corospondent

The Personal Investments Quarterly

The power issue

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APRIL 2019 AUTUMN EDITION

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Notes from my inbox

A good quarter for investors, but a tough one for South Africa

By Pieter Koekemoer

"… human beings have a strong dramatic instinct toward binary thinking, a basic urge to divide things into two distinct groups, with nothing but an empty gap in between. We love to dichotomize. Good versus bad. Heroes versus villains. My country versus the rest. Dividing the world into two distinct sides is simple and intuitive, and also dramatic because it implies conflict, and we do it without thinking, all the time."
– Hans Rosling, Factfulness: Ten Reasons We're Wrong About the World – and Why Things Are Better Than You Think

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.

Homo sapiens' favourite way to make sense of the world is through a compelling narrative. For the plot to make sense, there needs to be conflict followed by resolution. If the storyline becomes too convoluted, we tend to lose interest. While we are hardwired to interpret the world in this way, it is often not the most sensible approach to truly understanding what is happening around us. Hans Rosling reminded us in my favourite recent read that we should be careful not to oversimplify the world in our search for the explanatory tale.

If you do insist on simplifying events, you can summarise the investor experience during the first quarter of 2019 in two main

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narratives, which, when taken at face value, seem contradictory: investment performance improved dramatically, while much of the economic news deteriorated. Time will tell how the rest of the 2019 plot plays out. Our aim in this issue of *Corospondent* is to fill in some of the gaps so that you can have a more nuanced perspective on how the story will unfold from here.

The good news is that markets around the world staged a strong recovery after a dismal 2018, with both our local and global equity funds delivering double-digit returns at the start of 2019, as can be seen on page 5. The key macro factor contributing to this outcome was central bankers' new-found dovish sentiment in response to signs of a slowdown in global economic growth. In several cases we have also seen the market taking a more benign view on the idiosyncratic factors impacting some of the key holdings in our portfolios (such as the platinum miners, British American Tobacco, MTN and Chinese internet businesses such as 58.com, JD.com, and Tencent/Naspers).

The bad news is that the economic outlook for South Africa remains very weak. In the near term, Eskom is the darkest cloud on the horizon. Mauro Longano sets out our power utility's dire condition on page 6, while Neville Chester deals with the likely impact on sentiment and business activity of what looks like a prolonged period of inadequate power supply that lies ahead. Marie Antelme points out on page 20 that the timing of the energy crisis could not be worse, given that, during 2018, already depressed economic activity led to the slowest growth in compensation of the democratic era. While it seems clear that a combination of deregulation and competition will eventually alleviate the energy supply problems, it remains to be seen how much more pain will have to be taken before we arrive at this inevitable destination.

Nicholas Hops deals with another risk posed by widely accepted narratives in his piece on the dangers of headline investing. He illustrates how conventional wisdom can lead you astray when investing, using examples from the global paper, primary energy and vehicle drivetrain industries.

Finally, we celebrated the 20th anniversary of the Coronation Optimum Growth Fund in March. This fund was a pioneer in the worldwide flexible fund category when it launched in 1999. As the name implies, it is an unconstrained fund that truly celebrates active investing, as it can invest in any listed asset from anywhere in the world. Its broad mandate benefits from the breadth and depth of our 54 investment professionals covering equities, bonds and property across the domestic, frontier, emerging and developed markets. The fund returned 14.3% per annum over the past two decades, which turned an initial R100 000 investment into nearly R1.4 million today, an increase in purchasing power of 4.25 times over this period.

As always, I invite you to get in touch with us if you want more information about your investment or if you think that there is something we should do better. ✚

Pieter

IN THIS ISSUE

Key performance indicators and fund performance

AS AT 31 MARCH 2019

	QTD	YTD	1 YEAR	3 YEARS	5 YEARS	10 YEARS	15 YEARS	20 YEARS
DOMESTIC INDICES								
CAPI (J303T)	6.8%	6.8%	3.5%	5.0%	6.3%	14.0%	15.3%	-
ALSI (J203T)	8.0%	8.0%	5.0%	5.7%	6.5%	14.0%	15.0%	15.2%
Top 40 (J200T)	8.5%	8.5%	6.1%	5.9%	6.2%	13.7%	14.7%	15.2%
SWIX (J403T)	6.0%	6.0%	0.4%	3.7%	6.2%	14.2%	15.5%	-
ALSI Industrials (J257T)	7.4%	7.4%	(3.7%)	0.6%	6.3%	17.9%	18.2%	14.9%
ALSI Financials (J580T)	(0.4%)	(0.4%)	(5.8%)	2.8%	7.6%	15.8%	14.9%	12.3%
ALSI Resources (J258T)	17.8%	17.8%	41.6%	22.2%	0.9%	5.4%	9.2%	14.5%
All Property Index (J803T)	1.3%	1.3%	(7.0%)	(5.9%)	4.1%	11.5%	-	-
BEASSA (TR) All Bond Index	3.8%	3.8%	3.5%	10.1%	8.3%	8.7%	8.9%	11.0%
Short Term Fixed Interest 3 Month Cash Rate	1.7%	1.7%	6.9%	7.1%	6.7%	6.3%	7.1%	-
CPI	1.7%	1.7%	4.8%	4.9%	5.0%	5.2%	5.7%	6.1%
INTERNATIONAL INDICES								
MSCI ACWI (USD)	12.2%	12.2%	2.6%	10.7%	6.5%	12.0%	6.8%	-
MSCI WORLD (USD)	12.5%	12.5%	4.0%	10.7%	6.8%	12.4%	6.8%	4.8%
MSCI GEM (USD)	9.9%	9.9%	(7.4%)	10.7%	3.7%	8.9%	7.9%	8.4%
S&P 500 (USD)	13.6%	13.6%	9.5%	13.5%	10.9%	15.9%	8.6%	6.0%
BGBA (USD)	2.2%	2.2%	(0.4%)	1.5%	1.0%	3.0%	3.3%	4.1%
3 Month Libor (USD)	0.7%	0.7%	2.6%	1.6%	1.1%	0.7%	1.8%	2.2%
MSCI ACWI (ZAR)	13.3%	13.3%	25.8%	10.3%	13.5%	16.7%	12.9%	-
MSCI WORLD (ZAR)	13.6%	13.6%	27.5%	10.3%	13.8%	17.1%	12.9%	9.4%
MSCI GEM (ZAR)	11.0%	11.0%	13.5%	10.3%	10.5%	13.6%	14.1%	-
3 Month Libor (ZAR)	1.7%	1.7%	25.7%	1.3%	7.8%	5.0%	7.6%	6.7%
SPOT RATES								
Rand Dollar exchange rate	14.4	14.4	11.8	14.7	10.5	9.6	6.3	6.2
Rand Dollar % change	(1.0%)	(1.0%)	(18.4%)	0.4%	(6.2%)	(4.1%)	(5.4%)	(4.2%)
Rand Euro exchange rate	16.5	16.5	14.6	16.7	14.5	12.6	7.7	6.6
Rand Pound exchange rate	18.3	18.3	16.6	21.1	17.6	13.7	11.6	10.0
Gold price (USD)	1 281.7	1 281.7	1 323.9	1 237.0	1 291.8	916.5	423.7	279.45
Oil price (USD barrel)	54.4	54.4	69.4	40.3	107.8	49.2	31.5	14.9

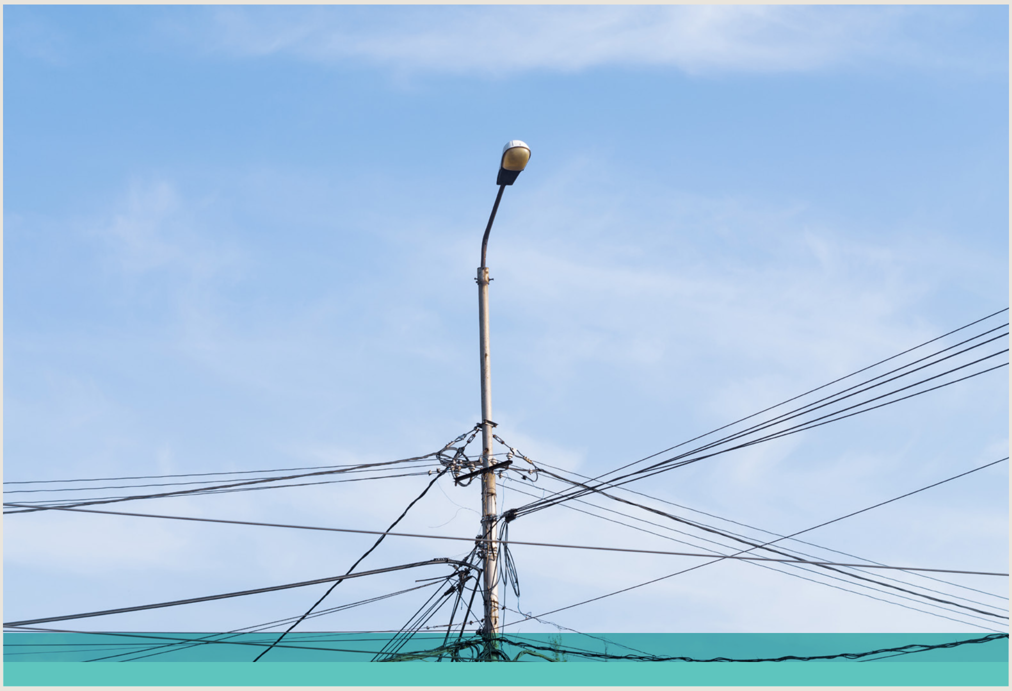
	QTD	YTD	1 YEAR	3 YEARS	5 YEAR S	10 YEARS	15 YEARS	20 YEARS	SINCE LAUNCH
DOMESTIC FUNDS (PERFORMANCE IN RANDS)									
Coronation Top 20 Fund	10.1%	10.1%	2.7%	5.8%	4.3%	14.3%	16.9%	-	17.6%
ASISA Mean of South African Equity General	5.8%	5.8%	1.3%	2.6%	4.2%	11.9%	13.7%	-	14.1%
Coronation Market Plus Fund**	8.6%	8.6%	5.1%	4.4%	5.7%	13.2%	14.6%	-	15.4%
ASISA Mean of South African Multi-Asset Flexible	4.7%	4.7%	3.9%	2.8%	5.3%	10.9%	12.0%	-	11.7%
Coronation Balanced Plus Fund	8.5%	8.5%	5.2%	4.3%	6.1%	12.5%	14.3%	13.7%	14.4%
ASISA Mean of South African Multi-Asset High Equity	5.8%	5.8%	5.8%	3.8%	5.7%	10.4%	12.4%	12.8%	12.4%
Coronation Capital Plus Fund	5.8%	5.8%	5.8%	4.1%	5.1%	9.7%	11.2%	-	11.8%
ASISA Mean of South African Multi-Asset Medium Equity	5.3%	5.3%	6.4%	4.1%	5.6%	9.5%	10.5%	-	11.1%
Coronation Balanced Defensive Fund	5.1%	5.1%	8.3%	5.8%	6.8%	10.3%	-	-	9.5%
ASISA Mean of South African Multi-Asset Low Equity	4.0%	4.0%	6.8%	5.2%	6.4%	8.6%	-	-	7.7%
Coronation Strategic Income Fund	2.5%	2.5%	7.9%	8.6%	8.3%	9.1%	9.3%	-	10.3%
ASISA Mean of South African Multi-Asset Income	2.3%	2.3%	7.7%	8.0%	7.6%	7.4%	8.0%	-	9.1%
INTERNATIONAL FUNDS (PERFORMANCE IN USD)									
Coronation Global Opportunities Equity Fund	16.1%	16.1%	0.6%	8.6%	5.4%	11.2%	-	-	5.6%
Coronation Global Emerging Markets Fund	23.0%	23.0%	(6.7%)	10.4%	0.9%	10.6%	-	-	4.8%
Coronation Global Managed Fund	11.2%	11.2%	(0.5%)	5.4%	2.7%	-	-	-	5.9%
Coronation Global Capital Plus Fund	6.6%	6.6%	2.6%	3.6%	1.7%	-	-	-	3.9%
Coronation Global Strategic Income Fund	2.0%	2.0%	2.1%	1.8%	1.4%	-	-	-	2.5%

* All ASISA averages exclude Coronation funds in that category

** Highest annual return (Coronation Market Plus): 50.0% (Aug 2004 - Jul 2005); lowest annual return: -20.1% (Mar 2008 - Feb 2009); fund launch date 2 July 2001

Figures as at 31 March 2019; for detailed fund performance, refer to pages 46 and 48

Meaningful periods

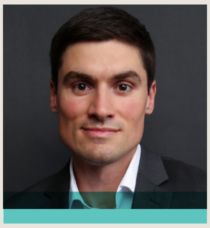


South Africa's power conundrum

Keeping the lights on needs dedication to complicated turnaround plans

By Mauro Longano

Mauro joined Coronation's Fixed Interest investment unit in 2014 and is responsible for co-managing the Strategic Income, Money Market and Jibar Plus funds. In addition to this, he is involved in credit research and pricing. Mauro has eight years' investment experience.



ESKOM IS ALWAYS a contentious topic, with the very mention of its name causing anguish and frustration for most South Africans. Since 2007, Eskom's 10 different CEOs have been unable to successfully address the issue of load shedding. And, despite the appointment of various task teams, clarity about the problems facing Eskom and the steps required to solve them remain elusive.

This is further inflamed by the alleged corruption highlighted through the likes of the Zondo Commission (as well as the R20.7 billion of reported irregular expenditure) and the failure, as yet, to hold anyone legally accountable. However, it is important that we do not let the facts be clouded by emotion and politics. The problems facing Eskom are complex, and it is important that all stakeholders remain focused on finding a solution.

Prior to 2007, when load shedding became a ubiquitous term in South African households, government had already been notified of the impending energy crisis. They chose not to act, and this led to former President Thabo Mbeki apologising in December 2007, with the admission, "Eskom was right and government was wrong".

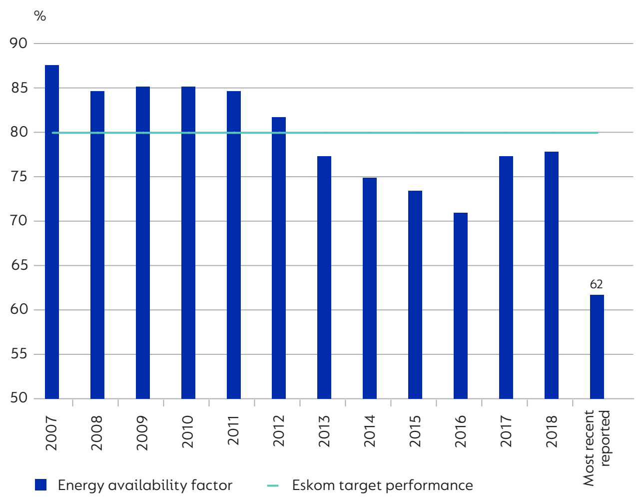
This put into motion the construction of Medupi and Kusile, the mega power stations, which together were to contribute an additional 9 600 megawatts (MW) of generation capacity to the national grid. However, what was to be Eskom's saviour has become its largest liability, as the complexity and challenges of the projects have proved too much. Time delays, cost overruns and poor contractor performance, as well as allegations of high levels of corruption, resulted in the cost estimates for Medupi alone ballooning from a reported R69.1 billion in 2007 to current incurred costs of double that, at R145 billion. The final cost to completion is still unknown, and recent reports of design flaws mean that substantial further expenditure is likely required to make the plant viable.

SUPPLY CONSTRAINTS

Ironically, growth in electricity demand is no longer an issue for Eskom, as electricity sales have fallen over the last 10 years due to consumption having become more efficient. The problem today is different: Eskom has the capacity to meet demand, but it is unable to do so because of units that are either being maintained or have stopped working after years of lack of maintenance.

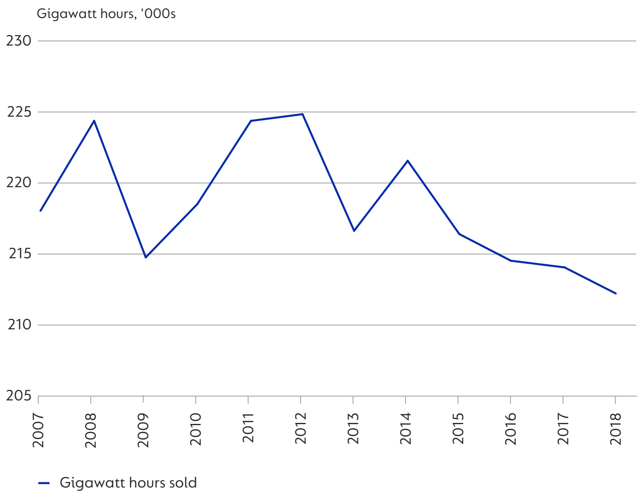
Eskom currently has 46 000 MW of installed capacity, but with the energy availability factor (a measure of the amount of time a plant is available to produce electricity) hovering around 62%, only 28 000 MW seem to be available. Unfortunately, trying to estimate when the situation will improve is a challenge, and Eskom needs time to perform the required maintenance. On this basis, our view is that load shedding will remain a reality for the foreseeable future. In fact, one could say that load shedding is needed to remedy the situation, providing it is efficiently scheduled and properly communicated.

ENERGY AVAILABILITY FACTOR



Sources: Eskom Annual Reports, Eskom Weekly System Reports

ELECTRICITY SOLD



Sources: Eskom Annual Reports, Eskom Weekly System Reports

FINANCIAL WOES

Unfortunately, Eskom's generation challenges are not being assisted by its precarious finances. The Eskom revenue model should be straightforward: it sells electricity for a price regulated by the National Energy Regulator of South Africa (NERSA), and this should be enough to cover the costs required to generate that electricity, together with a modest return. But the tariffs are granted on assumed levels of expenditure, and this is where the model has failed. Costs, particularly on energy and interest, have grown significantly faster than revenue; capital expenditure on Medupi and Kusile continues to increase above budget; and a culture of nonpayment has started to develop among some of Eskom's larger customers. To complicate matters further, the financial pressures have meant that Eskom has reduced expenditure on repairs and maintenance, a decision which has had a significant impact on the performance of its fleet of power stations. The extent to which this underinvestment extends to Eskom's other divisions, such as Transmission, is another concern which could lead to further financial stress in the future.

FUELLING THE FIRE

Eskom relies on coal as its primary fuel source. This was traditionally sourced from Eskom mines located adjacent to coal power stations in Mpumalanga. Over the years, Eskom has not invested in these mines, resulting in their productivity decreasing and additional coal having to be procured and transported from independent coal suppliers at a significantly higher cost. In times of crisis, Eskom has also resorted to using its open cycle gas turbines (OCGTs), which are exceptionally expensive due to their high consumption of diesel. During the 2014 financial year, Eskom spent R10.5 billion on diesel, and it is likely that diesel costs will be elevated while the system remains under pressure. It also bears remembering that the OCGTs were designed to be used as a temporary backup, not run 24/7, and this is likely to result in significant wear and tear on these generators as well.

In addition, Eskom's debt burden has increased to R419 billion, of which R336 billion is under government guarantee. To put this into context, this full debt balance equates to around 9% of South African GDP. The interest required to service this debt is significant, and in Eskom's most recent half-year report, the R26.6 billion of operating cash flow that it generated was quickly absorbed by interest costs of R17.7 billion and capital investments of R17 billion. The deficit was, of course, financed by more debt, and so the vicious cycle continues. Lower levels of revenue collectability are also pressuring cash flows.

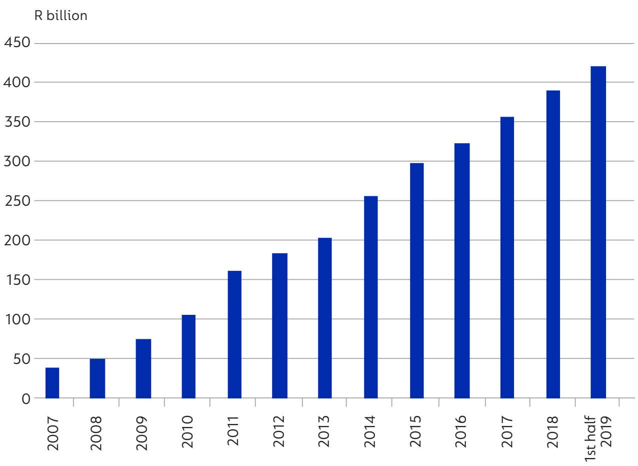
As at 30 September 2018, Eskom had invoiced municipal arrears debt of R17 billion, excluding Soweto's arrears debt – which, at R12.6 billion, is worth a separate mention. This issue is unlikely to be resolved without government support and commitment to ensure consumers pay for the electricity they use.

PER ANNUM INCREASES OVER 10 YEARS ENDING 31 MARCH 2018

Revenue	14.8%
Primary energy	16.6%
Employee expenses	10.0%
Finance costs	18.6%
Repairs and maintenance	12.5%

Sources: Eskom Annual Reports, Coronation

DEBT SECURITIES AND BORROWINGS



Sources: Eskom Annual Reports, Coronation

BAILOUT

To assist Eskom with its financial predicament, government has committed to injecting R23 billion annually into the entity for the next 10 years. In addition, NERSA recently granted the entity a 13.8%[1] tariff increase for its 2020 financial year, with 8.1% and 5.2% increases stipulated for the subsequent two years. In our view, this is unlikely to be enough, and Eskom, together with its stakeholders, will need to make difficult decisions to reduce costs going forward. The recently appointed Eskom CEO, Phakami Hadebe, and the Chairman of the Board, Jabu Mabuza, have both been shown capable of turning around struggling entities in their previous roles at the Land Bank and Telkom, respectively. However, Eskom is a political minefield with many vested interests at play, complicating any potential restructuring and turnaround plan.

SO WHERE TO FROM HERE?

