volatility. It is this axiomatic assumption we have to thank for the plethora of betas, Sharpe/Sortino ratios and tracking errors we have in our industry. At Coronation, we disagree. We define risk as the possibility of permanently losing capital. Warren Buffett has this to say on the distinction: "… now if the stock had declined even further to a price that made the valuation $40 million instead of $80 million, then its beta would have been greater. And to people that think beta measures risk, the cheaper price would have made it look riskier. This is truly *Alice in Wonderland*. I have never been able to figure out why it's riskier to buy $400 million worth of properties for $40 million than $80 million."

The irony is that risk (of losing money) is often highest at times when volatility is low and complacency abounds. A Minsky moment refers to the risks that often bubble under the surface in extended periods of prosperity. In this environment, asset values typically rise. This often leads to increased confidence, which then fuels speculation and increased levels of leverage. Good recent examples of this include the US housing bubble and the commodity bubble in the mid-noughties. On both occasions volatility was at historically low levels at a time of great risk (of losing money) to investors.

The conventional definition of risk implies that a portfolio full of cash has high active risk and the likelihood of a high tracking error. We would counter that the risk of the investor losing his/her money is low.

I should qualify my comments by saying that I think that volatility does have some informational value. I even think that it gives some indication of the riskiness of a security or a portfolio. But I do not think it is a proxy for risk, and I certainly do not think that volatility equals risk. I think the reason the investment industry picked the volatility definition of risk is its lack of ambiguity. Seth Klarman, head of Boston-based hedge fund Baupost Group, recently said, "Wall Street is a place that highly confident people go to work". He could have added 'highly numerate' to that description.

Our industry is full of highly numerate people – and for the person with a hammer, every problem looks like a nail. Volatility is a number that is easy to understand and easy to observe. It does not enter the murky realm of opinion (which the alternative definition does). Volatility is a hard fact, and I think that is why our industry backs it.

HOW CAN ONE MEASURE RISK?

The bad news is, I do not think one can.

Fortunately, as American baseball legend Yogi Berra said, you can observe a lot just by watching:

- **Returns over the very long term.** Although returns achieved over a short assessment period reveal little, inadequate risk management should be exposed over long periods. The bad news is that I think the required assessment period is beyond the patience of most observers. (I am thinking here of at least 10 years.)

- **Inflection points in major cycles.** As Buffett so famously said, it is only when the tide goes out that you see who was swimming naked. For example, high exposure to US financials or commodity stocks in the mid- to late-noughties looked prescient at the time, but was subsequently exposed as momentum investing when the cycle turned – with little regard for the risk of losing clients' their money, permanently.

WHY IS IT IMPORTANT THAT RISK IS AN OPINION AND NOT A FACT?

Sometimes, explanations can be more helpful than definitions. My favourite explanation of risk is Elroy Dimson's: "More things can happen than will happen."

Human beings are consummate storytellers. Even in an impartial telling of history, we tend to give too little recognition to the fact that while events played out in one way, they could so easily have played out in another. Nothing ruins a good story more than the spoilsport who dwells too long on an inconvenient nuance or the role that happenstance played in the final result. How different would the world we live in be had Adolf Hitler or Mao Zedong not been born, or had the Bolsheviks not prevailed in what was a fragmented and disorganised Russian revolution?

Although our brains are wired to think that the passing of time reveals all, we need to keep reminding ourselves that it does not. All we ever get to know is which one of the multiple possible sequences of events that could have played out actually did, and who profited from that coincidence. While the passing of time may reveal some of the risks that were lurking beneath the surface, we never get to know what all the risks were and how easily they might have come to pass. That is why I say that although returns will always be a fact, risk will always be an opinion. It is something to think about in an industry obsessed with performance league tables that tell you exactly what returns were delivered, but nothing about the risk taken to deliver them.

HOW DOES CORONATION MANAGE RISK?

Managing risk is not something that you should have to clear at the final hurdle in an investment process. We believe it needs to be woven into the DNA of the process, as we endeavour to do in ours.

1. In the research process:
   - **Through a strong valuation discipline** (i.e. paying less for assets than they are intrinsically worth) **and a long time horizon** (i.e. looking through the cycle). Together, these are a great defence against the risk of getting sucked in at the top of the cycle, when prices are high and the risk of permanent capital loss is pronounced.

   - **Through a bias to quality.** We demand significantly higher margins of safety for poor-quality companies, because high-quality companies generally surprise with their growth over long periods and tend to provide the best downside protection in tough economic times. In times of adversity, it is the poor-quality companies that suffer most. High-quality companies are more resilient, and often come out of tough times in a competitively stronger position than they went in with. There is no

doubt that this quality bias has resulted in us leaving some return on the table over the years (a situation we are very comfortable with). We will always take a low-risk 30% over a high-risk 50% return. A good example would be gold stocks, which have presented many compelling trading opportunities over the years. We have avoided all of them, because we fundamentally think that they are cyclical, low-return businesses that can always halve just as easily as they can double.

2. In the portfolio construction process:
   - **We spend as much time thinking through portfolio construction as we do researching securities.** Knowing what weighting to give a security is just as important as identifying which securities deserve to make it into the portfolio. We have spent years refining our own proprietary tools to understand overall portfolio positioning, exposure to key risk factors and the risk of unintended bets in a portfolio. The research process will always be the first defence in the risk management process. The portfolio construction process may be a little less sexy and more difficult to articulate, but its contribution is just as significant.

   - **We believe in diversification.** One often hears Buffett's famous comment that diversification results in 'diworsification'. I (respectfully) believe that quote to be somewhat misinterpreted. The 'benchmark hugger' that owns everything in the index clearly adds no value and does nothing but 'diworsify'. However, we believe that a diversified portfolio of undervalued assets is the best defence that any investor has against an uncertain future and markets that eventually humble us all. For this reason, although our portfolios will always represent the high conviction views coming out of our research process, they will always seek to achieve diversification across sectors, geographies and asset classes (where possible).

3. In our cultural values:
   - **Through a team-based investment process.** It is the job of every person in our team to challenge the Coronation portfolio DNA that underpins all our portfolios. As an investment house that has not hedged its bets through multiple teams, boutiques or investment styles, we have no other horses in the race. We simply cannnot afford a low-probability, high-impact event (Nassim Taleb's 'black swan') to derail our portfolios.

   - **We have deep respect for the fact that no one knows the future.** It is a key principle that underpins our investment process. As was appropriately articulated by economist Edgar R. Fiedler, "He who lives by the crystal ball soon learns to eat ground glass". Although we value securities and construct portfolios using a base case scenario, we continually stress-test those assumptions with alternative scenarios.

Ultimately, all investors are judged by their results. A good investment process and an experienced team certainly help, but ultimately it is the runs on the scoreboard that count. We understand this. But at the same time, our clients can find comfort in the fact that we do not get sucked into the temptation to push for returns at the expense of risk. In fact, the converse is true. We live by the maxim that it is often what you get wrong, not what you get right, that defines your long-term track record in investments. For this reason, we leave return on the table every day in pursuit of achieving robust and antifragile portfolios that are your best defence against the uncertain world we live in. ■

SBERBANK

A NIMBLE RUSSIAN GIANT

By Lisa Haakman

Lisa is a global emerging markets equity analyst. She joined Coronation in 2016 and has 10 years' investment experience.

Investing in some shares can be like owning fine wine. They may be expensive, but are worth every cent. The finest can be kept for years, are velvety smooth, elegantly balanced, perfectly rounded, immensely satisfying to drink and continue to get better with age.

Sberbank is not that. Some would argue that owning Sberbank is more akin to drinking vodka, an experience conceivably filled with remorse, hangovers and new lows. A common misperception is that Sberbank is cheap and nasty Stoli vodka being downed on the streets. A more intimate knowledge of the company reveals something much more sophisticated. Founded in 1841, with 139 million customers, Sberbank is more Grey Goose (steeped in heritage) or Smirnoff (the largest vodka brand globally) than it is Russian Bear!

Let us put this in context. With 139 million retail customers, Sberbank is ...

- twice as big as Wells Fargo, the largest retail bank in the US;
- nearly five times the size of Lloyds Bank, the largest retail bank in the UK; and
- over 10 times as big as Standard Bank, the largest retail bank in SA.

In addition to its massive retail base, Sberbank manages 1.5 million corporate customers through 15 700 branches, 82 000 ATMs and 328 000 employees.

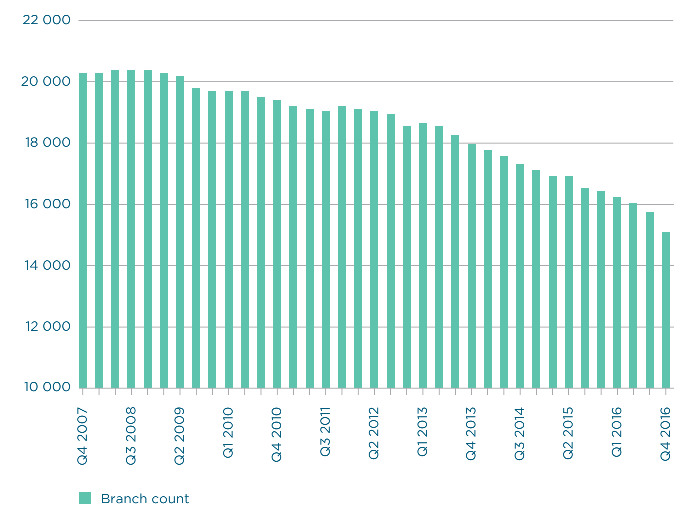
Sberbank has a market share of almost 40% of retail loans and 46% of retail deposits. On the corporate banking side, it has a 32% share of corporate loans and almost 23% of corporate deposits. Its nearest peer, VTB, holds only 10% of retail deposits and 22% of corporate deposits. Outside of these two players, the market is very fragmented. Consequently, Sberbank is the dominant bank in the Russian market by an order of magnitude.

Sberbank enjoys a number of competitive advantages over its peers, including a lower cost of funding and superior digital capabilities. Not only do retail deposits constitute a higher proportion of its funding base than its peers', but it also pays less on these deposits due to the perceived safety of the bank. On the digital side, the Sberbank behemoth is managed through one centralised IT system. Yes, one. Since 2008, it has invested heavily in its IT platform, rationalising its IT infrastructure from over 2 500 systems to a single system today, a phenomenal feat by any global standard.

As a result of its scale and its IT system, Sberbank has one of the lowest cost-to-income ratios of any universal bank, at only 39.7% (its peer group would be immensely proud of a number sub-50%). Consequently, Sberbank is able to price loans substantially lower than competitors to earn the same return on assets, resulting in positive selection for itself and negative selection for the peer group.

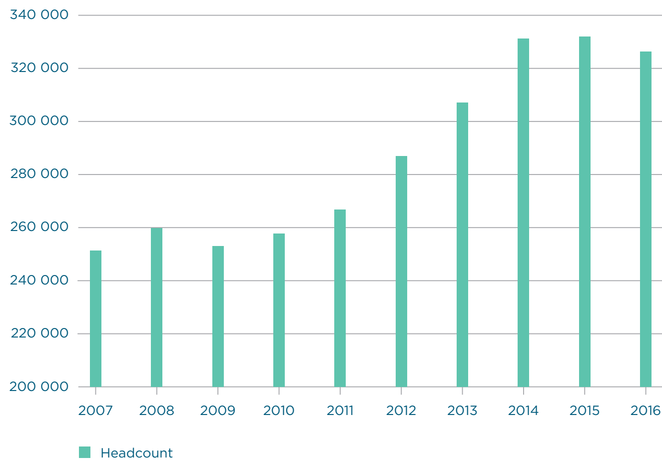
In addition, big data analytics have resulted in significant time savings in decision-making, and a 98% reduction in processing time. Almost 34 million customers are using the web or the Sberbank app as their primary banking channel

SBERBANK BRANCH COUNT



Source: Sberbank

SBERBANK HEADCOUNT



Source: Sberbank

and a staggering 91% of all transactions are now conducted via digital channels or ATMs. As a result, Sberbank is in a position to start reducing and rationalising both its branch footprint and its staff headcount.

In the fullness of time, management believe they can reduce the number of branches by 25% and the headcount by at least 50%. This then becomes a virtuous circle, reducing Sberbank's cost-to-income ratio further and rendering its peers even less competitive.

