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Notes from my inbox

"Uncertainty is the only certainty there is. Knowing how to live with insecurity is the only security." – Mathematician John Allen Paulos

By **PIETER KOEKEMOER**

Pieter is Head of Personal Investments

HUMAN BEINGS ABHOR uncertainty. In a recent study, subjects played a computer game where they received an electric shock if they overturned a rock with a snake underneath. The researchers varied the probability of encountering the unpleasant outcome when overturning a specific rock over time, making it alternately easier or harder to predict where the snakes are. They found that stress levels peaked when the sequence was random and the player just did not know what was coming next, which they equated to irreducible uncertainty. Study participants were much more agitated when they did not know what was coming than when the level of shocks incurred was higher, but more predictable.

This outcome has a lot to do with how we are wired. The striatum, an ancient part of the brain, combines two core functions. It is responsible for taking action, as it controls movement and other aspects of cognition. It is also linked to a dopamine-rich part of the mid-brain and as a result is often referred to as the brain's reward centre. While dopamine is proven to cause pleasurable sensations, it is also a precursor to adrenaline, which in turn exists to provide us temporarily with more clarity and energy to deal with life-or-death situations. The striatum effectively anticipates good and bad outcomes and creates most stress if the outcome is highly uncertain, when a quick response is most likely to make a difference to the likelihood of survival.

Unfortunately, this system becomes unhelpful if it is constantly triggered by stressors that are not life threatening and it can certainly impede successful investment decision-making. As portfolio manager Neville Chester points out on page 5, the response of many investors to the Covid-19 market shock in February and March last year was to de-risk their investment portfolios and move to cash. Given the strength of the subsequent market recovery, this was not a useful reaction.

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The magnitude of market movements over 2020 is illustrated by the performance of Top 20, our concentrated equity fund. By mid-March, when the scale of the pandemic became clear and a few days before the first hard lockdown was announced, the value of the fund declined by a third (measured from the start of 2020). Since then, its unit price increased by 68%, for a total return at the time of writing of 13.2% over the last 12 months. An investor who divested in late March would have missed the subsequent recovery, and given the very low (albeit more certain) cash returns, would still be nursing a loss of around 30%.

Craving certainty is a fool's errand when you are dealing with the future, which is by definition uncertain. Academic literature defines the excess return expected from equity markets as a risk premium, basically a reward for embracing and managing uncertainty.

A NEW YEAR, NEW RISKS AND OPPORTUNITIES

At the start of 2021, there is, as always, much uncertainty to stress about. The state of the local economy is still precarious, and government as yet has no clear path to fiscal sustainability. The pandemic caused inequality to widen further, with job losses falling more severely on low-paid, often young and female, employees in industries such as hospitality and tourism. Higher taxes on asset owners and companies will be one likely result. Supported by unprecedented levels of fiscal and monetary support, many equity markets around the world are trading at record highs. At some point the income support programmes and central bank balance sheet expansion will stop, with unclear consequences for markets. Pundits, especially in the US, are debating whether we are in bubble territory or not. Over time, inflation may make an unwelcome return. Locally, vaccine procurement and roll-out have not been handled well initially, rendering South Africa one of the worst-supplied countries in the world, which will delay the exit from pandemic-related social and economic constraints.

Yet, there are also reasons to be positive. The local economic problems are well known and reflected in asset valuations. South African government bonds pay the highest real yield available in the world's investable bond markets. Local equity valuations are very undemanding on an already severely depressed earnings base. A small change in investor confidence can lead to significant gains from current levels. Over the longer term, investors can protect themselves against pockets of overvaluation and inflation by investing in sensibly diversified portfolios built from the bottom up, based on the individual investment cases from assets sourced from around the globe. While inequality has increased, a more conventional administration in the US means more global alignment in fighting climate change and a move away from the trade war rhetoric of the Trump era. The work-from-anywhere lessons we learnt last year widen the gap between businesses that successfully embrace technology and those that do not. All these trends create an environment in which good stock-picking and portfolio construction can add significant value.

There may even be better news on the vaccine front soon. While we currently only have vaccine supply for a fraction of the population, this situation may change more quickly than generally expected. Most developed countries placed multiple advance orders for enough doses to cover two to four times their population. Some of this excess will eventually become available to the stragglers, especially as more vaccine candidates are proven to work. In addition, if the Johnson & Johnson vaccine proves to be efficacious, this may also help to accelerate domestic supply. Aspen has the contract and capacity to annually manufacture 300 million doses of this vaccine in Port Elizabeth. It is possible to imagine that some of this may become available locally later this year.

ALSO IN THIS EDITION

Marie Antelme provides a comprehensive review of the global and economic data and shares our macro outlook for 2021. Nicholas Stein provides some colour on how undemanding valuations have become in the local equity market and sets out the investment case for life insurers and, specifically, Momentum Metropolitan Holdings. Home improvement retailers were one of the beneficiaries of people spending more time at home. Danie Pretorius sets out the investment case for Home Depot and Lowe's Companies, the US market leaders in this sector. We also include Nishan Maharaj's regular bond market update, as well as detailed fund commentaries from our portfolio management team.

After two consecutive years where investors were rewarded for taking risk, we hope that it becomes a little easier for our clients to deal with the inevitable uncertainty that comes with long-term investing. We remain focused on the task of managing uncertainty on your behalf, by making sensible security selection and asset allocation decisions in our portfolios. As always, I invite you to contact us via **clientservice@coronation.com** if any aspect of our delivery to you is unsatisfactory.

Take care.

Pieter

INSIGHTS

The biggest risk is taking none

Are long-term investors positioned for the future?

By **NEVILLE CHESTER**

THE QUICK TAKE

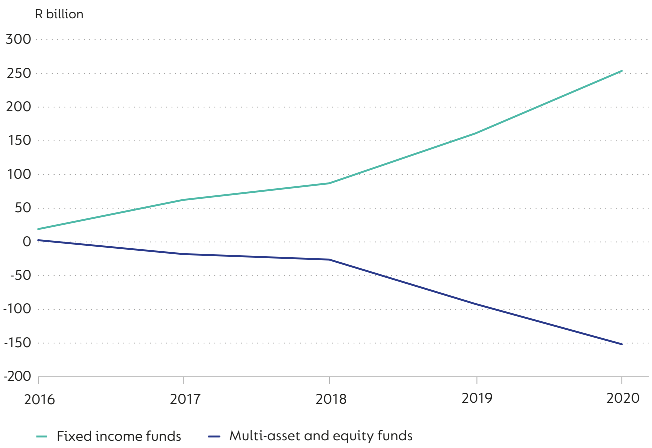
- SARB's Covid-19 policy response has shifted the outlook for asset classes
- Money market and income funds have lost their shine
- Current equity valuations trump history in a low-interest environment
- Risk assets are better positioned to achieve long-term growth

Neville is a senior portfolio manager with 24 years of investment experience.

CASH, AS THE OLD saying goes, is king. And in a local equity market where we have had a paucity of returns, cash and cash-plus funds have certainly been reigning, both in terms of returns and inflows. South Africa, one of the last few countries that has a truly independent central bank, has maintained, up until now, positive real interest rates. The South African Reserve Bank (SARB) believed that, due to South Africa's loose fiscal policy, it needed to offset this by running a very tight monetary policy. This has meant that, on a pre-tax basis, cash investors could have achieved a return ahead of the official inflation rate.

Figure 1

CUMULATIVE FLOWS OF FIXED INCOME AND MULTI-ASSET FUNDS



Sources: Morningstar, Coronation

The various cash-plus and income funds could then use some duration and opportune credit selection to add an additional 0.5% to 1.0% over and above this. For the five years up until the end of 2020, the average money market fund returned 7.1%, the average cash-plus fund 8.0% and tactical income funds 7.5%. This compares to an average domestic equity fund return of 3.2% over the equivalent period and 4.4% for the average high-equity balanced fund.

Given the lower risk profile and lower volatility of returns, it is no wonder that money market and income funds have attracted the lion's share of flows. For the past five years, R252 billion has flowed into these funds, while equity funds and multi-asset funds with exposure to growth assets have experienced outflows of R150 billion (see Figure 1). What has been surprising, however, is how this trend has continued in 2020, even though the forward-looking opportunities are now very different.

LOWER EXPECTED RETURNS

A money market fund return profile is very different from that of an equity fund. Where the return for equities can never be guaranteed and upside in any given year is effectively unlimited, in a money >

market fund you have a very good idea of what you are going to earn over the next 12 months. On the day you invest you can easily obtain the 12-month yield, and, barring any surprise interest rate moves, that is exactly what you'll earn. Further, as policy rates are adjusted by only 0.25%-0.5% at a time, potential interest rate moves are also unlikely to result in a significantly different return. And, given the low duration in money market and income funds, a decline in rates triggers little to no capital gains.

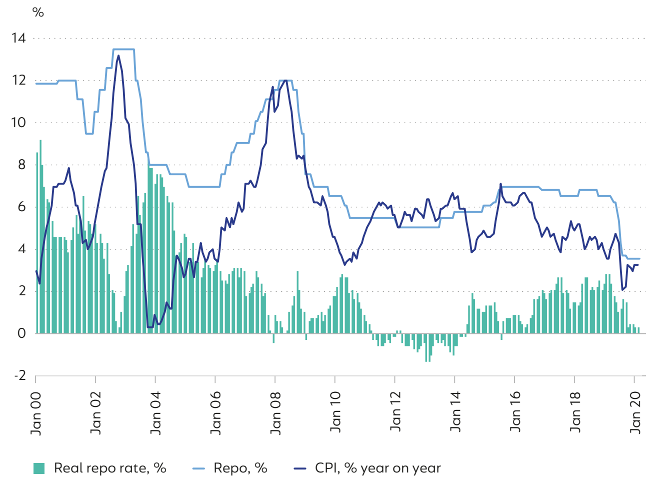
Today, given the poor state of the local economy, the potential return from money market funds and income funds is significantly different from those achieved historically. In 2020, the SARB aggressively cut interest rates to their lowest levels in 50 years. And with rolling lockdowns continuing to weigh on the economy, rates are unlikely to increase in the short term. The SARB has felt comfortable cutting rates given that official inflation is solidly positioned in the Bank's target range of 3%-6% and they have more confidence in the fiscal prudence of the current government (see Figure 2).

This has all been good news for borrowers, but, of course, very bad news for savers. With the Johannesburg Interbank Average Rate offering a yield of 3.6% at the moment, the average money market fund is going to struggle to offer investors a meaningful return. This yield is at or below official inflation (which tends to be below actual inflation), meaning that real returns will also be far worse than they have been over the past five years.

A further challenge to income funds being able to return a yield ahead of this rate is the fact that credit spreads for good quality corporates have tightened significantly over the past few years. In fact, today a good quality corporate can borrow term money at a cheaper rate than the South African government is able to, meaning the funds can actually earn a negative spread over the risk-free rate for lending to a quality company.

Figure 2

SOUTH AFRICAN INFLATION VERSUS INTEREST RATES



Sources: Statistics South Africa, South African Reserve Bank

WHERE TO FROM HERE?

This leads to the debate as to what the alternatives for investors are. In 2020, despite the immense impact of the lockdown on the economy, South African equities managed to return 7.0% for the year and proved once again how difficult it is to time equity markets based on macroeconomic factors. And, this was despite the fact that many South African companies saw their share prices declining significantly (the more South African-biased FTSE/JSE Capped Shareholder Weighted All Share Index was up only 0.6%).

Over the next several years, given the very cheap relative levels of the market, we expect equity markets to continue to deliver solid returns. While there is never guaranteed certainty in equity market returns, the balance of probabilities is firmly in favour of equities being able to beat the return that a money market fund is going to be able to achieve in the foreseeable future.

Similarly, a multi-asset fund that can allocate between equities, longer dated bonds, property and alternative assets, all of which offer meaningful return prospects, stands a far better chance of delivering a much more meaningful return than a money market fund.

In behavioural finance, it is a well-known fact that investors tend to allocate money to funds that have performed well, and away from those that have underperformed, even though there are very strong rational reasons for why they should be doing the exact opposite. Today there is a clear inflection point, and we know, with a high degree of certainty, that the potential returns from money market and income funds will be significantly lower than those achieved for the last decade.

At the same time, over the same period, equity markets have derated to the point where the dividend yields alone of most domestic equities are in excess of money market rates, and there is potential for capital appreciation over and above that.

For any investor with a long-term investment horizon, allocating funds to the safety of cash is likely to be locking in significant underperformance relative to equity and multi-asset alternatives. The implications of taxation, with capital gains and dividends taxed at a lower effective rate than interest income, will only further increase this differential. ✚

ECONOMIC COMMENT

Global outlook

Post-pandemic recovery in the balance of vaccines and a return of confidence

By **MARIE ANTELME**

THE QUICK TAKE

- Good prospects of an H2-21 recovery in global markets despite second lockdowns
- Vaccines and confidence will determine the degree of recovery
- Fiscal and monetary policy interventions should support economic activity and restore confidence
- Emerging markets with pre-pandemic debt burdens will lag in recovery

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

Covid-19 (and the subsequent lockdowns) is the most severe exogenous shock to the global economy in modern history. More akin to a natural disaster or war than a financial crisis, the supply shock the pandemic imposed on the global economy stunned a healthy system into the deepest recession in 70 years. Containment policies, which necessarily restricted mobility, were largely to blame for the massive loss of output in the first half of 2020 (H1-20). But unprecedented, broad-based and aggressive policy responses across the globe were able to cushion the impact of the pandemic on incomes, financial systems and governments' ability to intervene, assisting in a sharp recovery in the second half of 2020 (H2-20). Given these events, the global economy managed to achieve a remarkable, if uneven, recovery during late-2020.

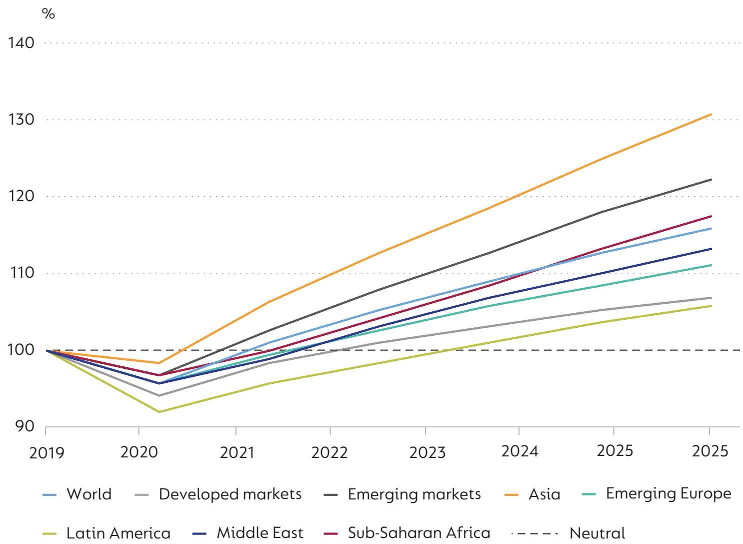
The pandemic's second wave has prompted renewed lockdowns in Europe, Japan, the UK and the US, as well as in many emerging markets, and will stall some of this recovery momentum into the new year. With many earlier relief programmes coming to an end, the economic impact may be exaggerated until further support is felt. Despite this, the prospects for recovery in H2-21 are still good. Not only is there positive news of a widening availability of prioritised vaccines, but the nature of the crisis, which has seen little financial sector damage and relatively targeted income and employment protection, bodes well for a growth recovery in the year ahead. That said, the strength of the recovery will depend on how the balance of forces evolves.

Most analysts expect the global economy to see 2021 growth off a shattered base. However, there is quite a range of opinion as to how strong and fast the recovery to pre-pandemic GDP levels, and the trajectory, will be. Two key factors will determine the strength of the recovery – first, the speed with which effective vaccines are deployed, and second, the degree to which the impact of breaking the link between containment and mobility sees a return of confidence to economies that were in relatively good shape before the crisis hit.

1) The prospects of a widely available vaccine in 2021 have improved, and many countries are already implementing administration programmes. While there is still some friction between the speed with which vaccines can be produced and how widely and quickly they are accepted and can be administered, it seems sensible that vaccines that offer protection at low risk will be popular. The availability of such vaccines in emerging markets will probably take longer than in advanced economies, but with commitment by producers to help, there should be incremental and accelerating rollout globally this year.