As a first step, government has proposed unbundling Eskom into three separate units: generation, transmission and distribution. This concept is not new and has been proposed several times over the last two decades. More importantly, however, this model is more in line with international standards and has also been followed by other African countries. The benefits are simple: each division can focus on its own revenue and costs, thereby driving efficiencies, and improving accountability and governance. But perhaps the most important benefit for the public will be the associated improvement in price transparency and competition. While not an immediate solution to load shedding, allowing multiple participants to be involved in the broader energy market should, over time, improve the integrity and resilience of the electricity system. In our view, unbundling is certainly a step in the right direction, but achieving it will not be easy.

Creating new legal entities and transferring existing assets to them will take time and additional costs will have to be incurred. Furthermore, there is the question of what Eskom does with its enormous debt burden and how, if at all, this is allocated to the newly separated entities. Government and NERSA also need to move quickly to ensure that the legislative and regulatory frameworks are in place to allow reform to happen.

One way or another, the market will solve the electricity crisis, and the role of Eskom as the sole provider of electricity will diminish. How much more discomfort South Africans will endure before this happens, however, is a question that ultimately only government can answer. ✚

[1] A 9.41% tariff increase, together with a 4.4% regulatory clawback

COMMENTARY AND ANALYSIS

Eskom: the investment impact

Bad news for economic recovery, business and consumer confidence, and jobs

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 Top 20 and Market Plus funds.

WHILE THE ANNOYANCE and frustration of dealing with load shedding has impacted our personal lives, the impact on the economy and the investment climate is of far greater concern. There was a rude awakening in December 2018 when the spectre of renewed load shedding arrived, something we all believed had been done away with in 2016. And its impact was immediately felt in the most important month in retailers' lives, the December holidays.

SENTIMENT

The unannounced arrival and high level of load shedding had a hugely detrimental impact on the psyche of a consumer who was already struggling to deal with a year that included increases in VAT, interest rates and municipal rates; numerous commissions detailing allegations of vast corruption across the country; and the continuous job shedding that was the inevitable result of

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these factors on our stretched economy. While South Africans are generally resilient and have dealt with many challenges over the last decade, rolling blackouts and the inability to indicate how long load shedding will continue have further undermined South African consumers' confidence in the future. The net result of this is significant curtailment of consumption expenditure and capital investment.

Whether it is being less inclined to eat out, purchase an additional item of clothing, or delaying a new car purchase or a home upgrade (except for buying solar panels and a battery), the lack of confidence derails spending. This then obviously impacts heavily on the various businesses providing these services and products, resulting in fewer sales, lower profits and potential losses. This in turn could lead to further job cuts and potential insolvencies – the classic negative reinforcement spiral downwards, which will be tough to arrest without some kind of external input.

The high levels of emigration that have become evident in 2018 are also likely to remain elevated by fears over the future of the power system in the country, further eroding the consumer and tax base in South Africa. So, while sentiment is not something tangible, it undoubtedly has an enormous effect on the economy from the consumption side. This then feeds into corporate investment, as companies that see no growth in the local environment will not invest in further capacity, since there is no investment case to be made for, or return to be generated from, this additional investment.

While sentiment is not something tangible, it undoubtedly has an enormous effect on the economy.

PHYSICAL IMPACTS

The rolling blackouts arrived suddenly and without warning but, due to our experience from earlier in the decade, we have established systems to deal with them. Individuals and corporates quickly became accustomed once again to factoring the daily schedules of load shedding into their lives. However, some businesses are able to handle the daily shedding better than others.

Generally, industrial customers who operate directly on the Eskom grid and who are advised well ahead of time as to the level of load shedding coming can adjust their processes to factor this in. They can take steps to ensure that no energy-intensive processes are scheduled for the downtime, nor in progress when the power drops, or that they have enough backup power to handle these fluctuations. This does not mean there is no negative effect, as efficiencies are impacted by having to move processing around, and the cost of overtime, backup facilities and running power off diesel as opposed to grid power is significantly higher.

This cost gets passed on to the end-consumer, or is borne by the company itself, putting its own profitability under pressure. In the difficult consumer environment that we find ourselves in, the ability to pass costs on to the consumer has been very limited, so in most cases these costs are being borne by the companies, resulting in the aforementioned cost cutting, job losses and ultimately corporate failures. Industrial customers operating on municipal grids are not so fortunate, and generally suffer the same vagaries of load shedding as the typical residential customer. In the retail environment, there is obviously less mitigation that companies can implement. If the power goes down during key sales periods like lunchtime and late afternoon, there is no way for them to capture sales from consumers who will not come back at a later time. The restaurant and quick service restaurant industry is particularly exposed here.

While many individual retailers have implemented their own backup power generation, particularly those with cold chains to protect the quality of fresh foods, the fact that the overall shopping centre is dark, or that streets are gridlocked, will still deter any potential shopper from venturing out to find the one shop that still has its lights on. This impact will clearly also be felt by the various landlords, as lower sales put pressure on rent renewal agreements, and those that do put in additional backup power sources need to fund this and attempt to collect these additional costs from their tenants.

As with the industrial sector, the mining industry is more flexible in dealing with the fluctuating power supply and, as massive customers of Eskom, generally get better line of sight into coming outages. As important drivers of the economy and large paying customers, they are also receiving better consistency of supply, although when Stage 4 load shedding hits, they also suffer rolling outages and, if this becomes the norm, it will definitely have an impact on their ability to produce at current levels.

Those companies that will feel the brunt the most are the various small to medium enterprises (SMEs) of all types of industry that do not have the balance sheet to be able to put in place alternative measures to handle power outages. Drive down the main street of any town during a power outage and you will see the multitude of small service outlets, be it hair salons, takeaways or small retailers that cannot function without power, but cannot afford to implement alternatives.

COSTS

As is evident from all the above, load shedding comes at a significant cost. Ignoring the fact that Eskom needs to pass through significant price increases over the next few years to recover the costs of the enormous debt that they have built up over the past decade, electricity consumers have to incur additional costs to deal with security of supply.

Most companies we have spoken to indicate that the cost of using diesel generation is three to four times that of current Eskom power. This ignores the significant capital outlay required to buy additional generation capacity in the first place. Energy-intensive industries, where power is a large part of their cost base, will obviously feel this the most. For example, for gold mining companies, which require significant ventilation and cooling deep underground, 20% of their cost base is electricity. If this grows at double digits for three to five years, it erodes margins massively in an industry already under significant pressure.

What is important to know for industry is the extent of the problem and its likely duration. Short-term load shedding, and mainly at Stage 1 or Stage 2 will require a significantly different response than multi-year Stage 3 and Stage 4 load shedding would.

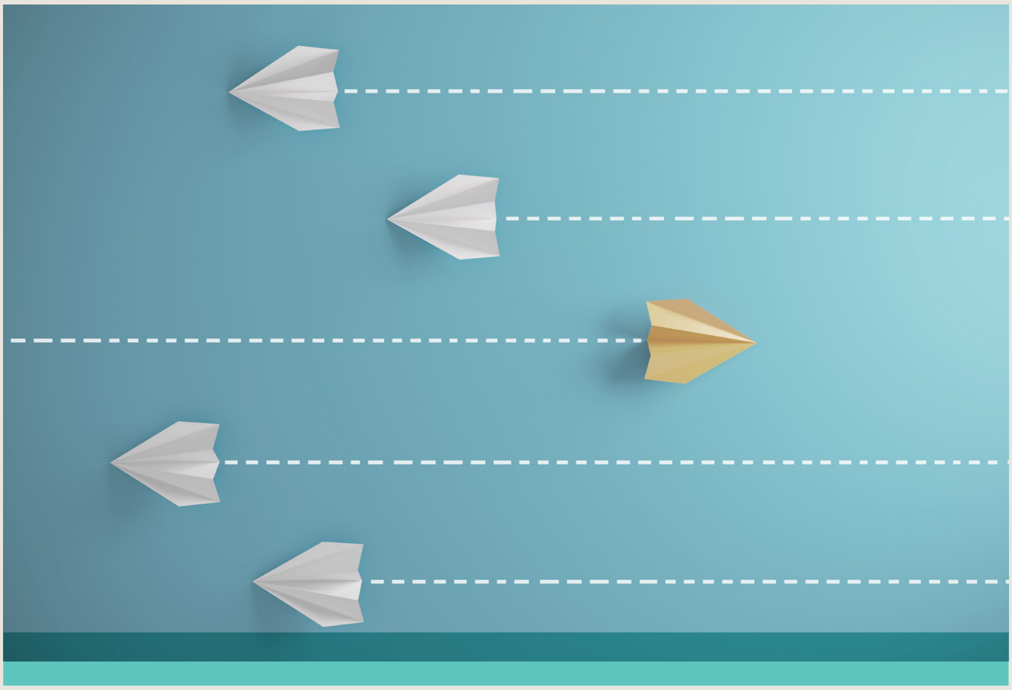
While the above deals with risks posed by power generation, it is becoming increasingly evident that there are major issues looming on the transmission side. Over the years, Eskom has underinvested in this network as maintenance and refurbishment plans were cancelled. Even when it is in a good state, the transmission network is not designed to handle the repetitive on/off fluctuations of power very well and in its reduced state we have seen numerous substation failures. In addition, in a country where cable and metal theft is rampant, having long periods where cables and equipment are not carrying live current has seen a dramatic uptick in cable theft and vandalism. The cost of this replacement is often picked up by the various municipalities and needs to be recovered by additional increases in electricity prices or overall rates charged.

CONCLUSION

Given the above, our investment stance has remained one of caution on the local economy. Any recovery is likely to be slow. From an equity perspective, we are avoiding discretionary-spend retailers and businesses that are heavily reliant on the growth of the overall economy.

Our large exposures remain global businesses listed on the JSE and where we can find value in defensive South African businesses, such as nondiscretionary retailers and healthcare businesses. In addition, we remain exposed to both global and local miners where operating fundamentals are robust enough to deal with the impact of load shedding.

In fixed income and property, we have increased our exposure to bonds after a long period of owning very little in these asset classes. While still remaining underweight and concerned about the fiscal situation given low growth and state-owned enterprise debt, we feel that real rates of return are attractive, as we have seen 10-year bonds sell off to yields in excess of 9%, while inflation has been steady in the 4% to 5% range. Property faces more significant risks of negative reversions and lower inflation-linked increases from tenants, while at the same time having to deal with higher costs and municipal rates, making it less attractive in this environment. ✚



The dangers of headline investing

Only deep, proprietary research sharpens analysis, providing the necessary focus to look through the noise

By Nicholas Hops

IT IS PERILOUSLY easy for investors to get caught up in the sentiment of the day and buy into 'story stocks'. Not wanting to miss out on the next big thing, the market often drives up the price of favourably positioned assets, far beyond their underlying intrinsic value, and pushes the perceived losers far below theirs.

At these times, there is often considerable emotion involved, and the disconnect between price and value can be extreme. At a time when headlines scream 'buy' or 'sell', almost regardless of price, only detailed analysis can give one the kind of conviction needed to take an alternative view and go against the tide. The following three commodity markets serve as useful case studies.

Nicholas co-manages the Resources Fund and is an equity analyst within the South African investment team. He joined Coronation in 2014 and is a CFA charterholder.

UNCOATED FINE PAPER

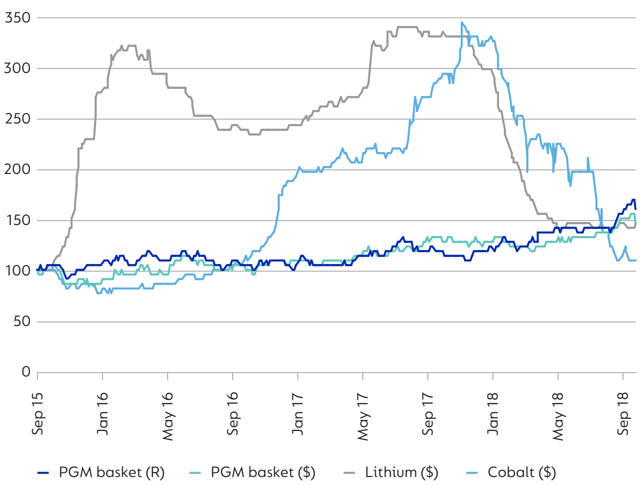
For at least a decade, paper has been written off as an attractive investment, with most observers expecting a relentless and brutal decline in demand. Despite this bleak outlook, Mondi has grown earnings before interest and taxes from its uncoated fine paper division almost threefold since 2007. This surprising outcome is due to a combination of constrained supply (a consequence of underinvestment) and demand proving to be more resilient than most expected. Mondi's low-cost assets and excellent management team have thrived through more than a decade of declining demand. The clear learning in this case is the danger of obsessing over one variable without giving due focus to the interaction between supply and demand, which is fundamental to the price discovery process in any market.

THERMAL COAL

This is another commodity market in which most observers agreed that demand would decline as renewable energy took market share. As a consequence, many investors wrote off coal assets as an investment. What this negative thematic view once again failed to consider is the intersection between supply and demand.

Although thermal coal demand will decline over time, it is likely to remain more resilient than many expect. In addition, under-investment in supply has, and will likely continue to, lead to constrained supply. This has resulted in supply deficits and price increases (over 140% from trough to peak). We expect constrained supply to endure and would therefore not be surprised to see prices remain elevated above incentive prices in the years to come.

METAL PRICE PERFORMANCE (INDEXED TO 100)



Source: Bloomberg

ELECTRIC VEHICLE COMMODITIES

When the Volkswagen emissions scandal ('Dieselgate') broke in September 2015, it coincided with the rise of Tesla as an automaker and battery electric vehicles (BEVs) as an alternative drivetrain. Tesla's share price has risen sevenfold in the last seven years and its market capitalisation is comparable to that of traditional automakers such as General Motors (GM) and Ford, despite the fact that the company has struggled to turn a profit and produces only 3% of the vehicles that GM produces. At the time, headlines announcing the death of the internal combustion engine were everywhere.

Within six months of 'Dieselgate', the price of lithium, a key component of BEVs, went up over three times. Cobalt, another key component, started to rally a year after the scandal broke and went up threefold in the following two-and-half years. Prices of lithium and cobalt rose to multiples of their incentive prices and existing producers were enjoying super profits. In contrast, when cobalt and lithium hit their peaks in March 2018, the platinum group metals (PGM) basket price was trading well below marginal cost, and up to half of the South African industry was burning cash.

The BEV thematic was everywhere as investors chased the long-term opportunity and shunned the technologies that they stand to displace. Fast forward 12 months and the rand PGM basket is up 43% – close to lifetime highs – while lithium and cobalt prices are down 56% and 68%, respectively. As we have noted before, we are believers in BEV technology in the long term, but expect the process to be evolutionary rather than revolutionary because the hurdles to mass adoption are significant and they will likely take decades to overcome.

After an enormous amount of detailed work on the future of the drivetrain and ridesharing, we have concluded that demand for PGMs will be more resilient than most expect. We are of the view that mass adoption will take decades and that hybrid vehicles with similar, and in some cases higher, PGM content than standard cars will bridge the gap between today's cars and BEVs.

Regulatory tightening supports PGMs

In the medium term, we also expect PGM demand to surprise positively as a consequence of tightening emissions standards globally. In addition to this, 'Dieselgate' placed the auto industry under the microscope, and exposed the industry's collusion and manipulation of emissions testing.

Car manufacturers will soon have to meet far tougher standards than in the past. Vehicles in the EU and China will have to pass emissions tests that cover the first 160 000 km to 200 000 km of a car's life, as opposed to previous testing simply at the point of production; and that assess emissions in real-world driving conditions, as opposed to in a laboratory. The tightening of emissions legislation has large benefits for the broader climate as well as local air quality; PGMs are a key enabler of this while the slow mass adoption of BEVs takes place.

In addition to this, material underinvestment in mine supply over the last decade means it will take many years before supply can meet current demand. We therefore expect structural PGM market deficits to persist for at least the next decade. Although prices may appear elevated, with the rand PGM basket up 45% off 2018 lows, we estimate that prices are only now close to incentive prices, enabling PGM miners to earn no more than a fair return on their invested capital. This is in sharp contrast to the lithium and cobalt price rallies, where prices last year hit multiples of incentive prices for both commodities.

>

CONCLUSION

Scrutinising what is in the price is a critical consideration for making any investment decision. When the market gets overly negative on a story, an opportunity is often provided for investors who can cut through the almost deafening noise and take the long-term view.

At peak negativity in the PGM sector last year, Impala Platinum (Implats) and Royal Bafokeng Platinum both touched price-to-book lows of 0.15 times. Impala's market cap hit R11.7 billion, down 94% from peak levels and roughly equal to the cost of just one shaft at the Implats lease (compared to its 11 shafts and four additional mines). Although Implats was the extreme case in the sector and its peers traded at less depressed levels, they also offered significant opportunity (with less risk).

As a counterweight, investing where sentiment is extremely positive and prices are already high can be dangerous and often carries the risk of a permanent loss of capital. +

PERSONAL INVESTMENTS

The choices you will face at retirement

And what you need to know to help you make them

AN EARLIER *COROSPONDENT*[1] article, 'The numbers that drive retirement' provided some guidance on how to plan as efficiently as possible for your retirement to avoid being caught unawares. Equally important is understanding the choices you will face at the point of retirement.

Because you are likely to save towards your retirement nest egg over multiple decades, by the time you retire it may well be the single biggest asset on your balance sheet. What you end up doing with this pot of money is one of the most critical financial decisions of your life, as your decisions will determine your lifestyle for the next 25 to 30 years.

YOUR TWO CHOICES AND WHAT YOU NEED TO KNOW TO MAKE THEM

If you are close to retirement, you will soon need to make two decisions about the savings that you have accumulated over your lifetime. As both require careful thought, it may be best to make them with the help of an independent financial adviser (IFA).

YOUR SAVINGS AT RETIREMENT

Do I take a cash lump sum? If so, how much?	Any amount you withdraw reduces the total amount you have to invest to provide for your retirement income.
Where do I invest the rest?	You will need to select between two annuity options, or a combination thereof, according to your needs.

To make this process a bit easier to navigate, we have outlined some of the considerations:

1. Do I take a cash lump sum from my savings? If so, how much should I take?

Before deciding on the amount of cash you wish to take as a lump sum, you need to determine its purpose (such as settling any outstanding debt at retirement, funding a holiday or setting up an emergency fund) and whether you can afford it. As a general rule, funding capital transactions such as acquiring an asset or settling debt is preferable to funding current expenditure. It is important to keep in mind that any cash amount withdrawn leaves you with less capital to purchase an annuity from which you will be drawing your retirement income for the rest of your life.

A useful exercise to conduct with the help of your IFA is to map out liquidity scenarios over at least 20 to 30 years, based on your personal circumstances. Importantly, the amount of money that you can take in the form of a cash lump sum is determined by the type of retirement fund of which you are a member:

Fund membership	Cash payout permitted
Retirement annuity Pension fund Preservation pension fund	Up to one third of investment, or 100% if the total value is <R247 500
Provident fund Preservation provident fund	Up to 100% of investment

Tax is another important factor to consider. The good news is the first R500 000 taken as a cash lump sum is tax free. If you wish to withdraw an amount greater than that, the following tax rates apply:

Cash lump sum taken*	Rate of tax
R0 – R500 000	Nil
R500 001 - R700 000	18% of the amount over R500 000
R700 001 - R1 050 000	R36 000 + 27% of the amount over R700 000
R1 050 0001 +	R130 500 + 36% of the amount over R1 050 000

* The taxable cash lump sum is cumulative across all retirement funds from which you retire during your lifetime.

2. Where do I invest the rest?

Whether or not you choose to take a portion of your retirement savings in cash, the balance of your investment must be used to purchase an annuity that will pay you a retirement income.

Retirement savers currently have two main options from which to draw their post-retirement income: a living (market-linked) annuity or a guaranteed (life) annuity underwritten by a life insurance company. Each product has its own set of advantages and limitations. The biggest difference is that in the case of a guaranteed annuity, you forfeit your capital but your income

[1] Edition Q4 2018

is guaranteed for life, while a living annuity offers greater flexibility as you retain ownership of your capital, but offers no income guarantee. The following table outlines some of the key differences between the two options.

GUARANTEED (LIFE) VS LIVING (MARKET-LINKED) ANNUITY

	Guaranteed annuity	Living annuity
How does it work?	A guaranteed pension for life. Your accumulated retirement savings are paid as a premium to a life insurer, who agrees to pay you an income for the rest of your life at a set or predetermined escalating rate.	No income guarantee but offers the potential for capital growth. Your accumulated savings are invested in a portfolio of underlying investment options such as unit trusts.
Who carries the risk?	The insurer carries the risk that you will live a longer than average life (longevity risk), as well as the investment risk associated with making regular income payments over time.	You carry the investment and longevity risk as the selected income payment is not guaranteed. The value of your retirement pot can go up and down, depending on the performance of the investment option(s) you have chosen.
Can I change my level of income?	You typically only have a choice at inception of the annuity, between a level or an escalating life annuity. A **level** life annuity provides an income which stays the same in rand terms for the rest of your life. This means that your spending power is less in future years as the cost of your expenses increase due to inflation, while your income remains the same. An **escalating** life annuity adjusts your income at a pre-determined rate (or inflation), resulting in a lower starting level of income.	You can set your level of income (ranging between 2.5% p.a. and 17.5% p.a. of your total capital investment) once a year (on the anniversary of your investment). **Note:** when your income rate exceeds that of your investment return, you start to pay out a portion of your income from your capital, reducing the capital base available to fund future income payments. The lower the level of income you take, the longer your capital will last. This is important should you have a long life expectancy.
What about heritability?	Once transferred to the insurer, you cannot leave any capital to your estate or heirs.	Whatever capital remains at death is inherited by nominated beneficiaries.
Can I switch between a living or guaranteed annuity?	No. Once you have chosen a guaranteed annuity, there is no option to convert to a living annuity, nor to switch between providers of guaranteed annuities.	Yes. A living annuity can be transferred between providers, and it can be converted to a life annuity at a later stage.