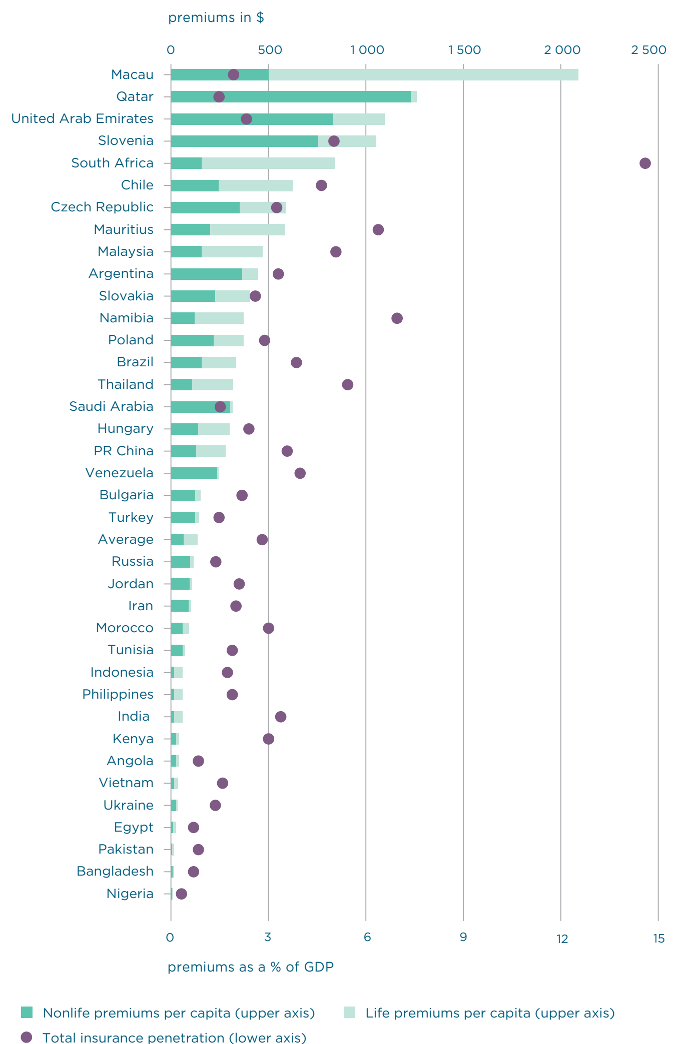
This world-class cost-to-income ratio is one of the primary reasons Sberbank enjoys one of the highest returns on equity (ROE) of any bank globally, currently almost 21%. There is scope to increase this ROE further, yet the share trades at only 1.1 times forward book, well below its fair value.

In addition, Sberbank carries optionality via a potential joint venture with one of the world's internet giants. Yandex, Mail.ru (Naspers) and AliExpress.ru (Alibaba) have all engaged in discussions with Sberbank to serve as the backbone of its e-commerce platform in Russia. To date, none of these negotiations has resulted in a deal; however, should such a deal emerge, this would represent significant upside that we are not paying for at the current price.

As banks increasingly become indistinguishable from technology companies, we believe we are backing a winner. Over and above a superior cloud-based IT system, Sberbank is already piloting blockchain, machine learning and artificial intelligence 'bots', each of which could make a significant positive impact on both the customer experience and the cost to serve. Many of Sberbank's products, such as Smartkassa, have changed the way small businesses operate, offering online payments, card payments, accounting, reporting, customer relationship management and other banking services in a single point-of-sale device.

The bank has a very long runway for growth, evidenced by Russia's low banking penetration by global standards – domestic credit is 59.3% of GDP compared with the OECD average of 109% of GDP. In addition, the nonbanking financial services market (insurance, wealth management and pension management) is in its infancy. Sberbank has plans to capture market share in the underpenetrated mortgage market, and with respect to the nonbanking financial services industry will likely create a market that currently is almost nonexistent. By way of comparison, Sberbank currently operates the largest asset manager in the country with a market share of 24%, yet manages only $15 billion of assets. To put this in perspective, Coronation has more assets under management than all of Russia. Also, Sberbank is the largest life insurer in Russia, with a market share of 29% – yet premium income was only $1 billion in 2016. Total insurance premiums represent only 1% of GDP, extraordinarily low even for emerging market countries, as per the International Monetary Fund data below.

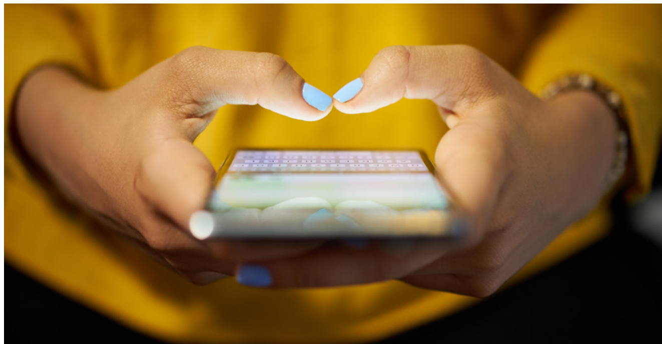
INSURANCE DENSITY AND PENETRATION IN EMERGING MARKETS (2015)



Source: Swiss Re Economic Research & Consulting

We believe Sberbank is best placed to capture these opportunities.

Still, we acknowledge the risks involved in being a minority shareholder in a state-owned bank, especially in Russia. However, under the capable leadership of Herman Gref, CEO since 2007, minority shareholders have been fiercely protected. The macro environment, while always prone to shocks, is improving, and the likelihood is that sanctions against Russia will be eased over time. Nevertheless, we factor these risks into our valuation. The share is trading at 5.5 times our estimated 2017 earnings and 1.1 times our estimate of 2017 net asset value, and carries a dividend yield of almost 4%. On this basis, we believe the share is very attractively priced and we are optimistic that future returns will be cause for celebration. Na zdorov'ye! ■



MTN

DOWN BUT NOT OUT

by Pallavi Ambekar

Pallavi joined Coronation in 2003 and manages assets within Coronation's Aggressive Equity Strategy. She has 14 years' investment experience.

"He who is not courageous enough to take risks will accomplish nothing in life." – Muhammad Ali

MTN came out of 2016 battered and bruised. The $5.2 billion fine on its Nigerian operations over unregistered SIM cards dealt a massive blow to its image as an African champion in mobile telephony. However, Nigeria was not MTN's only hot spot last year. Many of its other operations also battled weakening economies as well as governments that were keen to bolster fiscal revenues by targeting cash-rich corporate entities. In addition to increasing regulatory demands for customer SIM card registration, MTN found itself subject to additional taxes and obligations in some markets to localise ownership of its subsidiaries. Internally, the company was attempting to stabilise its senior management team and to catch up on data network investment in key markets. Difficulties around the fine were compounded by constraints on extracting cash out of Nigeria, and there were concerns about the sustainability of the company's dividend payment.

Recently released annual results for the year ended December 2016 saw continued pressure on MTN's earnings, reflecting the tough environment and internal turmoil at the company. It did, however, manage to keep to its commitment to pay out a R7 dividend for the full year, and has committed to keep this flat for the 2017 financial year. With the fine settlement behind it and the rebasing of earnings, MTN now faces a critical turning point to prove whether it can capitalise on the still latent growth opportunity in its operations. It is certainly well equipped to do so. It commands strong, leading positions in most of its regions. It can also use tough times to entrench its moat by investing in infrastructure, while its competitors struggle with financing. With proper management execution, we think the next leg of growth for MTN will be delivered over the coming few years.

Historic growth witnessed in MTN's early years was driven by entering virgin markets and building scale and coverage quickly. MTN enjoyed first-mover advantage, which resulted in it easily obtaining a large customer base that previously had very little access to communication. Once the business had built scale, however, it struggled with transitioning from an entrepreneurial operation to a professional organisation. Management's focus on cost efficiencies and cash generation came at the expense of network investment in data capacity and providing customers with high-quality service. As a result, the company allowed competitors to take valuable market share.

The Nigerian fine was a significant shock. While it was a major negative event, we think it forced the board into taking fundamental strategic steps to address complacency. The introduction of a new, experienced senior management team will enhance the ability of the company to deliver on its growth potential. These new appointments bring fresh energy to the company. They are also capable of addressing the underlying issues on a clean-slate basis, without any ties to legacy thinking.

Future growth in MTN will come from three areas:

- managing the existing base business better;
- accelerating the growth of new adjacent revenue streams; and
- good capital allocation.

RECENT APPOINTMENTS AT MTN*

Name	Position	Announcement	Office start date	Former key position
Rob Shuter	President/CEO	Jun 16	Mar 17	Served as head of Vodafone's European cluster
Ralph Mupita	CFO	Oct 16	Apr 17	CFO of Old Mutual Emerging Markets
Jens Schulte Bockum	Group COO	Dec 16	Jan 17	CEO of Vodafone Germany
Bernice Samuels	Group CMO	Dec 16	Jan 17	Marketing officer at MTN (SA) and First National Bank; Executive Director of Strategy and Business Development at SABMiller in SA
Oliver Fortuin	Enterprise segment head	Dec 16	Mar 17	CEO of BT Global Services sub-Saharan Africa
Felleng Sekha	Executive for regulatory affairs and public policy	Oct 16	Oct 16	Various roles in MTN including executive director for corporate services in Nigeria
Stephen van Coller	M&A/Strategy head	Jul 16	Oct 16	Barclays Africa head of investment
Kholekile Ndamase	Deputy head M&A	Jul 16	Sept 16	Led equity-based financing business at Rand Merchant Bank
Godfrey Motsa	Vice-president for South and East Africa	Jun 16	Jul 16	Vodacom's chief officer for consumer business
Babak Fouladi	Group executive for technology and information systems	May 16	May 16	CTO of Vodafone Spain
Giovanni Chiarelli	CTIO of MTN SA	Nov 16	Nov 16	CTO of Vodafone Romania

*Highlighted management members were at Vodafone previously.

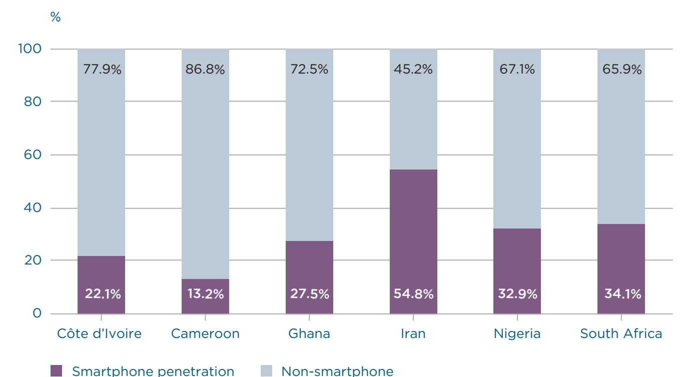
Source: Bank of America Merrill Lynch Global Research

While MTN has built a big business, it has not made the most of leveraging its scale. It has done some work to improve purchasing power in network equipment and handsets, but it has not been able to put in place a central steering function that is able to give coordinated direction to each of the operational companies. The new management team will implement this central model, which will enable regions to drive market strategies quickly and intelligently. Management is also focused on the very basics of network deployment, and is looking to improve network availability by using spectrum more efficiently and increasing 4G tower rollout (which will improve data capacity). These actions were first implemented in SA and Nigeria, and will be implemented in other operations during 2017. Network improvements will be coupled with the standardisation of business metrics and the upgrading of IT systems, which will allow for greater customer and business analytics. Combined, the increased quality of service and enhanced management information should enable MTN to grow market share and accelerate data revenue growth.

While business basics are being addressed, there is also a clear opportunity to grow revenue streams that are complementary to basic voice and data services. Smartphone penetration in MTN's main markets is set to increase as handsets become more affordable. Customers are also using these handsets to perform more transactions and consume more content. MTN has already rolled out some of these services (music, gaming and mobile money) and they are growing strongly, with reported revenue growth of 44% (off a low base) in 2016.

This is not uncharted territory. Safaricom in Kenya is a good example of how a mobile telephony business can successfully leverage its scale to grow into a new category. M-Pesa (Safaricom's mobile money product) has 16.6 million active subscribers, and mobile money now contributes 22% of Safaricom's total revenues. MTN has 20 million mobile money subscribers, concentrated mostly in Ghana and Cameroon. We do not expect MTN to replicate the full success of Safaricom across all of its operations, but there is potential to capture more of the financial services income stream in Africa. This will come via the rollout of mobile money products into more countries (mobile money is only in five of MTN's operating countries at the moment) and the launch of new financial products (such as remittances, microlending and savings products) in addition to basic payments and airtime purchases.

SMARTPHONE PENETRATION IN MTN'S KEY MARKETS STILL LOW



Source: MTN 2016 annual results release

We expect these initiatives to support healthy organic earnings growth over the medium term. In addition, as the company comes out of a heavy capital expenditure cycle, it will convert a high percentage of earnings into cash flows. The business has a good track record of cash conversion – over the past 10 years it has converted about 85% of its earnings into cash. This will be supportive of growth in dividend payments to shareholders.

There is also the opportunity to realise further value from the future sale of tower investment assets and digital investments. The current share price attributes little to no value to these investments, and presents another leg of optionality in the investment case.

Some market participants believe MTN is a broken business. We do not think this is the case. The company has weathered a particularly nasty period but has come out of it focused and better equipped to deal with a complex environment. The earnings base is low, and expectations are not high. We acknowledge that there are risks in how this investment case plays out, but feel that these risks are more than adequately discounted in the current share price. Our analysis of past case studies shows that investors tend to underestimate the upside case when new management teams come into undermanaged businesses with good fundamentals. In an uncertain investment environment, we think that MTN presents a powerful combination of attractive fundamentals and self-help initiatives, at an undemanding valuation. ■

FORMALISING THE INFORMAL

OPPORTUNITIES IN FRONTIER MARKETS

By Gregory Longe

Gregory is an investment analyst within the Global Frontiers investment unit. He joined Coronation in February 2013 after completing his audit training at Ernst & Young.