Figure 1

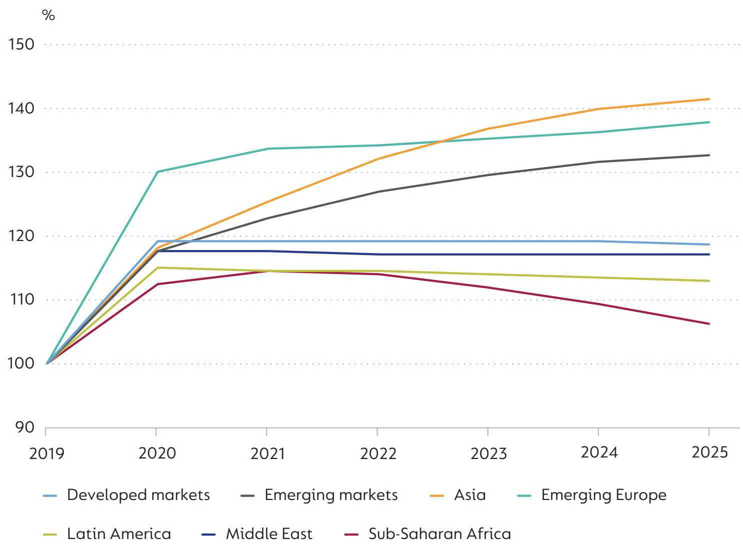
GLOBAL REAL GDP; EMERGING AND DEVELOPED MARKETS



Source: IMF

Figure 2

GLOBAL FISCAL POLICY TRACKER (GOVERNMENT DEBT TO GDP)



Source: UBS/IMF

2) The size and nature of policy response to the pandemic in 2020 were remarkable, and facilitated a sharp recovery in H2-2020. Income-targeted policies of a scale not seen before accounted for the bulk of fiscal interventions, which the IMF estimates added nearly four percentage points (ppts) to global growth in 2020. This may become less supportive as some emergency programmes roll off, and in economies – largely emerging markets – where fiscal space is more constrained.

However, there is clear debate globally about the need to avoid a ‘fiscal cliff’ prompted by the premature withdrawal of policy support. The recently approved US expenditure package is indicative of a change in thinking. The early withdrawal of fiscal support after the 2008/2009 Global Financial Crisis (GFC) undoubtedly slowed the economic recovery. Governments are less likely to enforce the same degree of consolidation in 2021, although capacity to sustain expansions varies greatly by country, again, with visible constraints in emerging markets.

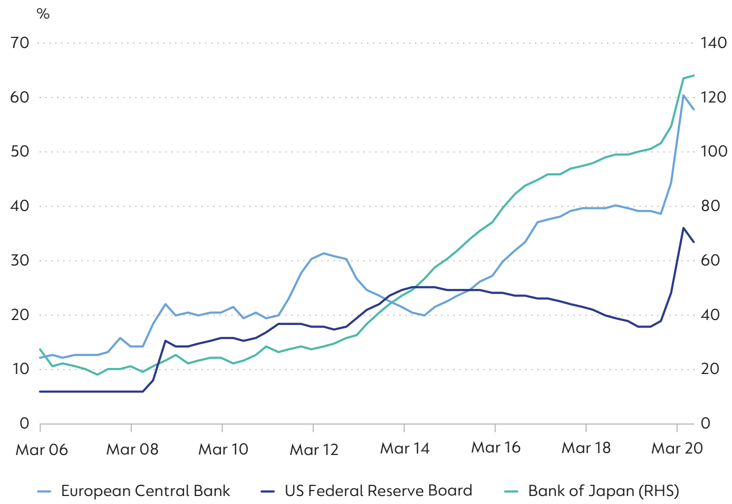
CENTRAL BANK POLICY AND ACTION ARE KEY DRIVERS TO RESTORE CONFIDENCE

Fiscal support is being underwritten by monetary policies. Central banks in most developed economies cut policy rates and deployed their balance sheets in stunning size to support fiscal sustainability during 2020. Utilising unconventional policies initiated in the wake of the financial crisis, developed market central banks were able to ensure ongoing market liquidity to fund fiscal policies and ensure overall borrowing costs remain exceptionally low. Some emerging market central banks followed, employing quantitative easing strategies and credit policies to limit the impact of lockdowns on financial markets and the spillovers to the real economy.

Available data suggest the combined quantitative easing and credit policies of the G4 (Brazil, India, Germany and Japan) central banks added $8 trillion to their balance sheets in 2020, boosting the size of these by 20ppts – compared to 7ppts in the aftermath of the GFC. As the recovery stalled in late 2020, the large central banks have committed to ongoing monetary accommodation, which should provide support for fiscal policies in developed economies, as well as emerging markets, as investors seek yield in a low-yield world.

Figure 3

CENTRAL BANK ASSETS, % GDP



Source: Haver

Figure 4

US BUSINESS AND CONSUMER CONFIDENCE

Source: Haver

EASING OF GEOPOLITICAL TENSIONS

Geopolitical uncertainty should also diminish in the year ahead, creating a more constructive political narrative. The transition to a new, more conciliatory and cooperative US administration should ease the tension brought on by the uncertainty of the past four years, help reduce aggravated trade risks and see traditional allegiances strengthened, rather than weakened. The conclusion of a Brexit deal eliminates the risk of a 'hard' no-deal, even if the economic cost to the UK of full withdrawal is likely to linger. Overall, however, this should be positive for global trade and general sentiment. All the factors discussed above provide the basis for a growth recovery of some strength in 2021. But, critical to the economic recovery prospects for this year will be the degree to which these interventions combine to restore consumer and business confidence. For the recovery to be complete – for global GDP to return to pre-pandemic levels – employment and investment need to recover to the same degree.

LINGERING EFFECTS

One area where recovery will undoubtedly lag is the services sector, notably travel and tourism, but also parts of retail and business services. With inter-regional mobility constrained in most parts of the world until a vaccine is widely and compellingly implemented, a full employment recovery in these critical sectors is unlikely. Cross-border restrictions are also likely to continue even as vaccines are rolled out.

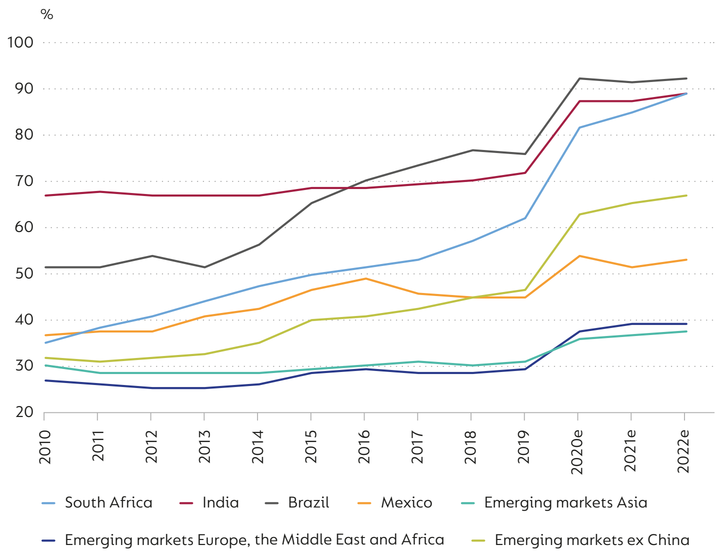
The labour market may be 'scarred' for some time. A slow recovery will undermine the pace of employment growth, and long periods of under-employment tend to be reinforcing. That said, the impact on incomes and domestic demand is less negative. Data from the US and Europe (and South Africa) suggest that a large proportion of job losses have been in lower-income occupations (mostly in the services sectors). Fewer high-income jobs have been lost (unlike during the GFC) and ongoing income support for these households should cushion the economic impact of employment loss for some time. Importantly, savings rates have surged, presenting a large potential source of demand on recovery.

DEBT WEIGHS ON EMERGING MARKETS

It isn't clear cut how emerging markets will fare in the year ahead, as large imbalances have been exposed and have worsened during the crisis, with striking intra-country variance. There are good prospects for growth to recover, even if at a lag, as vaccines become effective. Global tailwinds will also provide an important boost to emerging markets. However, fiscal fault lines may become more fragile in the year ahead. Many emerging markets entered the crisis with persistent deficits, already-large stocks of debt and limited fiscal headroom to support an economic recovery. Necessary fiscal provision and revenue losses have pushed these economies into uncertain fiscal positions, with doubtful sustainability.

Figure 5

MAJOR EMERGING MARKET DEBT (% GDP)



Source: UBS

While the G20 has recognised the dire position of many emerging markets and implemented the Debt Service Suspension Initiative (DSSI) for 73 qualifying countries (the DSSI does not cover middle-income countries like South Africa), appeals to private creditors to do the same have been unsuccessful.

The Institute for International Finance estimates that nearly $7 trillion in emerging market debt will fall due in 2021 – three times the amount owed in 2020. While low interest rates globally have been a considerable support for emerging market government yields and will certainly continue to contribute to easier financing conditions, this may not be enough in 2021.

Several factors will determine these countries' fiscal prospects. These include the strength of pandemic management, the starting fiscal position, the pace of recovery – supported by domestic growth strategies and policy implementation – and each country's ability to leverage global demand. The US reflationary policy stance should boost emerging market exports, and the ongoing recovery in China should be positive for commodity producers.

However, some emerging markets will have to consolidate last year's fiscal largesse, and this may be an offsetting drag on growth, possibly reinforcing areas of fiscal and political instability.

RECOVERY MARKERS

Consensus seems to lie in a cautious recovery outlook, with an incomplete recovery as the baseline for 2021. On balance, we are more positive about the prospects for a close-to-full global recovery in 2021, notwithstanding the plethora of tightening lockdowns currently under way.

Ultimately, what will drive 'completion' is a sufficient recovery in business and consumer confidence based largely on credible fiscal and monetary policy support to propel new investment and re-employment. Here we see advanced economies, and China, as being best able to capitalise on the current levels of policy support, for longer.

INFLATION SURPRISES ARE NOT FAR-FETCHED

It is also worth highlighting that, while there is clearly some debate about the strength of a global recovery this year, there is less debate about the risk of higher inflation. If GDP fails to recover to pre-pandemic levels, the implied global output gap should persist, and demand pressure is likely to remain low. This scenario certainly currently underpins the monetary policy positioning and communication of most global central banks.

However, a stronger recovery built on massive policy support, especially for incomes, and with a foundation of relatively healthy household balance sheets, supported by a robust financial system and healthy credit pathways amidst strong growth in transaction money, could certainly see inflation pick up ahead of current expectations.

A number of additional drivers are also possible, including shifting supply chains in the wake of the pandemic and retreating globalisation, a less constrained regulatory environment, the active promotion of credit extension, and central banks explicitly targeting higher inflation.

The unexpected can happen. Markets and analysts are less focused on this risk than on a weaker global recovery, despite its greater potential to disrupt financial and asset markets. ✚

ECONOMIC COMMENT

South African outlook

Good intentions and a renewed commitment to growth are not enough to make government's financial position sustainable

By **MARIE ANTELME**

THE QUICK TAKE

- Procuring and distributing a Covid-19 vaccine are crucial; supply deficit weighs
- SA's fiscal position was already critical going into the pandemic
- Increased confidence is the elixir for boosting growth; government policy action is a key factor too
- Global growth and China recovery should provide a welcome tailwind; debt a drag

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

THE MOST IMMEDIATE challenge facing South Africa is to effectively manage the Covid-19 pandemic crisis. The country's path to recovery will be dictated by its ability to vaccinate enough people to restore mobility and open sectors that are currently restricted. News on this front is sobering. South Africa has not been able to procure a large enough vaccine pipeline to adequately inoculate most of the population. Under the COVAX initiative, we have a commitment to receive enough vaccine to cover 20% of the population as supply becomes available.

In addition to this, government has managed to expedite an additional 1.5 million doses of the Oxford University-AstraZeneca vaccine for frontline workers, which is due in January and February. Beyond this, the outlook is uncertain. Gross global supply has been allocated, and South Africa cannot procure additional doses through bilateral agreements with producers unless it is at the expense of another country. Expanding supply is difficult and will take time, although it is likely that many vaccines currently under development may prove effective and become regulated in the coming months.

Expert opinion is that we will land enough vaccines to cover about 10% of the population by the end of the year, starting in April in variable lots. This implies that the population will still face additional waves of infection throughout the year, with the next likely to hit during the vulnerable winter months. Even though the ANC's National Executive Committee has mercifully ruled out another hard lockdown, this still exposes the economy to varying and ongoing degrees of restriction, with a potentially devastating impact on the vulnerable services sector and the fiscus.

The failure to have adequate pipeline supply and a credible rollout strategy in place poses a serious and prolonged risk to the economy. Some hope comes from the mobilisation of considerable private sector resources to administer vaccines, but supply remains a constraint. While encouraging >

areas of economic resilience emerged at the end of 2020, and global tailwinds are potential sources of upside support for growth, domestic health and containment risks are firmly to the downside.

A PRÉCIS OF THE YEAR IN REAR VIEW

The Covid-19 crisis came at a bad time for South Africa. Growth in 2019 was just 0.1%, and in the first quarter of 2020 (Q1-20), the economy was already in recession, deeply constrained by inadequate electricity supply, as well as a range of operational and organisational challenges at Eskom.

The unemployment rate was 29.1%, and the employment rate had fallen in annual terms in the second half of 2019 (H2-19). Per capita real GDP had declined every year since 2015 and was -1.3% lower in 2019 than in 2018. Combined, these factors have undermined business and consumer confidence.

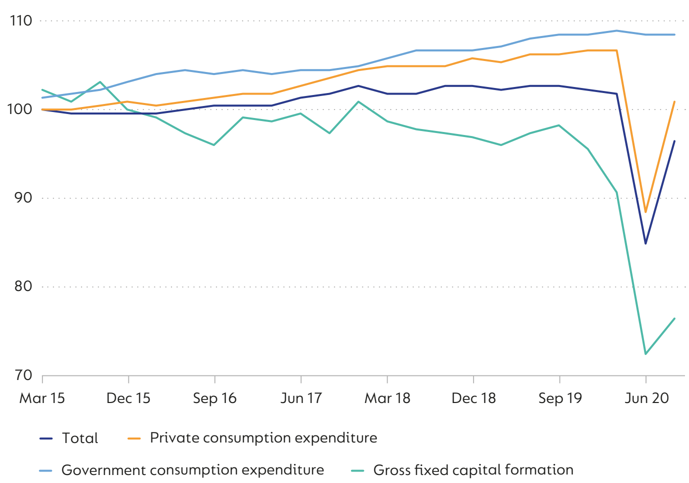
Figure 1

REAL PER CAPITA GDP, % Y/Y

Source: South African Reserve Bank

Figure 2

REAL GDP BY EXPENDITURE COMPONENT, Q1-2015 = 100



Source: Statistics South Africa

Companies and households have had limited ability to invest and spend in a weak economy. Both economic and political constraints have also compromised their willingness to do so. Weak economic policy delivery ('over promise' fatigue) and uncertainty related to critical aspects of the economy's regulatory framework combined to render very weak investment activity and associated low productivity.

When the pandemic hit and government implemented an early and hard lockdown, compliance was good, and there was a general support for the initiative. The central bank acted swiftly, cutting the repo rate cumulatively by 300 basis points (bps), reducing borrowing costs to the lowest level since the 1960s and, after some stalling, intervened to ensure financial stability and the smooth functioning of the money and rates markets, with regulatory support for the banks.

The National Treasury, already constrained by a weak fiscal position, tabled an Amendment Budget in June. The total relief package was billed at R500 billion, but R130 billion was reprioritised from the Budget. Adding this to an anticipated loss in revenue implied a deficit of -14.6% of GDP, with debt likely to step up 18.3 percentage points (ppts) of GDP, from 63.5% to 81.8%, and expected to rise further over the medium term.

Playing in the background of the economic crisis, the ebb and flow of factional politics continued in 2020. There were notable successes at the reinforced National Prosecuting Agency, but this was tempered by the ruling party's failure to credibly address corruption and restore confidence. Ongoing delays in the implementation of economic strategies, such as the release of spectrum, remained sources of frustration and criticism.

Attempts to address both the capacity of the State and to get things done, nonetheless, had some successes as the economic crisis helped focus political attention on reviving the economy and the government's financial position. Despite this, ongoing fiscal support for insolvent State-owned enterprises (SOEs) remained a critical and contentious drain on limited resources.

The lockdown in Q2-20 saw GDP collapse by 51.7% quarter on quarter (q/q) seasonally adjusted and annualised (-17.5% year on year [y/y]), with 2.2 million associated job losses. This was the biggest loss of output in South Africa's recorded GDP history. But the Q3-20 recovery in activity was much better than expected, with GDP rebounding 66.1% q/q, seasonally adjusted average, and accompanied by a partial recovery in employment.