Many investors choose to transfer their retirement savings to a living annuity (as opposed to a guaranteed annuity), as it comes with various advantages (as tabled above). However, choosing the living annuity as your retirement income vehicle comes with the most challenging of investor needs: balancing the needs of today (drawing an income) with those of the future (achieving long-term growth).

To ensure you can sustainably draw a certain level of income throughout your retirement years requires you to invest in an appropriately constructed portfolio and then to select a conservative income rate early in retirement. Drawing too high an income at the start of your retirement and/or expecting too high an investment rate of return is as dangerous as investing too conservatively or too aggressively. Once your living annuity plan is in action, you should carefully consider the amount of retirement income you draw in response to the actual performance of your underlying investment. By applying a few spending rules with assistance of your IFA, such as dynamically adjusting your income drawdown rate in response to returns, retirees can ensure capital preservation – your goal should be to first earn the returns before spending them.

MAKING THE MOST OF YOUR LIVING ANNUITY

1. Select a conservative income rate early in retirement:

The rule of thumb is an initial drawdown rate of 5% or less. This increases the probability that your underlying investment portfolio will grow and sustain its ability to protect the purchasing power of your retirement income over time.

2. Invest in an appropriately constructed portfolio:

To grow your income so that you keep up with inflation over the course of 25 to 30 years, your capital needs to grow too. Given that you still have a multi-decade time horizon over which you need inflation-beating returns, you require a diversified portfolio that has meaningful exposure to growth assets such as equities and property.

Investors early in retirement should seek funds that allow at least 50% of the portfolio to be invested in growth assets. But your living annuity's underlying investment fund (or funds) also needs a strong focus on risk and reducing the likelihood of potential negative returns over shorter time periods – this is important because you will be drawing a regular income from the fund.

GOOD NEWS FOR THOSE INVESTORS STILL BATTLING TO MAKE A CHOICE

As of 1 March 2019, investors who still grapple with choosing an annuity can consider investing in the annuity option pre-selected by their retirement fund trustees. This follows an amendment to the Pension Funds Act that requires trustees of retirement funds to select an appropriate annuity strategy to provide fund members with a sustainable income throughout retirement.

The Coronation Trustee selection

If you are a member of a Coronation retirement fund, the trustees have selected the Coronation Living Annuity as its annuity option and the Coronation Capital Plus Fund as its underlying investment portfolio. You can read more about why Coronation Capital Plus is a suitable investment option in the text box overleaf. If you wish to select the Trustee option, you will be required to 'opt in' by way of documentation that will be sent to you ahead of your retirement date. By choosing this option, you also accept the income withdrawal rates as outlined in the table on page 17. The income rate you will receive is determined by your gender and age at the point of retiring from your Coronation retirement fund.

TRUSTEE SELECTION INCOME DRAWDOWN RATES

Age at retirement	Male	Female
55 - 59	4.5%	4.0%
60 - 64	5.0%	4.5%
65 - 69	5.5%	5.0%
70 - 74	5.5%	5.0%
75 - 79	6.0%	5.5%
80 - 84	7.0%	6.0%
85+	8.0%	7.0%

What if this option no longer suits my needs?

If you prefer to invest in another Coronation fund (or funds) as your underlying investment option, you can switch to your own selection at any time. You can also select a higher income rate on your annual annuity anniversary date.

By switching funds or changing your income rate, you are 'opting out' of the trustees' selection and you will simply be invested in a standard Coronation Living Annuity. Should you wish to transfer to an annuity option offered by another company, this can also be done at any time.

WHY CORONATION CAPITAL PLUS?

Coronation Capital Plus is our flagship living annuity portfolio. The fund is designed and managed specifically for the retired investor who needs to draw an income from their investment over multiple decades. Capital Plus therefore invests in a reasonable amount of growth assets – typically ranging between 40% and 70% of the portfolio – to achieve returns ahead of inflation.

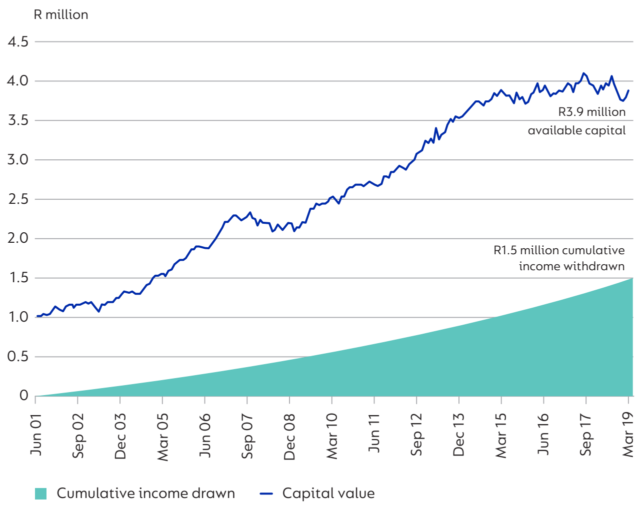
However, given that investors also need to be drawing a regular income from the fund, Capital Plus has a strong focus on managing risk and reducing the potential of negative returns over shorter time periods. The fund is therefore managed with the dual objectives of achieving growth over the longer term while minimising the risk of delivering negative returns over any rolling 18-month period.

Since its inception in 2001, this approach has worked well, with Capital Plus having produced a nominal after-fees return of 11.8% per annum (or 5.9% per annum in real terms) as at end-March 2019. (Refer to page 46 for detailed fund performance.) Over its history, the fund has also achieved a positive rolling 18-month return 97% of the time (with the only negative rolling 18-month return period coinciding with the financial crisis of 2008).

The graph below demonstrates how, in the fullness of time, the benefit of having reasonable exposure to growth assets becomes clear for income-drawing investors.

Let us assume you retired in July 2001 when the Coronation Capital Plus Fund was launched and invested R1 million worth of retirement savings into the fund through your living annuity. If you started to draw 5% per year and allowed your annual income to increase in line with inflation of roughly 6% per year, you would have withdrawn a cumulative R1.5 million rand over the almost 18-year period as income while still having R3.9 million of capital available to fund future income or pass on to your heirs. +

CORONATION CAPITAL PLUS



Source: Coronation

To read more about post-retirement investing, download the September 2018 issue of Corolab, The Income and Growth Challenge, *from www.coronation.com.*

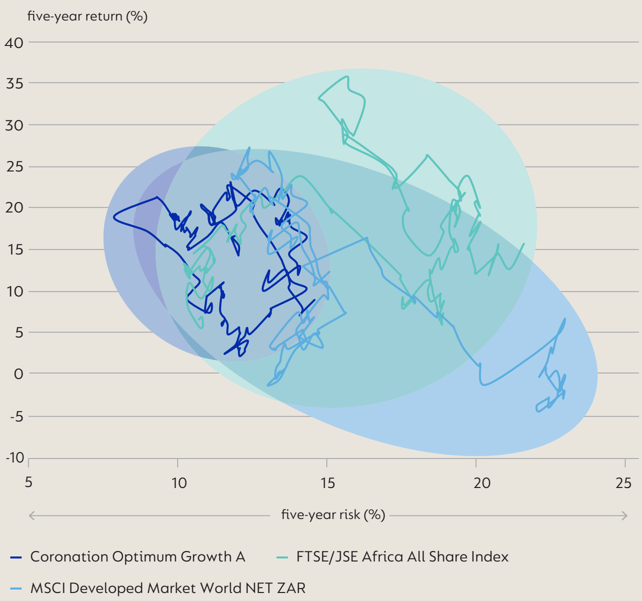
Coronation Optimum Growth Fund

A sound multi-asset solution for discretionary long-term savings

MARCH MARKED THE 20th anniversary of the Coronation Optimum Growth Fund. It is the least constrained fund in our range, with the ability to invest anywhere in the world and in any of the listed asset classes. This rand-denominated fund is benchmarked against a combination of shares and bonds (70% shares and 30% bonds) as well as local and global assets (50% South African assets and 50% global assets), and benefits from our wide research coverage across local, developed and emerging markets. It therefore is a sound multi-asset class solution for long-term investors not subject to retirement fund investment restrictions and who are looking for a larger exposure to offshore assets but still require their fund manager to decide on the allocation between domestic and foreign assets.

The graph below represents a risk-return snail-trail plot that shows how the return and associated risk of the fund and the indices used for comparison changed over time. As investors prefer higher returns and lower risk, an investment that shows a skew in favour of a top-left position on the graph can be deemed to be superior to investments with a bottom-right skew.

OPTIMUM GROWTH VS ALSI VS MSCI WORLD



Sources: Morningstar, IRESS

YOUR RETURNS

The A-class of the fund returned 14.3% per annum (or 8.2% per annum after inflation) since launch, which is in line with the local equity market but nearly 1.5 times the compound annual growth rate produced by global shares. Over two decades, this translates into an increase in purchasing power of 4.25 times and 2.4 times the end capital of an equivalent investment in the developed market MSCI World Index.

The benefit of wider diversification is reflected in the outcome that this return was achieved at significantly less downside risk than both the local and global equity markets, as illustrated in the graph below left. Over the past five years, the fund has generated a return of 10.7% per annum and over the past 10 years, 16.0% per annum.

During the first quarter of 2019 the fund appreciated by 16.9% as global equity markets rallied and selected shares performed well. The largest contributor over the quarter was British American Tobacco, up +32% in rands within the portfolio, making a positive impact of 1.1% on your portfolio.

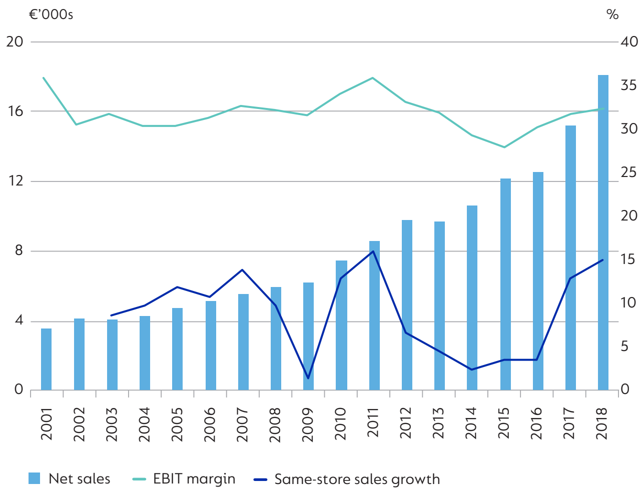
Other stocks that boosted performance were Airbus (+38%, making a 0.9% contribution); Chinese retail giant, JD.com (+36%, a 0.9% contribution), tobacco manufacturer, Philip Morris (+34%, a 0.8% contribution), and Chinese education group, New Oriental Education & Technology Group (+62%, a 0.8% contribution). There were no detractors of more than 0.5%.

PORTFOLIO POSITIONING

As at the end of March 2019, 75% of the fund's portfolio was allocated to equities. This was up from 66% at the start of the year, largely due to market moves. Of this, approximately 55% is invested in developed market shares, 5% in South African shares and 40% in other emerging markets. Large holdings include 58.com, Alphabet, Blackstone Group, Diageo, JD.com, Heineken and Charter Communications, in addition to the shares listed on the previous page.

Our negative view on global bonds remains largely unchanged, although we did buy short-dated US Treasuries (around 3% of the fund) late last year when US government 10-year bond yields were north of 3%. The fund's position in L Brands (owner of Victoria's Secret) corporate bonds remains (1.7% of fund) and is now yielding 6.8% compared to our initial purchase yield of 7.3%. In total, bonds make up 4.7% of the fund. The fund also has around 4% invested in global property, largely in Rodamco-Westfield (European and US retail property) and Vonovia (German residential property). Lastly, the fund has a physical gold position of 2.5%. The balance of the fund is invested in cash, largely offshore.

FASHION AND LEATHER GOODS



Sources: Coronation, LVMH annual reports

OUR SHOPPING BASKET

We bought a selection of new shares in the quarter, with the most significant being a 2.0% position in global luxury goods giant LVMH Moët Hennessy Louis Vuitton (LVMH), which has a selection of premium brands under its label, including, obviously, Louis Vuitton (c. 50% of group profits) and Moët & Chandon, as well as Hennessy, Christian Dior, Fendi, Bulgari and Tag Heuer. Interestingly, over 40% of sales come from emerging markets, and the Chinese consumer alone (purchasing at home as well as while travelling) is responsible for well over 50% of incremental growth.

LVMH has an enviable track record, with its earnings per share having compounded at about 12% annually over the past 20 years. Today it is well placed to reap the rewards of the growing emerging market middle and upper class, and the wealth effect. The barriers to entry inherent in the true global luxury brands (Hermes, Louis Vuitton and Gucci) are among the highest in any industry in our view – in the case of Louis Vuitton, a 150-year history and investment in the brand for a start.

The resilience of both the top-line and profitability of the Louis Vuitton brand, in particular during tough economic periods, is also unparalleled. In 2009, post the Global Financial Crisis, sales of the LVMH Fashion & Leather Goods Division, which is dominated by Louis Vuitton, grew by 2% and earnings before interest and taxes (EBIT) grew by 3%. In 2002 (post-September 11), the Fashion & Leather Goods Division experienced 16% sales growth (following double-digit sales growth in 2001 as well) and 5% EBIT growth. ✚

Notes:

Benchmark: Composite (35% JSE Capped All Share Index, 15% All Bond Index, 35% MSCI All Country World Index, 15% Bloomberg Barclays Global Aggregate Bond Index)

Highest annual return: 51.1% (Jan 2013 - Dec 2013)

Lowest annual return: -31.5% (Mar 2008 - Feb 2009)

Inception: 15 March 1999

Uncertainty is the enemy of growth

Government's management of the power crisis will be telling of its broader capacity for reform

By Marie Antelme

WE STARTED THE year cautiously optimistic that a cyclical recovery, driven by some acceleration in consumer spending, was a reasonable expectation for the year ahead. However, we cautioned that anything more durable needed a commitment to accelerated policy reform and that time to deliver was short. We also cautioned that Eskom remained the biggest, most immediate threat to growth. At the end of the first quarter of 2019, we must reset these expectations. We still expect consumer spending to be the biggest driver of growth, and for growth to be marginally better than last year, but the starting point has weakened, time is even more of the essence and Eskom has indeed become the biggest threat to growth. On pages 6 to 11, we provide a detailed analysis and investment impact of the crisis at Eskom.

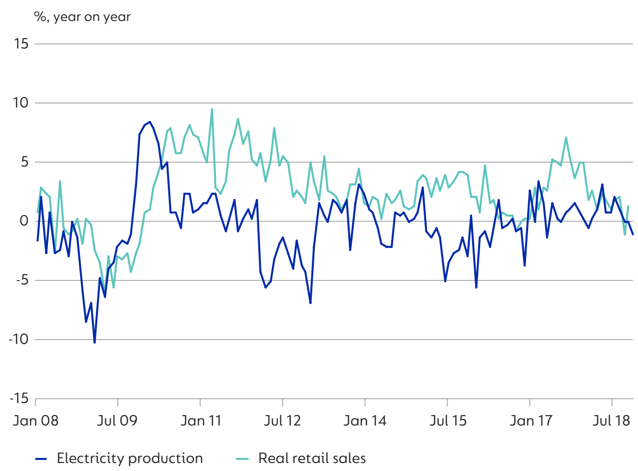
Marie is an economist with 18 years' experience in financial markets. She joined Coronation in 2014 after working for UBS AG, First South Securities and Credit Suisse First Boston.

ESKOM ELEMENT 2.0

The shock escalation in load shedding in March, following a mild (although also unexpected) period in the last quarter of 2018, has materially increased downside growth risk. It is difficult to incorporate or make allowance for unprecedented uncertainty in an economic forecast, specifically the risk embodied by Eskom, which is clear and present, but unscheduled and prone to randomness.

The direct impact on numbers at this stage is limited by the relatively short period of actual Stage 4 outages. Anecdotal evidence suggests large users had the capacity to mitigate most of the impact associated with unscheduled outages and managed production accordingly. Some users could protect core operations using generators (which still cost more), while small and medium enterprises are likely to have been most affected by production downtime, stalled supply chains, a backup in inventories and weak sales. However, historic data show only a loose relationship between blackout periods and a change in retail sales volume.

ELECTRICITY PRODUCTION AND RETAIL SALES

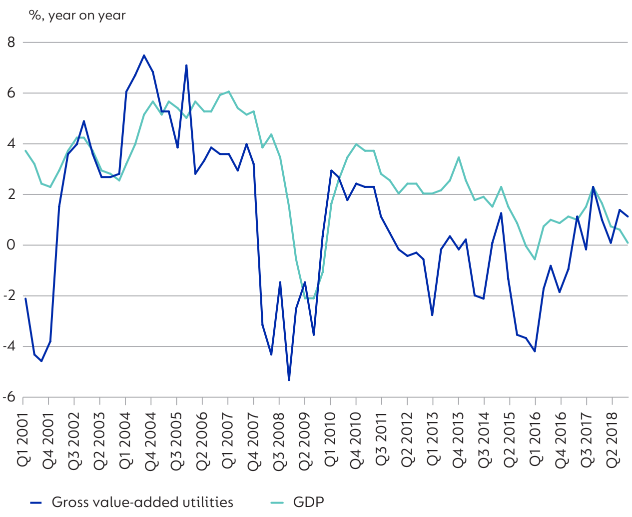


Source: Statistics South Africa

The broader impact on the fiscus, should more financial support be needed, and importantly on sentiment, is harder to estimate. However, it seems reasonable to expect further delays in any planned capex, and disruptions to consumption. We remain very concerned that the escalation in March load shedding reflects a significantly more decrepit underlying generation fleet than previously assumed and that the prospects of stabilising long-term energy availability and the associated cost are all unknown. This will have a material impact on sentiment, and such aggravated uncertainty is the enemy of growth.

Past periods of failing energy production and rolling blackouts have reduced GDP by 0.2 to 0.4 of a percentage point. These periods were prolonged relative to what we have seen now, although the recent load shedding was even more severe. Experience has also improved communication between users and Eskom, with some corporates better prepared to mitigate the impact on production than before.

ELECTRICITY PRODUCTION AND GDP GROWTH



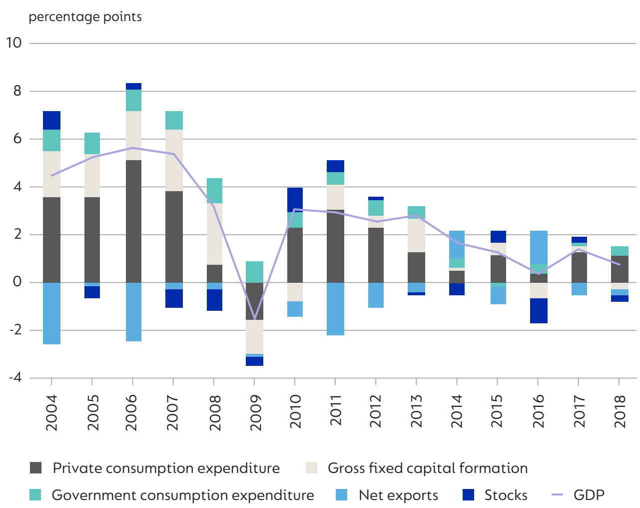
Source: Statistics South Africa

GDP REVISITED

For now, we have shaved 0.3 of a percentage point off our 2019 GDP estimate, and lowered the 2019 and 2020 estimates to 1.3% and 1.7% respectively. There is still downside risk to these numbers, but until we have better information about Eskom's future supply and actual impact from hard data, we are reluctant to extrapolate this relatively short-lived, although severe and alarming, episode.

The domestic economy grew 0.8% in 2018, in line with our expectation and the poor average GDP of the past decade. Within this, consumer spending was the biggest contributor, with real household spending up 1.8% year on year (y/y), but slower than 2017's 2.1%. Government added at the margin, but this was disappointingly offset by outright contractions in gross fixed capital formation, net exports and a large drawdown in stocks.

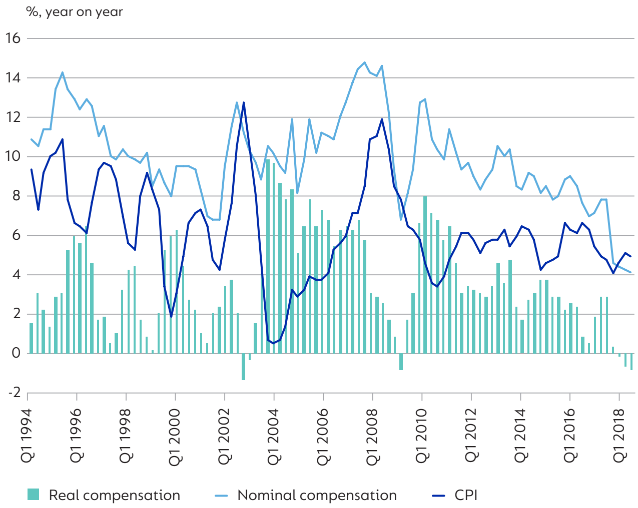
GDP CONTRIBUTIONS BY COMPONENT



Source: Statistics South Africa

The outlook for consumer spending is still critical to any improvement in activity in the year ahead. In this regard, the publication of full-year GDP data held several negative surprises. Most important was a significant revision to the underlying estimates for compensation. Compensation and employment are the biggest drivers of consumer spending, in turn 60% of GDP. In the last *Corospondent*, we flagged the downside risk to spending due to a slowing in compensation. New data show that household compensation indeed slowed – in nominal terms – to 4.1% y/y at the end of 2018. This is the lowest ever since 1994 and represents an outright inflation-adjusted contraction of 0.8% in both the third and fourth quarters of 2018. This is a deeper contraction and more prolonged than we saw in the depths of the crisis in 2009 when formal employment fell 5% from the 2008 peak.