After a tough week – or even a particularly good one – indulging in a guilty pleasure brings enjoyment to millions across the globe. In a high-end bar in London, it may be an e-cigarette paired with a top-shelf whiskey or craft gin (served with Fever-Tree tonic water, of course). In a shebeen in Lusaka, it might be a scud of Chibuku. In Colombo, a beedi and a cup of toddy. The location and refreshments may differ, but the ritual remains the same – and businesses built around meeting these needs have become some of the largest and most successful in the world. It is no surprise then that shareholders in these global giants have been handsomely rewarded.

Our Global Frontiers strategies look to invest in the emerging markets of tomorrow. These are countries characterised by tremendous opportunity and strong economic growth, but also by low levels of economic development. Infrastructure is often poor, banking penetration low and formal retail limited. Out of necessity, and often ingenuity, the informal sector in these markets is usually sizeable. As a result, many larger companies find themselves competing with both formal and informal players. This can be tough, given the questionable tax compliance practices, patchy health and safety records, and low cost bases associated with the informal sector. Despite these challenges, however, companies that can find the right value proposition have seen customers happily pay for the benefit of a safe, consistent product.

Competition from the informal sector is particularly fierce for the large alcohol and tobacco companies. But it is also this competition that gives rise to some of the most exciting opportunities.

INFORMAL HOME BREWS IN AFRICA

SABMiller (SAB), now part of Anheuser-Busch InBev, has a long history on the African continent. With roots stretching back to 1895, it has spent over 100 years competing with traditional or opaque beers in Southern Africa. Opaque beer is typically fermented in small quantities from sorghum or maize. It has been drunk for thousands of years in villages across the continent, and is brewed based on recipes passed down through generations. Drinking opaque beer at social occasions is part of the cultural fabric of rural villages and urban capitals across sub-Saharan Africa.

With the introduction of Chibuku, SAB's opaque beer, the brewer has been able to formalise the mass brewing of traditional beer, tapping into the informal home brew opportunity in 10 countries to date. It has profited from

offering an affordable, safe and consistent alternative to small-scale backyard brewers. By formalising the informal sector, it has also brought these profits into the tax net, which benefits the governments in these countries. In Zimbabwe, one of the first markets to sell Chibuku, opaque beer sales amount to triple the volume of lager beer sales and account for double the profits.

Chibuku broadened SAB's product offering and allowed it to move beyond the clear beer or lager market. Formalising the informal beer market also helped SAB capture a larger share of the total alcohol market. A secondary impact is that Chibuku makes the business more stable and less cyclical. Periods of increased consumer spending see beer drinkers trade up from opaque beer to lager beer, while recessions see down-trading from lager to opaque beer. SAB is able to capture the full range of consumption in both economic environments.

In addition to Zimbabwe, this exciting story is currently playing out in SA, Botswana, Ghana, Malawi, Mozambique, Tanzania, Zambia, Lesotho and Swaziland. The opaque beer opportunity is also part of our investment case for holding the brewers in some of these countries.

BEEDIES IN ASIA

A more nascent opportunity lies in beedies. Beedies are small, hand-rolled cigarettes made of tobacco flakes wrapped in leaves and tied with colourful string. Beedies are prevalent in India and much of Southeast Asia, and are a very low-cost alternative to cigarettes. However, the industry is synonymous with child labour and beedi smoking is considered to be significantly more harmful than cigarettes. While no global cigarette company has found a way to compete with the beedi industry yet, we believe that the formalisation opportunity in Sri Lanka is particularly interesting.

Ceylon Tobacco Company (CTC), a British American Tobacco subsidiary, has a monopoly in Sri Lanka's formal cigarette market. However, this does not tell the full story, as beedies account for 45% of the total tobacco market. For CTC, the opportunity to produce a beedi-type product will see its addressable market almost double. Machine-rolled beedies will be safer than informal beedies, and cheaper than cigarettes. Entering this market would therefore allow CTC to grow volumes, while customers would be able to consume a less harmful product. As is the case with Chibuku in Africa, the Sri Lankan government also stands to benefit, as any profits from beedi sales would be taxable (which is unlikely to be the case today). Furthermore, applying global health and safety practices to the beedi industry should be positive for lawmakers and should help keep more children in schools.

CTC is currently pursuing the beedi opportunity. If successful, we have no doubt that the technology will be rolled out into other markets. Bangladesh, where beedies account for 40% of the tobacco market, is another prime candidate for formalisation. Even in an industry such as tobacco where volumes are declining, the company that is able to formalise the informal sector can see a return to growth.

As we scour the world's frontier markets looking for investment opportunities, we often come across companies innovatively meeting their customers' needs. As these economies move from frontier to emerging market status, we will no doubt see more examples of this. The governments in these countries stand to benefit. Consumers stand to benefit. And hopefully, as shareholders, we will benefit as well. Now surely that is something to toast to. ■

As long-term investors, environmental, social and governance (ESG) considerations are fully integrated into our investment process and form part of the mosaic for any investment case, in understanding the long-term sustainability of companies and their business worth. When valuing a business, we take ESG factors into account predominantly by adjusting the discount rate applied to the assessment of its normalised earnings. We therefore implicitly build the risks relating to ESG considerations into the ratings of the businesses we analyse. Where we can, we explicitly allow for ESG costs in the modelling of a company's earnings.

Social objectives vary significantly between investors, and ESG issues are often intrinsically fraught with ambiguity. We do not exclude investments in companies that perform poorly on ESG screens, but we do require greater risk-adjusted upside before investing. In practice, a business with an ambiguous ESG profile will be required to deliver higher returns to justify its inclusion in the portfolio.

HOPE FADES FOR SA GROWTH

HARD-WON GAINS AT RISK

By Marie Antelme

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

In January, I wrote about how a little good news could go a long way to making this year feel quite a lot better than last year. For the first time in a long time, forecasters were revising growth numbers up, not down, and inflation down, not up.

The constraints of 2016 – the drought, skyrocketing inflation, rising interest rates, slowing growth and the ongoing threat of ratings action – were all set to ease. Good rains had produced a large maize crop, and food inflation was slowing already. The SA Reserve Bank's (SARB) monetary policy committee (MPC) signalled that it 'may' be at the end of the hiking cycle, and an improvement in terms of trade helped stabilise the exchange rate and brought the trade balance into surplus. The Budget tabled by former minister of finance Pravin Gordhan was credible, consistent and committed. Better growth and fiscal discipline raised the possibility that negative ratings actions might just be delayed.

And then the president sent that SMS on 27 March.

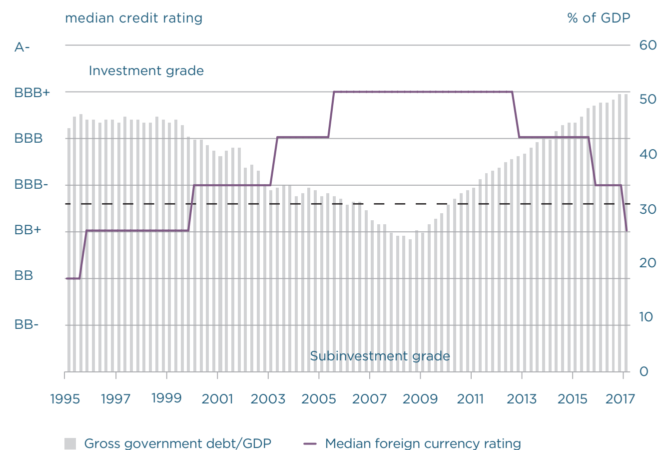
This is where the good news starts to fade.

The message calling Gordhan home from his offshore roadshow came at a time when the economy was just showing statistical evidence that it was turning the corner. Following the subsequent events – the cabinet reshuffle of key ministerial positions, most notably the replacement of the finance minister and his deputy, followed by the resignation of the Treasury's director-general; the foreign currency ratings downgrade below investment grade, first by S&P and then by Fitch, which downgraded both local and foreign currency ratings; and the currency weakness, equity losses and significantly higher bond yields – the outlook for the economy has clearly changed.

The first evidence was the MPC's communiqué at the end of March. The statement concluded that the SARB 'may' be at the end of the hiking cycle. Without the political uncertainty at the time, the wording of this would have been more dovish, and probably would have opened the door for easing later in the year. This now seems unlikely. While low growth and moderating inflation may have allowed for a shallow easing cycle into early 2018, the SARB is more likely to hold steady and weather the political volatility.

Hard-won fiscal gains are also at risk. After implementing counter-cyclical fiscal policy in the wake of the global financial crisis in 2009, the failure to moderate spending has led to a meaningful deterioration in SA's fiscal position. The deficit has been stuck at around 3.5% to 4% of GDP since 2009, resulting in ballooning debt: from a nadir below 30% of GDP in 2007 to over 50% at the end of 2016. In his second term as finance minister, Gordhan worked hard to maintain a ceiling on spending, and in his past two budgets, he raised revenue through a variety of tax adjustments. His efforts were aimed at regaining some of the lost 'fiscal space' by driving down the pace of debt accumulation, and ultimately lowering the stock of debt relative to GDP. A loss of the current fiscal discipline is likely to see debt continue to accumulate, probably at a faster pace. Rising debt initially limits government's ability to invest in 'good' capacity spending, and ultimately risks that it can no longer meet its financing obligations.

SA MEDIAN CREDIT RATING (1995 - 2015)



Sources: HSBC, National Treasury

Gordhan's fierce commitment to rooting out corruption and improving governance at state-owned enterprises (SOEs),

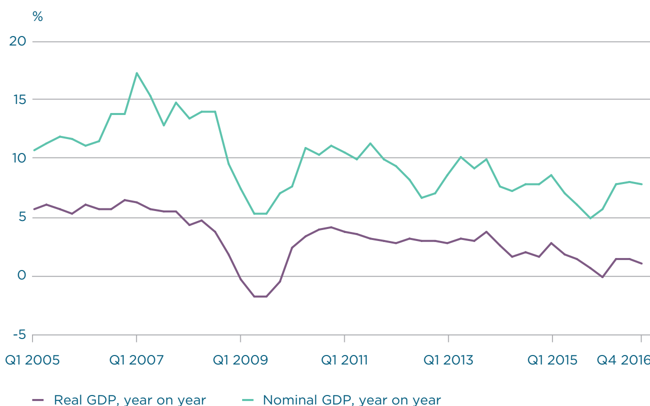
which continue to cost the state enormous sums through mismanagement, has also been undermined. Already SAA has announced that its realised loss in 2016 was R3.5 billion – double the original estimate. State-owned broadcaster SABC has also reported persistent losses, the last estimate being R400 million. These losses now represent direct capital claims on government, and together with Eskom, Transnet, the SA National Roads Agency and the Road Accident Fund have added to considerable contingent liabilities to the state. Government has extended guarantees totalling R480 billion in the last fiscal year; if utilised, this is currently about 10% of GDP.

Also, the ratings downgrades are not likely to happen in isolation. Moody's has SA on notice for a downgrade too, and will make an announcement soon. Ratings are important – they imply a higher cost of funding for government and corporate debt as the issuers' risk assessment deteriorates. Ratings can have a material, direct impact on capital flows as sentiment deteriorates – especially if the ratings action affects the country's inclusion in investor benchmark indices such as Citi's World Government Bond Index. At this stage, exclusion is not imminent, but it is certainly a lot closer than it was. Government is likely to pay more for its debt, and even before these developments, interest service on the rising stock of government debt is the fastest growing expenditure item in the Budget.

RISK FIRMLY TO THE DOWNSIDE

Despite this, there is still sufficient momentum to suggest this year will, indeed, produce better growth than last year. GDP statistics published for 2016 show that for the year as a whole, the economy grew just 0.3%, from 1.3% in 2015. The latest data, for the fourth quarter of 2016, revealed growth contracted by 0.3% from the previous quarter (after seasonal adjustment), from just 0.4% in the third quarter, but that it gained 0.3% from the same quarter in 2015. The weakness was concentrated in a drawdown of inventories, but household consumption was pretty resilient at 2.2% year on year, supported by ongoing gains in compensation. Unsurprisingly, capital formation remained weak, but at 1.7% year on year was less weak than in previous quarters. Much of the improvement came from the broader public sector – the private sector continues to underinvest. The trade balance registered a surplus and the current account deficit narrowed meaningfully in 2016, to 3.3% of GDP (in the fourth quarter, it reached -1.7%) from -4.3% the year before.

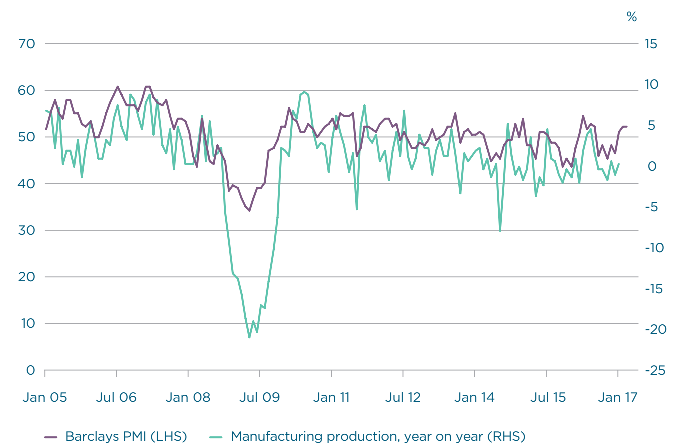
SA REAL AND NOMINAL GDP GROWTH



Source: Statistics SA

High-frequency data released by March built on small improvements in growth momentum seen in January and February. The Barclays Purchasing Managers' Index (PMI) remained elevated at 52.2, from 52.5 and 50.9 in the previous two months. This is a signal of stronger manufacturing output in coming months. New passenger car sales were up 2.1% year on year off a weak base, but on balance the quarter is sequentially the strongest in two years. The crop estimates committee forecasted that SA's total maize harvest could almost double last year's production (14.3 million tonnes, compared to 7.8 million tonnes in 2015/2016). This should give a meaningful boost to growth from agriculture, and will also help lower prices of cereals and feed, curbing food inflation.