A closer look at the real economy showed some recovery in incomes and stronger household balance sheets, as well as corporate profits. Household real net disposable income recovered from a fall of 15.7% y/y to -3.9% y/y. The household debt burden reduced to 75.7% of disposable income, from a spike to 86.5% in Q2-20 and an average level of 73% in 2019. Importantly, debt servicing costs benefited from materially lower interest rates and, at 7.5% of disposable income, is at a multi-decade low. Credit availability remains good, but is constrained by the limited appetite for additional debt. Household savings rose, with both the inability to spend and rising precaution contributing to the increase. Given the improvement in key household metrics, with growth momentum into Q4-20, we forecast a collapse in real GDP in 2020 of -7.2%.

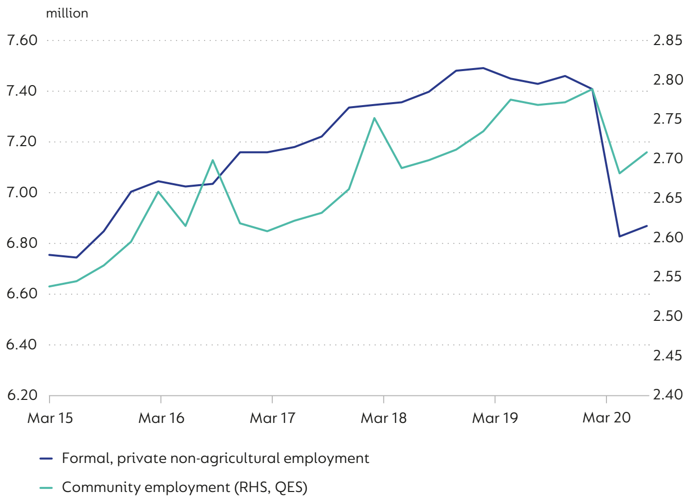
Figure 3

HOUSEHOLD DEBT AND COST OF SERVICE

Sources: Statistics South Africa, Coronation

Figure 4

PUBLIC AND PRIVATE EMPLOYMENT



Source: Statistics South Africa Quarterly Employment Survey data

2021: A MIXED BAG OF OPPORTUNITY AND RISK, THREATENED BY THE FAMILIAR PATH OF POLICY COMPROMISE

Against this weak but improving economic backdrop, the outlook for 2021 hangs in the balance between domestic economic resilience underpinning domestic demand and a combination of the impact of the second wave and the risk posed by existing areas of weakness, including weak policy implementation, electricity constraints, poor public sector capacity and a fragile fiscal foundation. Global recovery factors also count, with the possibility that these may provide a significant tailwind to the South African economy. Government's growth strategy and commitment to fiscal sustainability – with critical focus on actual implementation – will dictate the shape of the economic outcome.

WEAK VACCINE STRATEGY

The most immediate obstacle to recovery is a currently weak vaccine strategy. Some news of additional vaccine procurement is positive but inadequate. Importantly, government is not expected to implement another economically damaging hard lockdown, but a combination of partial restrictions, ongoing uncertainty and slow vaccine progress will continue to weigh heavily on the services sector, particularly tourism and recreation, with a likely increase in long-term scarring. Foreign tourism will also not recover until South Africa is deemed a safe destination with respect to Covid-19.

OUTLOOK FOR GROWTH RECOVERY

Looking at the drivers of expenditure-side GDP growth, a recovery in consumption expenditure has mixed potential. Private consumption expenditure (PCE) accounts for about 60% of GDP and, in Q3-20, contributed 43.8ppts to the surging recovery. PCE is driven by a combination of employment growth, real income growth, and the availability of credit and consumer confidence – people's ability and willingness to spend.

After the sharp fall in employment, there has been only a partial recovery, and formal employment is still 6.3% below the pre-crisis level. Although marginal, President Ramaphosa's Employment Stimulus Programme update in November detailed good progress on this front too.

Incomes remain constrained but also experienced a strong recovery in the third quarter as mobility constraints eased. Net disposable income is down -3.2% year to date in nominal terms – after a 13.6% y/y collapse in Q2-20 – while total compensation is down 1.6%, including the Q3-20 recovery, after falling 7.2% in Q2-20.

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In real terms, these are down -6.3% and -4.8%, respectively, year to date, but with solid positive momentum. For households that derive a significant proportion of their income/wealth from financial assets, the loss of dividend income has hurt, but the positive financial market performance should provide a fillip.

Savings balances (which represent residual cash) have surged. Measured as a proportion of disposable income, savings were 0.7%, the highest since early 2005. This is likely a reflection of a combination of an inability to spend and greater precautions taken. But it also creates the potential for a recovery in spending, while low interest rates and reasonably healthy balance sheets provide the opportunity for stronger credit growth as incomes and confidence improve.

We forecast a modest increase in disposable income as employment in hard-hit sectors, such as manufacturing, construction and parts of business services, improves. We see little prospect yet for increased employment in the trade sectors, and this remains a drag. With a forecast of real income growth of 1%, and a small contribution from increased credit utilisation, ongoing low interest rates and some improvement in confidence, we forecast real growth in private consumption of 2.7% in 2021, and 2.5% in 2022.

There is a more positive tilt to the outlook for gross fixed capital formation; but, again, pandemic, regulatory and capacity constraints persist. Private sector investment may get a fillip from the expansion of renewables within the new energy framework, and investment in machinery and equipment could be supported by ongoing adjustments to working from home. However, with profitability under pressure and poor prospects for State-funded investment, we expect gross fixed capital formation to remain weak and detract from growth momentum in the year ahead. Visible progress in reducing the constraint the State places on the economy by engaging more with the private sector has the potential to boost confidence – the magic ingredient for growth.

Net trade was a considerable tailwind for growth in Q3-20, contributing an annualised 38.3ppts to the recovery. Both mining and manufacturing export volumes recovered strongly from the hard stop of Q2-20, and agricultural exports contributed further. While terms of trade remain elevated and domestic demand – notably investment – remains depressed, the recovery in global growth and trade volumes should provide a welcome tailwind to growth into 2021. There is also further potential uplift for export value from a recovering China.

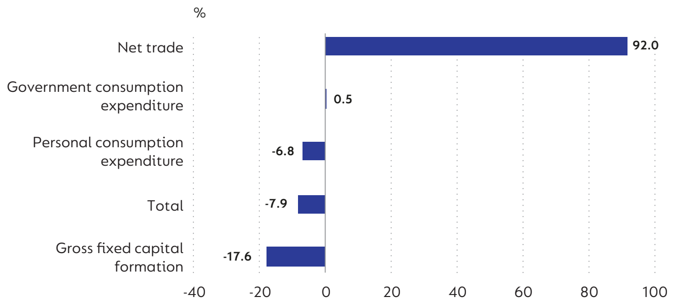
Figure 5

HOUSEHOLD SAVINGS, % DISPOSABLE INCOME

Source: South African Reserve Bank

Figure 6

REAL ANNUAL GROWTH BY COMPONENT, YEAR TO DATE



Source: Statistics South Africa

We expect the economy to grow 3.1% in 2021, with uncertain lockdown restrictions a considerable downside risk, while income recovery and net trade should provide a meaningful fillip. This is a below-consensus forecast. Our forecasts assume that capital expenditure will remain a drag on growth in the year ahead, although a more meaningful implementation of energy-related investment could see this number improve. Massive inventory drawdowns were a significant detractor from growth in 2020; a more modest drawdown in 2021 will add positively to growth momentum. We do not assume – given power constraints – any meaningful inventory accumulation over the forecast period.

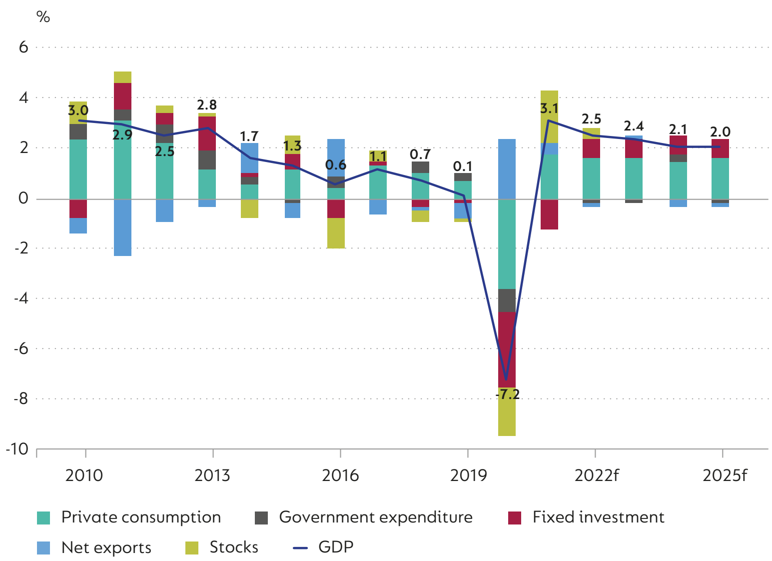
Importantly, this recovery profile does not see GDP levels return to pre-pandemic levels until 2023. This weak recovery implies that the output gap will remain negative, with little demand-related inflation pressure expected to emerge. Overall headline CPI is forecast to remain below the central point of the South African Reserve Bank's (SARB) target range in 2021 and 2022, before rising above it in 2023. We expect monetary policy to remain accommodative and see room for the SARB to cut the repo rate again to 3.25% in early 2021, as growth falters once more. At current levels, policy rates are at levels not seen since the late 1960s.

FINANCIAL DEFICIT A HEAVY DRAG

Government finances were the biggest casualty of last year's crisis and remained a significant source of domestic economic fragility. Of course, better growth would go a long way to boosting revenues

Figure 7

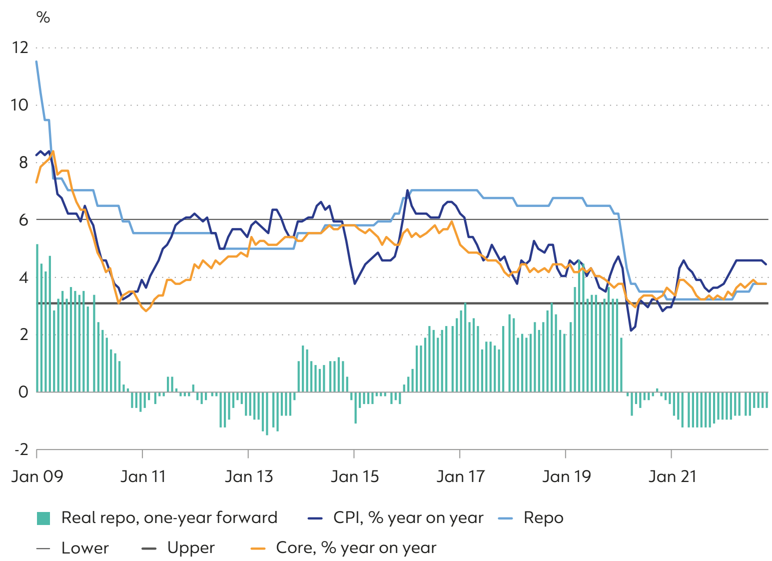
GDP FORECASTS, CONTRIBUTIONS BY COMPONENT SERIES



Sources: Statistics South Africa, Coronation

Figure 8

HEADLINE CPI AND REPO RATE (INCLUDING FORECAST)



Sources: Statistics South Africa, Coronation

and improving the outlook, but South Africa's fiscal weaknesses extend beyond this. There are three interrelated challenges:

1. Weak and disappointing revenue growth, partly owing to weak nominal GDP growth and partly due to the collapse of the tax collection infrastructure. Over-estimating revenues upon which multi-year expenditure is allocated has led to a decade of persistently large deficits.

2. The composition and size of expenditure, notably the public-sector wage bill, and therefore the rising debt service burden, must change. Decisions related to the size of government were taken as long ago as 2007/2008 when public-sector salary structures were expanded to protect and attract scarce skills in health and education. Several generous multi-year agreements, coupled with aggressive State employment growth saw the consolidated public-sector wage bill expand from 33% of expenditure to 36%. While efforts have been made to limit its expansion through headcount limitation, this has had little effect, as wage growth has outpaced both inflation and GDP growth.

3. Ongoing decisions to bail out SOEs have undermined much of the fiscal discipline imposed elsewhere over the past five years. Since 2008/2009, Eskom, SAA, the SABC and the Land Bank combined have cost taxpayers R229 billion. This is no longer affordable.

These fiscal vulnerabilities are well known. Consecutive budgets, and finance ministers, have attempted to right-size the large expenditure commitments – especially the wage bill – but successive crises, mostly related to SOEs, amidst very weak growth, have systematically worsened an already weak position.

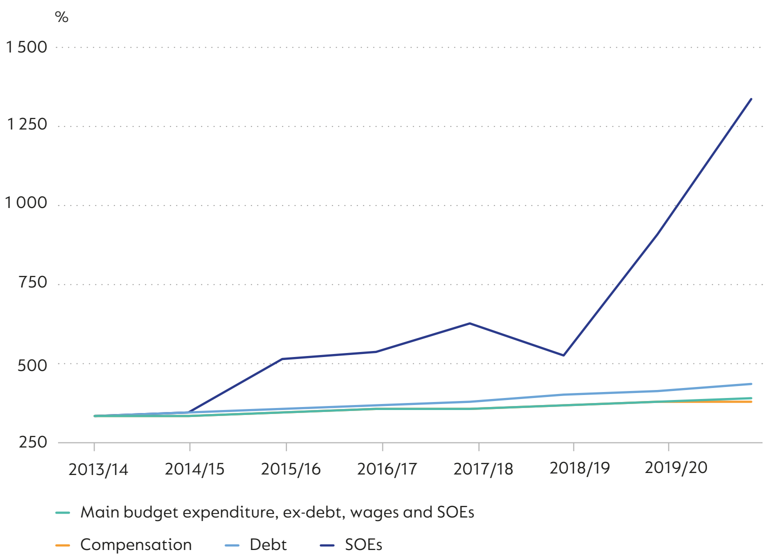
The December ruling in favour of the National Treasury in its dispute with public sector unions over the suspension of the final year of its wage agreement in 2019/2020 will go a long way to improve the starting position for right-sizing wages within expenditure. Assuming the full R38 billion is saved, the consolidated public-sector compensation budget should return to 33% of expenditure in 2020/2021. While this is clearly a 'win' for the National Treasury, much still hinges on the forthcoming wage agreement and the wider government backing of a painful consolidation plan.

Even with some consolidation in our numbers, fiscal metrics remain very weak. With a modest improvement in GDP growth, a slightly more robust rate of GDP inflation (boosted by terms of trade), gains in revenue somewhat ahead of initial expectations, and relatively contained expenditure, the main budget deficit is still set to be -14.3% of GDP in the current fiscal year. Excluding interest costs, this is still a primary deficit of -9.6% of GDP.

A recovery in revenues and improved GDP growth should see this narrow to -10.2% and -5% of GDP, respectively, in the coming year, assuming the new wage agreement limits annual increases to below inflation (we assume 3% nominal). But this deficit is large, and the fiscal adjustment required to push the deficit to a balance – or the surplus position required to stabilise debt dynamics – seems economically and politically unlikely. South Africa also does not enjoy the happy balance of nominal growth rates that exceed the average nominal cost of servicing government debt. In the absence of both, debt will continue to accumulate.

Figure 9

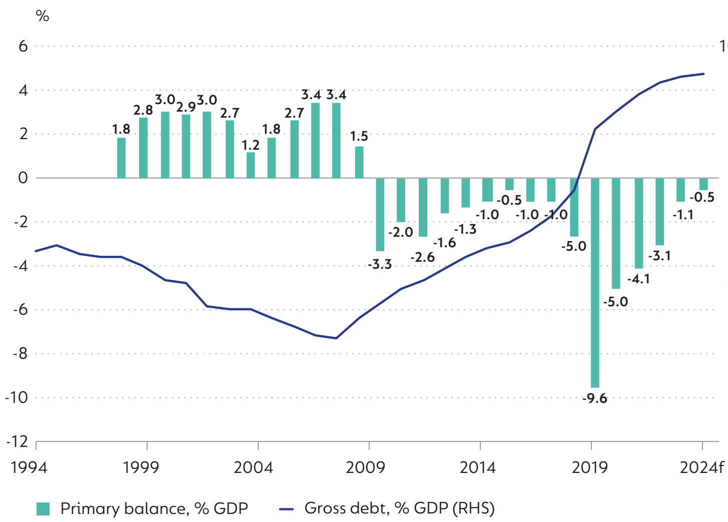
RELATIVE EXPENDITURE GROWTH BY COMPONENT, INDEX



Source: National Treasury

Figure 10

GOVERNMENT DEBT AND THE PRIMARY BALANCE, % GDP



Sources: South African Reserve Bank, National Treasury, Coronation

DEBT MANAGEMENT CRITICAL

Rising debt is economically costly; it lowers investment and productivity, and undermines growth through time. It also implies that as debt is accumulated, government is forced to issue more, not only to fund expenditure but also to pay off maturing debt in an endless cycle.