REAL COMPENSATION AT CRISIS LEVELS



Source: Statistics South Africa

When we adjust for other income and deduct taxes and social contributions, we can derive households' disposable income – the bit left over with which households purchase all consumer goods and services. At 4.9% y/y in nominal terms, disposable income outpaced compensation, because income from investments increased sharply last year. In real terms, disposable income was flat last year (0% y/y in the fourth quarter of 2018).

This massive deterioration in spending capacity not only reflects weakness in employment, but very constrained economic circumstances – compensation data capture salaries, overtime and bonuses, and pressure on all avenues of earning ability reflects an overall exceptionally constrained economy. While this is a 'backward-looking' data point, it not only explains a considerable amount about the bleak retail environment of the past year, but also represents a considerably weaker starting point from which households are operating.

Credit extension to households has picked up, providing a boost to spending late last year. We expect this to continue and look for a stabilisation in nominal compensation growth this year.

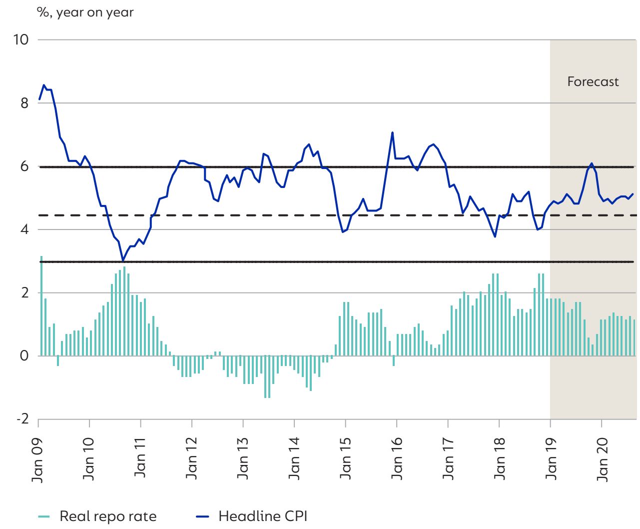
Low inflation should assist stability in real disposable incomes, although rising fuel prices and the possibility of higher food inflation are an additional risk as the year progresses, particularly if employment and compensation remain under pressure. Overall, we think household spending will grow 1.9% y/y in real terms in 2019 and accelerate to 2.5% in 2020.

We have never counted on an acceleration in capital investment over our forecast period. This is typically a late-cycle phenomenon in South Africa, and we believe there are still binding structural and cyclical constraints on investment. This remains the case, although the downside risk (off a weak base) has increased materially with Eskom's failing fleet.

INFLATION BENIGN FOR NOW

Consumer inflation remains low, printing 4.5% y/y in March, following a benign 4.1% in February and 4.0% in January. The acceleration in March mostly reflects the rise in retail fuel prices and Budget-related implementation of various taxes. However, behind the March headline acceleration was a very sharp drop in rental and owners' equivalent rent (OER) to 3.5% y/y and 2.6% y/y from 4.2% y/y and 3.5% y/y, respectively. Rentals are typically slow moving, and the sharp deceleration reflects a very constrained consumer and housing environment. With food inflation at 2.3%, this further moderation in rental (services) inflation provides a large anchor for headline CPI, which we expect to average 4.7% in 2019 and 5.3% in 2020.

CPI PLUS FORECAST



Sources: Statistics South Africa, Coronation

The March Monetary Policy Committee (MPC) meeting resulted in a unanimous vote to leave the repo rate unchanged at 6.75%, and detailed a downward-revised 2021 CPI forecast at 4.7%, from 4.8%. Within a low domestic growth and globally benign context, the MPC is in a more comfortable position than before as it assesses the outlook for inflation. A moderation in inflation expectations has helped reinforce more moderate forecasts. By mid-year, data confirming weak GDP figures for the first quarter of 2019 (which could be negative sequentially), low inflation and a possible compositional change within the MPC may well see some members consider cutting the policy rate at coming meetings. For now our base case remains that the repo rate will be unchanged through the end of the forecast horizon, allowing the already accommodative stance to increase as inflation rises moderately.

FISCAL POLICY – DOWNSIDE RISK OVERWHELMS UPSIDE POSSIBILITIES

The February Budget presented a worse set of fiscal data than we had expected. The fiscal deficit was revised larger, reflecting weaker revenue outcomes and greater support for Eskom than expected at the time of the Medium-Term Budget Policy Statement in October.

Provisional financing data released by the South African Revenue Service (SARS) for the end of the fiscal year showed a R14.6 billion shortfall relative to the Budget expectations and a R57 billion (1.2% of GDP) miss compared to the Budget in 2018. It also implies that the 2018/2019 consolidated deficit will widen relative to the -4.2% of GDP Budget expectations.

Looking ahead, it is uncertain whether committed support for Eskom will grow, given the unknown outlook for the entity. On the revenue side, weaker growth may well put pressure on projections, although we are hopeful that efforts to rehabilitate SARS and the permanent appointment of a new Commissioner will offset some of this risk.

Moody's, the only ratings agency with South Africa's sovereign rating within investment grade, did not review the rating in March and maintained an unchanged rating at Baa3 (stable). This provides a near-term reprieve, although downside risks for both growth and the fiscal position suggest that a ratings action in due course remains a considerable risk.

THE ELECTION AND STRUCTURAL REFORM

The 8 May election outcome may provide President Cyril Ramaphosa with a decisive win and a stronger mandate to appoint a Cabinet better equipped to change the tone and focus of economic policy. Almost regardless of the outcome, we still expect the President will try to ensure that key economically systemic ministries are headed by capable people and that this, combined with interventions at key institutions, should help provide some stability where uncertainty in the past has been deeply detrimental to growth.

A coordinated vision of the ANC's election manifesto, which aims to transform the economy through job creation, sustainable land reform and addressing anticompetitive corporate concentration, is necessary to encourage investment. While we expect Eskom's role as the country's sole energy provider to diminish over time (as we argue on page 8), the way in which government manages the crisis will give us some insight into its broader capacity for reform. A clear signal of the administration's ability to deliver a new vision for economic policy will not just be its ability to stabilise the entity in the short term, but having a clear, decisive and far-reaching vision for long-term energy supply as well as making the political decisions this entails. ✚

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BOND OUTLOOK

Local bonds treading water

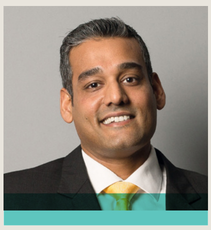
Serious longer-term economic risks mean local bonds' appeal remains neutral

By Nishan Maharaj

"Speculation … allows you to put your emotions first, whereas investment gets emotions out of the picture." – John C. Bogle

DECIPHERING THE WORLD of investment is not about having the fanciest quantitative model or being a mathematical genius; rather, it is about being able to separate emotion from decision-making. To quote Warren Buffet: "The most important quality of an investor is temperament, not intellect". Over the last quarter, there has been quite an increase in volatility, due to both global and local factors. Globally, there has been a complete about-turn by central banks on monetary policy normalisation, leading to an inversion of the US yield curve, which has stoked concerns of an imminent US recession, not to mention the continuing uncertainty about the outcome of US-China trade negotiations and total paralysis surrounding the Brexit process.

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



Emotions have also been running high in South Africa over the last quarter. The Zondo Commission continues to reveal shocking details of alleged corruption in government and associated institutions. Evidence strongly suggests that years of mismanagement and looting are now resulting in the intensification of load shedding, contributing to an already sombre mood locally. Consumers and corporates have continued to tighten their belts, deepening concerns of continued low growth in South Africa. In these times, it is important to separate fact from emotion, and let valuation guide investment decisions.

The All Bond Index returned 3.8% over the last quarter, bringing its return over the last 12 months to 3.5%. Inflation-linked bonds continued to lag nominal bond performance, producing 0.6% over the last quarter and -3.1% over the last 12 months. In dollars over the quarter, South African bonds returned 2.8%, in line with the 2.9% returned by other emerging markets (as measured by the JP Morgan Government Bond Index – Emerging Markets Global Diversified Composite). However, they remain quite a laggard over 12 months (-15.6% versus -7.5%). The 10-year benchmark bond traded in quite a narrow range over the quarter (9.47% to 9.08%) before breaking lower to sub-9.0% after the end of the quarter, following rating agency Moody's decision to keep South Africa's credit rating stable at investment grade.

BURDEN OF THE STATE

The sustainability of South Africa's investment grade rating will remain a key concern. Credible monetary policy has caused inflation and inflation expectations to gravitate towards the midpoint of the band (4.5%), yet it remains adequately accommodative given the subdued growth profile. Growth, or the lack thereof, remains at the core of South Africa's structural problems. Cyclically, growth should pick up to approximately 1.3% in 2019 and 1.8% in 2020. However, the risk to this outcome is to the downside, given the threat of load shedding, the effect it has on business and consumer confidence, and how rising electricity-related costs affect corporate profitability. The burden of low growth and state-owned enterprise (SOE) support weighs heavily on fiscal policy.

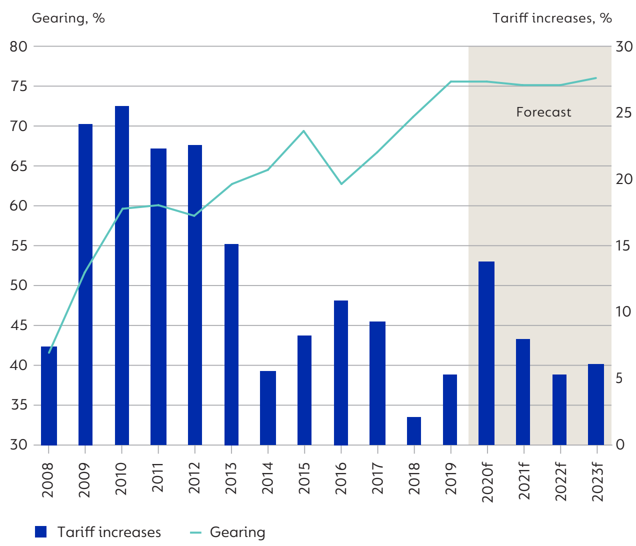
Until more concrete structural reforms are put through, it is up to fiscal policy to provide a supportive growth environment and support for SOEs in a manner that does not widen the fiscal deficit or increase South Africa's debt burden. Up to now, this has been well managed, as is evident in the February budget, where despite the R23 billion per year capital injection for Eskom, National Treasury still managed to limit fiscal slippage by cutting expenditure, primarily through a reduction in the wage bill. Unfortunately, given Eskom's precarious financial and operational position, the SOE still poses immense risk to both the fiscus and the economy.

ESKOM – THE GREAT UNKNOWN

Eskom's key areas of concern are the appropriateness of the magnitude of capital support that Treasury has set aside, the merit of the turnaround plan that has been proposed, its operational ability to keep the lights on and its financial sustainability. Given the current available information, the R23 billion annual capital injection and the framework outlined in the turnaround plan, one should expect the entity to stabilise. Implementation risk, however, remains elevated, which is not helped by the omission of a timeframe and the apportionment of responsibilities within the turnaround plan. Operational efficiencies and cost saving will have to be realised quite quickly if the entity is to return to any form of stability.

In the graph below, we show Eskom's gearing levels, taking into consideration the new tariff increases, the annual capital injection and increased diesel costs due to the use of open cycle gas turbines (OCGTs) to help increase electricity production because of failures at coal plants.

GEARING AND TARIFF INCREASES



Sources: Coronation, Eskom

Key areas of risk include the halving of maintenance during the next six months to bring up energy availability, which will remain below the norm (refer to Mauro Longano's article on page 6) and financial gearing that does not decrease despite the immense amount of support rendered, placing pressure on the need to cut costs. More concerning unknowns that will continue to weigh on outcomes is the current state of Eskom's plant fleet – how bad deterioration has been, the significance of design deficiencies at the new power plants Medupi and Kusile, and the cost to bring this back to norms. Given its poor baseline (both operationally and financially) and the large number of obstacles Eskom needs to overcome, chronic load shedding is something that the South African economy will have to deal with for at least the next two to three years, posing downside risks to both the fiscus and expected growth outcomes.

When the lights go out, there will always be a tendency for emotions to take over and all hope to be lost. When it comes to investment, it is vital to step back to observe the bigger picture, separate emotion from the research process and let valuation guide investment decisions.

GOLDILOCKS OR THE BEARS?

Global monetary policy has again turned accommodative. Following the US's about-turn on monetary policy, the European Central Bank followed suit a few weeks later. Global bond yields have plummeted, with the US 10-year Treasury Note continuing to rally to below 2.4%.

An amazing 20% ($10.3 trillion) of all issued government bonds now trade with yields below zero. In previous periods, this proved to be quite supportive for emerging market government bonds; however, this time around, given the inversion of the US yield curve (10-year rates trading below cash rates), more caution has been exercised.

An inverted US yield curve has been a successful predictor of all recessions over the last 30 years; however, the period between curve inversion and the onset of recession varies between 12 and 24 months. Therefore, over the short term, we might see this 'goldilocks' period for emerging markets continue, supporting their currencies and bond yields.

Over the longer term, we still see fair value for US bond yields being above 3%. Growth in the US has come off in the shorter term due to the government shutdown at the beginning of the year and the tax cuts of 2018 coming out of the base, but is still expected at 2.5% for 2019 and 2.0% in 2020. Furthermore, wage inflation has continued to prove quite sticky, which should keep headline inflation close to the 2.0% level.

Market expectations of interest rate cuts in the US seem premature at this stage, with the economy growing at 2.5% and inflation at 2%. A 1.0% real policy rate still seems appropriate given the prevailing conditions, which suggests a 3.0% nominal long bond rate at the minimum (2.0% inflation plus 1.0% real policy rate). The risks posed to global bond yields are therefore to the upside.

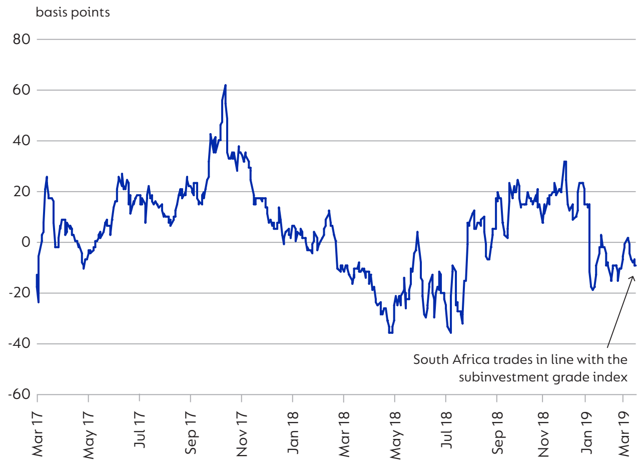
DOES THE RATING MATTER?

The key consideration for a South African bond investor is whether the yield on offer by South African government bonds compensates them for the underlying risks that the economy faces. The main areas of concern are the effect of South Africa losing its investment grade rating, the impact of higher global yields on South African bond yields and how South African bonds fare relative to their emerging market peers.

South Africa's credit rating has and continues to trade at sub-investment level. The following graphs show the South African credit spread relative to the BB Spread Index (the index representing the credit spread of the first rung of subinvestment grade) and then the BB Spread Index (second graph) over a long period of time.

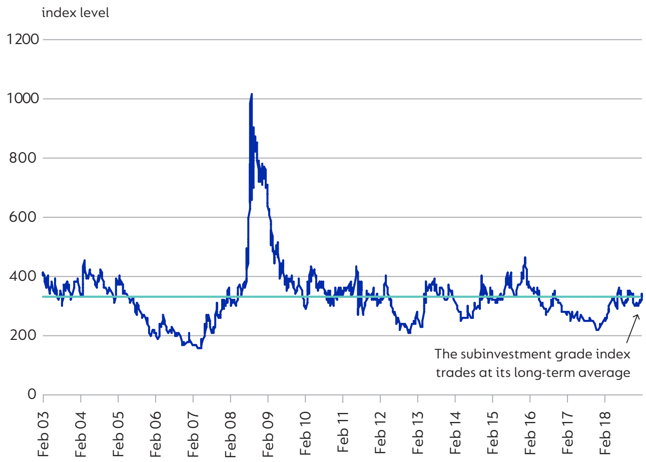
The first graph shows that South Africa trades in line with the subinvestment grade index (10 basis points [bps] more expensive than current index levels), while the second graph shows that the subinvestment grade index trades pretty much at its long-term average.

SOUTH AFRICA VERSUS BB INDEX



Source: Bloomberg

BB INDEX



Source: Bloomberg

Both metrics suggest that South Africa, even if Moody's were to move the country to subinvestment grade, at worst could see a widening of between 10 bps and 20 bps.

PEER REVIEW

In the following table we show South Africa's government bond relative to its emerging market peers, both from a nominal bond perspective and an implied real perspective (using two-year expected average inflation).

Once again, South Africa features as quite attractive relative to its peers, especially considering that Brazil has yet to pass a massively unpopular pension reform initiative to reduce its debt to GDP ratio from 80%, while Mexico's largest SOE (petroleum company Pemex) is in dire need of further financial support that will weigh on the Mexican fiscus and, hence, creditworthiness.

SOUTH AFRICA'S GOVERNMENT BOND RELATIVE TO ITS PEERS

	Nominal yield	Implied real yield
Brazil	8.97	4.87
Mexico	8.01	4.03
Indonesia	7.60	3.96
South Africa	**9.00**	**3.81**
India	7.35	3.67
Russia	8.19	3.53
Average	6.18	2.18
Turkey	17.18	2.12
Malaysia	3.76	1.80
Chile	3.97	1.04
China	3.06	0.89
Poland	2.83	0.66
Israel	1.81	0.48
Hungary	2.87	(0.12)
Czech Republic	1.78	(0.41)

Source: Bloomberg

LIMITED APPEAL

If we construct a fair value for South African 10-year bonds using the global risk-free rate (US 10-year yields), the expected inflation differential (between South Africa and the US) and South Africa's credit premium, the result is 8.92% (3.0% + (5%-2%) + 2.92%). Current levels of 9.0% on South Africa's 10-year government bond therefore compare quite favourably to our fair value estimate.

Given the long-term risks the local economy faces, predominantly from a further deterioration in Eskom, one would look to move from a neutral to slightly underweight allocation to South African government bonds, as levels move through our fair value estimate. Chronic load shedding and poor local sentiment will continue to weigh on South Africa's growth outcomes. Inflation should remain under control, allowing policy rates in South Africa to, at worse, remain stable.

Global monetary policy has again turned more supportive for risk sentiment, which should help buoy emerging market valuations over the shorter term. At current levels, South African government bonds trade cheap to fair value estimates. However, given the longer-term risks posed to the economy from further deterioration in SOEs, allocations should be kept at a neutral level. +

An unsure world under pressure

But 'one-off event' corrections should bring some relief

By Marie Antelme

Marie is an economist with 18 years' experience in financial markets. She joined Coronation in 2014 after working for UBS AG, First South Securities and Credit Suisse First Boston

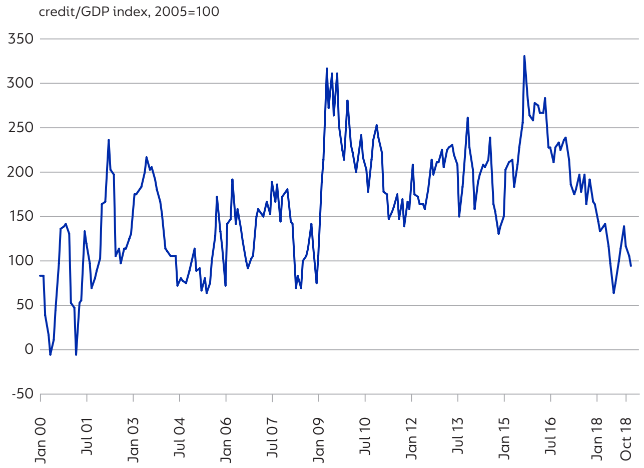
GLOBAL GROWTH SLOWED through most of 2018. But the pace of slowing accelerated meaningfully from mid-2018 into the first quarter of 2019. 'Recession indicators' started rising in the US, and growth concerns in Europe and China were reinforced by an escalation in trade tensions and ongoing deterioration in an increasingly wide set of economic data. Uncertainty about the future interconnectivity of the global economy will undoubtedly play a bigger long-term role in the global growth moderation than the direct impact of trade weakness, but the current situation has undeniably been exacerbated by idiosyncratic issues in several key economies, which should ease. The longer-term cost of heightened uncertainty is still to be counted.

Within this context, it is instructive to try to identify the sources of economic weakness and uncertainty, and then assess how durable the effects may be. These seem to fall broadly into three buckets:

1. CHINESE ECONOMIC ACTIVITY

The internal, policy-driven moderation in Chinese economic activity started in 2017. Successive stimulus interventions have seen an unprecedented accumulation of debt relative to GDP in China, which peaked at an estimated 250% of GDP in mid-2017. Reasonable concerns about the sustainability of both the stock and the rate at which it has increased prompted policymakers to moderate credit availability from the end of 2016. The impact of credit withdrawal led to a moderation in growth momentum, which affected domestic activity and then rippled into global trade.

CHINESE CREDIT IMPULSE



Source: Emerging Advisors Group

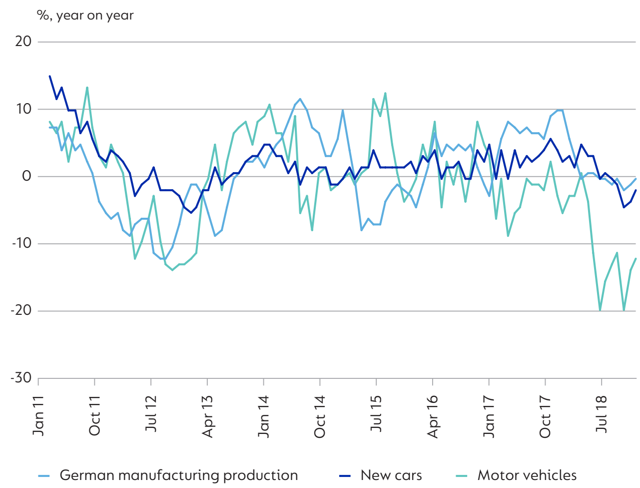
2. US-SINO TRADE TENSION

The above factors coincided with the escalation of US-Sino trade tension, which saw the US initially impose 10% tariffs on $200 billion of Chinese imports in mid-September, followed by retaliatory tariffs from China on $60 billion of US imports. While the US and China's negotiations are still ongoing, global trade indicators remain weak. The knock-on has started to affect global manufacturing and, more broadly, sentiment and business investment. The hardest hit have been large trading economies, including Germany, much of Asia and Japan.