SA INDUSTRIAL ACTIVITY



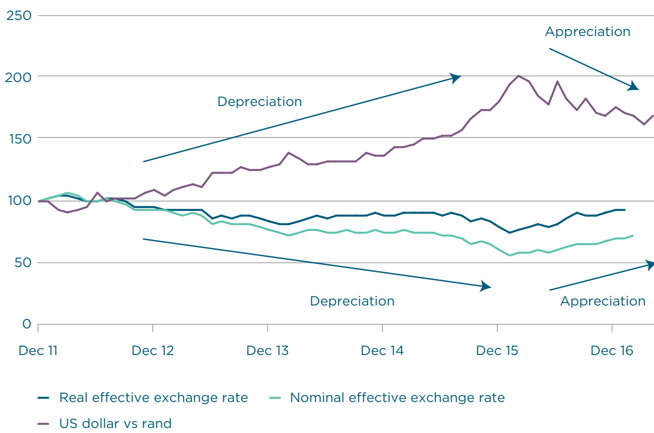
Sources: Barclays, Statistics SA

While tax increases announced in the Budget will offset some of the positive impact of lower inflation on household spending, cooling prices should help raise the real incomes of households, especially the poor. CPI inflation, which reached 6.7% year on year in December, moderated to 6.3% by February despite some hefty increases in retail fuel prices earlier this year.

Relative to a year ago, food inflation has been sticky, and remains high at 10% year on year. But this is already off the peak of 12% reached in October last year, and the high base, coupled with the improved outlook for maize prices (as a cereal, and as feed), should also contribute to easing retail prices. The lagging impact of relative strength in the exchange rate following the sell-off in December 2015

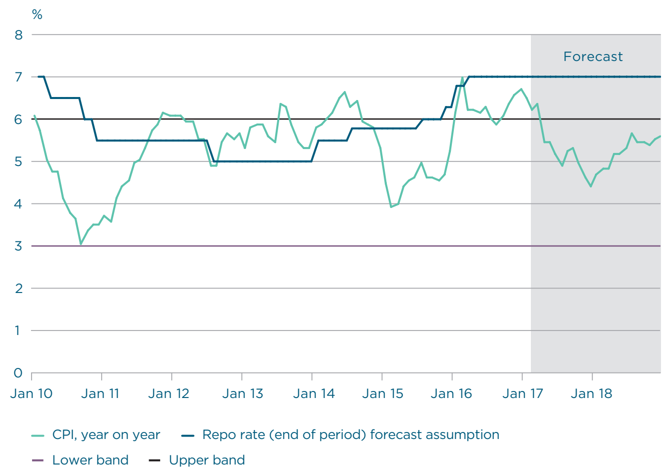
(before the most recent decline) should continue to provide positive support for lower inflation in coming months.

SA EXCHANGE RATES (DECEMBER 2011 = 100)



Source: Reuters Datastream

SA INFLATION AND INTEREST RATES



Sources: Reuters, Statistics SA, Coronation

At this stage, we do not think the MPC will cut interest rates amid high political uncertainty and persistent risks to the currency. That said, if inflation falls meaningfully, the outlook for 2018 improves from the SARB's 5.4% forecast and growth fears are realised, it is not inconceivable that rates could fall modestly.

DAMAGE DONE?

The impact of the political changes of the past weeks may only really transpire in many years to come as the slow bleeding of resources and loss of skills and investment feed through. Then again, the fallout may also hit quickly, as fiscal losses at SOEs, government departments and state-owned corporations bubble to the surface, revealing the extent of mismanagement, corruption and degradation that took root years ago, but now emerge as the structures holding everything together collapse. It is possible too that a new narrative emerges from within the ruling party that recommits itself to sustainable, responsible economic policies.

Growth remains the single most important ingredient in fiscal sustainability, in poverty eradication, and in generating and supporting institutions that protect the vulnerable. For an economy to grow, it needs to create jobs, invest in capacity and improve productivity. Job creation and investment only happen when households and businesses are confident about the prospects of the economy. This is not just about big companies, which in the case of SA have been offshoring operations for years, but also about the 'mom-and-pop' outfits that provide small services or speciality manufacturing. It is about the young people who start businesses with friends and invest in their communities. When these are supported, the additional funding, especially the foreign funding that fills the gap between what SA saves and what it consumes (the current account), can come. Without it, everything is much, much harder. ■

BOND OUTLOOK

A CAUTIOUS OUTLOOK IN POLITICALLY UNCERTAIN TIMES

By Nishan Maharaj

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

"Life isn't about waiting for the storm to pass … It's about learning to dance in the rain." – Vivian Greene

SA started 2017 with such promise and exuberance, as underlying drivers of the local economy entered a cyclical upswing amid what seemed to be a much calmer and supportive political landscape. In addition, the global backdrop had become (and remains) supportive of emerging markets, with the adherence of the US Federal Reserve (Fed) to a gradual path of rate normalisation, continued monetary policy accommodation on the European continent and a more upbeat overall growth outlook, driven primarily by cyclical upswings in China and the US.

The SA 10-year benchmark bond traded below 9% for most of the quarter (supported by a rally in the rand to below R12.50/$), grinding steadily towards a low point of 8.25%. Unfortunately, this rally was short lived as political events in the last week of March caused major reversals in the rand, local bond yields and sentiment towards SA.

The All Bond Index (ALBI) returned 0.4% in March, 2.5% for the first quarter of 2017 and 11% over the last 12 months. The 12-year and longer range of the bond curve was the biggest contributor to this performance, due to its greater than 60% weighting in the index. Inflation-linked bonds (ILBs) have continued to perform poorly, returning -2.15% in March, -0.5% for the quarter and 3.4% over the last 12 months. This was due to very high initial levels of implied breakeven inflation (6.5% to 7%), which necessitated a move higher in real yields as the 12-month to 18-month inflation average and profile moved considerably lower (towards 5%). ILBs now trade at approximate real yields of 2.3%, which are much cheaper than previous levels, and although they do not scream value, they warrant consideration for inclusion in a bond portfolio.

Over the last two years, SA assets have been on a roller coaster ride, with local headline news adding to the volatility of asset prices. Markets have the ability to administer lessons that every investor, regardless of experience or expertise, should pay close attention to. Over the recent past, two lessons in particular have stood out and echoed the key principles of Coronation's investment philosophy. Firstly and most importantly, valuation is the only true objective guide one has when it comes to investing. Secondly, trying to forecast macro events is a job best left to those highly intelligent and talented individuals who write comic books that turn into blockbusters.

The events of 9 December 2015 (Nenegate) took both markets and the country by surprise. Ever since, all eyes have been on the machinations and actions of the reformist camp in their battle against the tenderpreneurs. An astute and logical individual following these developments would have naturally drawn the conclusion that there had been a very large reduction in the ability of the tenderpreneurs to launch an attack against the reformists. More importantly, the progression of events over the last 15 months had suggested that, if the attack were to materialise, it would spell an almost immediate end to the tenderpreneurship faction.

The cabinet reshuffle at end-March and the events that followed unfortunately suggest the direct opposite to any such conclusion. This is a clear illustration of how difficult it is to attempt to predict macropolitical events – and more importantly, how basing investment decisions on expectations around certain key outcomes is tantamount to investment suicide (a lesson further reiterated by Brexit and the surprise election of Donald Trump as US president last year).

The margin of error in forecasting can be very large, which means that when you are making a decision on whether to buy or sell an asset (in this case, SA government bonds), you have to ensure that the price you pay for that asset provides a sufficient margin of safety against forecasting error and short-term volatility. In the same breath, however, you cannot purely rely on a single measure of value to determine the attractiveness of an asset. Rather, you must utilise a few methods to validate a cheap valuation signal.

The simplest way to determine the fair value of an SA 10-year government bond is to construct it as a function of global

risk-free rates, inflation differentials and a country-specific risk premium:

FAIR VALUE DETERMINATION: SA 10-YEAR GOVERNMENT BOND

Global risk-free rate (US 10-year bond)	2.50%
US expected 10-year inflation	(2.00%)
SA expected 10-year inflation	6.00%
SA-specific risk premium	2.41%
SA 10-year fair value estimate	**8.91%**

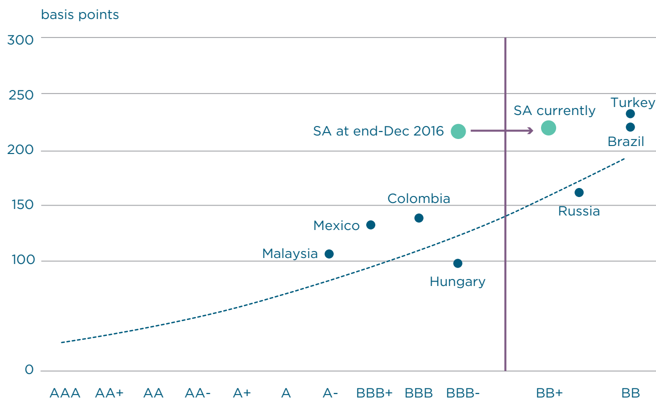
Source: Coronation analysis (as at 7 April 2017)

We have applied a level of conservatism to all the variables listed above, especially to SA inflation expectations, where 6% is the top end of the inflation band and significantly above our estimates of average inflation over the next two years (5.35%). However, SA's risk premium is the most questionable variable. In the case of further political interference and policy inaction, is it representative of a sufficient margin of safety?

As illustrated in the graph below, SA's sovereign spread has not changed significantly post the recent credit rating downgrades from Standard & Poor's (S&P) and Fitch, as it was already pricing in subinvestment grade status.

SUBINVESTMENT GRADE HAS BEEN PRICED IN

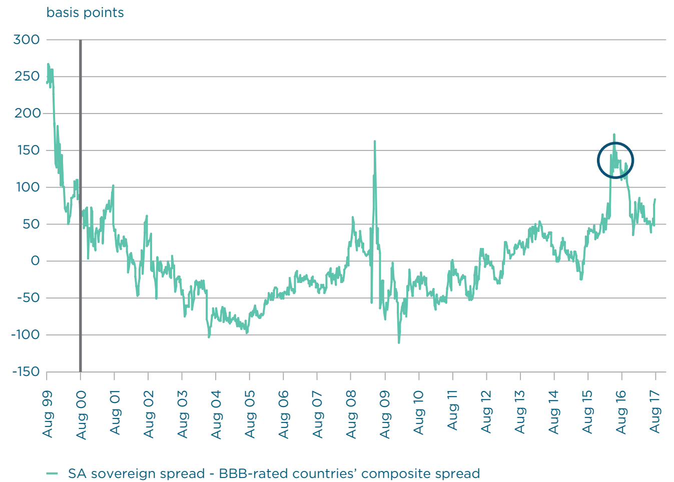
Credit default swap spread vs Moody's sovereign credit rating



Source: Bloomberg

However, the more important question is how distressed the sovereign spread may get in the event of significant stress. The following graph shows the spread between SA's sovereign spread and a grouping of BBB-rated countries (countries with BBB+, BBB and BBB- ratings), to provide more context on the assumptions used in our calculation in the table above (currently 80 basis points [bps]). Two key stress areas to take note of are the period in December 2015 (Nenegate; spread of 140 bps) and the period before 2000, when S&P and Fitch had upgraded SA to investment-grade status (the average spread during this period was 180 bps).

SA'S SOVEREIGN SPREAD VS BBB-RATED COUNTRIES

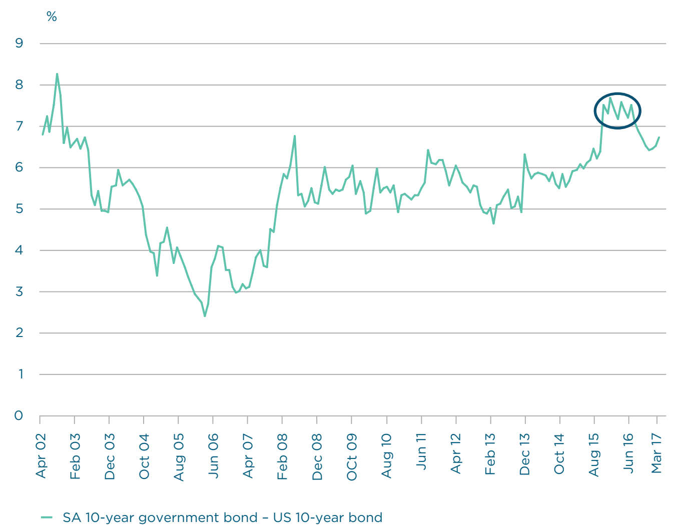


Source: Bloomberg

This suggests it is reasonable to expect that the current sovereign spread would need to reprice between 60 bps and 100 bps higher if the economy were to experience significantly more stress – that is, move further away from the underlying fundamentals of an investment-grade economy. Plugging in a sovereign spread that is 60 bps to 100 bps wider suggests a fair value of SA government bonds of 9.5% to 9.9%, significantly above the current level of 9%.