This reinforces the dynamics that compound the problem and may accelerate a crisis. Ultimately, this will become unsustainable. The IMF defines debt as sustainable when a government can meet all current and future payment obligations without exceptional financial assistance or going into default.

History tells us that sovereigns are poor at mitigating the risk of looming debt crises, and financial markets, in a world of extremely low global rates, may not impose adequate discipline early enough.

Our own economic history is littered with many sensible plans and good intentions, but, at best, extremely weak public policy execution. Even with the best intentions and a renewed commitment to a sensible growth strategy, the road to fiscal sustainability for South Africa is likely to remain very challenging. ✚

INVESTMENT ANALYSIS

A revival in the life insurance sector

Growth potential at MMH undervalued

By **NICHOLAS STEIN**

THE QUICK TAKE

- Pandemic-induced headwinds to still-cheap life companies are short term
- With drag factors accounted for, a 2021 earnings recovery is likely to be robust
- MMH's current discount to embedded value does not reflect positive future prospects
- New management and a re-energised distribution channel bolster growth potential

Nicholas Stein is an equity analyst with 11 years' investment experience.

CORONATION OWNS STAKES in both Sanlam and Momentum Metropolitan Holdings (MMH) on behalf of clients. Sanlam has long been a share we wanted to own, but its persistent premium to embedded value (a measure of a life company's intrinsic value) left little margin of safety. The Covid-19-induced selloff in March hit high-quality and low-quality businesses indiscriminately and provided us with a good entry point to acquire shares in Sanlam below its embedded value. We suspect, however, that readers will find our Sanlam purchase uncontroversial and may be more interested in the thought process behind our MMH stake.

LIFE COMPANY ATTRIBUTES

Life companies may be considered mature and boring, but they have attributes that contribute to their desirability:

- Extensive distribution networks of advisers that are complex to manage and costly to replicate.
- A number of companies faced existential threats from Covid-19, for example, restaurants and landlords. Life companies have large in-force books of business that generate ongoing fees, often based on asset levels (which are driven by stock market levels). This makes them a bit more defensive.
- Tied to this, we believe the JSE offers compelling value at the moment. A strong stock market lifts the asset levels on which fees are earned.
- Above-average returns on equity through the cycle.
- Very strong capital positions designed to withstand 1-in-200-year stress tests. Companies that are inadequately capitalised are often forced into sub-optimal decisions at wrong points in the cycle.

And yet, while the share prices of many domestic shares have recovered meaningfully from their March lows, most life insurers are not trading far off them (see Figure 1 overleaf). We suspect there are two main reasons for this:

- Life companies' earnings (and to some extent embedded values) were hit very hard this year.
- A dividend mainstay as life companies ceased dividend payments.

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Yet these reasons are short term. When the life insurance companies reported their June results this year, markets had not fully recovered. Credit spreads also widened materially. Both factors impact earnings meaningfully (negatively to June), but have already started reversing. Perhaps more importantly, life companies 'front-end loaded' the earnings pain caused by Covid-19 by raising provisions for the expected financial impact and expensing them through their income statements. For example, MMH assumed its share of 40 000 Covid-19-related deaths and expensed this. The company also assumed that 50% of policyholders requesting premium holidays would lapse, and up to 10% of all other policyholders, too. MMH also expensed this. This resulted in a R1.3 billion knock to embedded value and a R1 billion knock to reported earnings. However, by taking the pain upfront, life companies should see 2021 earnings rebound quicker than the typical company.

We would also expect most companies in this sector to resume dividend payments when they report in February and March 2021.

MMH

MMH trades at a record 40% discount to embedded value (Figure 2). We find this surprising for three reasons:

- The Covid-19 provision has resulted in a more conservatively stated embedded value.
- Over the last few years, management has made the life and non-life valuations within the embedded value more conservative (effectively using a lower price earnings/discounted cash flow to value their own business).
- The new management team under Hillie Meyer, Jeanette Marais and Risto Ketola has done a good job in turning around the operating performance of the group.

As such, the 40% discount to embedded value is even starker than it first appears, given that the embedded value is far more credible and conservative than it was previously, and the company's business prospects are brighter.

NEW BROOM UNDERESTIMATED

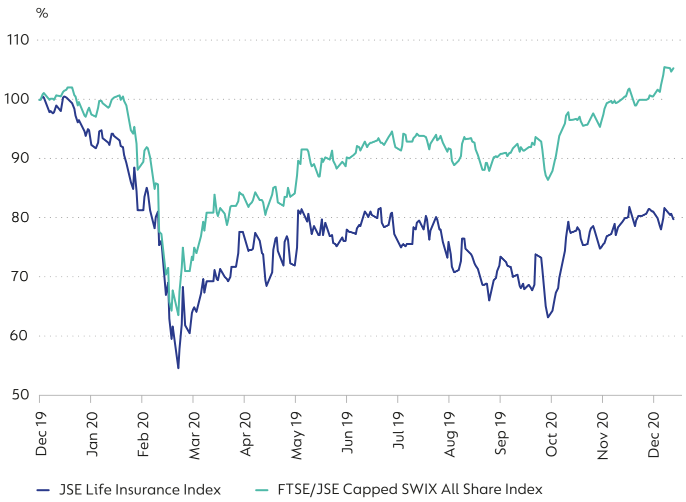
The last point on the new management team and the operational turnaround warrants further discussion. New management has been in place since early 2018. In our view, the market is not recognising the turnaround currently under way and is adopting a wait-and-see approach. Turnarounds often take time to fully manifest in reported numbers, but we believe there are some very encouraging signs that the market isn't attaching sufficient weight to.

Some divisions within MMH, such as Employee Benefits and Guardrisk, have historically performed well versus their peers. However, there are also signs that previously lagging divisions are turning around. A driving force behind these improvements is the reintroduction of divisional profit and loss statements, which has boosted divisional management accountability.

- Both Metropolitan and Momentum have been growing their tied agency forces ahead of the broader market, suggesting life insurance agents are starting to view them as attractive places to work. Improved product offerings and service levels to agents support this.

Figure 1

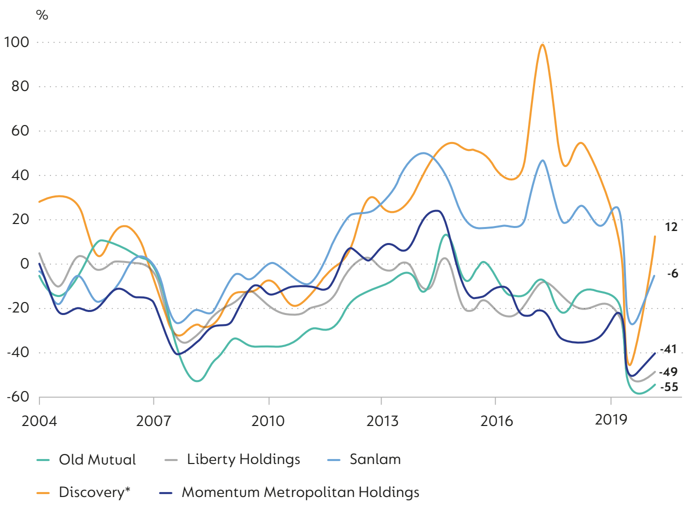
LIFE INSURANCE INDEX VERSUS BROADER MARKET INDEX FROM COVID-19 ONSET TO PRESENT



Source: IRES

Figure 2

LIFE COMPANIES' PRICE TO EMBEDDED VALUE HISTORY



*Embedded value excludes emerging and startup entities

Sources: Company data, Bloomberg, Avior Capital Markets

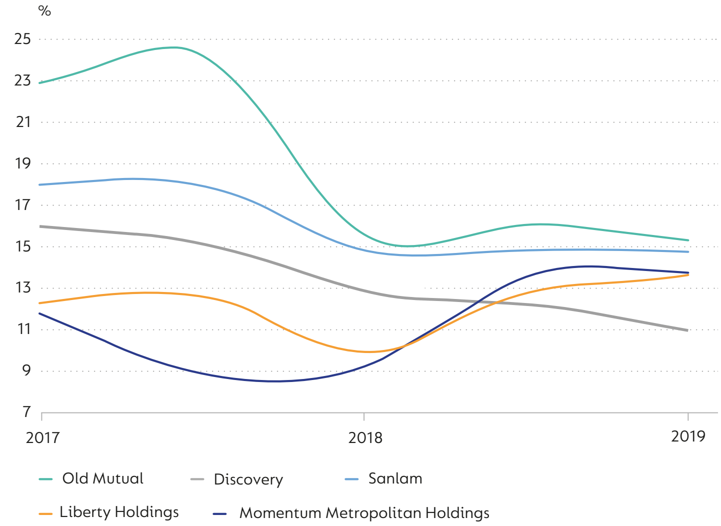
- Metropolitan Life was seen as a likely victim of Old Mutual's dominance in the entry-level market, as well as Capitec's entry into funeral product sales. Yet the number of policies that Metropolitan's advisers sell per week has never been higher – an impressive peak given that this includes the Covid-19 operating environment. Metropolitan's earnings have remained resilient.
- Momentum Investments has languished relative to its peers, with its platform shunned. A concerted effort to improve service levels and re-engage with the independent financial adviser community has seen a big pickup in platform net flows and a trend of market share losses being reversed.
- Five years ago, MMH had the weakest franchise of the four mature life insurers. We don't think it's a stretch to say that the company is now on its way to the no. 2 spot (after Sanlam).

Returns on equity and earnings have started picking up nicely off a low base (figures 3 and 4). We think this trend can continue as the divisional operational improvements continue, given that Covid-19 provisions are now in the base and as loss-making divisions become profitable (if MMH's new Indian Healthcare Insurance joint venture reaches breakeven, it would result in a R300 million earnings improvement alone).

If management's internal profit expectations are realised, MMH trades on c. six times two-years-out earnings. We think this is a compelling multiple and provides a large margin of safety. ✚

Figure 3

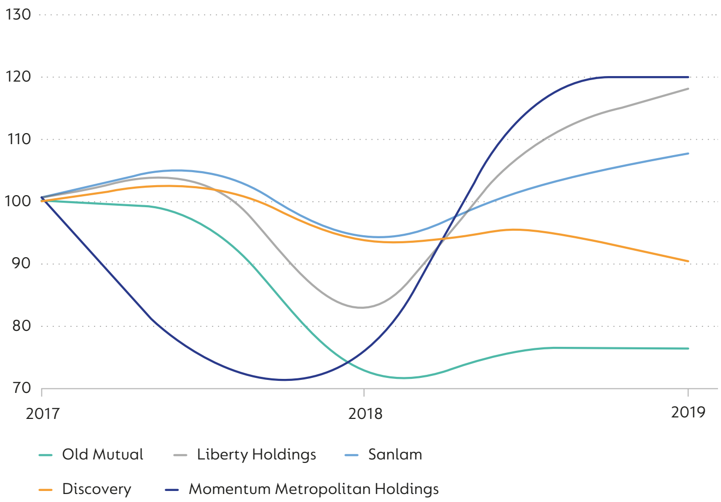
LIFE COMPANIES' RETURN ON EQUITY



Source: Avior

Figure 4

EARNINGS BASED TO 100



Source: Avior

BOND OUTLOOK

Deteriorating local fiscal dynamics remain a concern

But SAGBs and ILBs still offer attractive opportunities, despite economic challenges

By **NISHAN MAHARAJ**

THE QUICK TAKE

- SA's headwinds increase as second-wave infections escalate
- Growth recovery is integral to debt sustainability; options are limited
- SAGBs deserve a place in a bond portfolio; select ILBs are also attractive
- Recovery hangs in the balance of growth, expenditure allocation and debt mitigation

Nishan is head of Fixed Interest and has 18 years of investment experience.

IN THE FIRST 19 years of the 21st century, the world has faced catastrophic events in the form of terrorist attacks (9/11), hurricanes (Katrina) and earthquakes (in Haiti and Japan) that tested the very fabric of humanity. However, the last two decades have also given us a new medium to connect with one another (social media), devices to allow us to communicate more efficiently (smartphones) and the first black leader of the free world (Barack Obama). Economic fluctuations, distortions and crises have tested the resolve and agility of policymakers to keep the wheels of the global economy moving. This initial part of the 21st century provided the ideal training ground for 2020. Covid-19 provided the undertones of a terrestrial disaster that manifested in an economic crisis. It did, however, spur the fastest developed vaccine in human history, but the economic scarring will be felt for years to come.

SA ENTERED PANDEMIC CRISIS ON THE BACK FOOT

Covid-19 literally brought the world to a standstill, but as we move into 2021, vaccine in hand, there is a ray of hope that life might finally start to return to normal. South Africa, unfortunately, was ill equipped to handle such a pandemic. Years of corruption and mismanagement left the State severely incapacitated as it tried to navigate its way through the crisis. The country now faces the difficult task of trying to accelerate growth to 3%-4%, without additional spending, given its precarious debt position. Despite the South African Reserve Bank (SARB) reducing the cost of capital to the lowest in the country's democratic history, the government's cost of funding remains elevated, as bond yields reflect investor disbelief in the administration's commitment and ability to right the ship. The local bond market delivered a return of 8.65% over the course of 2020, well in excess of cash at 4.80%. The yield curve steepened aggressively, with the 10-year bond trading in excess of 200 basis points (bps) above the five-year bond and almost 600bps above cash rates. As such, the three- to seven-year area of the yield curve provided the best return at 16.26%, and the longer end of the curve (>12 years) provided the poorest return of 4.59%. Inflation-linked bonds (ILBs) delivered poorer absolute returns of 4.22%, but provided a similar pattern of return across the ILB yield curve (front end outperforming longer end).

REALITY BITES; DEBT WEIGHS

The globe and South Africa remain firmly in the grips of the second wave of infections. As the numbers turn into names and the names turn into people we know, the harsh reality of Covid-19 has dawned on us as we enter 2021. Even more stark are the difficult tasks and choices that lie ahead of the country. South Africa remains on the precipice of a debt trap.

There are only two ways to escape – either increase growth so that tax revenue rises sufficiently to compensate for increased spending, or decrease spending to balance the equation. All this needs to be done while keeping borrowing costs low enough to ensure that debt financing doesn't consume all available expenditure and that no extraordinary support is needed by any State-owned or guaranteed entity. Inflation is expected to remain relatively well contained over the next two to three years, averaging around 4.5% over the period. This means that one needs to see real growth of 3%-4% in order to generate nominal growth of c.8%, which is needed to stabilise the nation's debt profile.

Government has made progress towards reigniting local growth by attempting to revive business confidence and infrastructure development. However, this will only bear fruit over the medium to longer term. This means that expenditure will have to be reallocated and contained until growth starts to pick up. Progress is being made in this regard with the high court ruling in favour of the 2020 public sector wage freeze and government attempting to keep wages frozen for the next three years. The health of State-owned companies and municipalities remains a concern, especially now with Covid-19 placing even further pressure on these vulnerable entities. Thus, the risk of fiscal slippage is high, rendering the fundamental economic backdrop unsettled.

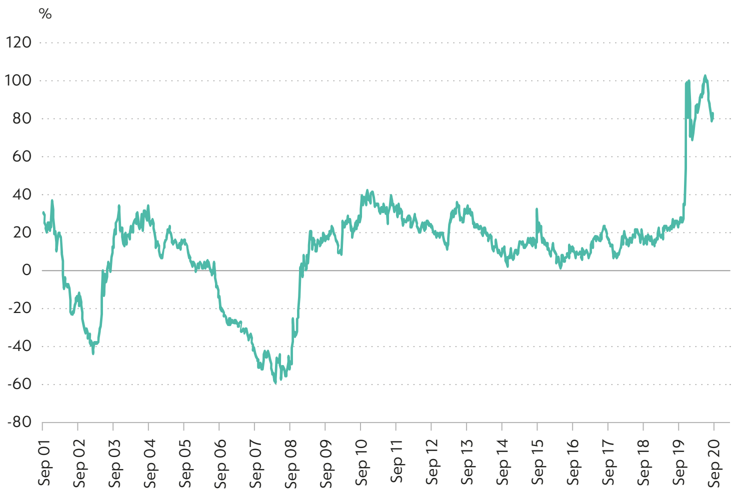
SOUTH AFRICAN BONDS – ARE THEY STILL ATTRACTIVE?