3. INDIVIDUAL MARKET EVENTS

More randomly, there are a number of idiosyncratic events which have either materially exacerbated the impact of the above, such as the change in emissions regulations in Germany, or had the effect of weakening broader sentiment and hard data, such as a combination of US market volatility, the polar vortex and the shutdown of the Federal government in February. Elsewhere, political tension in France and the chaotic Brexit negotiations have negatively affected confidence and biased growth weaker.

GERMAN VEHICLE PRODUCTION AND MANUFACTURING OUTPUT

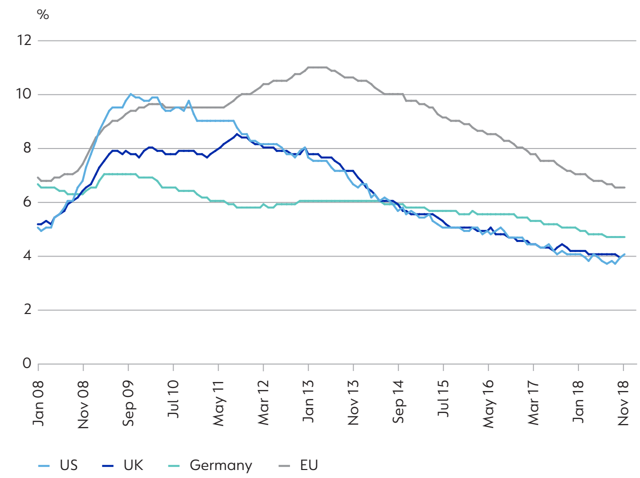


Note: 'Motor vehicles' include light, medium and heavy vehicles, and usually buses, too.
'Cars' refer to cars only, usually with a weight limit.

Source: Datastream

For all this weakness, the resilience of domestic demand in these economies has provided a relatively robust buffer. Across a broad base of developed and some emerging markets, the current economic cycle has seen unemployment fall to multi-decade lows. While there are ongoing questions about the quality of this employment growth, low levels of unemployment support wage growth – and we have seen earnings pick up in the US, UK, Japan and parts of Europe, to the extent that developed markets' income growth now rivals the last expansion. This has not been enough to mitigate all the headwinds, but it is an important source of stability.

DEVELOPED MARKET UNEMPLOYMENT RATES



Source: Datastream

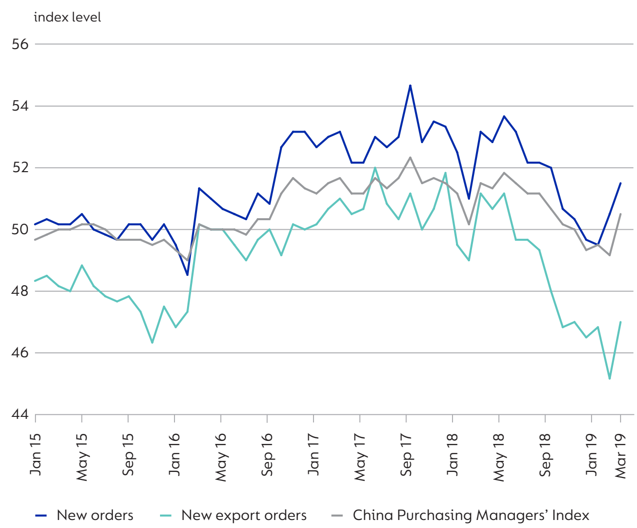
Despite all the bad news, at the time of writing, there is mounting evidence that the first quarter of 2019 may be the low point of global growth. Several 'nowcast' models (UBS >

and JP Morgan), which track changes in high-frequency data to monitor the state of the economy in real time, are pointing to an improvement in global growth momentum. While the activity data are still mixed, there is enough evidence to suggest that, at the minimum, disruptions in the US and parts of Europe are normalising, and policy intervention is gaining traction in China.

This base is narrow because global trade-related activity and associated indicators are still uniformly weak. Data published by Morgan Stanley suggest that global trade volumes slowed to just 0.5% year on year in March, from 1.0% in February, based on export expectations in the Ifo Institute for Economic Research survey and hard export volume data from Korea captured by their trade indicator. For better certainty of a recovery in global growth, we need a few things to go 'right':

Firstly, China's outlook is critical to the prospects and magnitude of a global recovery, given its significant contribution to the global demand weakness over the past six to nine months. The main drag on growth remains property construction and manufacturing capex. This should be countered by an improvement in consumer spending and the support from fiscal stimulus. The rise in China's Purchasing Managers' Index new orders for the second consecutive month is encouraging.

CHINA PURCHASING MANAGERS' INDEX



Source: Datastream

Secondly, some resolution to the US-Sino trade tension is needed in the form of an agreement on terms and implementation between the US and China. Not only is this key to an improvement in trade volumes; a better framework for dispute resolution is also a necessary condition to avoid a repeat of the past year's standoff or a deterioration to something more hostile. The likelihood of achieving a robust agreement with long-term solutions is questionable given the US and China's very different economic policies, but a stabilisation in tariff uncertainty should support confidence lost in the current state of flux.

Then, we need to continue to see the influence of the 'one-offs' fade, especially the disruptions to US activity and spending after February, and the lesser influence of the manufacturing disruptions in Germany. The US Federal Reserve's commitment to 'patience' should also provide a meaningful fillip by keeping global financial conditions easy for a prolonged period, although better growth could also see an uptick in inflation and ultimately put pressure on the Federal Open Market Committee to continue raising rates. Similar very dovish guidance from the European Central Bank suggests it will take a considerable change to conditions to alter its outlook, and we assume monetary policy will stay accommodative in coming months, even as activity picks up again.

Lastly, the 'red flags' raised during this period of slowing growth need to be tested. Not all of the decline in growth momentum that we have seen in the past two quarters can be fully explained by the events listed above and, in some cases, these have not been resolved.

In China, we assume that much of the slowdown in growth started with tighter credit conditions, which have started to ease modestly, and that fiscal interventions will buoy activity in the second half of 2019. It is possible, however, that the impact of credit withdrawal has not yet fully played out, notably on the property market, and that we have yet to feel the full impact of the trade war with the US. Both factors are considerable uncertainties, and hard to quantify.

For the US, the combined sluggishness in the housing market – which is at odds with the very supportive macro factors, including employment and wage growth, household formation and very supportive financing conditions – and emerging weakness in business investment are traditional signs of cyclical weakness, which are important to monitor.

In Europe, the impact of protracted weakness in the external sector may have a much deeper effect on growth. Global trade is a much stronger driver of internal growth momentum than in the US or China. Political uncertainty will play in the background and is not limited to Brexit. It also includes the outcome of the European Parliamentary elections, taking into account more populist and less traditional leadership in several member countries, as well as the impact of weak growth on Italian fiscal metrics, especially under the coalition government.

The umbrella risk is that the uncertainty imposed by all these factors becomes reinforcing in a global economy that is weaker and more fragile than it was at the start of 2018. Our base case, however, is that one-offs correct – and a few things go right – aided by strong domestic demand conditions in key economies and very supportive monetary policies.

We expect global growth to slow to about 3.4%, from 3.8% in 2018, and to recover to 3.7% in 2020. Within this, growth from emerging markets should be supported by recovering economies hard hit in 2018, including Argentina and Turkey, with emerging market aggregate growth expected to be 4.7% in 2019 from 5.0% in 2018, and 5.1% by 2021. Developed economies are more likely to remain under pressure, with the growth forecast flat at 1.8% in 2019 and 2020 as momentum from 2018 is lost and the US tax boost fades. ✚

Emerging market equities – a horizon of opportunities

Potential for high growth and diversity, but over a longer-dated timeframe

By Suhail Suleman

Suhail is a portfolio manager within the Global Emerging Markets investment unit. He joined Coronation in 2007 and has more than 16 years' investment experience.

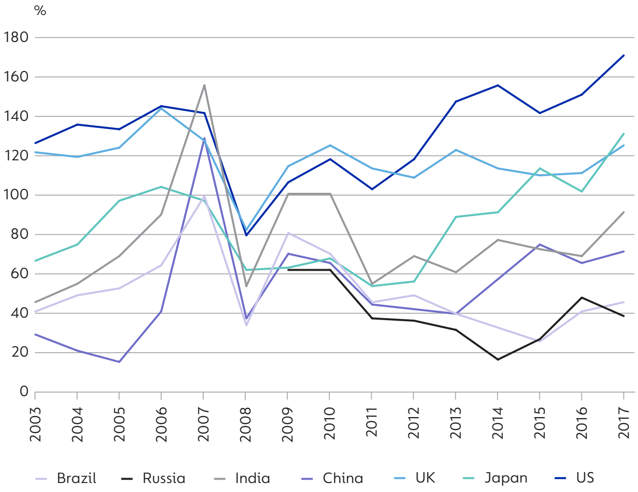
AROUND 80% OF the world's population live in the developing world, with close to half this populace from China and India alone. In terms of land mass, similar statistics prevail, with the bulk of global land located in countries yet to reach economic maturity. As a general principle, developing countries started on the path to industrialisation decades after their developed peers and remain far poorer overall. For this reason, their contribution to global economic output, at between 40% and 50% – depending on whether market or purchasing power parity (PPP) exchange rates are used – is substantially below their population share.

Financial markets in developing regions also developed much later than those in the developed world, resulting in their current share of global market capitalisation being only around 25%.

>

Once free-float adjustments are taken into account, their share of benchmark global indices reduces to below 20%. While many large developed markets boast market capitalisation rates greater than 100% of GDP, very few emerging markets are anywhere near this level. The exception to this rule is South Africa, where financial markets developed far earlier and where many global multinationals have listings on the JSE, artificially boosting the market capitalisation ratio to 200% of GDP.

MARKET CAP TO GDP: BRIC AND SELECTED DEVELOPED MARKETS



Source: World Bank estimates

While I have touched on developing markets more generally, this piece will concentrate on emerging markets, as they make up the bulk of the investable equity universe outside developed markets.

Within the broader MSCI All Country World Index (ACWI), emerging markets have a 12% weight and frontier markets have no representation at all. Given that emerging markets are between 40% and 50% of global output and are growing between 1.5 times and 2 times faster than the developed world (in aggregate), investors in ACWI (or any other global index) are structurally underweight emerging markets and are generally missing out on the long-term opportunities they offer.

THE TORTOISE AND THE HARE

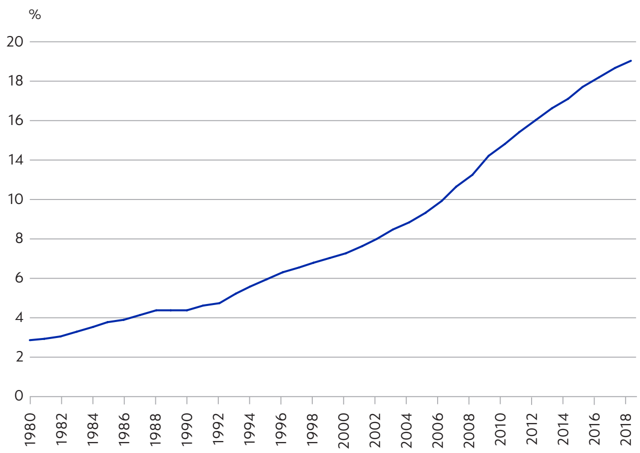
Emerging markets are growing faster than developed markets as a result of several drivers. The simplest explanation is that when installed capital and productivity levels are low – which was the case in most emerging markets 30 years ago – a dollar of capital invested yields higher incremental returns than in a country with a high base of installed capital and an already productive workforce.

China and India were both very poorly managed by their respective governments until the early 1980s and 1990s, and it is no coincidence that a loosening of regulation and an opening up of domestic markets to capital investment and competitive forces coincided with a significant increase in growth rates in these countries.

China's transformation, in particular, could rank as humanity's greatest ever poverty alleviation project. In 1980, China's GDP per capita was similar to that of Zambia and more than 85% of the population lived in extreme poverty. Since then, the country has averaged real GDP growth of close to 10% per annum, raising GDP per capita from under $200 at the time to $9 000 today – a fifty-fold increase in the space of one generation. Today, less than 10% of Chinese live in extreme poverty.

The relatively low increase in population – cumulatively only 40% over 29 years – has certainly helped to ensure that high aggregate growth translated into high per capita growth. However, even if China's population had doubled over the period, abject poverty would still largely have been eliminated. The one-child policy certainly played a role in reducing population growth, but its role should not be overstated – the birth rate was already in steep decline when the population curbs were introduced and examples elsewhere in Asia suggest that the rising wealth levels would have seen it naturally decline even further. In the process, China's share of global output has moved from 2% to close to 20%, as the graph below illustrates.

CHINA'S SHARE OF WORLD GDP AT PURCHASING POWER PARITY



Source: IMF estimates

China is not alone in having raised living standards materially, although it is probably the most dramatic example of what compounded high growth can do for countries. India, the world's only other billion-person country, has also come a long way since it started opening up in the early 1990s. Despite being a democracy (with the occasional emergency rule) since independence from Britain, India traditionally had a very protected and state-dominated economy, with many key sectors (notably banking) nationalised in the years after independence from Britain, foreign investment severely curtailed and price controls distorting economic incentives.

The result was close to 50 years of economic stagnation, made worse by a fairly high birth rate that saw the population increase by 2.5 times in the 44 years after independence and until 1991 when reforms were introduced by then-Finance Minister

Manmohan Singh (who would subsequently serve as Prime Minister for 10 years from 2004). India's GDP per capita in 1991 was $300 (at market prices) and, by the end of 2018, was estimated to have grown to $2 000 – a compound growth rate of 7.3% delivered despite a 50% increase in population over the 27-year period.

THE OPPORTUNITIES IN THE STEP CHANGE

Why is the above context important when considering opportunities available to equity investors? The answer stems from the investment opportunities created when economies modernise, increase in size and see a step change in financial sophistication. Shanghai's stock exchange, for example, was re-established in late 1990 after a 41-year closure. From having no listed companies at all 30 years ago, the market capitalisation of Chinese stocks today exceeds $10 trillion.

India's market capitalisation has increased from $280 billion in 2003 to $2.5 trillion in 2018, a ninefold increase in 15 years. The table below, drawn from the World Federation of Exchanges database, shows how the market capitalisation (in current US dollars) has changed for the listed universe of several countries over the latest 14 years for which data are available for all the selected countries.

STOCK MARKET SIZE

Country	2004 $ market cap	2017 $ market cap	% change CAGR	Classification
China	448	8 711	25.6%	Emerging
Indonesia	73	521	16.3%	Emerging
Thailand	115	549	12.7%	Emerging
Korea, Rep.	428	1 772	11.5%	Emerging
Brazil	330	955	8.5%	Emerging
South Africa	443	1 231	8.2%	Emerging
Argentina	41	109	7.9%	Frontier*
Mexico	171	417	7.1%	Emerging
Nigeria	16	37	6.8%	Frontier
Turkey	98	228	6.7%	Emerging
The Netherlands	539	1 100	5.6%	Developed
Switzerland	829	1 686	5.6%	Developed
US	16 324	32 121	5.3%	Developed
Australia	776	1 508	5.2%	Developed
Germany	1 195	2 262	5.0%	Developed
France	1 559	2 749	4.5%	Developed
Portugal	70	76	0.6%	Developed
Spain	941	889	(0.4%)	Developed

* To join the Emerging Markets Index in May 2019

Source: World Federation of Exchanges

The results above speak volumes, although I would caution that they are not directly translatable into equity returns as, at the very least, they include new listings over the period and follow-up equity offerings on already-listed stocks, and they ignore dividends that have been paid. Nonetheless, the figures do highlight that the investment universe in emerging markets has expanded rapidly and therefore should be given serious consideration by investors. As markets develop, and as liquidity and trading continuously improve as they have done over the last two decades, we would expect that the weight of emerging markets within global indices would increase significantly from the 12% to 13% mentioned earlier.

It is important to highlight that emerging markets are not a homogeneous asset class where equity values in the various countries move in tandem. The returns in the various individual emerging markets can and do diverge materially, as their drivers are very different. As an example, China's market has grown with the rapid industrialisation that the country has undergone. Its market comprises oil, property, banking, industrials, consumer and internet stocks, and there remains heavy influence from the state through direct and indirect ownership and regulation of the listed universe. No single individual industry or sector dominates and, with a quasi-fixed currency, the influence of exchange rate movements for dollar-based investors is also more muted than, for example, for South Africa, which has a freely floating exchange rate (the rand) with substantial volatility.

Brazil, on the other hand, has a higher equity weighting towards oil, iron ore, agricultural commodities and regulated utilities. The Brazilian currency, like the rand and the Russian ruble, is volatile and heavily influenced by commodity prices. At times when commodity prices are high and terms of trade are in Brazil's favour, Brazil's equities tend to increase substantially in value, and the currency strength that accompanies this amplifies the movement.

The broader emerging market classification includes countries that are growing fast but are relatively poor in absolute terms, such as India, and those that are relatively wealthy and growing at rates similar to those of developed markets, such as South Korea and Taiwan. The investment opportunities between these countries therefore differ materially, since industry structures are quite divergent. Less developed countries tend to have more fragmented industries with substantial scope for consolidation, whereas wealthier emerging markets tend to have a greater degree of consolidation.

Some of the best returns in emerging markets will be available where companies increase their market share at the expense of weaker players, growing revenue at a rate substantially above nominal GDP growth. In the process, these companies will be able to raise margins as their scale relative to competitors' increases and barriers to entry for new entrants rise. A good example of this is the Russian food retail sector, where the top two players have barely 10% market share each and the formal players, as a whole, around 65%. In developed markets, it is not uncommon for the top players in food retail to have market shares above 20% and for formal retail to command 75% to 80% of total sales. The only natural limitation to market share in Russia is a 25% single-metro market share limit in terms of Russia's food retail law, and both the market leaders are some way from hitting this ceiling.

Financial services is another sector in which substantial opportunities exist due to fairly low credit penetration. In most emerging markets, access to financial services is far from universal, and penetration of products such as bank accounts, credit cards and mortgages is at a fraction of that of their developed peers. As an example, in mid-2018, the Bank for International Settlements

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noted that the credit-to-GDP ratio (total credit to the private nonfinancial sector divided by GDP) of India stood at 56%. Brazil was not much higher, at 67%. In comparison, the UK's ratio was 170% and that of the US 150%. Some emerging markets do have developed-level credit penetration, but this is restricted to wealthier emerging markets such as Korea, with 194%.

TAKING ACTION

Some examples will naturally answer the question most asked by investors with respect to their potential emerging markets exposure – should the investment be passive or active? Coronation has been an active manager in emerging markets for more than a quarter of a century and we believe it is the most suitable option for investors looking for long-term value uplift in returns. As a starter, a large percentage of the indices in emerging markets are dominated by many mediocre businesses that often serve as state champions. Examples of these include the Chinese state-owned banks, whose credit allocation is very opaque, and national oil companies such as Petrobras and Gazprom. This is clearly different to some developed market countries like the US where the index is dominated by some of the best businesses in the world, run primarily for the benefit of their shareholders. Examples include technology stocks such as Apple, Amazon, Alphabet and Facebook.

While the index quality has improved over the last decade, we still don't believe it represents access to the most compelling businesses and investments in emerging markets.

We believe that some of the best opportunities are in private sector-run businesses such as the Russian food retailers mentioned earlier. Another very compelling example is in Indian banking. Some 70% of the market here is still run by the state-owned banks, whose operations have underperformed their private sector peers since their monopoly ended as part of the economic reform process. As recently as 15 years ago, the private sector market share was 10%. It has since tripled in a banking market (as measured by total assets) that has also grown by 15% per annum in nominal terms over the period. The private sector banks have better balance sheets, which allow them to grow their books faster than the public sector banks. They also have better credit granting processes, so the bad debts of the well-run private sector banks are substantially lower than those of public sector banks that often have a second agenda of furthering development regardless of credit risk.

The combination of high growth, robust credit processes and long-term thinking from management will yield higher returns for investors over the long term. An index-tracking investor would have a larger allocation to public sector banks and would also have significant exposure to overvalued consumer stocks in the fast-moving consumer goods sector. Here, a scarcity premium means that Hindustan Unilever (Unilever PLC's listed subsidiary) trades on more than 50 times earnings, despite delivering earnings growth below that of HDFC Bank, the leading private sector bank that trades on 20 times earnings.

To conclude, in our view emerging markets offer a compelling long-term opportunity for investors. The most important consideration, however, is time horizon. As countries and economies are still decades behind their developed market peers on most metrics, the duration of the investment opportunity is also long dated. A focus on the long term (five years or longer) rather than the shorter term will, in our view, deliver compelling returns for investors, even if shorter-term volatility may be higher than in developed markets. ✚

The rise of mobile money in frontier markets

Where the frontiers of consumer need, technical innovation and pragmatic regulation meet

By Peter Leger and Tascha Terblanche

Peter is head of Global Frontiers with 20 years' investment experience; Tascha is a Global Frontiers investment analyst.

IT IS EASY to know what a frontier market is when you are in one, but defining it from beyond its borders proves somewhat more elusive. Frontier markets are typically economies where the usual consumer brand suspects are largely absent: large-scale, production-type multinationals such as Heineken, Anheuser-Busch InBev and British American Tobacco may have taken root, but familiar consumer brands such as Starbucks, McDonalds and KFC have yet to establish extensive footprints in the somewhat virgin market territory.