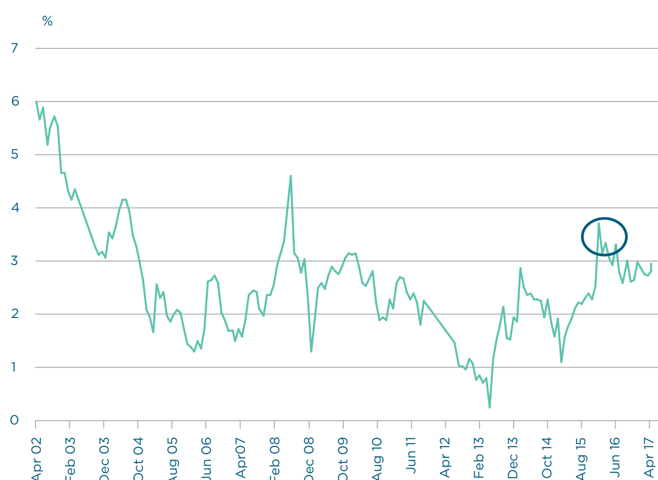
In the following two valuation metrics, we compare current yield levels to levels experienced during Nenegate, both from a real yield perspective and as a spread to US 10-year bonds, as this is the closest episode in our history that bears semblance to the current political landscape. SA inflation has averaged 5.8% since the start of inflation targeting in the early 2000s, and we use this as an assumption to strip out the implied 10-year real interest rate. The current level

SA 10-YEAR GOVERNMENT BOND VS US 10-YEAR BOND



Source: Bloomberg

SA IMPLIED 10-YEAR REAL INTEREST RATE



Source: Bloomberg

of 3% does not compare favourably to the 3.75% average between December 2015 and February 2016. In addition, when calculating the spread between current SA 10-year government bond levels and US 10-year bond levels over the same period, the current level of 670 bps is much lower than the range of between 740 bps and 750 bps reached during the Nenegate period. On both these measures, the fair yield on the SA 10-year government bond should be around 9.7% to 9.8% given the current backdrop – 70 bps to 80 bps higher than current levels.

ILBs are an important consideration in any fixed-income portfolio, as they provide an element of protection if yields sell off due to deteriorating inflation expectations. This is because their principal amount is scaled according to the inflation rate, and therefore coupon payments are too.

There are a few key considerations when it comes to valuing ILBs:

- the current pricing of inflation expecations, and how the total return expectation compares to other asset classes;
- the outright level of real yields compared to expectations and history; and
- consideration of greater capital risk, given the higher modified duration of these instruments.

The graph below illustrates implied inflation expectations as represented by the difference between SA government nominal bonds and ILBs. It suggests that inflation expectations are still quite a bit higher than the top end of the inflation targeting band, which is very hopeful considering that inflation has only averaged 5.8% since the start of inflation targeting. If you hold an ILB maturing in 2025 (currently yielding 2.35% till maturity), inflation would need to average 6.4% over the next eight years for the ILB's total return to exceed that of a nominal bond of the same maturity (9%). Considering that the nominal bond carries a modified duration of six (a 6% capital loss in the event of a 100 bps move higher in nominal yields) and the ILB a modified duration of 7.2 (a 7.2% capital loss in the event of a 100 bps move higher in real yields), the

NOMINAL BONDS VS INFLATION-LINKED BONDS

Sources: Coronation and Bloomberg

nominal bond seems to be the more attractive asset on a risk-adjusted basis, but only just. Considering that the real policy rate in SA has never sustainably been above 2.5%, a case can be made for a small holding of ILBs within a portfolio to protect against inflation being unanchored above 6% if the backdrop deteriorates further and the rand is put under greater pressure. However, one must be cognisant of symmetric probabilities in terms of political outcomes.

The current local backdrop remains challenging. Despite cyclical factors turning supportive of the local economy, the political landscape has once again soured, bringing into question the ability of policymakers to make the hard decisions necessary to implement much-needed structural reforms. In addition, ratings agencies have already started to move SA down a path into subinvestment grade from both a local and foreign currency perspective, further souring sentiment towards SA assets. SA's inclusion in the Citi World Government Bond Index relies on our local currency debt being rated as investment grade by both Moody's and S&P. S&P currently has SA one notch above investment grade, while in the next month it is very likely that Moody's will take a similar position. The continuation of the current status quo will inevitably lead to further downgrades of SA's key metrics. More specifically, growth will come under severe pressure as optimism – and hence investment into the economy – will continue to slow. A downgrade to subinvestment grade on our local currency rating would trigger mandated selling of SA government bonds to the tune of between R100 billion and R120 billion. That would be in addition to natural government issuance of R190 billion – R290 billion to R310 billion of net selling in a single calendar year!

Increased foreign participation in the local market has limited the sell-off in the SA government bond market, as foreign participants have purchased almost R25 billion worth of SA government bonds year to date (the majority in the week following the cabinet reshuffle). The foreign reaction has been based on the supportive global backdrop, and hope of a turnaround based on the recent experience in Brazil (following the impeachment of Dilma Rousseff as president and the consequent rally in Brazilian assets).

As a South African, I remain hopeful that the turnaround in SA will be as quick and energetic as in Brazil, but realistically one has to be honest in the assessment of the current context and circumstances in SA.

Firstly, the Brazilian government was a coalition government made up of equally strong parties that broke up their alliance in retaliation against the president's wrongful actions. Secondly, unemployment in Brazil more than doubled in a very short period (from under 5% to 10%), which caused mass protest and public outcry, further intensifying calls for the president to step down. In addition, foreign ownership of the local debt market in Brazil was under 15%, given the string of taxes that had been implemented previously to limit hot money flows into the country, and government bonds were trading at double-digit yields of 13% to 14% (implied real yields of more than 6%). From start to end, the Brazilian real weakened almost 40%, and bonds sold off 300 bps to 400 bps in the lead-up to the final impeachment.

SA has a one-party government, an unemployment rate that is already in double digits but has not deteriorated further significantly, foreign local debt ownership of already close to 40% and local debt that still trades in single digits. Therefore, key differences exist that will cause the turnaround process to stretch on for a bit longer – meaning that valuations, although cheaper now, could get a whole lot cheaper.

The current environment warrants a certain degree of caution when assessing the valuation of SA government bonds. Despite the cyclical upswing that the economy is undergoing and the supportive global environment, political uncertainty could derail an already precariously fragile local recovery. In addition, current valuations of SA government bonds, although closer to fair value, are still some way off from offering a sufficient margin of safety in their reflected yields, especially if a downgrade of the local currency debt rating becomes more of a concern.

We are therefore more cautious in our approach to SA government bonds, and would need to see a further widening from the current levels of 9% to above 9.5% before committing in a meaningful way to the asset class. ■

SA FLAGSHIP FUND UPDATE

PERFORMANCE AND POSITIONING

Our funds have emerged well from an extremely turbulent start to the year.

The FTSE/JSE All Share Index's return of 3.8% for the first quarter (2.5% for the rolling 12-month period) belies the sharp sell-off in locally focused shares following the surprise cabinet reshuffle at the end of March. Domestic investors have also seen a currency shock and a surge in government bond yields in recent weeks in reaction to the political uncertainty.

We expect the domestic situation to deteriorate further, so we remain inclined to favour businesses operating outside of SA and will require a greater margin of safety before increasing positions in purely domestic businesses.

We do not believe that the decline in pure domestic stocks was large enough to adequately compensate investors for the deterioration in the macroeconomic environment and enhanced levels of risk. In aggregate, we think our portfolios are well positioned with an overweight position in rand hedge equities and limited exposure to domestic government bonds.

INVESTOR NEED: LONG-TERM GROWTH

Domestic general equity funds

Both our flagship equity funds have delivered a strong performance in a volatile environment. Rand hedge holdings, which we believe offer compelling stock-specific fundamentals, remain the cornerstone of these strategies. While Top 20 only invests in locally listed shares, the Equity Fund is close to its maximum 25% exposure to foreign shares.

Our rand hedge industrial holdings, such as Naspers, British American Tobacco and Mondi (which in particular continues to deliver a steady earnings growth profile and good cash generation) have had a solid start to the year, notwithstanding relative rand strength. Despite the political events, the rand ended the quarter 2.1% stronger (up 9.3% over the rolling 12 months). Although the rand has weakened since quarter-end, we believe it is still pricing in a relatively optimistic political and economic outcome.

PERFORMANCE FOR VARIOUS PERIODS

	Launch date	5 years*	10 years*	Since inception*
Top 20	Oct 00	12.8%	12.1%	19.3%
Equity	Apr 96	13.8%	11.4%	16.6%
Average competitor		10.5%	8.3%	15.5%

**Annualised. Average competitor performance is defined as the mean return of the SA General Equity category excluding Coronation funds as measured by Morningstar and is shown since the inception date of the Coronation Top 20 Fund.*

Prices in the resource sector spiked towards quarter-end, with Northam Platinum (up 27%), Exxaro (up 32%) and Glencore (up 13%) gaining ground. Although we have taken profits in some of our resource holdings, we retain a healthy weighting in the sector. The platinum sector remains an interesting one. Although these equities have recovered strongly off their lows, they remain depressed. A stock like Impala still trades 87% off its peak at the top of the commodity market in 2008, and at a 50% discount to its book value. Platinum group metals markets are in deficit and the industry cannot survive at current prices. We think there are significant opportunities, should prices increase to a level sufficient to keep platinum miners in business. Northam is our key pick in the sector. It is a low-cost producer with less labour-intensive operations than its peers, and a strong balance sheet.

We increased exposure to MTN during the quarter. The share has halved from its peak a few years ago and sentiment is currently very negative. Although the risks inherent in regions such as Nigeria and Iran are high, we believe that the potential upside in the stock justifies our current weighting. (A detailed investment case of MTN can be found on page 16.)

Multi-asset class funds

Our balanced funds performed well during the quarter but more importantly continue to outperform over the more meaningful periods shown above. Despite great uncertainty, locally and globally, the funds have a high allocation to growth assets (equity and listed property). These funds are managed to meet the needs of investors who still have decades to

invest, where the biggest risk lies in inflation eroding real capital values over time. In aggregate, we think the funds are well positioned, with offshore exposure close to maximum levels, low holdings in domestic government bonds and local equities tilted towards businesses with offshore earnings streams.

PERFORMANCE FOR VARIOUS PERIODS

	Launch date	5 years*	10 years*	Since inception*
Balanced Plus	Apr 96	12.4%	10.6%	15.3%
Market Plus	Jul 01	13.2%	11.3%	17.0%
Average competitor		10.5%	8.4%	13.0%

**Annualised. Average competitor performance is defined as the mean return of the SA Multi-asset High Equity category excluding Coronation funds as measured by Morningstar and is shown since the inception date of the Coronation Balanced Plus Fund.*

Our global equity position, which includes an allocation to other emerging markets, has delivered a strong outperformance. Emerging markets sustained their rally into the new year, after a strong 2016. Our overall allocation to offshore assets is sitting close to its maximum, as we are very concerned about the risks in SA.

In our domestic exposure, our allocation to resource shares has contributed to performance. Our underweight position in companies that are sensitive to domestic interest rates and the local economy has also been beneficial, as these companies have been hit hard following the recent replacement of the finance minister.

Our property allocation includes domestic SA property holdings, UK property stocks listed on the JSE and some high-quality domestic counters. We consider UK listed property an exciting opportunity for the patient investor. Our largest holding is Intu, a portfolio of high-quality shopping centres. We expect the local property sector to show mid-single-digit growth in distributions over the medium term. Reasonable distribution growth, combined with an attractive initial yield (typically in the 8% to 10% region), should result in an attractive holding period return.

We have been very underweight government bonds for some time, and have maintained this position. Global bond markets remain very expensive due to central bank buying strategies. Locally, the market does not fully price in the risk of greater budget deficits in the event that economic growth weakens and potential political demands on the Treasury increase.

INVESTOR NEED: INCOME AND GROWTH

Multi-asset funds

Despite the volatility towards the end of the quarter, the funds protected capital well over the period. Disappointing returns relative to inflation over the past three years bear testimony to the tough investment environment in which real returns in the interest-bearing areas have been far lower than the historical trend. Sluggish economic growth has also limited the ability of domestic companies to grow profits, as reflected in the FTSE/JSE All Share Index trending sideways.

Given the well-diversified multi-asset nature of the strategies, we construct the portfolios to withstand unforeseen events. In the case of SA, the rand invariably acts as the biggest shock absorber and owning a high proportion of domestically listed companies that derive the bulk of their earnings from outside the country has again proven to be a prudent approach.