Coronation's investment philosophy is founded on pricing appropriately for underlying risk and ensuring that the valuation of assets that we place within portfolios sufficiently compensates for underlying fundamentals. In previous publications, we have continually flagged the inherent cheapness of South African government bonds (SAGBs). But as we enter 2021 – and given the strong performance of risk markets in the fourth quarter of 2020 following the vaccine news and the successful campaign of Joe Biden to win the US election – it is worth reassessing this cheapness. We measure the attractiveness of SAGBs through 1) their attractiveness relative to cash and implied real yield; 2) their risk premium relative to developed market rates; and 3) their comparative attractiveness to other emerging markets.

The best way to measure SAGBs' attractiveness relative to cash is by looking at their breakeven relative to cash; that is, how much can bond yields sell off before their total return equals that of cash and how that looks relative to history. In addition, the implied real yield on offer provides one with an indication of the return one can expect from SAGBs after the effects of inflation. In both cases, we can see in figures 1 and 2 that the 10-year benchmark SAGB, although not at its cheapest level, still encapsulates a significant yield premium relative to history.

Figure 1

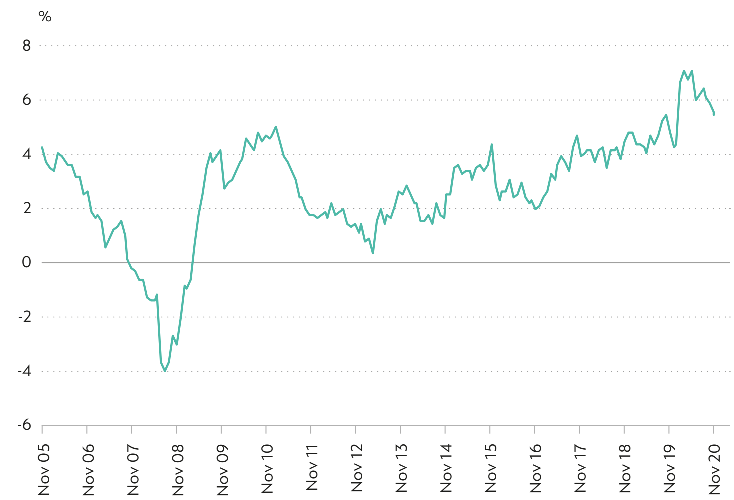
10-YEAR SAGB BREAKEVEN RELATIVE TO CASH



Sources: Bloomberg, Coronation

Figure 2

10-YEAR SAGB IMPLIED REAL YIELD



Sources: Bloomberg, Coronation

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Currently South African debt issued in offshore markets trades at levels of 4.2% in US dollars for 10 years, which implies a credit spread of 320bps. Expected local inflation over the next decade is 4.5% (economist estimates) and for the US is 2% (Treasury Inflation-Protected Security market expectations), implying an inflation differential of 2.5%. If we assume that movement in currencies over the long term compensates for inflation differences, then this implies local currency South African debt should trade at 7.7% (4.2% + 2.5%). However, current South African 10-year SAGB yields are trading at 8.7%, suggesting that the implied credit spread in local currency debt is significantly higher. In addition, they trade 800bps above developed 10-year rates, further emphasising the significant size of the risk premium (Figure 3).

DOUBT FUELLING TRADING YIELDS

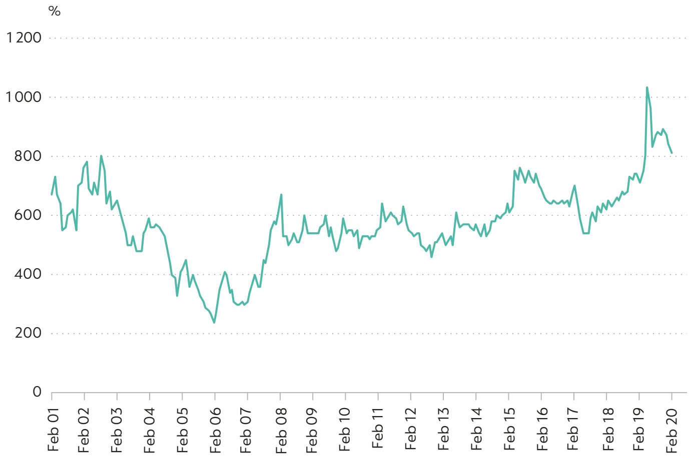
Emerging markets were hard hit during the Covid-19 crisis, but still contain significant valuation buffers in their local bond markets. Among them, South Africa stands out as relatively cheap, from an outright nominal yield, implied real yield and curve steepness perspective (figures 4 and 5). There are a few countries among the peer group that have fiscal dynamics that are deteriorating to the same extent as South Africa's, but doubt as to the country's ability to claw its way back from the abyss remains the highest, as indicated in the current trading yields.

Bringing these valuation metrics together, they still suggest a significant risk premium in place within SAGBs, despite the rally we have seen. This risk premium still provides an offset to the fundamental risks and earns SAGBs a deserved place in portfolios.

Inflation linkers have underperformed nominal bonds for some time now; however, not all ILBs have underperformed nominal bonds. Shorter-dated ILBs have outperformed nominal bonds, with the bonds in the three- to seven-year area generating a return in excess of 10%. This has been a result of high real yields and attractive rolldown to zero real policy rates. We continue to view real yields in the shorter end of the curve as quite attractive, given that real yields remain quite high; the inherent inflation protection in these instruments in the event that inflation does start to surprise to the upside; and their attractive total return prospects relative to nominal bonds. As an example, the I2025 bond trades at a real yield of 2.73%, which implies a total return range of 5.69% (if inflation is at 3%) to 7.61% (if inflation is at 5%) over the next year.

Figure 3

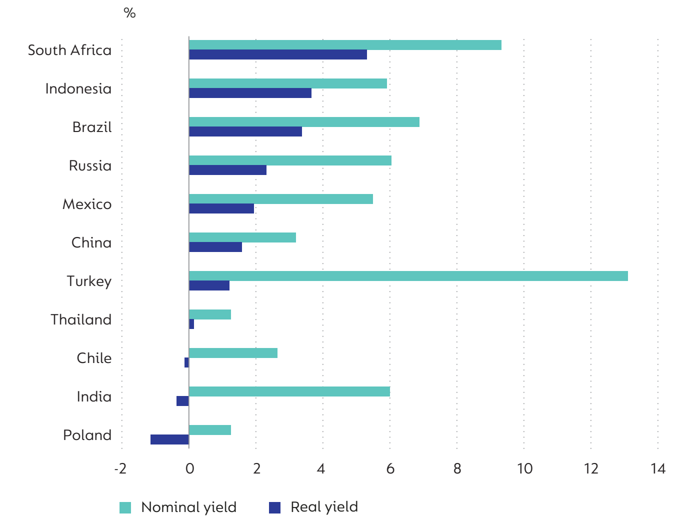
10-YEAR SAGB VERSUS 10-YEAR US TREASURY NOTE



Sources: Bloomberg, Coronation

Figure 4

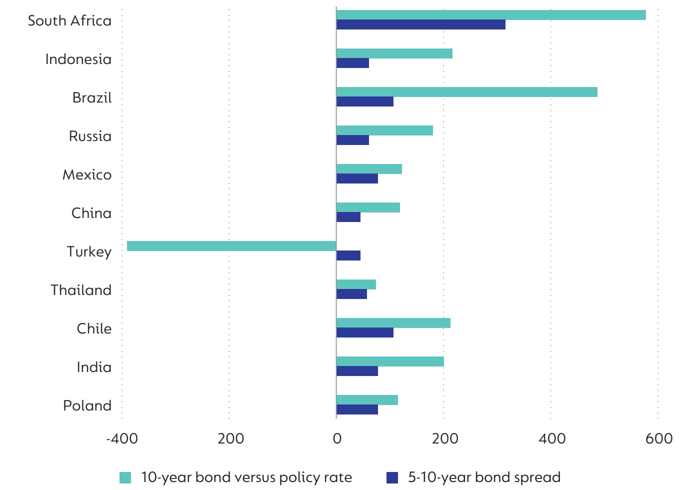
EMERGING MARKET REAL AND NOMINAL YIELDS



Sources: Bloomberg, Coronation

Figure 5

EMERGING MARKET CURVE STEEPNESS



Sources: Bloomberg, Coronation

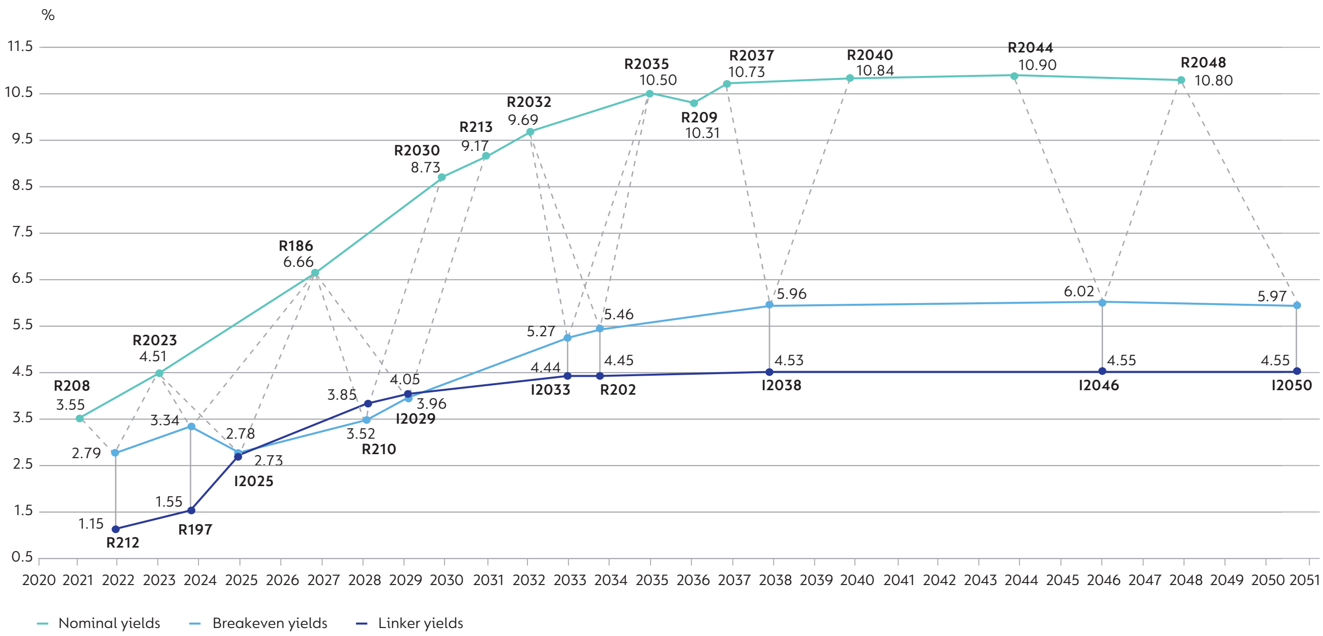
This is attractive relative to both cash rates and the equivalent nominal bonds. We still view this as an attractive opportunity set for bond portfolios.

LOOKING AHEAD

Underlying economic conditions are easing but remain challenging given South Africa's poor starting point. Inflation will remain under control, but a stronger shift needs to be made towards higher growth without pushing the country further into a debt trap. Progress has been made by reallocating expenditure away from a bloated wage bill towards pro-growth elements; however, further unpalatable austerity might be required if reforms are not accelerated. SAGBs, despite their rally at the end of 2020, still encapsulate a significant risk premium that provides a decent offset to the underlying fundamental backdrop. Shorter-dated ILBs, with their elevated real yields and inherent inflation protection, also provide an attractive allocation opportunity for bond portfolios.✚

Figure 6

NOMINAL BOND YIELDS VERSUS INFLATION-LINKED BONDS



Sources: Bloomberg, Coronation

INVESTMENT ANALYSIS

US home improvement retailers

A growth opportunity in the lacklustre retail space

By DANIE PRETORIUS

THE QUICK TAKE

- Lockdown boosted already-strong home retailers despite ailing retail sector
- Scale, product breadth and accessibility favour big-box DIY retailers
- Service and operational efficiency key to keeping physical retailers ahead of online competition
- We see further momentum in the home improvement space

Danie is an investment analyst with 13 years of investment industry experience.

THE BIG-BOX HOME improvement retailers, Home Depot and Lowe's Companies, have been a bright spot in the otherwise moribund US retailing industry. While the broader sector has been littered with high-profile bankruptcies and store closures, the shares of Home Depot and Lowe's have returned 52% and 83%, respectively, over the past three years. This performance has been a function of an advantaged competitive position, favourable macroeconomic trends and good execution.

This strong performance has been amplified during the Covid-19 crisis. Lockdowns and work-from-home mandates around the country forced people to spend more time in their homes in 2020. In many cases, this led consumers to place greater value on their homes, and prompted a flurry of do-it-yourself activity. As a result, while many retailers were reporting sales declines, Home Depot and Lowe's saw sales grow 18% and 23%, respectively, for the first nine months of the year.

FAVOURABLE MARKET DYNAMICS AND HARD-TO-REPLICATE BUSINESS MODEL

The US home improvement market is worth roughly $650 billion annually. Home Depot (with a 14% market share) and Lowe's (10% market share) dominate the industry; outside of the top two, the market is highly fragmented, with a long and diverse tail of smaller competitors such as regional lumberyards, electrical and plumbing distributors, smaller hardware stores and garden centres.

The value proposition for the big-box retailers is premised on lowest price (scale), breadth of assortment and ubiquity (particularly relevant for professional contractors). Smaller and specialist competitors, on the other hand, often compete on the basis of service levels, reliability of delivery (within the local catchment area) and depth of assortment within category. Given ongoing investment in in-store execution levels, delivery infrastructure and e-commerce (allowing for significantly higher stock-keeping unit [SKU] count online than the retail box), the value proposition of many independents is steadily being eroded by Home Depot and Lowe's. The vast majority of the competitor set lacks the scale and resources to match Home Depot and Lowe's on pricing and capital investment. As a result, big box (Home Depot in particular) has taken market share, and is likely to continue doing so, from the fragmented tail.

Compared to other categories of retail, Home Depot and Lowe's enjoy strong positions relative to Amazon and other pure-play online retailers (e.g. Wayfair and Build.com). The risk of online disintermediation varies by product category – disposable, consumable categories such as light bulbs, paper towels or detergents can readily be sold competitively by Amazon; however, these categories comprise <5% of sales and are typically not drivers of traffic.

On the other end of the spectrum, big-ticket project-based purchases (where purchases from multiple product categories are coordinated across the scope of a remodelling project) lend themselves to the store (where sales associates help coordinate the project). Amazon can conceivably compete for categories such as power tools, but consumers appear to value the product expertise and in-store trial offered by the big-box retailers (e.g. Lowe's has a wall that customers can drill into to test new drills).

In addition, home improvement typically requires a more specialised supply chain. For instance, Home Depot believes that while c.80% of Amazon's sales could theoretically be delivered by drone, only c.30% of Home Depot's sales would be small enough. The average Home Depot delivery weighs 9kg. Both Home Depot and Lowe's are investing heavily in their supply chains to allow for fast and efficient delivery of big and bulky orders. While Amazon, of course, has the resources to replicate, the delivery infrastructure required to get timber and cement to a job site is quite different from Amazon's current configuration.

RISING MAINTENANCE NEEDS SUPPORT DEMAND GROWTH

The backdrop for home improvement retail is structurally attractive. For much of the past decade, Americans have underinvested in residential real estate compared to historical norms. This has led to an ageing of the housing stock – the median home is now over 40 years old, an age where maintenance requirements typically accelerate. In addition, homes have steadily increased in size over time, which naturally also leads to higher maintenance requirements.

House prices have consistently grown by 5% over the past decade, which has resulted in a complete replacement of homeowners' equity that was eroded in the 2008/2009 Global Financial Crisis. When consumers see appreciation in the value of what is, for most households, their largest asset, their willingness to reinvest in maintenance increases.