While these markets are frequently viewed as quite fragile and high risk, it is quickly becoming apparent that certain business models work far better in a frontier market than in a developed one, allowing investors some very interesting return opportunities. One such an opportunity is mobile money (MM).

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In the June 2017 edition of *Corospondent*, we wrote about the parallels between two MM businesses, bKash in Bangladesh and M-Pesa in Kenya. These businesses have done well and we continue to hold both companies in our Africa and Global frontier market portfolios.

MM businesses in frontier markets are fascinating subjects. It is an industry born from a marriage of consumer need, legacy high-cost banking infrastructure and exceptional technical innovation, and one that produces fast-growing, profitable businesses. Globally, the MM industry processed $1.3 billion a day in 2018, with the number of registered MM accounts increasing to 866 million, making MM the leading payments platform for the digital economy in several emerging and frontier markets[1].

In 2018, there were 272 MM businesses across 90 countries. Of these, 62 had more than one million active users, compared to only 13 in 2013[2]. Having investigated a number of payments businesses globally, there are a few that stand out for us: M-Pesa in Kenya and Tanzania, EcoCash in Zimbabwe, Orange Money in West Africa, MTN MoMo in Ghana and bKash in Bangladesh. These markets have a few things in common that have supported the growth of MM. The most significant in our view are the following:

1. Large unbanked populations that are in dire need of convenience and an affordable, secure way to complete very simple transactions

An inadequate legacy banking system in frontier economies renders a large percentage of the population unbanked, while mobile telephony has enjoyed huge penetration. Mobile phones play a central role in the lives of these users, creating higher levels of trust in mobile services than elsewhere.

[1 & 2] GSMA 2018 State of the Industry Report on Mobile Money

2. Pragmatic regulators with an approach that enables financial access

When paired with a supportive regulatory system, a fertile environment is created for the formation of formidable mobile financial services businesses that can grow from concept to profitability in a very short space of time. And, in so doing, these businesses aid in the financial inclusion – and consequent economic liberation – of millions of people.

MOBILE MONEY BUSINESSES AS INVESTMENTS

Some of our best investments have been when we have paid a low multiple on low earnings. For the MM businesses we like, both these metrics hold true.

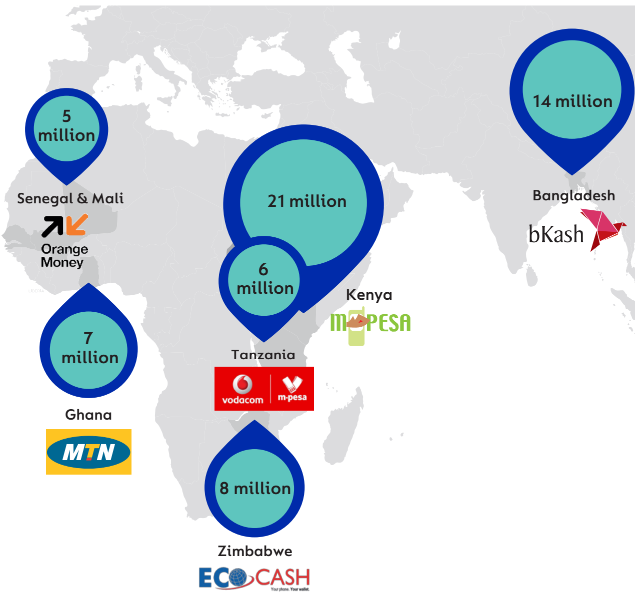
Current earnings are low

The profitability of MM businesses in the very early stages of their lifecycle is a characteristic that is often in stark contrast to what we see in developed markets. International payments businesses are often lossmaking, whereas our estimates indicate that EcoCash and M-Pesa, for example, have net profit margins in the region of 20%.

Across MM businesses, we believe there is significant potential for earnings growth driven predominantly by margin expansion. Over the long term, the true value of these businesses lies in the payment and transaction ecosystem being created. Once this ecosystem is established, there is almost no limit to the auxiliary services that can be added.

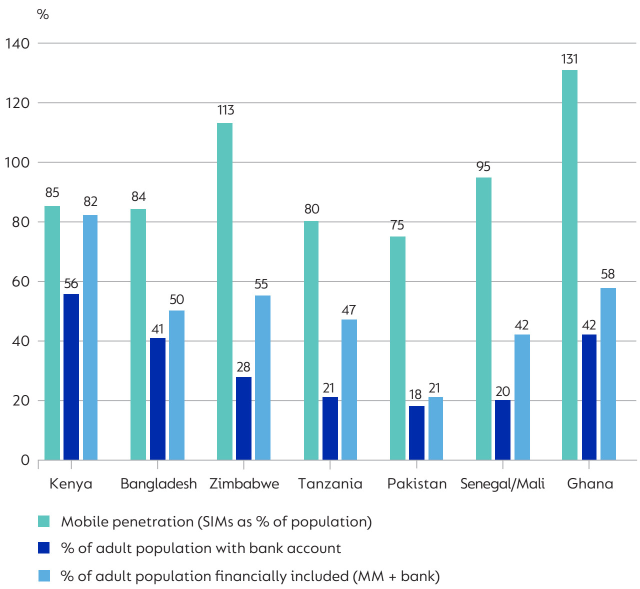
Services such as loans, insurance products, merchant payments, utility payments, salary disbursements and even asset management services can easily be added – all of which usually come with very high margins. Current levels of earnings are therefore well below what we believe to be normal.

ACTIVE USERS OF MOBILE MONEY SERVICES



Source: GSMA 2018 State of the Industry Report on Mobile Money

LARGE UNBANKED POPULATIONS WITH MOBILE PHONES



Sources: Coronation estimates, World Bank Global Findex

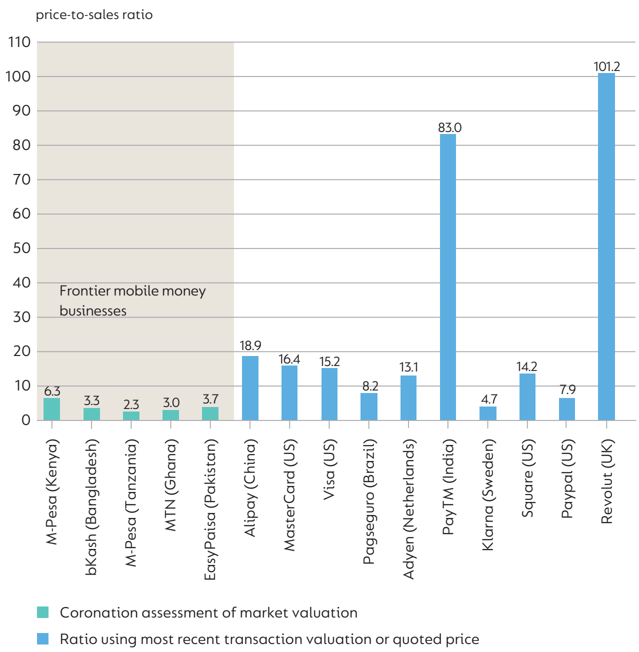
M-Pesa in Kenya serves as an example of this dynamic. In 2012, traditional person-to-person transfers accounted for 95% of revenue. By 2018, this had dropped to 74%, as M-Pesa had added loans, insurance products and an e-commerce business to its platform. Product proliferation is one of the key drivers of the significant margin expansion witnessed over the same period. M-Pesa has also packaged its capabilities into a targeted value proposition in DigiFarm, an M-Pesa platform that currently allows around one million farmers to access funding and sell their goods.

The opportunity to add to the ecosystem once it is established is remarkable. Alipay, the payments platform of billionaire Jack Ma's Alibaba, is arguably the most successful global mobile financial services provider. Over time, it has added food ordering, ride hailing, insurance and investments products to its offering, supporting its valuation of $150 billion.

Multiples are attractive

What really excites us as valuation-driven investors is that these businesses tend to trade on much lower multiples than developed and even emerging market peers – you get a whole lot more mobile bang for your buck. The graph below shows this by comparing the price-to-sales (P/S) ratios.

MOBILE MONEY BUSINESSES TRADE ON LOWER MULTIPLES THAN DEVELOPED AND EMERGING MARKET PEERS



Sources: Best estimates based on internal research, Bloomberg and publicly available media reports; most recent valuations and sales/revenue figures used

One of the reasons we believe MM businesses trade at such large discounts in frontier markets is that they are not listed separately. The only way an investor can access such a business is by owning the parent company, usually a telecommunications company or bank, which typically trade on lower multiples. Given the higher-quality income stream and the growth potential of MM businesses, we believe they should trade on higher multiples. However, the nascency of these businesses mean that they are a small part of current earnings, so often very little attention is paid to understanding the quality of these earnings.

A case in point is bKash, the largest MM business in Bangladesh, which is 51% owned by private commercial bank, BRAC Bank. In 2018, Alipay acquired a 20% stake in bKash in a deal that valued bKash at $700 million. The implied P/S ratio of this valuation is 3.3 times, well below that of peers, even those in frontier markets.

bKash currently has around 30 million subscribers; multiple times that of its closest competitor and compared to only 48 million formal accounts held by banks in Bangladesh. This scale creates a network effect that continues to attract more users and service providers to the ecosystem. The growth opportunity is extraordinary: revenue per user is still only about half of what we see in more mature markets such as Kenya and the profit margin is much lower, because bKash continues to invest in the business.

We believe the Alipay deal should be transformative for bKash. Alipay brings with it years of experience, more sophisticated technology and a new dimension to customer acquisition, which is shifting the business even further towards a revenue growth model rather than a profit-driven model.

As a comparative, when looking at the valuation of mobile network operator Safaricom in Kenya, we estimate that the market currently assigns a value to M-Pesa in the region of $4 billion. We see no reason why bKash should not be worth at least as much as M-Pesa – Bangladesh's population is more than three times that of Kenya, with only 41% of adults having a bank account, compared to 56% in Kenya.

RISKS – THE THREAT OF PAYMENT APPS

When building an investment case, we spend a lot of time investigating the risks. Regulation is the most obvious risk associated with payments businesses and, indeed, financial institutions more generally. But a risk that is perhaps less widely appreciated is disruption from messenger apps such as WeChat, WhatsApp and Facebook that are entering the mobile payments space.

Messenger apps have the same ability to leverage their existing platforms (which already capture consumer attention and enjoy an established degree of trust among users) when introducing mobile payment services. This is what KakaoTalk is doing in Korea and WhatsApp in India, and what Line is now hoping to do in Japan, Taiwan and Thailand.

The graph overleaf shows the most popular social messaging apps around the world, with a number of these either already offering payment services or likely to soon develop a payment offering (WhatsApp, Facebook, Line, WeChat and KakaoTalk).

One of the key constraints messenger apps face in frontier markets is transferring money into the user's mobile wallet. MM players use large agent networks that physically receive deposits and process cashouts – in Bangladesh, bKash now has more than

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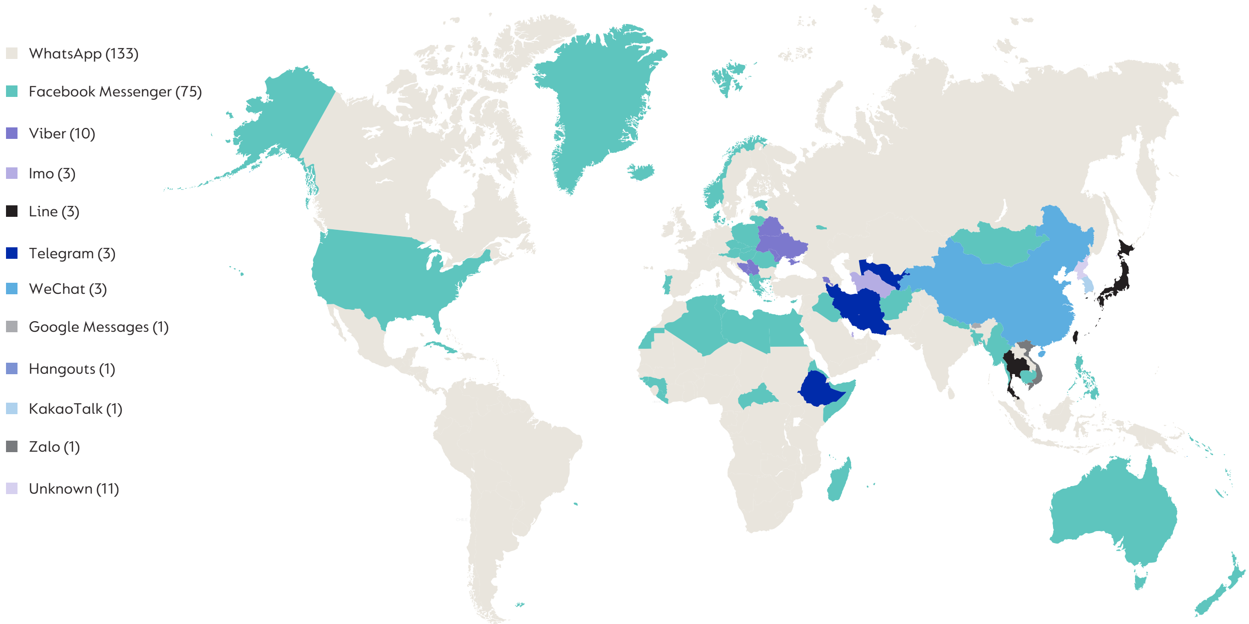
TOP SOCIAL MESSENGERS AROUND THE WORLD

The most popular messenger app by country/territory in December 2018



Note: Figures in parentheses in the legend represent the number of countries/territories in which each platform is the top-ranked messenger app.

Source: Hootsuite, January 2019; based on SimilarWeb's algorithm integrating current installs from the Google Play Store with active app users (December 2018).

200 000 agents doing this. Messenger apps typically partner with banks when launching payment functions and require users to link their bank card – therefore requiring a bank account. This is what WhatsApp is doing in India, where 80% of the adult population has a bank account, compared to 41% in Bangladesh. The lack of bank accounts in a typical frontier market is therefore problematic for messenger apps.

The extent of smartphone penetration in frontier markets presents another barrier. While mobile phone penetration is typically high, smartphone penetration is much lower, explaining the success of MM businesses that leverage unstructured supplementary service data-based (USSD) technology for feature phones.

We have seen several case studies of collaboration rather than competition in frontier markets. In Africa, a recent partnership between WhatsApp and telecommunications network provider MTN has allowed MTN customers to recharge airtime and check their bank balances using the WhatsApp platform. We have also seen large players such as mobile and online payment platform Alipay partner with MM businesses. In addition to bKash, Alipay purchased 45% of Easypaisa, the largest MM player in Pakistan. In Kenya, Alipay has partnered with Safaricom to allow customers to use M-Pesa when paying on Alipay's online retail service, AliExpress. It targets around 100 000 traders in Kenya who source goods from China each month.

While messenger apps and large players such as Alipay pose a risk, partnering with MM businesses that have large, established ecosystems that already benefit from network effects likely makes more strategic sense than meeting them head on.

Over the past 25 years of investing, we have learnt time and time again that the combination of low earnings and low multiples can result in very rewarding investments for our clients. We believe MM businesses are already showing these same signs and will be multi-year compounders, making them among the most compelling investment opportunities in our universe. ✚

INCLUSIVITY AND DIVERSITY

Accessing the diversity dividend

Why being (and being allowed to be) yourself at work is valuable to your organisation

By Kirshni Totaram

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

AS SOUTH AFRICANS, our complex history has ensured that we inherently understand the deep need to nurture diversity and inclusion at every level of government, society and business.

There are essentially two kinds of diversity, and considering both is useful when it comes to understanding how they impact an organisation for the better.

Identity diversity refers to diversity of race, gender, ethnicity and age, whereas **cognitive diversity** is the diversity in people's perspectives, culture, socioeconomic circumstances and education.

In South Africa, achieving identity diversity in its employee profile is an obvious goal for any business in order to correct the inequality of the past and appropriately reflect the demographics of our country. But beyond the benefits of identity diversity in the

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workplace, more global companies are realising the value created by tapping into cognitive diversity.

LOOK BEYOND VISIBLE DIVERSITY

South African businesses, in particular, are very familiar with the identity diversity part of it, to a large degree driven by broad-based black economic empowerment (B-BBEE) legislation that impacts companies operating within the South African context. And, depending on who you are, the mere mention of B-BBEE incites very different feelings and responses. But I want to address and unpack the big casualty to the heavy focus on headline statistics – the concept of cognitive diversity and inclusion, i.e. creating an environment where people can be who they are, that values their unique talents and perspectives, and makes them feel like they belong. I believe the 'inclusion' component captures the zeitgeist of this complex topic and is key to unlocking the diversity dividend.

For those of us operating in the asset management industry, embracing true diversity and inclusion seems obvious. Our environment is characterised by competitiveness and uncertainty, and thriving in that context requires creative thinking. This is exactly what makes diverse collaborators better equipped to face these challenges.

Cognitive diversity means recognising what isn't always visible in people, embracing this difference, and actively including people who think differently, and have differing viewpoints and skill sets. This is the really difficult part. Our South African experience has shown that looking beyond the many superficial assumptions based on identity has been one of the biggest challenges. This, in turn, creates a barrier to digging deeper and identifying the cognitive – something that we have had to work hard at changing.

Improved cognitive diversity goes a long way to boost collective intelligence among teams

Harvard Business Review[1] has reported that teams solve problems more effectively when they are cognitively diverse. Researchers looked closely at how individuals with different perspectives or information processing styles add value in a team that is tackling new challenges. The results showed a significant correlation between high cognitive diversity and high performance, which makes intuitive sense. When we take on a new challenge, we need to balance what we know with discovering what we don't know that might also be important. So, it's valuable for everyone involved to be able to apply their unique expertise to the task at hand.

THE BARRIERS

Visibility

The problem is that cognitive diversity does not come with a well-printed label and is hard to detect at face value. A person's race, gender, culture or generation may not necessarily tell us how that person thinks and processes information. It takes effort to draw out those internal differences and harness the benefits, the 'how' of which I discuss further on.

An organisation's culture

Cognitive diversity can be restrained unintentionally by an organisation's cultural barriers. It is normal and natural for people to gravitate toward others who think and express themselves in a similar way (aka 'group think'), and so organisations often end up with like-minded teams. This is called functional bias and research globally continues to show that people have a more positive skew towards individuals who have the same qualifications and went to the same schools or universities as themselves. The result is low cognitive diversity. It's a problem because teams with little cognitive diversity have limited ability to see things differently and engage creatively and innovatively. This can become a material decision-making handicap in fast-changing and complex environments.

Organisational beliefs and setup

In addition, an organisation's beliefs about diversity creates a self-fulfilling cycle. Industries and companies that view diversity as important and actively implement it in their recruitment, capture the benefits from it. Those that don't, don't. Diversity creates positive benefits when people ***believe*** in its intrinsic value. They don't see it as an obligation or a social tax. Because when you value diversity, you encourage diverse idea exchange. Research has shown that truly diverse teams can develop more innovative ideas. When people from different contexts work together, their unique perspectives often lead to greater creativity.

Tied to this is the fact that diversity does not work without psychological safety. People only contribute unique ideas to the group when they feel comfortable enough to speak up and present a contrarian view. It is difficult and stressful for those who do not fit into an entrenched culture or identity group. Many choose to hide important parts of themselves and importantly, their ideas.

Experimental studies further support this, showing that psychological safety is key to idea generation. Increasing a team's collective intelligence is not just about having cognitive diversity but also about having equality in the distribution of conversational turn-taking to unlock it. This is essential because it is easy for differences in views to be lost within a team setting that is dominated by a few individuals who think similarly.

When there is a failure to harness the true diverse thinking of different people, everyone loses.

HOW TO ACHIEVE COGNITIVE DIVERSITY AND INCLUSIVITY

Cognitive diversity is all around us, but you have to look out for it. When you are faced with a complex business challenge, and everyone agrees with you on what to do, find someone who disagrees and ***actively*** make an effort to understand their viewpoint. I know firsthand that this is really hard – we all prefer the comfort of being surrounded by our own echo chambers. But, the evolution and robustness of your thinking improves significantly when considering different views, and the end result is far better than your initial thoughts.

At Coronation, we encourage robust debate. We know how important it is to give everyone a voice and to enable them to be

[1] Harvard Business Review 30 March 2017

themselves. And we know that this alone is not enough. We actively promote communications or interactions where those views are truly heard and the individuals expressing minority views are celebrated for thinking differently. It makes for richer and deeper analysis, and, ultimately, better outcomes for our clients.

But to achieve this, one must take deliberate action. Start with the right tone at the top and ensure that progress is being made at every level of the organisation. Make it clear that not only diversity but also inclusion is a business necessity and not just a human resources target. It needs a long-term plan and commitment in order to become entrenched in the culture.

Mentoring talent

A good way to encourage cognitive diversity and an inclusive environment is to establish mentoring programmes within the business. Giving advice as someone with experience and expertise can help others along their own path. My mentoring programme for high school learners who receive a Coronation bursary and Coronation's Lean In initiative for employees are just two examples of how we provide a safe and supportive space for participants to learn and grow. We become stronger by leveraging our mix of capabilities, skills and personalities, and we intentionally seek to maximise our collective intelligence through cognitive diversity. In an industry where you are only as good as the people you employ, it gives you a competitive edge when you enable that group of people to collaborate seamlessly and to bring out everyone's best.

I am personally proud of our distinctive and inclusive culture, which has evolved (and continues to evolve) since our launch over 25 years ago, and it would be encouraging to see inclusivity and diversity accelerated across the industry. Anyone with the appropriate skills and qualifications should feel that they belong in asset management. No-one should avoid pursuing a career in the industry because of their background or upbringing. The outdated thinking epitomised by the age-old question, "Where did you go to school?" is out of step with our industry which, like the rest of the world, is changing fast. Companies can only survive if they inherently understand their clients, deliver on what they promise, and act to stay relevant.