PERFORMANCE FOR VARIOUS PERIODS

	Launch date	1 year	3 years*	5 years*	Since inception*
Capital Plus	Jul 01	5.2%	6.0%	9.5%	12.9%
Balanced Defensive	Feb 07	5.1%	7.3%	10.2%	10.2%
Average competitor		3.5%	6.5%	9.2%	8.1%
Inflation (CPI)		6.4%	5.6%	5.7%	6.4%

**Annualised. Average competitor performance is defined as the mean return of the SA Multi-asset Medium Equity and the SA Multi-asset Low Equity categories excluding Coronation funds as measured by Morningstar and is shown since the inception date of the Coronation Balanced Defensive Fund.*

Global stock markets were generally strong, driven by expectations of positive policy changes by the Trump administration (such as lowering corporate taxes). However, the markets have in our view ignored the risks of tensions in the global economy as president Trump advocates protectionism through his 'America First' approach. We consequently decided to reduce our exposure to global risk assets somewhat by lightening both our developed and emerging market equity holdings. Still, we continue to hold close to the maximum allowable exposure to global assets. We have navigated uncertain periods before by steadfastly focusing on the tenets of our long-term, valuation-driven investment philosophy and, once again, we have seen it pay off in the most recent performance of our portfolios.

INVESTOR NEED: IMMEDIATE INCOME

Income fund

The fund comfortably met its objective of providing a better return than a traditional money market fund for investors with a time horizon between one and three years.

We remain vigilant of risks emanating from the dislocations between stretched valuations and the underlying fundamentals of the SA economy. However, we believe that the fund's current positioning correctly reflects appropriate levels of caution. The fund's yield of 9.1% continues to be

PERFORMANCE FOR VARIOUS PERIODS

	Launch date	1 years*	3 years*	Since inception*
Strategic Income	Jul 01	9.0%	8.2%	10.5%
Average competitor		8.0%	7.2%	8.8%
Cash (STeFI3M)		7.2%	6.4%	7.8%

**Annualised. Average competitor performance is defined as the mean return of the SA Multi-asset Income category excluding Coronation funds as measured by Morningstar and is shown since the inception date of the Coronation Strategic Income Fund.*

attractive relative to its conservative 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. For a detailed investment review of all our funds, please refer to our fact sheets and commentaries in the Funds & Products section of www.coronation.co.za. ■

INTERNATIONAL OUTLOOK

OPERATING IN UNUSUAL TIMES

By Tony Gibson

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

STRONG MARKET PERFORMANCE

All in all, the first quarter of 2017 was another good one for global asset performance. Although weakness in the US dollar somewhat flattered returns, almost every asset class delivered a positive total return – with the exception of certain commodities. Gold reversed its position as the worst-performing asset class of the fourth quarter of 2016 to end at the top of the performance tables in the first quarter of 2017, rising 8.4%. Global equities also did well, rising 6.9% and thereby continuing to outperform bonds (as has been the case since the global low point in yields seen around the time of the Brexit vote).

The best returns came from the global technology sector, which rose 12%. To put this in perspective, it is worth noting that the top four megacaps of the sector (Apple, Alphabet, Amazon and Facebook) now have a combined market capitalisation twice that of the French CAC 40 Index. Energy was the only sector not to deliver positive performance, falling 5% on the back of lower oil prices.

In the bond and credit markets, returns largely appear to have followed a pattern commensurate with asset risk. Therefore, the lower the credit rating, the better the return. This is illustrated by the fact that despite the interest rate hike by the US Federal Reserve (Fed) in March, emerging market debt (in local currency) performed very strongly, producing a 6.4% total return. Additionally, returns were boosted by strength in emerging market currencies, with the Mexican peso, Russian rouble and Korean won rising 8% to 10% against the US dollar. Interestingly, despite a more hawkish Fed, US Treasury yields moved lower over the quarter, albeit marginally. In the currency market, the clear trend during the quarter was that investors' long-standing preference for the US dollar has declined, with the currency underperforming every other major currency during the quarter. The Australian dollar (+6%) and Japanese yen (+5%) were the standout performers among developed market currencies.

ECONOMIC OUTLOOK

Looking at economic statistics, global nominal GDP appears to be on track to record its second consecutive 6% annualised quarterly gain in the first quarter of 2017. This will represent a sharp acceleration from the 4.5% annualised growth rate over the previous two years. Supporting this assertion is the fact that manufacturing output growth is accelerating to a pace of 4.6% for the quarter, suggesting a significant boost from a positive turn in the inventory cycle. The strength in manufacturing activity appears to have been broad based, and has prompted economists to revise their GDP forecasts – particularly for western Europe and Asia.

As we already know, the US economy grew more modestly during the fourth quarter of 2016. That said, the US is also starting to experience the global pick-up in manufacturing (output is tracking a 3.8% annualised rise this quarter) and sentiment is improving. It seems probable that US economic

growth is poised to bounce back to a level of around 3% as the year progresses, fuelling a faster gain in overall global GDP for the next couple of quarters.

Looking at Europe, growth dynamics in the region continue to improve: the European Commission's Economic Sentiment Indicator is at a six-year high, the German Ifo Business Climate Index is improving and the European labour market is tightening. Again, economists are steadily revising their 2017 growth outlook for the region upwards. Given the pace of labour market tightening, it was somewhat unexpected that core inflation in March surprised significantly to the downside.

At an annual rate of 0.7%, core inflation is now back at the low end of an already low four-year range. However, beyond this year, changing labour market dynamics should begin to put upward pressure on prices. While core inflation may only rise to 1.4% (year on year) by the end of 2018, the upward momentum in both growth and inflation should be sufficient to trigger quantitative easing tapering early next year. That said, the first rate hike from the European Central Bank (ECB) will most likely not come until late 2018. This forecast is reinforced by recent ECB comments.

ALL EYES ON THE TRUMP ADMINISTRATION

Looking towards the medium term, it should be noted that the US Standard & Poor's (S&P) 500 Index had been moving broadly sideways for nearly two years during the build-up to the 2016 US election. This period of muted performance coincided with the Fed beginning to normalise policy, during a time in which the economy was mired in a stop-go pattern of growth.

Additionally, corporate earnings actually declined (mostly because of reported earnings declines from companies in the energy sector) during 2016. Then along came Donald Trump and the equity market changed tack, as it wholeheartedly embraced his reflation argument. The strongly bullish line of argument was that growth would be energised by a combination of deregulation, tax cuts and infrastructure spending.

Thus far, little that is either elegant or convincing has been forthcoming from the Trump administration. Investors have increasingly begun to wonder whether the recent healthcare reform failure is telling of how Trump's other main policy proposals may play out. It has also raised questions about whether his policies will be sufficient to generate a sustained increase in the growth rate of the US economy. A worry is that tax reform legislation will be just as hard to achieve following the healthcare reform failure. Additionally, financial deregulation could face significant opposition and infrastructure spending plans may have a more muted impact on the economy than many believe, as it appears these plans are based on tax credits that will rely on private sector investment. Either way, whether positive or negative on the Trump administration, the events of recent weeks have to cast doubt on just how successful Trump will be in boosting the US economy.

Certainly, after the strong gains following Trump's election, investors are more cautious that the healthcare debacle will have a negative impact on sentiment in the US. The question is essentially whether survey data were 'leading' actual economic data or simply getting carried away. The most recent US Purchasing Managers' Index release for February disappointed. That said, the services sector remains strong.

GRADUAL NORMALISATION

Taking a longer-term perspective, although fears of an unstoppable deflationary global contraction have reduced in recent months, expectations for a prolonged disinflationary environment are still built into developed world financial markets. The multi-year rationalisation, and acceptance, of negative real returns on short- and medium-term debt is fed by the self-reinforcing effect of momentum investing. This has distorted borrowing and investing patterns, and should not be seen as sustainable by any rational investor.

As a reminder, and to offer perspective, US 10-year Treasury yields fell from the early 1980s to a low of just over 1.4% in mid-2012, and back to that low again in mid-2016. During the time before these already low yields were exaggerated by Fed bond buying, 10-year yields traded in a range between 4% and 5% from mid-2002 through to mid-2008.

Over the coming two to three years, as the Fed continues to raise short-term borrowing rates, it will also begin to retire (rather than reinvest) maturing Treasuries in its portfolio. Without this bond demand distortion (which has been in force since 2009), 10-year yields should continue to 'normalise' and slowly rise back to and above 3%. During this period, bondholders will most likely question the scenario again and might believe that tepid global growth – combined with the glut of global savings, continued bond buying by the ECB and the Bank of Japan, and (yet more) political gridlock in the US – will offset the reduction in Fed bond buying. This (bond-bull) argument therefore believes that further raising the federal funds rate would merely flatten the yield curve, slow the modest domestic recovery and force the Fed to pause – or even loosen again later next year or in 2019. We believe that this is bond-bull rationalisation rather than sound logic.

While prices of basic materials have risen significantly from depressed levels a year ago, the price of gold has remained relatively flat in US dollar terms. To give some context, year-on-year prices of natural gas, crude oil and copper are up by 69%, 34% and 21% respectively. By comparison, the price of gold rose by just 7% over this period. While the price behaviour of gold implies limited immediate inflationary

price pressure, the year-on-year increase in the price of oil has triggered a near-term inflationary effect that will move through the supply chain during the course of 2017. Despite this, it is unlikely that the rise in the price of oil will materially suppress consumer spending power in the US, since most of the jump resulted from the over-sold conditions prevailing a year ago. More important is whether sustained higher energy prices later this year might trigger a second round of inflationary effects, which would lead to expectations of higher wage and consumer prices into 2018.

CHANGE IS COMING

It is our opinion that during the next two years, the outlook points to a modest upturn in global economic activity, resulting in a synchronised period of global growth. This will be led by the US and will be supported by continued momentum from China and India. In China, it appears that to protect its consolidation of power, China's ruling elite needs to support the momentum of growth this year. This in turn should support a further rise in base metal prices. As mentioned, the recent cyclical upturn in commodity prices should add to input price pressure over the next 12 to 18 months. Worryingly, over the longer term it appears likely that the global economic growth rate is set to slow and increasingly diverge between regions.

In examining likely future trends, investors need to be reminded that momentum investing (whether on a macro or share selection level) becomes self-fulfilling. In the late 1970s, inflationary expectations shaped group think, while by the late 1980s, it was Japan's export-driven economic boom. A decade later, the collective focus had shifted to a US-led, tech-driven investment boom. By 2007, the masses of momentum investing were seduced by expectations of a super-long-term, China-driven commodity super cycle. The subsequent collapse, caused by the leverage-driven risk peak in 2008, led the next wave of consensus toward deflationary expectations. This saw the rationalisation of negative real interest rates and a critical mass of investors assuming chronic slow growth, a global savings surplus and a glut of production capacity. Distilled into one line, the belief was that interest rates would remain lower for longer for many years into the future.

All we can state with reasonable certainty is that looking ahead over the next 10 years, the environment that will shape the late 2020s is likely to be far different from the influences that shaped the critical mass of consensus thinking that exists today. We believe that the world will most likely be moving from the current period (which encourages excess savings and is characterised by lower debt yields) towards a period of demographic divergence, during which modest growth in the US will be insufficient to compensate for the ongoing contraction in most of Europe and North Asia. The worry is that rapidly ageing populations, and the resultant negative effect on economic growth, will drain savings and set in motion a process leading towards higher capital costs and reflation. As mentioned earlier, in each of the past five decades, such a transition and the resulting shift in the direction of momentum investing will be dramatic. At Coronation, we know well that during the early stages of such a macro change, inertia towards recognising the trend can frustrate premature contrarian investments.

Put another way, it may well take another two to three years before rising nominal interest rates produce a real rate of return (after inflation) for passive investors. However, it is our belief that the era of disinflation that led to negative real interest rates is over. It is the interference of central banks (by buying public sector debt) that is preventing markets from pricing capital, and thereby distorting risk and financial asset allocation. Without this temporary and artificial support, the transformation of the global economy and financial system would have already become more apparent.

Therefore, while near-term conditions favour a period of growth in 2017 that is likely to last into 2019, we foresee this fading quickly in the 2020s as the economic, financial and political environment will begin to deteriorate across most of Europe and North Asia. Collectively, the common thread is likely to be a steady contraction in the global pool of mobile capital. This will result in the cost of capital becoming increasingly unaffordable for those countries failing to manage their economies in a prudent and productive manner. SA will be particularly vulnerable to this trend.

With regard to global equity markets, the valuation of the US market is the benchmark from which investors generally take guidance. There is little doubt that US equities appear overpriced – especially when measured against long-term averages. Additionally, a recent survey undertaken by Bank of America indicates that over 80% of participants believed that the US equity market looks expensive. A measure that is often turned to when seeking valuation guidance is the cyclically adjusted Shiller Index. This index is the S&P 500 price-to-earnings ratio based on average earnings over the past 10 years. This index is now well above the very long-term average of 16.7 times – currently standing at 29.7 times.

While this undoubtedly high valuation calls for caution, it is worth pointing out that this has been the case for a number of years in the severe post-2008 equity bear market. Additionally, statistical studies have shown that historically, the Shiller Index has only explained around 10% of market movements over any subsequent five-year period. As we well know, we operate in very unusual times at present, when assessed in terms of ease of forecasting. Many fundamental demographic and social changes are currently unfolding, which make forecasting problematic. It is a time during which investors who draw on their ability to apply much-needed perspective and calm will navigate the uncertainty successfully. ■

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.