HOME DEPOT HISTORICALLY THE LEADER, BUT LOWE'S IS CLOSING THE GAP

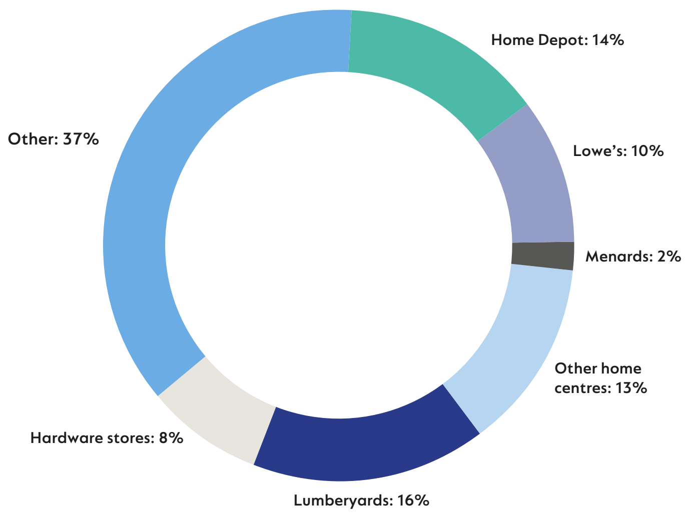
The investment case for both Home Depot and Lowe's remains very compelling. Home Depot is the market share leader, has more productive stores, a greater following among professional customers and higher margins. Nevertheless, despite historically living somewhat in the shadow of Home Depot, Lowe's is our preferred stock in the sector currently.

A new management team, under the leadership of CEO Marvin Ellison, has been in place for the better part of two years now, and has demonstrated a very credible path to narrow the performance gap to Home Depot. For instance, in the past year, non-core businesses have been sold or shut, IT infrastructure has been modernised, merchandising functions have been overhauled and significant investments have been made in logistics.

Many of the changes are simple in nature, but highly impactful. For instance, implementing a task-based labour scheduling system has led to a nearly 50% increase in the amount of time spent serving customers, as opposed to doing administrative >

Figure 1

US HOME IMPROVEMENT RETAIL MARKET SHARE



Sources: North American Retail Hardware Association, Home Depot tasks. Similarly, carrying higher levels of inventory in key items such as lumber has made Lowe's more appealing for professionals. These operational changes are translating into meaningful financial gains. Over the past 12 months, Lowe's has grown revenue by 19% (versus 13% for Home Depot) and operating margins from 9% to 11%. Margins are expected to reach 12% in the next year or so, and 13% soon thereafter (versus Home Depot's current 14%).

SUSTAINABILITY MATTERS

Both Lowe's and Home Depot are responsible corporate citizens – for instance, during the early stages of the pandemic, both companies donated their entire stock of N95 respirator masks to the health-care system, along with other critical items in short supply.

No investment is without risk, and the fortunes of Lowe's and Home Depot cannot be completely divorced from the broader economy and the housing market in particular. Should fiscal stimulus measures fail to adequately compensate for the economic damage wrought by Covid-19, or if interest rates aggressively start rising, the housing economy may be negatively impacted.

Nevertheless, in a retail sector that's been under fire from multiple angles, the big-box home improvement players have been standouts, and are, in our view, likely to continue to outperform. ✚

MARKET REVIEW

From volatility through rebound to recovery

THE COVID-19 PANDEMIC had a dramatic effect on markets during 2020 and resulted in high levels of volatility. Markets fell rapidly as the virus spread, with the S&P 500 losing a third of its value during the first quarter of 2020 before recovering sharply in late March. Anticipation of an economic recovery was aided by record amounts of stimulus and low interest rates.

The rebound continued through the year, with the S&P up 18.4% in US dollars (12.1% for the fourth quarter of 2020 [Q4-20]) to end the year at a record high. Notwithstanding the outbreak of second waves of infection, the fast-tracking of a vaccine roll-out programme is in place across most developed nations. Anticipation of a return to normal levels of economic activity in the second half of 2021 has supported market sentiment.

The MSCI All Country World Index returned 16.3% for 2020, also ending the year at a record high. European markets were weaker (+5.3% for the year; +15.6% in Q4-20), with the UK market (the FTSE 100 returned -9.0% for the year; albeit +17.2% for the quarter), again dominated by Brexit. Gold (+25.1% in US dollars) had its strongest year in a decade, reflecting concern over the ongoing expansion of central bank balance sheets as countries print unprecedented amounts of money.

Emerging markets also performed strongly, up 18.7% for the year and 19.8% in Q4-20 in US dollars. Asian markets outperformed as they were better able to control the spread of the virus and their economies recovered faster (China +29.7% and South Korea +41.8%, both in US dollars for the year). Our multi-asset class funds benefited from exposure to emerging market equities, with strong market performance and good stock picking within the asset class.

The Barclays Global Aggregate Bond Index was up 9.2% in US dollars for the year and 3.3% for Q4-20. We remain cautious on global bonds given the very low yields at which they currently trade, high (and rising) levels of government indebtedness and the risk of inflation.

In South Africa, the All Bond Index returned 6.7% for the quarter, bringing annual performance to 8.7% (in rands). This compares favourably to other domestic asset classes.

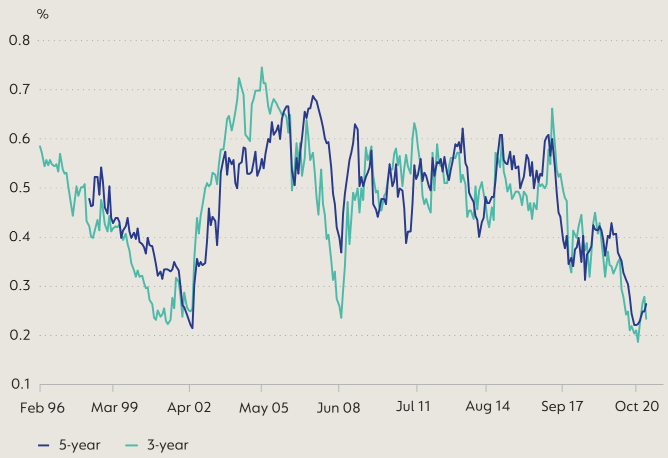
The rand ended the year 3% weaker against the US dollar, but this number belies the volatility seen during the year. At its weakest, the rand lost almost a third of its value relative to the dollar before strengthening on recovering sentiment globally as well as supportive news out of South Africa. In the third quarter of 2020, GDP exceeded expectations, with the rebound in export activity resulting in a sizeable trade surplus. However, weak import demand reflects poor investment confidence.

The JSE All Share Index (ALSI) returned 7.0% for the year and 9.8% for Q4-20. This performance is flattered by the performance of a few mega-caps. The market has been extremely narrow, with only 20% of shares outperforming the ALSI over the last three and five years. The average domestic share has collapsed and currently trades at roughly half its peak. This is reflected in the performance of domestically concentrated sectors, with a decline in the financial and property indices for the year (Financial Index -19.7%, Listed Property Index -34.5%), even after a fourth-quarter bounce (financials +19.5%, property +22.2%).

The industrial sector performed better, returning 7.4% for Q4-20 to end the year up 12.0%. This was driven by a handful of large shares like Naspers (+32%), Prosus (+52.6) and Richemont (+21.5%), which benefited from exposure to more resilient sectors and offshore economies. Resources, with their significant exposure to a resurgent Chinese economy and tight commodity markets, did well (+21.2% for the year).

Figure 1

PERCENTAGE OF STOCKS OUTPERFORMING THE ALSI OVER THREE-YEAR AND FIVE-YEAR PERIODS



Source: Johannesburg Stock Exchange

Key performance indicators and fund performance

AS AT 31 DECEMBER 2020

		QTD	YTD	1 YEAR	3 YEARS	5 YEARS	10 YEARS	15 YEARS	20 YEARS
INTERNATIONAL INDICES [USD]									
Global Equity	MSCI ACWI	14.7%	16.3%	16.3%	10.1%	12.3%	9.1%	7.2%	6.1%
	MSCI WORLD	14.0%	15.9%	15.9%	10.5%	12.2%	9.9%	7.3%	6.0%
	MSCI GEM	19.7%	18.3%	18.3%	6.2%	12.8%	3.6%	6.6%	9.6%
	S&P 500	12.1%	18.4%	18.4%	14.2%	15.2%	13.9%	9.9%	7.5%
Global Property	Global Property (FTSE EPRA/NAREIT Developed Index)	13.5%	(8.2%)	(8.2%)	2.5%	4.7%	6.3%	5.2%	8.1%
Global Bonds	Barclays Global Bond Aggregate	3.3%	9.2%	9.2%	4.8%	4.8%	2.8%	4.1%	4.8%
US Cash	3 Month Libor	0.1%	0.7%	0.7%	1.8%	1.5%	0.9%	1.6%	1.8%
SPOT RATES AND COMMODITY PRICES									
Exchange Rates	Rand Dollar exchange rate	16.8	14.0	14.0	12.4	15.5	6.6	6.3	7.6
	Rand Dollar % change	14.0%	(4.7%)	(4.7%)	(5.6%)	1.0%	(7.7%)	(5.5%)	(3.3%)
	Rand Euro exchange rate	19.6	15.7	15.7	14.9	16.8	8.8	7.5	7.1
	Rand Pound exchange rate	21.6	18.6	18.6	16.7	22.5	10.3	10.9	11.3
Select Commodities	Gold price (USD)	1 886.9	1 523.0	1 523.0	1 296.5	1 062.3	1 405.5	513.0	274.5
	Oil price (USD barrel)	42.3	66.2	66.2	66.5	37.3	94.8	59.4	23.9
SOUTH AFRICAN INDICES [ZAR]									
SA Equity	ALSI (J203T)	9.8%	7.0%	7.0%	3.1%	6.4%	9.6%	11.5%	13.8%
	CAPI (J303T)	10.6%	6.5%	6.5%	2.8%	5.9%	9.5%	11.5%	-
	Capped SWIX (J433)	11.5%	0.6%	0.6%	(1.5%)	3.2%	-	-	-
	Resources Index (J258)	8.3%	21.2%	21.2%	21.6%	23.3%	4.1%	7.7%	12.1%
	Industrial Index (J257)	7.4%	12.0%	12.0%	0.2%	2.9%	12.4%	14.4%	15.0%
	Financials Index ex property	19.0%	(15.6%)	(15.6%)	(5.9%)	2.3%	10.0%	9.5%	-
SA Property	Africa All Property Index (J803T)	23.6%	(35.5%)	(35.5%)	(21.6%)	(11.3%)	2.6%	-	-
SA Bonds	BEASSA (TR) All Bond Index	6.7%	8.7%	8.7%	8.9%	10.4%	8.2%	8.1%	9.9%
SA Cash	Short Term Fixed Interest 3 Month Cash Rate	0.8%	4.8%	4.8%	6.2%	6.6%	6.0%	6.9%	7.6%
SA Inflation	Inflation	0.5%	3.1%	3.1%	3.9%	4.6%	5.1%	5.6%	5.7%

	QTD	YTD	1 YEAR	3 YEARS	5 YEARS	10 YEARS	15 YEARS	20 YEARS	SINCE LAUNCH
DOMESTIC FUNDS (PERFORMANCE IN ZAR)									
Coronation Top 20 Fund	12.9%	9.0%	9.0%	3.5%	9.1%	9.8%	12.6%	16.2%	16.7%
ASISA Mean of South African Equity General	9.6%	1.9%	1.9%	0.2%	3.3%	7.1%	9.1%	13.0%	12.9%
Coronation Market Plus Fund**	9.7%	8.9%	8.9%	4.7%	5.9%	10.0%	11.3%	-	14.6%
ASISA Mean of South African Multi-Asset Flexible	7.2%	2.8%	2.8%	2.0%	3.3%	8.5%	9.3%	-	10.5%
Coronation Balanced Plus Fund	9.0%	8.9%	8.9%	4.8%	5.4%	9.7%	11.1%	13.4%	13.9%
ASISA Mean of South African Multi-Asset High Equity	5.8%	5.1%	5.1%	3.5%	4.4%	7.9%	8.9%	12.0%	11.9%
Coronation Capital Plus Fund	7.0%	6.8%	6.8%	4.4%	4.9%	7.7%	9.1%	-	11.3%
ASISA Mean of South African Multi-Asset Medium Equity	4.5%	5.1%	5.1%	4.1%	4.6%	7.4%	8.0%	-	10.5%
Coronation Balanced Defensive Fund	4.7%	6.4%	6.4%	5.9%	5.9%	8.8%	-	-	9.1%
ASISA Mean of South African Multi-Asset Low Equity	3.6%	4.9%	4.9%	4.8%	5.2%	7.4%	-	-	7.4%
Coronation Strategic Income Fund	2.4%	4.5%	4.5%	6.7%	7.7%	8.2%	8.6%	-	9.9%
ASISA Mean of South African Multi-Asset Income	2.5%	6.0%	6.0%	7.2%	7.6%	7.0%	7.5%	-	8.9%
INTERNATIONAL FUNDS (PERFORMANCE IN USD)									
Coronation Global Equity Select Fund	16.8%	14.1%	14.1%	7.9%	11.8%	-	-	-	8.1%
Coronation Optimum Growth Fund	13.2%	15.9%	15.9%	8.6%	11.9%	8.0%	6.6%	10.2%	10.1%
Coronation Global Managed Fund	11.3%	9.5%	9.5%	5.1%	8.0%	6.6%	-	-	6.8%
Coronation Global Capital Plus Fund	5.6%	3.4%	3.4%	3.5%	4.8%	3.7%	-	-	4.2%
Coronation Global Strategic Income Fund	1.4%	1.2%	1.2%	1.8%	2.0%	-	-	-	2.4%

* All ASISA averages exclude Coronation funds in that category

Meaningful periods

** 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

Note for funds on page 43

Highest annual return (Coronation Optimum Growth): 51.1% (Jan 2013 - Dec 2013); lowest annual return: -31.5% (Mar 2008 - Feb 2009); Fund launch date: 15 March 1999

Highest annual return (Coronation Global Emerging Markets): 106.2% (March 2009-Feb 2010); lowest annual return: -33.6% (Sept 2014-Aug 2015); Fund launch date: 14 July 2008

Figures as at 31 December 2020; for detailed fund performance, refer to pages 48 and 50.

FUND UPDATE

Coronation Balanced Plus and Coronation Equity funds

By **KARL LEINBERGER, SARAH-JANE ALEXANDER** *and* **ADRIAN ZETLER**

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

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

Adrian is a portfolio manager with 12 years of investment industry experience.

FOR THE 2020 calendar year, Coronation Equity delivered 14.2% relative to the benchmark return of 8.4%, while Balanced Plus delivered a return of 8.9%, benefiting from value-adding asset allocation decisions and strong alpha in domestic equity. For Q4-20, Equity returned 13% and Balanced Plus returned 9%. The funds have performed well against their respective peer groups over meaningful time periods.

PORTFOLIO POSITIONS

The portfolios were well positioned in the domestic equity market, with a high exposure to the rand hedge names and resources. Selected rand hedge stocks remain attractive for a variety of stock-specific reasons. Major holdings include Naspers (+32%), British American Tobacco (-1.5%), Quilter (9.1%), Bidcorp (-19%), Textainer (104.9%) and Aspen (+5.2%). Despite slashing our expectations for domestic shares, their meaningful underperformance during the year means many of these names now look undervalued, with investor concerns reflected in single-digit price earnings. Over the last few quarters, we increased our weighting in the banks (predominantly FirstRand), life insurers (Momentum Metropolitan Holdings and Sanlam) and several others. Results from domestic businesses have exceeded our expectations thus far, with more top-line resilience and better cost control than we had anticipated.

We remain concerned about headwinds into 2021 as a weak macroeconomic environment persists and cost-cutting efforts result in another round of retrenchments. Banks, too, have exceeded our expectations as borrowers resume debt repayments and low interest rates improve affordability. Sizeable provisions offer near-term protection to bank earnings in a weaker economic environment. The funds remain underweight domestic businesses. Despite the selloff in property shares, we have not built up the position given concerns over the long-term outlook for rentals and weak balance sheets.

RESOURCES REMAIN ATTRACTIVE

Notwithstanding the outperformance by the resource shares, they remain a meaningful part of equity exposure, given undemanding valuations and solid free cash flow. The diversified miners are benefiting from tight markets, given the resilience of Chinese demand and a limited supply response due to disciplined capital expenditure over the last few years. The funds continue to hold a sizeable position in Anglo American, which despite its performance (+25.9%, +19.1% for the quarter) still trades on an attractive price-to-earnings ratio of less than 10 times one year forward. The funds also hold a position in Glencore (+8.0% for the year and +33.3% for the quarter), which, with its attractive commodity basket, should benefit meaningfully from decarbonisation. We see material upside, even after applying environmental, social and governance (ESG) factor penalties.