Celebrating the contribution of a minority view

As mentioned earlier, an important aspect of achieving cognitive diversity is the psychological safety produced by an inclusive culture. How to get this right varies by organisation, but most often it includes the following two important elements:

1. Creating a discussion framework where people, motivated by the genuine fear of missing important perspectives, look at differing views as an opportunity for all to learn more about a situation.

2. Ensuring that the organisation's culture celebrates the person giving rise to the minority view rather than punishing or alienating them. Let's face it, human beings are social characters and we all have a profound need to be accepted. Celebrating differing views elevates the perception around this and should encourage a greater confidence among others to do the same.

Building a strategy for the future

Management consulting firm *McKinsey*'s latest study on diversity in the workplace, 'Delivering through diversity', reiterates the positive relationship between a company's level of diversity and financial outperformance, and recommends how to develop more effective Diversity and Inclusion (D&I) Strategies (whether these are stand-alone policies or part of the company's cultural vision) as a source of competitive advantage. One needs to be mindful that groups of people in companies responsible for implementing D&I policies are themselves representative of a broader grouping – otherwise you are running the risk of merely institutionalising their individual biases.

The research shows that the success factors of top-performing companies include having a strong, sustained and inclusive leadership who are committed for the long term and who ensure that the strategy reflects their own unique company ethos and business-growth drivers.

CONCLUSION

Companies can empower themselves beyond creating a demographically diverse workforce by creating a cognitively diverse and inclusive environment. A willingness to openly recognise and tackle bias is at the heart of all recommendations. When people choose to ignore bias or deny that it exists, they keep seeking out colleagues and business partners, team members and employees who share their traits, and they miss out on the quantifiable benefits of diversity. Implementing a well-planned and long-term D&I Strategy is the key.

From personal experience, I know that you do not need to conform to a stereotype to fit in. Own and celebrate your differences and the value they bring to your area of work. Both you and your organisation will reap the rewards. ✚

Flagship fund update

INVESTOR NEED: LONG-TERM GROWTH

Domestic general equity funds

Top 20 and Equity

After a torrid 2018, in which global and local capital markets collapsed, we saw a complete reversal in the first quarter of 2019 (Q1-19), with very strong returns from all capital markets. Against this backdrop, our Top 20 and Equity funds enjoyed a good start to the year, returning 10.2% and 10.7% respectively in Q1-19. These funds' longer-term performance remains compelling, delivering annualised alpha of 3.8% and 2.6% since their respective launch dates.

Top 20 is a concentrated portfolio of locally listed shares only, while Equity is more diversified, with 80% invested locally and 20% in offshore shares.

Both funds benefited from strong performance by the mining sector over the quarter, particularly that of platinum group metals (PGMs), as well as being underweight domestic-facing South African stocks. The latter came under significant pressure over the period as the realities of operating in a no-growth economic environment filtered through into corporate earnings.

In Coronation Equity, the fund's large exposure to global equities contributed to its performance over Q1-19 and the past 12 months, with a very strong performance from Airbus.

After a long and frustrating wait, PGM shares have finally started to rally strongly, with fund holdings such as Northam Platinum (+47%), Anglo American Platinum (+38%), Impala Platinum (+66%) and our position in the Palladium Exchange-Traded Fund (ETF) (+12% in US dollars) all contributing meaningfully to returns for the quarter. We feel that this is a good example of our disciplined, long-term approach to investing in action, where our aim is to assess information objectively and dispassionately and to avoid being swayed by the news and sentiment of the day. (You can read more about this on page 12.)

Naspers, a major holding in both funds, added 19% over Q1-19, benefiting from a strong recovery in the Tencent share price as sentiment towards China shifted positively on the back of reduced trade war fears and Chinese authorities resuming the online gaming licensing approval process. Naspers also surprised the market in March by announcing the offshore listing and part unbundling of its offshore internet portfolio (i.e. Tencent, Mail.ru, OLX, its food delivery businesses, et al.) to reduce the discount at which it trades relative to its underlying intrinsic value. While this is certainly no 'silver bullet' that will immediately remove the entire discount, we nevertheless view it as a marginally positive step in the evolution of the group into a global consumer internet powerhouse and one that will allow it access to a wider investor base.

The share price of another major holding in both funds, British American Tobacco, recovered strongly in Q1-19 (+27%) on the back of good results which allayed market fears around US volume declines, the company's debt levels and the outlook for its next-generation products. It also appears that investor anxiety about the regulatory headwinds facing its US business is abating and sentiment is finally starting to turn positive on the share. Notwithstanding this short-term price rally, British American Tobacco continues to trade on only 9.5 times one-year forward earnings and a 7% dividend yield, which we regard as very attractive for a share of this quality.

Quilter, another holding of both funds, also performed very well over the period (+28%) as its maiden full-year results materially exceeded market expectations. The long-term outlook for UK-focused integrated wealth managers with advice forces at scale remains very attractive. This positive outlook is driven by a decline in advisers following the UK's adoption of the Retail Distribution Review, 'pension freedom' boosting demand for advice and opening up the post-retirement market to wealth managers, and a shift away from defined benefit funds to defined contribution funds.

Notwithstanding the uncertainties that abound, we are comfortable with the current portfolio positioning of both funds and remain positive about future return prospects. We remain focused on valuation and will seek to take advantage of attractive opportunities the market may present to us, and in so doing generate inflation-beating returns for our investors over the long term.

Multi-asset class funds

Balanced Plus and Market Plus

The Balanced Plus and Market Plus funds too had been well positioned to benefit from the bounce-back in domestic and global equity markets, delivering returns of 8.5% and 8.6% respectively in Q1-19. Since inception, the funds delivered annualised alpha of 1.2% and 1.9% respectively.

The MSCI All Country World Index ended the quarter up 12.2% in US dollar terms, despite the deteriorating macroeconomic environment in which central banks have become meaningfully more dovish than they were late last year. Developed equity markets, and in particular the US, performed strongly and recorded their best quarter in nearly 20 years. The funds have benefited from their large exposure to global equities and their overweight positions in emerging market equities contributed meaningfully to performance during the quarter. We have retained this overweight position in emerging markets, as the more accommodative monetary stance in the US is supportive of emerging market equity performance and currencies. While the start to the year has been strong, we continue to find opportunities in these markets that are very cheap, with good underlying growth prospects.

South African equity markets also delivered a pleasing recovery in Q1-19, though not to the same extent as global markets. The impacts of Eskom's rolling blackouts and a poor consumer environment have continued to weigh on local businesses, resulting in a swathe of profit warnings in the quarter, reducing some of the potential market returns. Fortunately, we have avoided owning most of those companies that are struggling, and our portfolios, which are overweight resources companies and global businesses, performed well ahead of the market.

While valuations for local businesses have come down significantly over the past few years as growth has severely disappointed, we are cautious about adding too much exposure here. The growth outlook remains anaemic and the prospects of a pick-up in consumer spending is poor, given a lack of job creation, renewed fiscal discipline at government level, and above-inflationary increases in administered prices and fuel.

We have not made significant changes to our fixed-income positioning. Our domestic property exposure has declined at the margin as we have reduced some of our positions. While yields are still attractive, the environment for property remains challenged, especially in light of the Edcon restructure announcement this quarter, which saw landlords having to forego half their rent for two years.

On the international front, we have continued to avoid fixed income, given no prospect of real returns, but kept up a reasonable exposure to European property that trades on attractive yields relative to bonds.

All in, the funds have made a pleasing recovery this quarter, and are well positioned and exposed to sound portfolios of assets that will drive future returns in line with their mandates of delivering real capital growth over the medium to long term.

INVESTOR NEED: INCOME AND GROWTH

Capital Plus and Balanced Defensive

Despite a more cautious growth outlook, Capital Plus and Balanced Defensive continued to hold large positions, mostly in fixed income, in domestic assets over Q1-19. While bonds have reacted positively to Moody's decision not to change its credit outlook at the end of March, we think this is a stay of execution rather than an absolute pardon. While the risk of a downgrade may still re-emerge in the coming months, for now the real yields on our portfolio of fixed-income assets remain attractive, given a benign inflation outlook.

We have kept our South African equity exposure fairly constant in both portfolios, with a high weighting to rand-hedge shares. Some of the funds' large equity positions, such as British American Tobacco and MTN posted robust recoveries after delivering good financial results. Resource counters in particular have had a big re-rating, and we took the opportunity of share price strength to sell out of our Anglo American Platinum position. We have also taken up select small exposures to domestically focused defensive businesses. While we are cautious about the South African growth outlook, our investment discipline is to focus on valuations. If an attractive opportunity presents itself at the right price, we will act accordingly.

>

South African property shares have continued to deliver a lacklustre performance. Landlords have now finalised an agreement to support Edcon, either via rental reduction or with a recapitalisation. These actions will result in muted distribution growth going forward. While yields are looking reasonable, we have chosen to largely maintain our exposure to domestic property.

At the start of the year, the two funds' international exposure was relatively low at 22.5% (Capital Plus) and 17% (Balanced Defensive). We bought currency futures to take advantage of attractive exchange rates and exposure now sits at 25.0% (Capital Plus) and 23.9% (Balanced Defensive). Our offshore exposure is still mainly allocated to global equities, and all of the underlying international investments have delivered good alpha in the last quarter, further assisted by rand weakness.

In summary, the funds have had an encouraging start to the year. Over the last 12 months, both portfolios have managed to beat inflation and Balanced Defensive also ended the period ahead of its real return benchmarks. While the ongoing global uncertainties create much volatility and can result in a range of positive or adverse growth outcomes, our unwavering focus is to build diversified portfolios that can absorb unanticipated shocks.

INVESTOR NEED: IMMEDIATE INCOME

Strategic Income

The fund returned 2.5% in Q1-19, bringing its total return for the 12-month period to 7.9%. This return is ahead of that delivered by cash (6.9%) and its benchmark (7.6%) over the same one-year period.

Globally, there has been a complete U-turn by central banks on monetary policy normalisation, leading to an inversion of the US yield curve, which has stoked concerns of an imminent US recession, not to mention the continuing uncertainty about the outcome of US-China trade negotiations and total paralysis surrounding the Brexit process.

Locally, emotions have been running high over Q1-19. The Zondo Commission continues to reveal shocking details of alleged corruption in government and its associated institutions. Evidence strongly suggests that years of mismanagement and looting are now resulting in the intensification of load shedding, contributing to an already sombre mood locally. Consumers and corporates have continued to tighten their belts, deepening concerns of continued low growth in South Africa.

The rand was down 1% over Q1-19, ending at 14.40 to the US dollar. Sentiment towards South Africa continues to swing with emerging market sentiment. The fund maintains a small exposure to offshore assets and, when valuations are stretched, it will hedge/unhedge portions of its exposure back into rands/US dollars by selling/buying JSE-traded currency futures (US dollar, UK pound and euro).

The sustainability of South Africa's investment-grade rating remains a key concern. Credible monetary policy has caused inflation and inflation expectations to gravitate towards the midpoint of the band (4.5%), yet it remains adequately accommodative given the subdued growth profile. Growth, or the lack thereof, remains at the core of the country's structural problems. Cyclically, growth should pick up to approximately 1.3% in 2019 and 1.8% in 2020. However, the risk to this outcome is to the downside, given the threat of load shedding, the effect it has on business and consumer confidence, and how rising electricity-related costs affect corporate profitability. Unfortunately, given Eskom's precarious financial and operational position, the state-owned enterprise still poses immense risk to both the fiscus and the economy. (Refer to our analysis and investment impact of the Eskom issue on pages 6 to 11.)

The spreads of floating-rate non-convertible debentures (NCDs) have dulled in appeal over the last few quarters because of a compression in credit spreads. This is due to the reduced need for funding from banks in South Africa, given the low-growth environment. Fixed-rate NCDs continue to hold appeal because of the inherent protection offered by their yields and relative to our expectations for a stable repo rate. However, credit spreads remain in expensive territory (less than 100 basis points [bps] in the three-year area and 110 bps in the five-year area). The fund continues to hold decent exposure to these instruments (less floating than fixed) and we will remain cautious and selective when increasing exposure. NCDs have the added benefit of being liquid, thus aligning the liquidity of the fund with the needs of its investors.

Inflation should remain under control, allowing policy rates to remain stable. Global monetary policy has once again turned more supportive for risk sentiment, which should help buoy emerging market valuations over the shorter term. At current levels, local government bonds are trading cheap to fair value estimates. However, given the longer-term risks posed to the economy from further SOE deterioration, allocations are kept at a neutral level. While nominal bonds continue to compare favourably to inflation-linked bonds (ILBs), the balance in the front end of the curve has shifted towards ILBs.

The local listed property sector was up 1.3% over Q1-19, bringing its return for the rolling 12-month period to -7%. Listed property has been the largest drag on the fund, primarily due to generalised equity weakness and idiosyncratic domestic issues related to the possible closure of Edcon, its impact on the broader property sector and lower real GDP growth. However, from an income perspective, distribution growth and expectations around future distribution growth remain sound. Despite the underperformance, from a valuation perspective, the sector is very attractive. The fund maintains holdings in counters that offer strong distribution and income growth, with upside to their net asset value. In the event of a moderation in listed property valuations (which may be triggered by further risk asset or bond market weakness), we will look to increase the fund's exposure to this sector at more attractive levels.

We believe that the fund's current cautious positioning correctly reflects appropriate levels of caution. The fund's yield of 8.9% remains attractive relative to its duration risk. We continue to believe that this yield is an adequate proxy for expected fund performance over the next 12 months.

INVESTOR NEED: OFFSHORE DIVERSIFICATION

Global Managed

No sooner had the dust settled on 2018 than global investors changed their focus from recessionary fears to the more dovish commentary from both the US and European central banks in response to the weaker global economic outlook. Expectations around future interest rate moves re-priced significantly, with investors now expecting the next move to be a decline in short rates in the US. We continue to hold a slightly more hawkish view with regards to interest rates and believe the market has become too complacent about inflationary pressures as well as interest rates. Long bonds rallied, with 10-year Treasuries now trading around 2.5% after touching 3.2% in Q4-18.

Global equities performed well, almost fully erasing the declines of Q4-18, with the MSCI All Country World Index returning 12.2% over the quarter (Q1-19). As a result, the lagging 12-month performance has turned positive again, achieving 2.6%. The US outperformed Europe by about 3% over Q1-19 and by 12.5% over the last year. Japan was a notable laggard over these periods, returning 6.6% over Q1-19, and negative 7.6% over the last year. Emerging markets (as measured by the MSCI Emerging Markets Index) also underperformed their developed market peers by generating 9.9% over Q1-19 and negative 7.4% over the year. China bounced back strongly, as would have been expected given the slightly improved macroeconomic backdrop, but still performed poorly over the last 12 months. Information technology was the best-performing sector, given the reduced long-term discount rate, while interest rate-sensitive sectors such as real estate and consumer discretionary also did well. Energy rebounded on the back of the stronger oil price. Healthcare and financials were the laggards, with financials suffering from the flattening of, and drop in, the yield curve.

Surprisingly, the US dollar also strengthened by 2.2% against the euro and by 1.1% against the yen, contributing to the underperformance of the other regions. Gold was marginally positive over Q1-19.

As alluded to above, global bonds (as measured by the Bloomberg Barclays Global Aggregate Bond Index) had a good quarter, producing a positive return of 2.2% despite the stronger US dollar suppressing non-US asset returns. Over the last 12 months though, the total return for global bonds was still marginally negative. Global listed property performed well against the more benign outlook for interest rates, returning almost 15% over Q1-19. All regions were strong, led by the US, although Japan again lagged the rest of the world. Retail property stocks rebounded from their oversold levels.

The fund had a strong quarter, generating alpha of 3.1% and a fund return of 11.2% in US dollar, the best performance in absolute terms since its inception and close to the best performance on a relative basis. Over the last one, three and five years, the fund is now marginally behind its benchmark.

While we increased the fund's equity exposure over Q1-19, we averaged an equity exposure of 60% so far this year, thus not fully benefiting from the sharp bounce in equity prices. Our property exposure, while lagging the overall property index returns, still contributed strongly to the good performance. Our fixed interest component was very conservatively positioned, thus not participating in the downward move in long bonds. Over the last 12 months the major detractors were our UK property holdings.

Within equities, it was pleasing that some of our detractors in previous quarters turned around strongly in Q1-19 to contribute to performance. British American Tobacco was the biggest contributor, followed by Altice USA, which has re-rated on slightly better than expected results and rumours of an asset sale that will help the company de-lever quicker than expected. Airbus continued to perform well, aided of late by the misfortunes of its biggest competitor, Boeing. Philip Morris, Charter Communications and Pershing Square Holdings (Pershing) also materially added to the fund's outperformance.

Pershing is a stock we have held in the portfolio for a long time. We received some questions about this holding, as it represents an investment into a fund that is actively managed by Bill Ackman, an activist investment manager with a great track record, until a few years ago. The fund is a permanent capital vehicle with a relatively high fee structure. This means that unless Ackman performs very well, the fund will tend to perform worse than the market after fees. At the time of investing, Ackman's fortunes have turned for the worse, following some high-profile disasters, such as investing in Valeant Pharmaceuticals and shorting Herbalife. We bought into the fund, which consists only of listed equities, at a discount to net asset value (NAV) of about 15% to 20%.

Interventions by Ackman since we established our holding included buying back 10% of the fund at a 15% discount to NAV and investing another 10% into the fund in his personal capacity. Over the last 12 to 18 months, his fortunes started changing materially, to the extent that the fund has outperformed the Standard and Poor's (S&P) 500 Index by more than 20% over this time. Investors have continued to remain on the sidelines though, as is evidenced by the current discount to NAV of 27%. We believe this level of discount is unsustainable, and that a number of alternative actions could help realise some or all of this value. In all of these outcomes, investors will benefit substantially. At the same time though, we have reduced exposure to the stock somewhat, as we are worried that the asset values are now at challengingly high levels. This experience has again highlighted the benefit of taking a longer-term investment view. While these high-conviction ideas do not always work out as well as Pershing, we will continue to look for ideas across the investment spectrum, in both conventional and unconventional sectors and circumstances.

We have somewhat reduced both our equity and listed-property exposure into the rally, and hence the fund is marginally conservatively positioned. While equity valuations are not high, we remain circumspect regarding US interest rates while also keeping an eye on geopolitical developments. +

For more information, please refer to the fund fact sheets available on www.coronation.com

Domestic flagship fund range

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

INVESTOR NEED

	INCOME ONLY	INCOME AND GROWTH		LONG-TERM CAPITAL GROWTH	
FUND	**STRATEGIC INCOME** Cash†	**BALANCED DEFENSIVE** Inflation†	**CAPITAL PLUS** Inflation†	**BALANCED PLUS** Composite benchmark† (equities, bonds and cash)	**TOP 20** FTSE/JSE 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] ● INCOME ● GROWTH	94.8% 5.2%	58.6% 41.4%	41.9% 58.1%	20% 80%	0% 100%
LAUNCH DATE	Jul 2001	Feb 2007	Jul 2001	Apr 1996	Oct 2000
ANNUAL RETURN[2] (Since launch)	10.3% 7.7%†	9.5% 6.0%†	11.8% 5.9%†	14.4% 13.1%†	17.6% 13.8%†
QUARTILE RANK (Since launch)	1st	1st	1st	1st	1st
ANNUAL RETURN (Last 10 years)	9.1% 6.3%†	10.3% 5.2%†	9.7% 5.2%†	12.5% 13.0%†	14.3% 13.6%†
STANDARD DEVIATION (Last 10 years)	1.4% 0.3%†	4.1% 1.3%†	5.7% 1.3%†	8.1% 8.0%†	13.2% 13.0%†
FUND HIGHLIGHTS	Outperformed cash by 1.6% p.a. over the past 5 years and 2.5% p.a. since launch in 2001.	Outperformed inflation by 3.5% p.a. (after fees) since launch, while producing positive returns over all 12-month periods.	Outperformed inflation by 6.0% p.a. (after fees) since launch, while producing positive returns over 24 months more than 99% of the time.	No. 1 balanced fund in South Africa since launch in 1996, outperforming its average competitor by 2.0% p.a. Outperformed inflation by on average 8.0% p.a. since launch and outperformed the ALSI on average by 1.1% p.a (since launch).	The fund added 3.8% p.a. to the return of the market. This means R100 000 invested in Top 20 at launch in October 2000 grew to more than R1.9 million by end March 2019 – 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 2019. Growth assets defined as equities, listed property and commodities (excluding gold).*

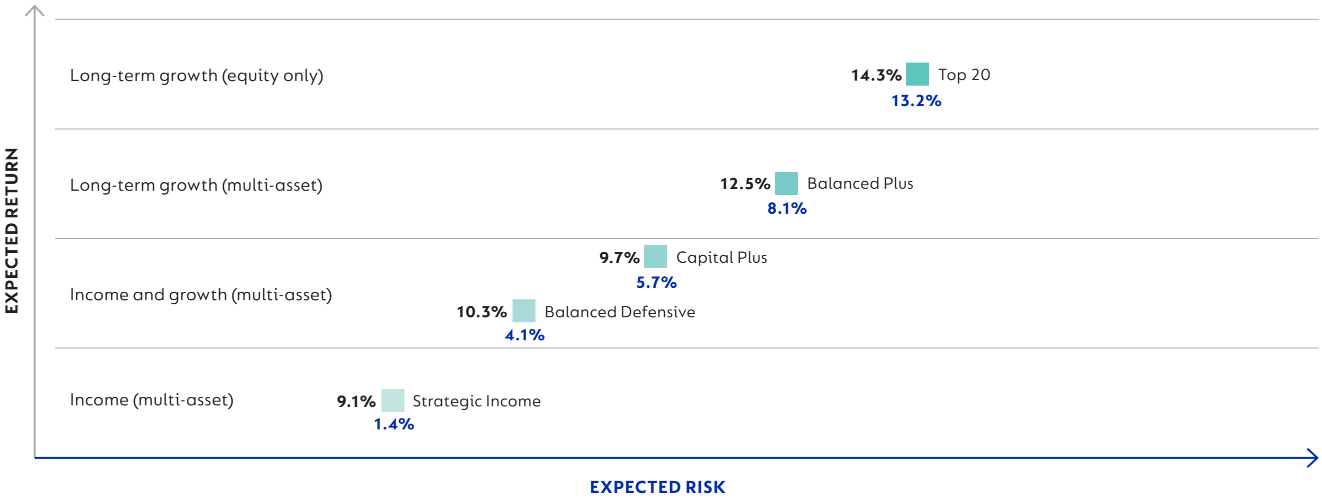
2 *Highest annual return*
Balanced Defensive: 21.2% (Jun 2012 - May 2013); Balanced Plus: 49.3% (Aug 2004 - Jul 2005); Capital Plus: 33.8% (Aug 2004 - Jul 2005); Strategic Income: 18.7% (Nov 2002 - Oct 2003); Top 20: 68.9% (May 2005 - Apr 2006)