■ INCOME ■ GROWTH

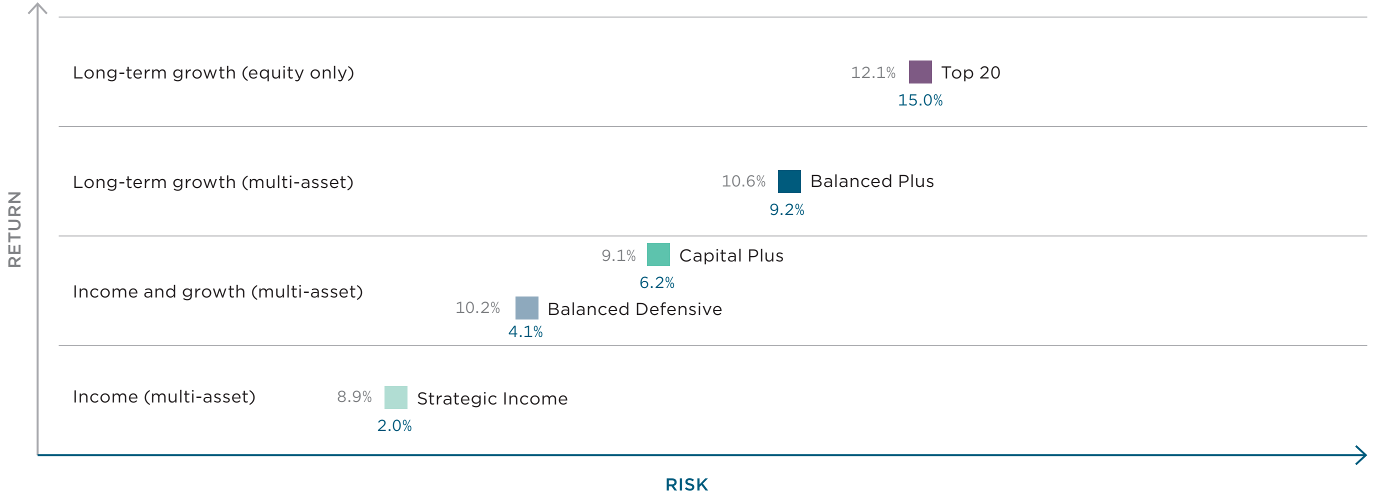
	INVESTOR NEED				
	INCOME ONLY	INCOME AND GROWTH		LONG-TERM CAPITAL GROWTH	
FUND	STRATEGIC INCOME Cash†	BALANCED DEFENSIVE Inflation†	CAPITAL PLUS Inflation†	BALANCED PLUS Composite benchmark† (equities, bonds and cash)	TOP 20 FTSE/JSE CAPI†
FUND DESCRIPTION	Conservative asset allocation across the yielding 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]	93.0% / 7.0%	61.7% / 38.3%	42.5% / 57.5%	21.6% / 78.4%	0.1% / 99.9%
LAUNCH DATE	Jul 2001	Feb 2007	Jul 2001	Apr 1996	Oct 2000
ANNUAL RETURN (Since launch)	10.5% †7.8%	10.2% †6.4%	12.9% †6.1%	15.3% †13.6%	19.3% †14.7%
QUARTILE RANK (Since launch)	1st	1st	1st	1st	1st
ANNUAL RETURN (Last 10 years)	8.9% †7.0%	10.2% †6.4%	9.1% †6.4%	10.6% †10.3%	12.1% †9.7%
FUND HIGHLIGHTS	Outperformed cash by 2.7% p.a. over the past 5 years and 2.7% p.a. since launch in 2001.	Outperformed inflation by 3.8% p.a. (after fees) since launch, while producing positive returns over all 12-month periods. A top-performing conservative fund in SA over 5 years.	Outperformed inflation by 6.8% p.a. (after fees) since launch, while producing positive returns over 24 months more than 98% of the time.	No. 1 balanced fund in SA since launch in 1996, outperforming its average competitor by 2.4% p.a. Outperformed inflation by on average 8.8% p.a. since launch and outperformed the ALSI on average by 1.5% p.a.	The fund added 4.6% p.a. to the return of the market. This means R100 000 invested in Top 20 at launch in Oct 2000 grew to more than R1.8 million by end-March 2017 - nearly double the value of its current benchmark. The fund is a top-quartile performer since launch.

[1] Income versus growth assets as at 31 March 2017. Growth assets defined as equities, listed property and commodities (excluding gold).

Figures are quoted from Morningstar as at 31 March 2017 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

RISK VERSUS RETURN

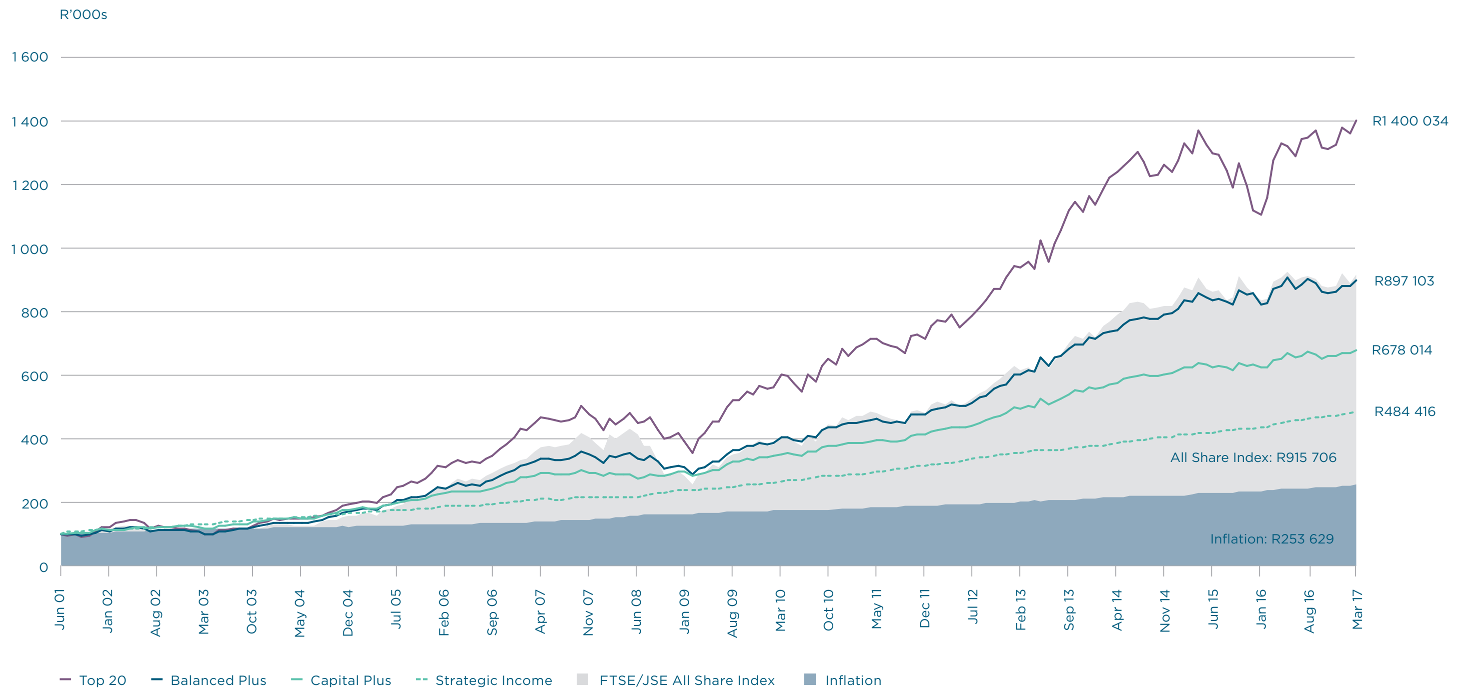
10-year annualised return and risk (standard deviation) quoted as at 31 March 2017.
Figures quoted in ZAR after all income reinvested and all costs deducted.



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 1 July 2001 as at 31 March 2017. 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 2 February 2007.



Source: Morningstar

INTERNATIONAL FLAGSHIP FUND RANGE

■ INCOME ■ GROWTH

	INVESTOR NEED				
	DEPOSIT ALTERNATIVE	CAPITAL PRESERVATION	LONG-TERM CAPITAL GROWTH (MULTI-ASSET)	LONG-TERM CAPITAL GROWTH (EQUITY ONLY)	
FUND[1]	GLOBAL STRATEGIC USD INCOME [ZAR] FEEDER GLOBAL STRATEGIC USD INCOME US dollar cash (3 Month Libor)†	GLOBAL CAPITAL PLUS [ZAR] FEEDER GLOBAL CAPITAL PLUS [FOREIGN CURRENCY][4] US dollar cash (3 Month Libor)*	GLOBAL MANAGED [ZAR] FEEDER GLOBAL MANAGED [USD] Composite (equities and bonds)†	GLOBAL OPPORTUNITIES EQUITY [ZAR] FEEDER GLOBAL OPPORTUNITIES EQUITY [USD] MSCI ACWI†	GLOBAL EMERGING MARKETS FLEXIBLE [ZAR] GLOBAL EMERGING MARKETS [USD] MSCI Emerging Markets 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.	A diversified portfolio of the best global equity managers (typically 6-10) who share our investment philosophy. An ideal fund for investors who prefer to own just one global equity fund. Investors who want to blend their international equity exposure may consider Coronation Global Equity Select, which has more concentrated exposure to our best global investment views.	Our top stock picks from companies providing exposure to emerging markets. The US dollar fund remains fully invested in equities at all times, while the rand fund will reduce equity exposure when we struggle to find value.
INCOME VS GROWTH ASSETS[2]	97.4% / 2.6%	58.9% / 41.1%	29.4% / 70.6%	1.5% / 98.5%	0.1% / 99.9%
LAUNCH DATE	Aug 2013 Dec 2011	Nov 2008 Sep 2009	Oct 2009 March 2010	Aug 1997 May 2008	Dec 2007 July 2008
ANNUAL RETURN[3] (Since launch)	2.7% †0.4%	5.7% †0.5%	7.2% †6.5%	6.6% †5.6%	1.8% †(0.2%)
QUARTILE RANK (Since launch)	-	1st	1st	1st	2nd
ANNUAL RETURN (Last 5 years)	2.1% 0.4%	3.0% 0.4%	6.2% 5.8%	7.6% 9.9%	0.9% 1.1%
QUARTILE RANK (Last 5 years)	-	2nd	1st	1st	2nd
FUND HIGHLIGHTS	Outperformed US dollar cash by 2.3% p.a (after fees) since launch in December 2011.	Outperformed US dollar cash by 5.2% p.a. (after fees) since launch in 2008.	No. 1 global multi-asset high equity fund in SA since launch in October 2009.	Both the rand and dollar versions of the fund have outperformed the global equity market with less risk since their respective launch dates.	Both the rand and dollar versions of the fund have outperformed the MSCI Emerging Markets Index by more than 2% p.a. since their respective launch dates.

1. *Rand- and US dollar-denominated fund names are included for reference.*
2. *Income versus growth assets as at 31 March 2017 (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.*
4. *Available in US dollar Hedged, GBP Hedged, EUR Hedged or Houseview currency classes.*

Figures are quoted from Morningstar as at 31 March 2017 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 SA (ASISA).

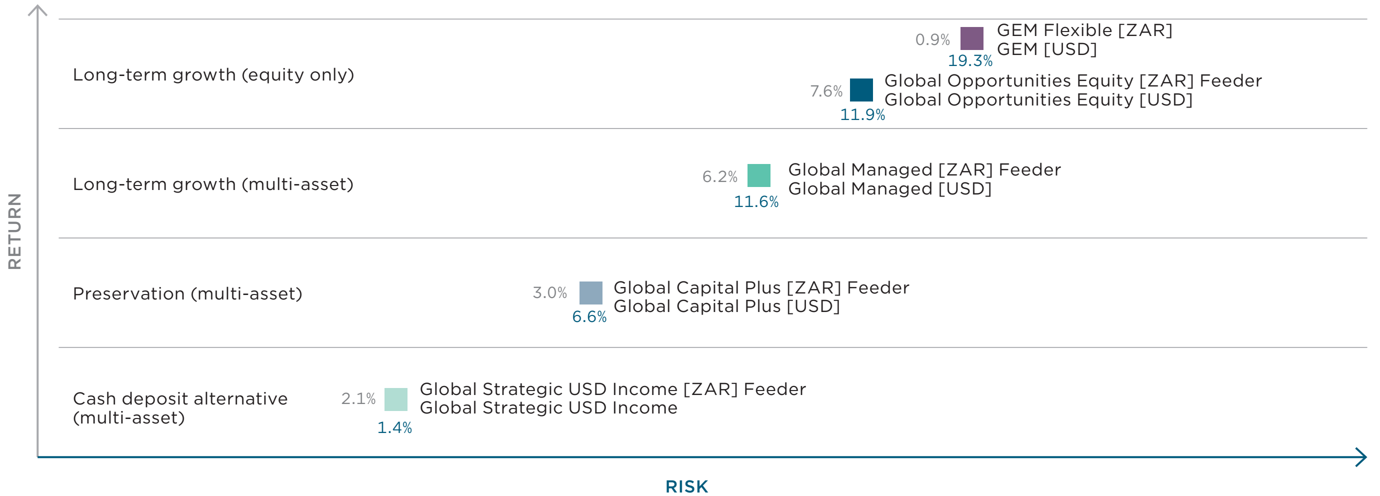
HAVE YOU CONSIDERED EXTERNALISING RANDS? IT IS EASIER THAN YOU MIGHT THINK.