The platinum group metals holdings in the portfolio (Northam +69.5% for the year and +23.1% for the quarter; Impala +47.7% for the year and +38.8% for the quarter) performed very well. They are expected to deliver material returns to shareholders as earnings growth is underpinned by tight markets on the back of mounting emissions regulations and a decade of underinvestment by the sector. Strong balance sheets and bounteous free cash flow generation enable high levels of cash return.

With the strong movement in the gold price, our underweight position in the gold equities hurt performance, given the leveraged nature of earnings for their high-cost, short-life assets. We used the selloff in the fourth quarter of 2020 (Q4-20) to start buying AngloGold. Balanced Plus benefited from exposure to physical gold in the year.

A TENUOUS SITUATION

Although Covid-19-related economic shutdowns and fiscal stimulus resulted in deteriorating fiscal metrics around the world, the South African situation was compounded by the country entering the pandemic with an already weak balance sheet. The October Medium Term Budget Policy Statement proposed a plan to cut levels of government expenditure by reducing the wage bill, but this will require union support and a willingness to endure sustained austerity.

Without these cuts, South Africa's debt-to-GDP levels will continue deteriorating and debt restructuring will be required. This tenuous situation is reflected in bonds yielding well above cash returns. We see better value at the long end of the curve where lower bond prices offer more protection. Despite the attractive yield, we continue to reassess the Balanced Plus Fund's exposure to bonds, given the risk.

OFFSHORE TECH BENEFITED

Both funds benefited from their offshore allocations as international markets rebounded more rapidly, given better management of the pandemic. In particular, the exposure to technology companies aided performance where Covid-19 resulted in an acceleration in the digital economy as many parts of the physical economy were locked down.

The Equity Fund's investments in JD.Com, Spotify, Alphabet, Facebook, Alibaba and MakeMyTrip all contributed to performance during 2020. MakeMyTrip was hard hit by the initial selloff, but recovered strongly in Q4-20 on an anticipated recovery in travel. A new position was established in Tencent Music Entertainment Group, which owns the leading music streaming platform in China. The business already has more than 650 million monthly users, but still has relatively low levels of monetisation.

The growing strength of technology companies in many sectors has increased scrutiny and is likely to result in tighter regulation. Despite this headwind, we believe the potency of the business models, with their compelling user offers, means these businesses will continue to grow strongly in the years ahead. The valuations therefore support continued ownership.

Throughout the volatility experienced during 2020, we have retained our commitment to investing for the long term. We have tried to use the uncertainty created by the pandemic to build robust portfolios of assets where we believe the market is mispricing the long-term fundamentals. We believe this will continue to deliver compelling returns in the coming years. +

FUND UPDATE

Coronation Capital Plus and Balanced Defensive funds

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

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

Pallavi co-manages the Absolute Return funds with Charles De Kock and has 18 years of investment experience.

THE YEAR 2020 was one that investors will never forget. The Covid-19 pandemic, the economic lockdowns, and the immense fiscal and monetary stimulus thrown at the problem created an exceptionally volatile investment environment. Many businesses and some industries, such as those linked to hospitality, tourism and travel, suffered immense damage. The lockdowns also accelerated the already fast-growing e-commerce sector, while work-from-home became the norm for many who had never thought it likely. The knock-on effects of these trends affected the normally safe property sector disproportionately.

During the fourth quarter of 2020 (Q4-20), encouraging news around the development of vaccines against the virus, as well as the Biden election victory in the US, were welcomed by financial markets, especially in the emerging economies where the new US administration is expected to move away from the trade war stance of the Trump era and pursue more trade-friendly policies. South Africa was no exception and experienced a strong rand and soaring stock market. The rand gained 12.3% against the US dollar, the JSE Capped Shareholder Weighted All Share Index rose by a whopping 11.5%, the beleaguered quoted property sector recovered some of its losses and declining yields also assisted the All Bond Index to post a 6.7% return.

The funds were well positioned to benefit from these developments. Capital Plus and Balanced Defensive posted a 6.96% and 4.75% return, respectively, for Q4-20, which lifted their one-year returns to a respectable 6.84% and 6.43%, respectively. It is a result that seemed unlikely at the end of the Q1-20. From the end of Q1-20, Capital Plus staged a very strong recovery, posting a 21.6% return over the past nine months. Its annualised two-year return of 8.02% is also ahead of the targeted inflation plus 4% return. The longer-term returns are 4.38% over the past three years, 4.85% over the past five years and 7.67% over the 10-year period.

In the case of Balanced Defensive, the annualised two-year return of 7.95% is also ahead of the targeted inflation plus 3% return. The longer-term returns for Balanced Defensive are 5.92% over the past three years, 5.88% over the past five years and 8.8% over the 10-year period. All numbers are annualised. The funds have exceeded inflation over all periods, but have fallen short of the targeted inflation plus 3% and 4% over the three- and five-year time horizons. The inflation-plus targets have proven to be a tough hurdle to meet for funds in the sector over the medium term. We are, however, confident that the target outperformance trend of the past two years can continue.

CLEAN ENERGY METALS FAVOURABLE

When the huge downturn came in March last year, the funds were light in cash, especially in hard currency cash, which was the only real safe haven in that tumultuous month. We, however, stuck to our strategy and, in fact, added to equities over the rest of the year, based on the very attractive valuations we found in many listed stocks. The funds' exposure to listed equities, domestic and global, is high relative to history (in the case of Balanced Defensive, we bumped against the upper limit of 40% for the first time since the Fund's launch 14 years ago). This is a sure sign of the absolute and relative value we see in equities. Money market interest rates are currently at the lowest level since the 1960s, and we think they are likely to remain at these low levels for at least another year. Inflation has also surprised on the downside and, although we expect it to accelerate somewhat, it should remain comfortably below the midpoint of the South African Reserve Bank's targeted range for the next year or two.

The global trend towards cleaner energy is a long-term one. This trend is favourable for many metals including copper, cobalt, nickel and the platinum group metals. In our view, Anglo American is well positioned to benefit from this trend. In addition, its balance sheet is very strong and is expected to reward shareholders with a very strong dividend flow. Anglo American is the second-largest holding in our equity portfolio, as we believe it still offers very good value, even after its strong performance over the past year.

The top contributors to performance during 2020 were Naspers/Prosus, Anglo American, the platinum stocks, Impala and Northam, and Altron. Detractors were the bank shares – Nedbank, Standard Bank and FirstRand – and Sasol and MTN. The listed property sector also detracted from performance.

DEBT MANAGEMENT IS ESSENTIAL

In the interest-bearing category, the government yield curve is exceptionally steep, reflecting the concerns that bond investors have over the fiscal state of affairs. South Africa finds itself in a debt trap that has arisen due to a decade of far too high government expenditure followed by a massive loss of revenue due to the self-imposed economic lockdown. Government debt to GDP is rising ever higher and will approach the 100% level if not addressed drastically. The only good way out of the fiscal mess government finds itself in is for the economy to grow enough so that tax receipts rise. The low confidence levels and power supply issues of Eskom make us cynical about our growth prospects. That leaves strict controls on government spending as the obvious route to follow to avert the debt trap. This is no easy task and calls for some unpopular measures around the payment of civil servants and the culling of loss-making State-owned enterprises. Bond investors are clearly concerned that the bold steps needed will not be taken. We share those concerns and are consequently not taking on excessive long duration in this low-risk portfolio. We continue to hold a diverse spread of bonds, including corporate bonds and inflation linkers. ✚

FUND UPDATE

Coronation Market Plus and Top 20 funds

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

Neville is a senior portfolio manager with 24 years of investment experience.

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

THE FUNDS FINISHED the year on a strong note, driven by a very good recovery in local and global equity markets. Market Plus returned 9.6% for the fourth quarter of 2020 (Q4-20), which brought the full year return to 8.9%, while Top 20 ended its 20th anniversary year with a very strong 12.8% in Q4-20, resulting in a 9% return for the year. Since inception, Top 20 has returned 16.7% per annum. We are very proud to have delivered this over the years to our loyal clients. An investment at the inception of the Fund would have delivered a return double that of an equivalent investment in its benchmark.

COMMODITIES ADDED VALUE

The big driver behind Top 20's performance for the quarter was the commodity exposure in the portfolio, which remained high throughout the year, despite the extreme volatility we have seen. The key premise behind our commodity view has remained that of improved discipline by the global commodity producers, which means we have not seen the usual supply response to higher prices. On top of this, the rampant money printing by central banks around the world and various stimulus plans to offset lockdowns have resulted in commodity prices moving up rapidly as the dollar weakened and expectations for further weakness remain. Despite the record-high commodity prices in key metals and the very strong cash flows that mining companies are producing, we initially did not see much movement in mining share prices. Markets have remained sceptical about the investment case for mining shares after previous boom-bust cycles. As it becomes evident that there is no significant new supply coming in and that mining companies will reward shareholders with strong cash flows from higher prices, you are likely to see a further re-rating of the commodity sector, in our view.

Our exposures in the Fund are predominantly in the diversified major commodity miners – Anglo American, Glencore and BHP Billiton. On spot prices (which we do think are above normal prices), these companies are all trading on high single-digit or even double-digit cash flow yields. Therefore, even though we think commodity prices will eventually retrace towards more normal levels, there is the prospect of very good dividends to shareholders in the medium term, and there is still upside to the miners, even based on our assessment of normal commodity prices, which is lower than where they are today.

While not a major diversified miner, Exxaro offers exposure to iron ore, thermal and coking coal, and mineral sands. South Africa will remain a major user of thermal coal to power its fleet of coal power stations for the foreseeable future, and it is imperative that coal supply remains intact to ensure a stable electricity supply. Therefore, despite the pressure on coal assets in developed markets, we still think it is important to support a well-managed and responsibly run supplier of coal to the local market. Based on the current Exxaro share price, all that one is paying for today is the iron ore assets; all the other assets are received for free. We think this is an overly pessimistic view on the stock and remain supportive investors in Exxaro to enable it to manage down its coal business in a socially responsible manner, while providing great returns to shareholders.

Our other big commodity exposure remains the platinum group metal (PGM) miners. The current deficit in palladium supply and the increasing recognition of a deficit looming in platinum have seen the prices of these metals move up significantly. Despite this recovery in metal prices and some movement in share prices, the PGM miners' share prices are still trading on single-digit earnings multiples. Much like the trend we have seen with the diversified miners, none of this cashflow is being invested in new mine expansions, but rather being returned to shareholders. This means prices should remain higher for longer and that investors stand to benefit from the strong earnings being delivered by these companies.

FINANCIAL SERVICES EXPOSURE

The last quarter also saw the beginning of a re-rating for some of the very hard-hit domestic shares that Top 20 owns. As the rand started to strengthen and the gloom over the general economy started to lift, we saw a sharp rise in the prices of the banks in particular. A lot of this happened in tandem with the improvement in the valuation of the South African government bond curve. Our two large bank holdings, Nedbank and Standard Bank, were up 28% and 17%, respectively, in this period. Despite this recovery, they are still offering significant value. Our recently purchased position in Bidvest also increased by 13% in the quarter, also benefiting from improved sentiment to the South African economy. However, as the new lockdown takes effect and the virus appears to be hitting a second wave, we are still very circumspect around our exposure to the local economy. We prefer more defensive businesses with the ability to drive earnings growth, even under constrained conditions.

Top 20's holding in Quilter, the UK-domiciled fund platform and advice business, has performed well, even though the rand strengthened in Q4-20. This has been driven predominantly by the successful conclusion of the largest part of the company's IT transformation journey, having re-platformed its main system to a new, significantly improved, functionality provider. With the project completed, the company should again be able to focus on growing its market share, especially as it is able to offer a very compelling solution to clients. In the meantime, the shareholder-friendly management team has continued with share buy-backs, enhancing the overall return for remaining shareholders.

Looking forward into 2021, we believe Top 20 remains very well positioned to continue to deliver long-term returns ahead of the market. 2020 gave us the opportunity to reposition the Fund into high-quality investments at very attractive prices. While markets have recovered to pre-Covid-19 levels, this recovery has been very uneven, and, as a result, we still see significant value in specific shares, making this environment very attractive to active managers.

DIVERSIFICATION BENEFITS

This was also a year where well-managed asset allocation funds could prove their mettle, and we are glad that Market Plus succeeded in minimising losses during the aggressive market selloff and benefited during the sharp recovery experienced thereafter. Use of active protection strategies, such as put options and owning non-correlated investments, as well as tactical increases in cheap equity and domestic bonds after the initial selloff, helped the Fund weather the storm and deliver inflation-beating returns.

Heading into Q4-20, we added to our domestic equity exposure in Market Plus. While most equity markets around the world were already above their pre-Covid-19 starting levels, the domestic market had lagged due to country-specific reasons. After months of holding off, we felt it was the right time to increase our local exposure, and this paid off in the period. Over and above the broad move up in the market, our funds benefited from the significant alpha generated by Coronation in its domestic equity allocations this year (as described earlier). Exposure to the resources sector saw our equity allocations deliver a stand-out year of outperformance, well ahead of the benchmark.

While the funds have been underweight the more South Africa-specific stocks during 2020, we reduced this underweight in Q4-20, and benefited from some of the recovery that we saw in the very cheap South Africa-specific stocks. These stocks remain cheap, given the very uncertain outlook

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for the local economy for 2021 as a second wave of Covid-19 infections has necessitated further lockdowns and restrictions.

Market Plus's global equity allocation benefited from a high exposure to emerging markets. This exposure is held via the Coronation Emerging Markets Fund, which had another great year, producing a return well ahead of the benchmark, which itself was ahead of the global market index. With the prospect of a weaker dollar remaining a high probability, given the US Federal Reserve Board's position on rates and Democratic Party control of both the House and the Senate, emerging markets should continue to outperform in the period ahead.

We have remained very circumspect on property, given the significant disruption that lockdowns have had on property usage and rentals. In Market Plus, we made small tactical moves, benefiting from very extreme valuations, but overall, the strategy has been to ensure only very defensive allocations to companies with strong balance sheets. With interest rates likely to remain lower for longer, there will ultimately come a time when the high yields available from property stocks will be viewed as attractive again. The opportunity for great returns is evident, but one needs to be extremely careful to avoid those companies with stretched balance sheets or fundamentally overvalued portfolios.

BOND HOLDINGS

The one asset class still offering good yield is South African government bonds. South Africa has one of the steepest yield curves in the world, where overnight money is earning 3.5%, while 16-year bonds are still offering a return in excess of 10%. Markets are clearly worried about the fiscal situation in South Africa, but the state of our fiscus is not significantly worse than that of many other emerging markets, and it is actually a lot better than that of many developed markets.

The main issue, in a kind of chicken-and-egg conundrum, is the high interest rates on South African debt. Were yields to be a lot lower, our debt burden would not be such an issue. What is needed is a return of confidence in the South African government, its budgeting and the country's economic outlook. If that can be achieved, it will drive a virtuous circle of reducing our funding costs, improving the outlook for the fiscus, which would further drive rates lower.

In the meantime, earning a real return of 6% while one waits compensates for a lot of the risk, in our view. In contrast to this, credit in the local market has rallied very hard, such that good quality corporates are trading below the yield of equivalent tenor government bonds. This market has been overdone and, barring special situations, there is very little upside in the credit market. An example of where some special situations have played out well for Market Plus is our exposure to convertible bonds. The Fund benefited from early investments in Impala and Royal Bafokeng convertible bonds. With the share prices up significantly, the embedded call options in these bonds have become very valuable. In Q4-20, we also invested in a Sappi convertible and a convertible issued by Capital and Counties in the UK.

Other alternative investments have also added to Market Plus's returns this year. We have benefited from direct commodity exposure, mainly to platinum and gold, but also from a smaller position in copper. These investments are still in place and we expect there to be continued price appreciation, given our view on the US dollar.

After a number of tough years, it is pleasing to be able to have delivered a decent absolute return to our clients for the second consecutive year. Given the yields and valuations in the current Market Plus portfolio, we expect to be able to continue to show good returns, well ahead of inflation for the medium term. ✚

FUND UPDATE

Coronation Strategic Income Fund

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

Nishan is head of Fixed Interest and has 18 years of investment experience.

Mauro is Head of Fixed Interest Research and a portfolio manager and has 10 years of investment industry experience.

The Fund returned 2.4% in the fourth quarter of 2020 (Q4-20), bringing its total return to 4.5% for the 12-month period. This return is behind cash at 4.8%, and the Fund's benchmark at 5.4%. During periods of extreme uncertainty that result in poor asset class performance, where many assets underperform cash, the best that managed income fund investors can hope for is a return in line with, or slightly below, cash. In a multi-asset class portfolio, even if one could move the entire portfolio to cash at exactly the right point, the costs incurred in doing so would still result in a return that is below cash returns. This is how asset class behaviour played out in 2020.