Lowest annual return
Balanced Defensive: 0.5% (Dec 2017 - Nov 2018) ; Balanced Plus: -17.4% (Sep 1997 - Aug 1998); Capital Plus: - 6.2% (Nov 2007 – Oct 2008); Strategic Income: 2.6% (Jun 2007 – May 2008); Top 20: -31.7% (May 2002 – Apr 2003)

Figures are quoted from Morningstar as at 31 March 2019 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

RISK VERSUS RETURN

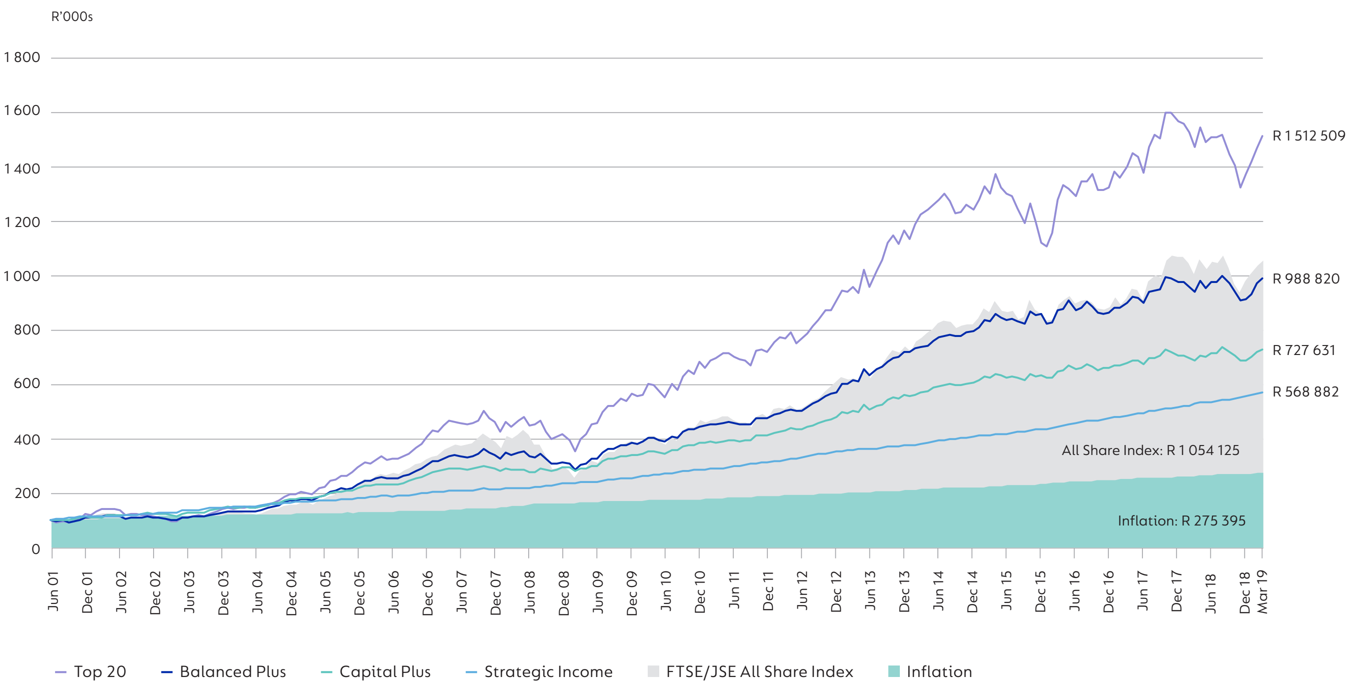
10-year annualised return and risk (standard deviation) quoted as at 31 March 2019.
Figures quoted in ZAR after all income reinvested and all costs deducted.



Source: Morningstar

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

Value of R100 000 invested in Coronation's domestic flagship funds since inception of Capital Plus on 2 July 2001 as at 31 March 2019. All income reinvested for funds; FTSE/JSE All Share Index is on a total return basis. Balanced Defensive is excluded as it was only launched on 1 February 2007.



Source: Morningstar

International flagship fund range

INVESTOR NEED

	DEPOSIT ALTERNATIVE	CAPITAL PRESERVATION	LONG-TERM CAPITAL GROWTH (MULTI-ASSET)	LONG-TERM CAPITAL GROWTH (EQUITY ONLY)	
FUND[1]	**GLOBAL STRATEGIC USD INCOME** US dollar cash (3 Month Libor)†	**GLOBAL CAPITAL PLUS** US dollar cash (3 Month Libor)†	**GLOBAL MANAGED** Composite (equities and bonds)†	**GLOBAL OPPORTUNITIES EQUITY** MSCI ACWI†	**GLOBAL EMERGING MARKETS** 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] ● INCOME ● GROWTH	97.4% 2.6%	39.9% 60.1%	31.8% 68.2%	0.5% 99.5%	4.0% 96.0%
LAUNCH DATE OF OLDEST FUND	Dec 2011	Nov 2008	Oct 2009	Aug 1997	Dec 2007
ANNUAL RETURN[3] (Since launch)	2.5% 0.9%†	5.0% 0.8%†	6.1% 6.5%†	6.6% 5.9%†	2.7% 1.2%†
QUARTILE RANK (Since launch)	–	1st	1st	–	1st
ANNUAL RETURN[3] (Last 5 years)	1.4% 1.1%	1.5% 1.1%	2.5% 4.6%	5.3% 7.0%	0.7% 3.8%
ANNUAL RETURN[3] (Last 10 years)	–	5.3% 0.7%	–	10.5% 12.8%	9.6% 9.2%
QUARTILE RANK (Last 5 years)	–	1st	2nd	–	4th
FUND HIGHLIGHTS	Outperformed US Dollar cash by 1.6% p.a (after fees) since launch in December 2011.	The fund has outperformed US Dollar cash by 4.2% p.a. (after fees) since launch in 2008.	No. 1 global multi-asset high equity fund in South Africa 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 1.7% p.a. since their respective launch dates.

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

2 *Income versus growth assets as at 31 March 2019 (for US dollar funds). Growth assets defined as equities, listed property and commodities (excluding gold).*

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

Highest annual return
Global Strategic USD Income: 7.1% (Jan 2012 - Dec 2012); Global Capital Plus [ZAR] Feeder: 31.4% (Mar 2009 - Feb 2010); Global Managed [ZAR] Feeder: 23.1% (Jul 2010 - Jun 2011); Global Emerging Markets Flexible [ZAR]: 96.0% (Mar 2009 - Feb 2010); Global Opportunities Equity [ZAR] Feeder: 56.9% (Apr 1999 - Mar 2000)

Lowest annual return
Global Strategic USD Income: -1.0% (Mar 2015 -Feb 2016); Global Capital Plus [ZAR] Feeder:-7.0% (Mar 2015 - Feb 2016); Global Managed [ZAR] Feeder: -14.9% (Mar 2015 - Feb 2016); Global Emerging Markets Flexible [ZAR]: -51.9% (Mar 2008 - Feb 2009); Global Opportunities Equity [ZAR] Feeder: -41.3% (Mar 2008 - Feb 2009)

Figures are quoted from Morningstar as at 31 March 2019 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

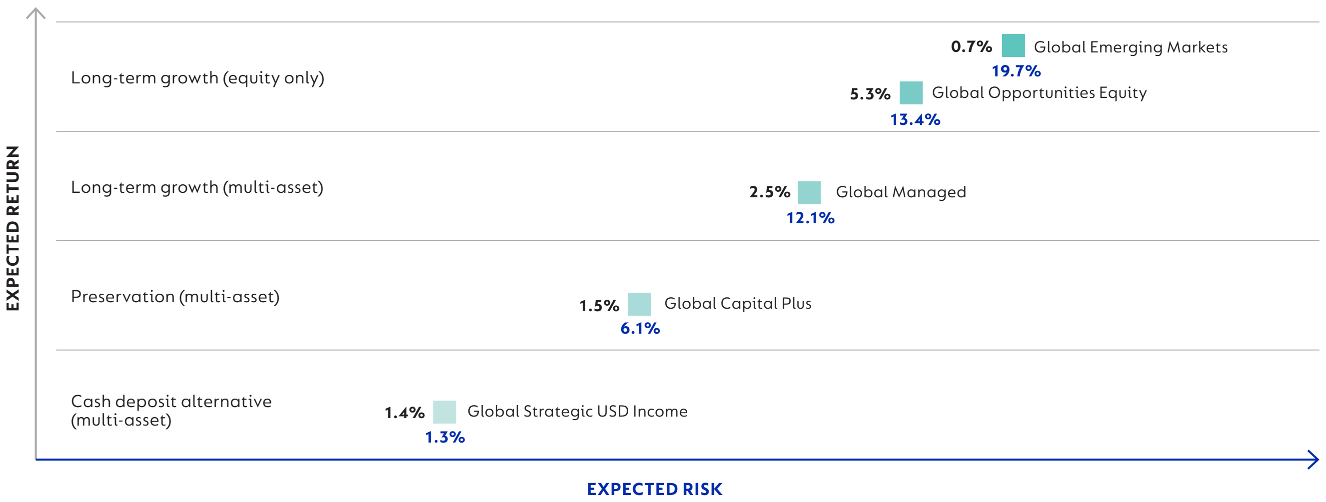
HAVE YOU CONSIDERED EXTERNALISING RANDS? IT IS EASIER THAN YOU MIGHT THINK.

The South African Reserve Bank allows each resident South African 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 the South African Revenue Service 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

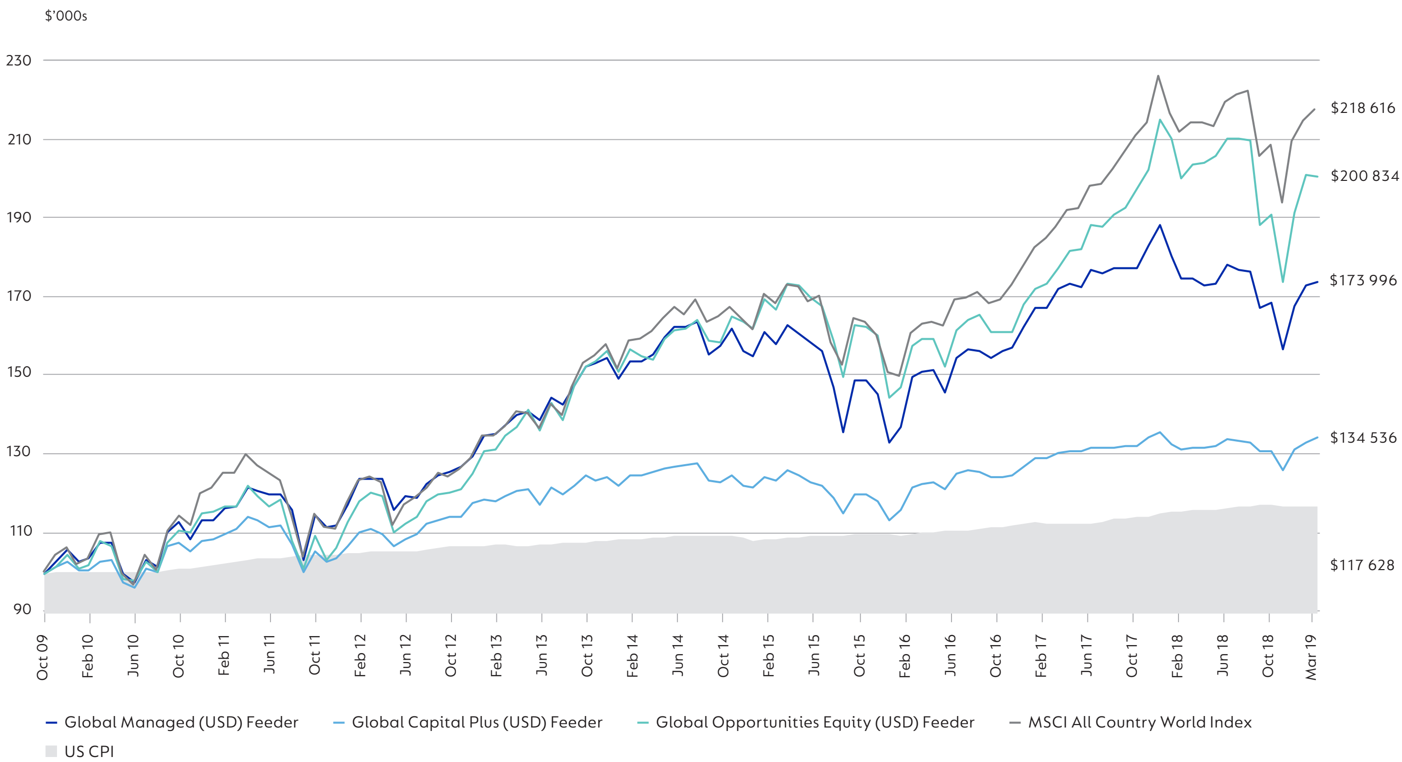
5-year annualised return and risk (standard deviation) quoted as at 31 March 2019. Figures quoted in USD (for the oldest fund) after all income reinvested and all costs deducted.



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, Global Capital Plus [ZAR] Feeder and Global Opportunities Equity [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.



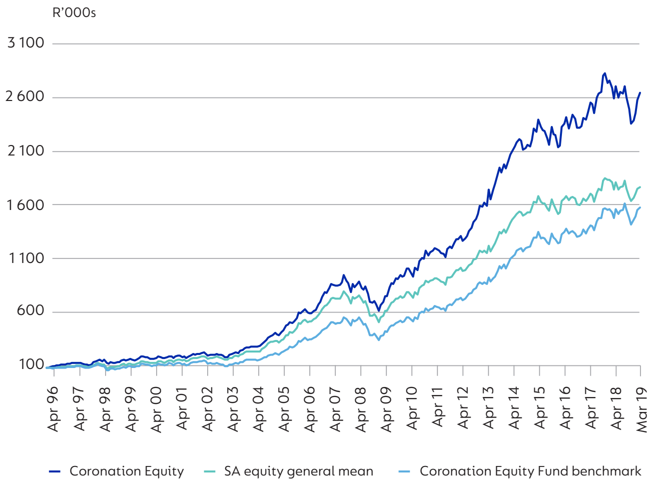
Source: Morningstar

Long-term investment track record

CORONATION EQUITY RETURNS VS EQUITY BENCHMARK

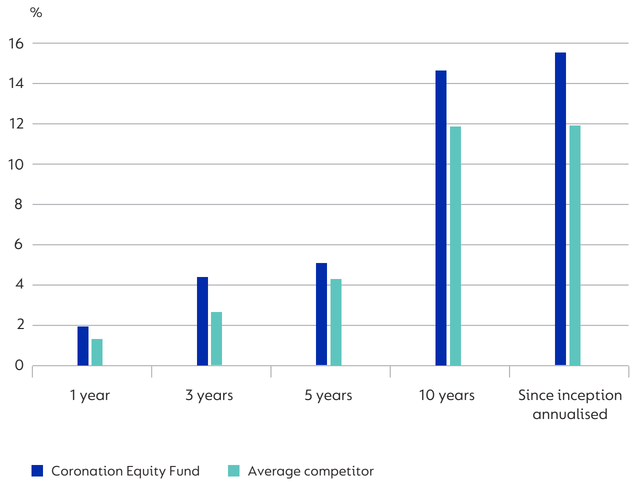
10-YEAR ANNUALISED RETURNS	CORONATION EQUITY	AVERAGE COMPETITOR	OUTPERFORMANCE OF AVERAGE COMPETITOR
2006	19.38%	17.09%	2.30%
2007	21.45%	19.23%	2.22%
2008	17.62%	18.47%	(0.84%)
2009	16.53%	16.68%	(0.15%)
2010	19.59%	19.14%	0.45%
2011	18.03%	16.98%	1.05%
2012	21.12%	18.94%	2.19%
2013	21.60%	18.68%	2.92%
2014	18.44%	16.32%	2.12%
2015	14.86%	12.62%	2.24%
2016	11.95%	9.54%	2.41%
2017	11.99%	8.90%	3.09%
2018	12.77%	10.54%	2.23%
9 years 3 months to March 2019	11.62%	9.25%	2.38%
ANNUALISED TO 31 MARCH 2019	**CORONATION EQUITY**	**AVERAGE COMPETITOR**	**ALPHA**
1 year	1.90%	1.29%	0.62%
3 years	4.35%	2.60%	1.74%
5 years	5.01%	4.25%	0.76%
10 years	14.51%	11.89%	2.62%
Since inception in April 1996 annualised	15.36%	11.79%	3.57%
Average outperformance per 10-year return			1.76%
Number of 10-year periods outperformed			12.00
Number of 10-year periods underperformed			2.00

CUMULATIVE PERFORMANCE



Source: Morningstar

ANNUALISED RETURNS TO 31 MARCH 2019



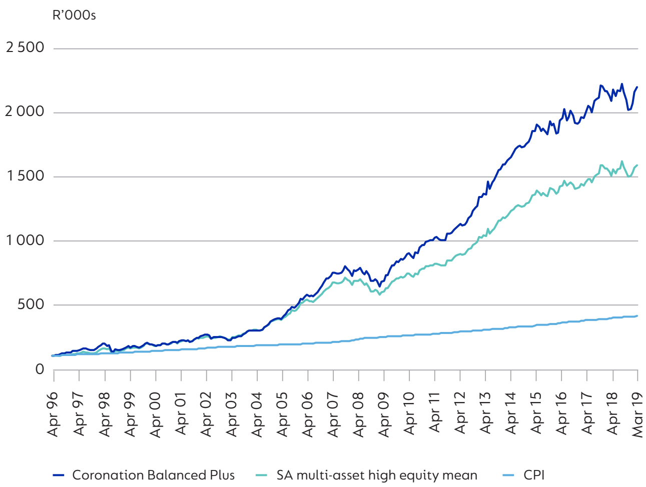
Source: Morningstar

An investment of R100 000 in Coronation Equity on 15 April 1996 would have grown to **R2 641 942** by 31 March 2019. By comparison, the returns generated by the fund's benchmark over the same period would have grown a similar investment to **R1 578 962**, while the South African equity general sector would have grown a similar investment to **R1 767 402**.

CORONATION BALANCED PLUS FUND VS INFLATION AND AVERAGE COMPETITOR*

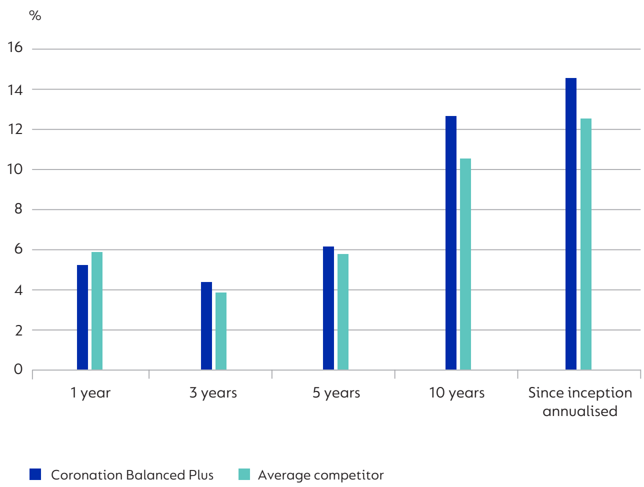
10-YEAR ANNUALISED RETURNS	CORONATION BALANCED PLUS	INFLATION	REAL RETURN
2006	18.33%	6.47%	11.86%
2007	17.81%	6.59%	11.22%
2008	16.96%	6.87%	10.09%
2009	15.69%	6.75%	8.94%
2010	17.20%	6.28%	10.93%
2011	15.78%	6.24%	9.54%
2012	17.85%	5.76%	12.09%
2013	18.63%	5.90%	12.73%
2014	16.58%	6.00%	10.57%
2015	14.01%	6.12%	7.89%
2016	11.08%	6.30%	4.77%
2017	11.04%	5.92%	5.12%
2018	11.26%	5.34%	5.92%
9 years 3 months to March 2019	10.71%	5.29%	5.43%
ANNUALISED TO 31 MARCH 2019	**CORONATION BALANCED PLUS**	**AVERAGE COMPETITOR**	**ALPHA**
1 year	5.18%	5.83%	(0.65%)
3 years	4.32%	3.80%	0.52%
5 years	6.10%	5.72%	0.38%
10 years	12.50%	10.41%	2.09%
Since inception in April 1996 annualised	14.38%	12.38%	2.00%
Average 10-year real return			9.08%
Number of 10-year periods where the real return is >10%			7.00
Number of 10-year periods where the real return is 5% - 10%			6.00
Number of 10-year periods where the real return is 0% - 5%			1.00

CUMULATIVE PERFORMANCE



Source: Morningstar

ANNUALISED RETURNS TO 31 MARCH 2019



Source: Morningstar

An investment of R100 000 in Coronation Balanced Plus on 15 April 1996 would have grown to **R2 171 579** by 31 March 2019. By comparison, the South African multi-asset high-equity sector over the same period would have grown a similar investment to **R1 569 685**.

** 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.*