The SA Reserve Bank allows each resident SA taxpayer to externalise funds of up to R11 million per calendar year (A R10 million foreign capital allowance and a R1 million single discretionary allowance) for direct offshore investment in foreign currency denominated assets. If you want to invest more than R1 million, the process is as easy as:

1. Obtain approval from SARS by completing the appropriate form available via eFiling or your local tax office. Approvals are valid for 12 months and relatively easy to obtain if you are a taxpayer in good standing.
2. Pick the mandate that is appropriate to your needs from the range of funds listed here. You may find the 'Choosing a Fund' section or 'Compare Funds' tool on our website helpful, or you may want to consult your financial advisor if you need advice.
3. Complete the relevant application forms and do a swift transfer to our US dollar subscription account. Your banker or a foreign exchange currency provider can assist with the forex transaction, while you can phone us on 0800 86 96 42, or read the FAQ on our website, at any time if you are uncertain.

RISK VERSUS RETURN

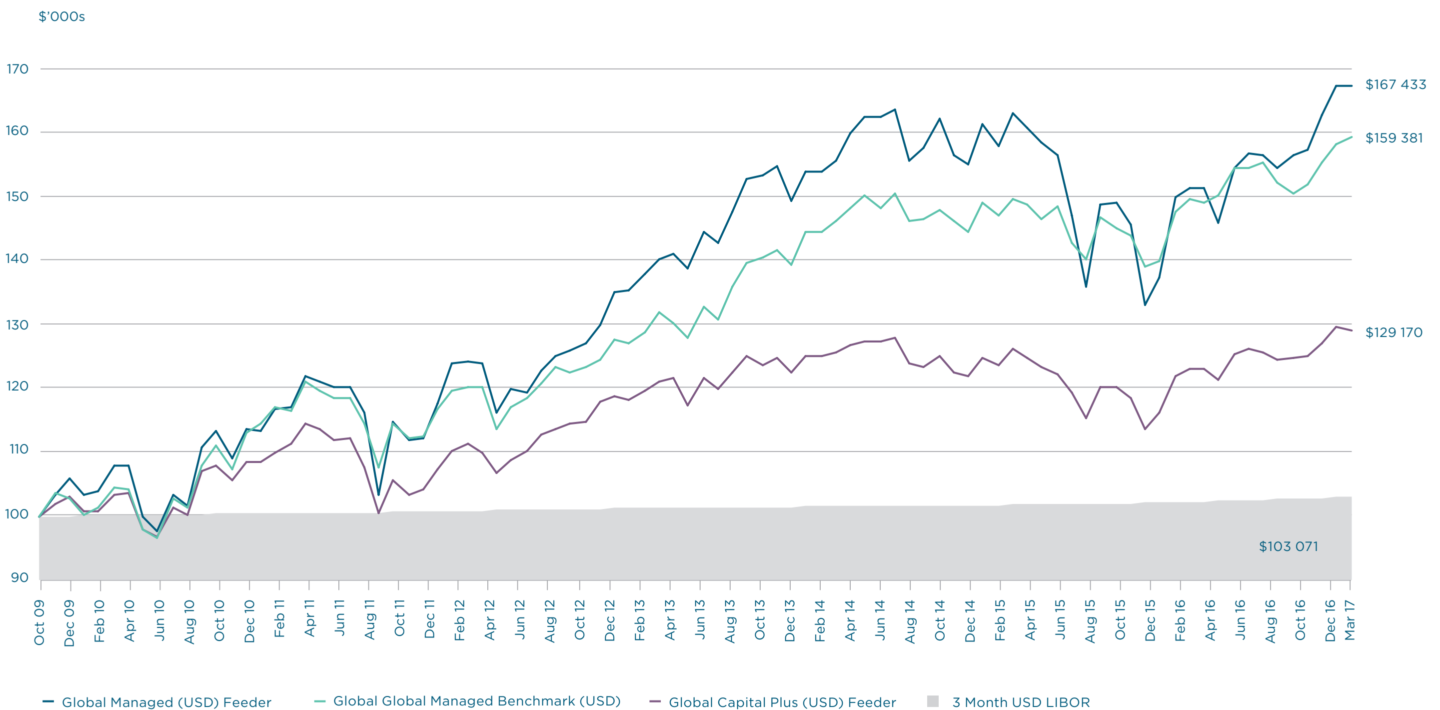
5-year annualised return and risk (standard deviation) quoted as at 31 March 2017. Figures quoted in USD (for the oldest fund) after all income reinvested and all costs deducted.



Source: Morningstar

GROWTH OF $100 000 INVESTED IN OUR GLOBAL MULTI-ASSET FUNDS ON 29 OCTOBER 2009

Value of $100 000 invested in Global Managed [ZAR] Feeder and Global Capital Plus [ZAR] Feeder since inception of Global Managed [ZAR] Feeder on 29 October 2009. All returns quoted in USD. All income reinvested for funds; MSCI World Index is on a total return basis.

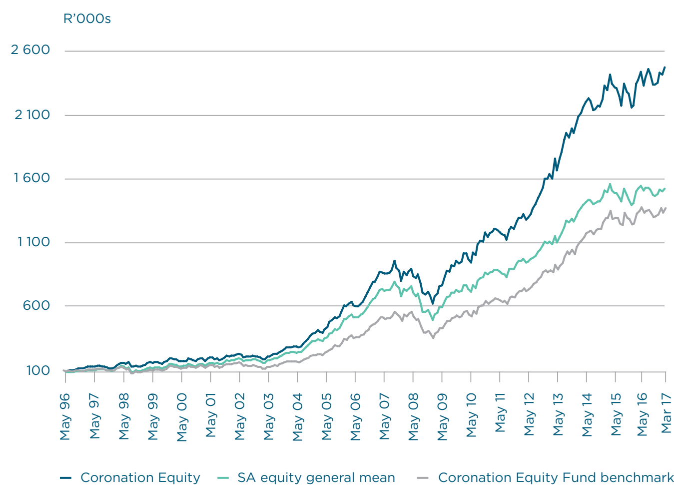


Source: Morningstar

CORONATION EQUITY RETURNS VS EQUITY BENCHMARK

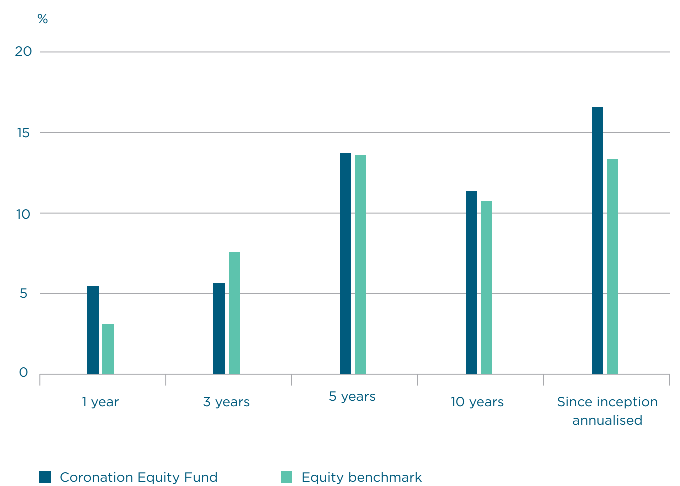
5-YEAR ANNUALISED RETURNS	CORONATION EQUITY	EQUITY BENCHMARK	ALPHA
2001	12.24%	9.38%	**2.86%**
2002	12.01%	7.14%	**4.87%**
2003	14.51%	13.49%	**1.02%**
2004	14.03%	10.46%	**3.56%**
2005	23.56%	19.44%	**4.12%**
2006	27.13%	23.91%	**3.22%**
2007	31.87%	30.40%	**1.46%**
2008	21.01%	20.09%	**0.91%**
2009	19.31%	19.37%	**(0.06%)**
2010	15.97%	15.12%	**0.85%**
2011	9.83%	8.65%	**1.19%**
2012	11.55%	10.60%	**0.94%**
2013	22.52%	20.60%	**1.92%**
2014	17.58%	17.78%	**(0.20%)**
2015	13.77%	14.72%	**(0.95%)**
2016	14.12%	14.44%	**(0.32%)**
4 years 3 months to 31 March 2017	11.94%	11.25%	**0.69%**
ANNUALISED TO 31 MARCH 2017			
1 year	5.54%	3.16%	**2.38%**
3 years	5.85%	7.55%	**(1.70%)**
5 years	13.78%	13.57%	**0.21%**
10 years	11.35%	10.76%	**0.60%**
Since inception in October 1993 annualised	16.56%	13.36%	**3.21%**
Average outperformance per 5-year return			**1.97%**
Number of 5-year periods outperformed			**14.00**
Number of 5-year periods underperformed			**4.00**

CUMULATIVE PERFORMANCE



An investment of R100 000 in Coronation Equity on 15 April 1996 would have grown to **R2 466 969** by 31 March 2017. By comparison, the returns generated by the fund's benchmark over the same period would have grown a similar investment to **R1 376 542**, while the average competitor would have grown a similar investment to R1 519 737.

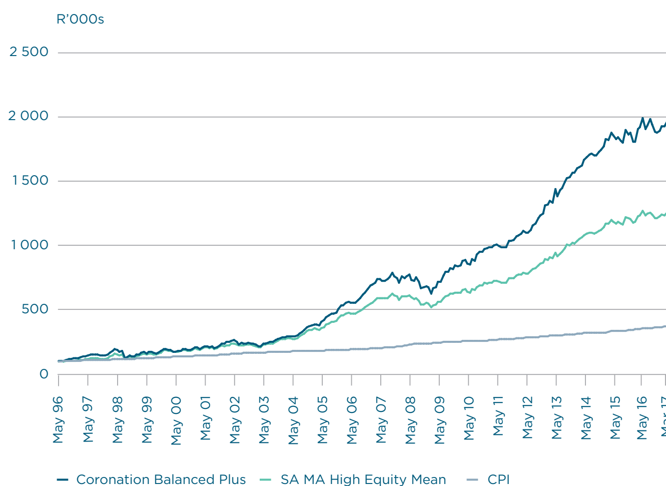
ANNUALISED RETURNS TO 31 MARCH 2017



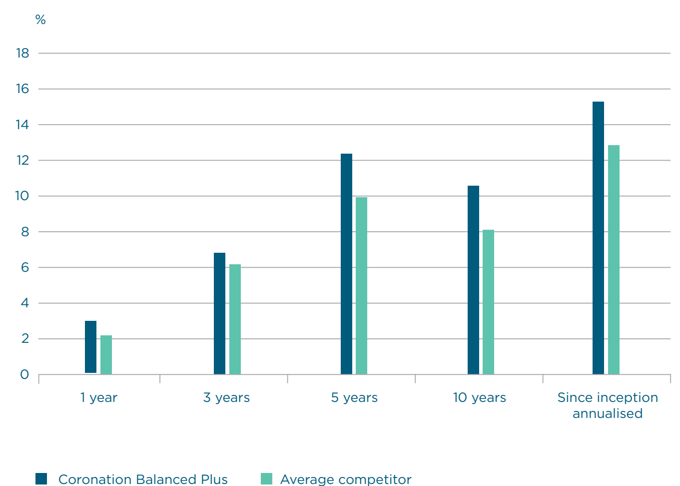
CORONATION BALANCED PLUS FUND VS INFLATION AND AVERAGE COMPETITOR*

5-YEAR ANNUALISED RETURNS	CORONATION BALANCED PLUS	INFLATION	REAL RETURN
2001	14.38%	7.41%	**6.97%**
2002	10.73%	8.04%	**2.69%**
2003	14.68%	7.33%	**7.35%**
2004	13.82%	6.68%	**7.14%**
2005	20.53%	5.85%	**14.68%**
2006	22.43%	5.54%	**16.89%**
2007	25.35%	5.17%	**20.18%**
2008	19.28%	6.41%	**12.87%**
2009	17.60%	6.82%	**10.77%**
2010	13.97%	6.71%	**7.26%**
2011	9.49%	6.94%	**2.55%**
2012	10.81%	6.36%	**4.45%**
2013	17.98%	5.39%	**12.58%**
2014	15.57%	5.19%	**10.38%**
2015	14.05%	5.54%	**8.51%**
2016	12.69%	5.67%	**7.02%**
4 years 3 months to 31 March 2017	11.23%	5.95%	**5.28%**
ANNUALISED TO 31 MARCH 2017	**CORONATION BALANCED PLUS**	**AVERAGE COMPETITOR**	**ALPHA**
1 year	3.00%	2.19%	**0.81%**
3 years	6.84%	6.17%	**0.67%**
5 years	12.40%	10.01%	**2.39%**
10 years	10.64%	8.12%	**2.52%**
Since inception in April 1996 annualised	15.32%	12.87%	**2.44%**
Average 5-year real return			**9.20%**
Number of 5-year periods where the real return is >10%			**7.00**
Number of 5-year periods where the real return is 5% - 10%			**8.00**
Number of 5-year periods where the real return is 0% - 5%			**3.00**

CUMULATIVE PERFORMANCE



ANNUALISED RETURNS TO 31 MARCH 2017



An investment of R100 000 in Coronation Balanced Plus on 1 October 1993 would have grown to **R1 970 157** by 31 March 2017. By comparison, the SA multi-asset high-equity sector over the same period would have grown a similar investment to **R1 258 941**.

** 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.*

NOTES

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