Inflation-linked bonds (ILBs) produced a return of 4.2%, preference shares returned -11.3% and listed property returned -35.5%. Only bonds, with a return of 8.7%, produced a return above cash. South African government bonds (SAGBS) continue to be our preferred asset class, but to produce a portfolio return that is line with historical experience (cash + 2%, which was c.6.8% in 2020), the required bond exposure level is too high to be consistent with the Fund's risk budget.

The local bond market yield curve steepened aggressively, with the 10-year bond trading in excess of 200 basis points (bps) above the five-year bond and almost 600bps above cash rates. As a result, the three- to seven-year area of the yield curve provided the best return in 2020, at 16.3%, and the longer end of the curve (>12 years) provided the poorest return of 4.6%. ILBs delivered poorer absolute returns of 4.2%, but provided a similar pattern of return across the ILB yield curve (the front end outperforming the longer end).

GLOBAL ENVIRONMENT

In the US, the Federal Open Market Committee left the target range for the federal funds rate unchanged at 0%-0.25% at its December meeting. The Committee's guidance indicated that it would closely monitor the pace and size of asset purchases until substantial economic progress has been made towards meeting its inflation and employment targets. The US Congress passed an $892 billion Covid-19 stimulus package to shield the economy from the effects of the pandemic. Headline inflation in November was unchanged from October's print of 1.2% year on year (y/y). Medical care services prices continued to decline, together with transport costs. Core inflation remained unchanged at 1.6% y/y.

In emerging markets, China's headline inflation contracted by 0.5% y/y in November, following an increase of 0.5% y/y in October. This moderation

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came on the back of a sharp decline in food prices and a slowdown in transport, household goods and services prices. Core inflation remained unchanged at 0.5% y/y. Elsewhere, the impact of Covid-19 on growth is still evolving, with many countries still battling rising infection rates and relatively stringent lockdown restrictions. Central banks, on balance, are maintaining their accommodative stance.

LOCAL STATE OF PLAY

The South African economy grew by 66.1% on a seasonally adjusted average (saa) quarter-on-quarter (q/q) basis for the third quarter of 2020 (Q3-20). This follows a revised 51.7% saa q/q contraction in Q2-20. The sectors with the most robust production-side recoveries were mining, manufacturing and trade. From the expenditure side, household consumption and net exports were the biggest drivers of growth. Early data surveys for performance in the fourth quarter show normalisation of production in most sectors, supported by strong global demand and stable commodity prices. However, the recent spike in Covid-19 infections and renewed lockdown restrictions pose a considerable downside risk to growth going forward, notably in the absence of an effective vaccination strategy. This may create an opportunity for further rate cuts.

The rand gained 14% against the US dollar over Q4-20, ending the year at $1/R14.69. The easing of lockdown measures globally and initial indications that the expected contraction would not be as severe as initially thought, served to buoy risk sentiment and emerging market currencies. However, the local fundamental backdrop remains quite poor. The Fund maintains its healthy exposure to offshore assets and, when valuations are stretched, will hedge/unhedge portions of its exposure back into rands/dollars by selling/buying JSE-traded currency futures (US dollars, UK pounds and euros). These instruments are used to adjust the Fund's exposure synthetically, allowing it to maintain its core holdings in offshore assets. In addition, the Fund currently has option structures in place to protect its holding if the rand moves materially below $1/R16 on a sustained basis.

At the end of December, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 4.8% (three-year) and 5.8% (five-year), tighter than the previous month. Shorter-dated NCDs have pulled lower due to the significant interest rate cuts, recovery in bond yields and tightening of credit spreads. Short-dated fixed-rate NCDs continue to hold appeal due to the inherent protection offered by their yields and relative to our expectations for a lower repo rate. In addition, NCDs have the added benefit of being liquid, thus aligning the liquidity of the Fund with the needs of its investors. The Fund continues to hold decent exposure to these instruments (fewer floating than fixed), but we will remain cautious and selective when increasing exposure.

VACCINE, DEBT MANAGEMENT AND CONFIDENCE ARE KEY

The globe and South Africa remain firmly in the grips of the second wave of infections. As the numbers turn into names and the names turn into people we know, the harsh reality of Covid-19 has dawned on many of us as we enter 2021. Even more stark are the difficult tasks and choices that lie ahead of the country. South Africa remains on the precipice of a debt trap.

There are only two ways to escape: either increase growth so that tax revenue rises sufficiently to compensate for increased spending, or decrease spending to balance the equation. This needs to be done while keeping borrowing costs low enough to ensure that debt financing doesn't consume all available expenditure and that no extraordinary support is needed by any State-owned or guaranteed entity. Inflation is expected to remain relatively well contained over the next two to three years, averaging around 4.5% over the period. This means that one needs to see real growth of 3%-4% to generate nominal growth of c.8%, which is needed to stabilise the nation's debt profile.

Government has made progress towards reigniting local growth by attempting to revive business confidence and infrastructure development. However, this will only bear fruit over the medium to longer term. This means that expenditure will have to be reallocated and contained until growth starts to pick up. Progress is being made in this regard with the high court ruling in favour of the 2020 public sector wage freeze and government attempting to keep wages frozen for the next three years. The health of State-owned companies and municipalities remains a concern, with Covid-19 placing even further pressure on these vulnerable entities. Thus, the risk of fiscal slippage is high, rendering the fundamental economic backdrop unsettled.

Underlying economic conditions are easing, but remain challenging, given South Africa's poor starting point. Inflation will remain under control, but a stronger shift needs to be made towards higher growth without pushing the country further into a debt trap. Progress has been made by reallocating expenditure away from a bloated wage bill towards pro-growth elements; however, further unpalatable austerity might be required if reforms are not accelerated. SAGBs, despite their rally at the end of 2020, still encapsulate a significant risk premium that provides a decent offset to the underlying fundamental backdrop. Shorter-dated ILBs, with their elevated real yields and inherent inflation protection, also provide an attractive allocation opportunity for income portfolios.

ONLY SELECT PROPERTY COUNTERS PASS MUSTER

The local listed property sector was up 23.6% in the last quarter of 2020, reducing its decline to -35.5% over 2020. Listed property has been the largest drag on the Fund's performance. The current crisis will reduce rental income, put pressure on asset values, increase the cost of borrowing for lower-quality businesses and test inexperienced management teams. It is entirely possible that most of the companies will require additional capital and that dividends are suspended to preserve capital. One must be cautious not to take high yields at face value and understand how the key issues mentioned above affect that yield. We believe there are a few select large-cap counters that satisfy our stringent conditionality.

The FTSE/JSE Preference Share Index was up 13.9% in the last quarter, bringing its 2020 return to -11.3%. Preference shares offer a steady dividend yield linked to the prime rate and, depending on the risk profile of the issuer, currently yield between 8% and 10% (subject to a 20% dividends tax, depending on the investor entity). The change in capital structure requirements mandated by Basel III will discourage banks from issuing preference shares. This will limit availability. In addition, most of the bank-related preference shares trade at a discount, which enhances their attractiveness for holders from a total return perspective and increases the likelihood of bank buybacks. Despite attractive valuations, this asset class will continue to dissipate, given the lack of new issuance and because of its associated risks being classified as eligible loss-absorbing capital (only senior to equity). The Fund maintains select exposure to certain high-quality corporate preference shares but will not actively look to increase its holdings.

LOOKING AHEAD

We remain vigilant of the risks emanating from the dislocations between stretched valuations and the underlying fundamentals of the local economy. However, we believe the Fund's current positioning correctly reflects appropriate levels of caution.

The Fund's yield of 5.36.% remains attractive relative to its duration risk. We continue to believe that this yield is an adequate proxy for expected Fund performance over the next 12 months.

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

FUND UPDATE

Global Equity Select, Global Managed and Global Capital Plus funds

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

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

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

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

EQUITY MARKETS CONTINUED their recovery from the March lows and delivered a strong 14.7% return in the fourth quarter (Q4-20). There were some notable macro events, including the US Presidential election, and second and third waves of the Covid-19 pandemic, but the quarter was perhaps dominated by the news of successful vaccine developments by a host of pharmaceutical companies with seemingly high efficacy. This triggered a violent rotation in markets, out of the recent 'Covid-19 winners' into perceived 'opening up' beneficiaries.

The funds performed well in Q4-20 against this backdrop, with Global Equity Select returning 16.8% in Q4-20 (2.1% ahead of the benchmark), Global Managed returning 11.3% (1.3% ahead of the benchmark) and Global Capital Plus returning 5.6% in the quarter (well ahead of the benchmark, which was virtually flat). For the year, markets returned 16.3%, which many will think remarkable, considering the economic disruption wreaked by the pandemic.

CONTRIBUTORS

The primary contributors to the return from Global Managed were:

- Equity holdings, which returned 17% for the year (ahead of the MSCI All Country World Index's [ACWI] 16.3%). It is pleasing to note that, after passing the Fund's 10-year mark, the core equity building block has added value over this meaningful time period, delivering 11.9% p.a. (1.8% p.a. ahead of the benchmark over this period).
- Gold, which increased 24.2% for the year.
- Fixed interest returned 6.2%, which is healthy in absolute terms, compared to inflation and considering the very low duration of the portfolio, although clearly lagging the Global Bond Index's 9.2%.

The primary contributors to return for Global Capital Plus were:

- Equity holdings, which returned 11.4% for the year. Over 10 years, the Fund's equity holdings have compounded at 10.7% p.a. (which is ahead of the ACWI).
- Gold, which increased 24.2% for the year.
- Fixed interest returned 5.2%, which is healthy in absolute terms, compared to inflation and considering the very low duration of the portfolio, although clearly lagging the Global Bond Index's 9.2%.

STREAMING REVENUE

Spotify was a top contributor for the year and a meaningful contributor for the quarter, with its shares up over 100% in 2020, as the market started to appreciate its multi-year growth potential (as outlined in previous commentaries). Spotify is the leading player (ex-China) in the fast-growing audio streaming market and will benefit from two powerful tailwinds, both of which are in the very early stages. First, music remains extremely under-monetised compared to other forms of media and in absolute terms, with US spending per capita halving in real terms since 1999. Secondly, traditional radio is a $30 billion-plus global revenue pool that is in the very early stages of the inevitable shift to online, and Spotify is aggressively trying to accelerate this move by investing in leading podcast content and creation tools.

Since 2015, Spotify has grown its revenue by 37% p.a. and we expect this strong growth to continue, forecasting growth of over 20% p.a. and steadily expanding margins going forward. With its excellent and innovative management team led by its visionary founder Daniel Ek, we believe that Spotify is well positioned for future growth. The stock has tripled from the lows, and with less upside to our estimated fair value, the Funds' holdings have been reduced.

AIRBUS RESILIENT

Airbus, reflecting the rotation within markets, was both a top-two contributor for the quarter and a top-two detractor for the year. After a precipitous decline in the first quarter of the year, Airbus's share price basically flatlined until early November and the announcement of Pfizer/BioNTech's strong Covid-19 vaccine results.

Despite returning 50% for the quarter (in US dollars), Airbus is still trading more than a third lower than pre-Covid-19 levels. This compares to the market which, as we know, is c.15% higher (at all-time highs). We recognise the high levels of uncertainty in the near-term, but believe that Airbus shares are offering a high margin of safety on a long-term horizon, as they are pricing in that air-travel growth will remain at levels c.20% below its 50-year growth trend, in perpetuity. Thanks to its robust initial balance sheet, and to moves that further increased the company's liquidity during the year, we are comfortable that Airbus can withstand a challenging environment for several months or even years ahead.

In fact, we think it is possible that Airbus could end the year in a net cash position, which was unthinkable a few months ago. We are also encouraged by the potential for a much-improved competitive position against its US peer Boeing, which is hamstrung by an over-leveraged balance sheet and has suffered a meaningful hit to brand equity through the 737MAX crisis. Finally, several vaccines have been approved and immunisation programmes are being rapidly rolled out; it would seem that the path to some form of economic normalisation is growing clearer and closer. We remain cautiously optimistic.

POST-PANDEMIC REBOUND LIKELY TO BE STRONG

The departure point for markets at the start of 2021 is provocative: many indices start the year at record highs, driven by a few mega-caps, with speculative froth evident in some hyper-growth sectors, in capital markets activity (especially some initial public offerings and special purpose acquisition companies) and in the behaviour of frenetic retail traders. However, interest rates are low, savings rates have exploded, monetary stimulus is set to be followed by fiscal stimulus, and economies will grow well above trend once the world emerges from the Covid-19 pandemic.

We continue to hold a balanced portfolio of competitively advantaged businesses in our equity allocations. This includes some of the mega-caps that have performed for a long period of time – these still have strong growth prospects and are phenomenal businesses. Also, some of the stocks left behind in the 2020 rally that had unjustifiably low starting valuations will be beneficiaries of world economies normalising. There would seem to be ample opportunities for stock pickers.

PORTFOLIO POSITIONING: GLOBAL MANAGED

At quarter-end, Global Managed was positioned with just under 70% in growth, or risk, assets comprised of the following:

- 56% effective equity
- 4% in property
- 3.5% in infrastructure
- 1.5% in convertible instruments
- 4.5% in high yield credit.

The remaining 30% of the Fund is invested in either more stable assets, or diversifying assets, which we think have lower correlations to equities:

- 7% in commodities
- 5% in inflation-linked bonds
- 5% in hedged equity
- 13% in investment-grade fixed income (with 5% in short-dated treasury bills and 4% in corporate credit).

PORTFOLIO POSITIONING: GLOBAL CAPITAL PLUS

At quarter-end, the Fund was positioned with c.47% in growth, or risk, assets comprised of the following:

- 28% effective equity
- 5% in property
- 4% in infrastructure
- 2% in convertible instruments
- 8% in high yield credit.

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The remaining c.53% of the Fund is invested in either more stable assets, or diversifying assets, which we think have lower correlations to equities:

- 8% in commodities
- 5% in inflation-linked bonds
- 6% in hedged equity
- 33.5% in investment-grade fixed income (with 9% in short-dated treasury bills and 29% in corporate credit).

As highlighted in prior commentaries, we continue to feel that the fundamental diversification evident in this portfolio construction, with an intentional tilt towards inflation protection at the expense of nominal government bonds, is both more appropriate and more robust than that of Global Managed's benchmark, which includes a 40% weighting to global government bonds. As a reminder, the bond index as a whole offers an expected return (if held to maturity) of less than 1% and a duration of approximately seven years. Setting this meagre return against the risks, which we feel are significant, including huge budget deficits and elevated debt levels, suggests to us that this part of the Fund's benchmark offers a poor risk-reward trade-off and that investors will do well to avoid these instruments entirely. In our view, they will be better served over the long term in diversifying assets, as outlined above.

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

FUND UPDATE

Optimum Growth and Global Emerging Markets funds

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

Head of Global Emerging Markets, Gavin has 22 years' experience as an investment analyst and portfolio manager.

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

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

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

OPTIMUM GROWTH DECLINED 0.7% in rands in the fourth quarter of 2020 (Q4-20), compared with a 3.4% benchmark return. As the Fund is rand denominated and most of the underlying exposure is in foreign currency, the strengthening of the rand (14% stronger) this quarter was the primary contributor towards the negative absolute return in rands. After strong alpha generation in the first nine months of the year, it is disappointing to underperform this quarter, but it is still pleasing to note that the Fund delivered a rand return for the year of 21.6%, resulting in 6.8% alpha. It can be expected that, in the short term, the Fund may underperform the benchmark, but we remain focused and excited that it is well positioned to achieve long-term outperformance. Over the last five years, Optimum Growth has generated a positive return of 10.8% p.a.; over 10 years, a return of 16.9% p.a.; and since inception over 20 years ago, 14.5% p.a. (3.1% annualised outperformance).

The Coronation Global Emerging Markets (GEM) Fund returned 20.0% in US dollars during Q4-20, 0.3% ahead of the 19.7% return of the benchmark. For the year, the Fund returned 23.1%, outperforming the market by 4.8%. It is pleasing for us that the Fund has followed up its best-ever year of relative returns (outperformance of the market was 19.8% in 2019) with another year of strong outperformance. Over more meaningful long-term periods, the Fund has also outperformed materially – by 1.7% p.a. over five years, 1.9% p.a. over 10 years and by 2.5% p.a. since inception just over 12 years ago.

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MARKET RETURNS ROBUST DESPITE VOLATILITY

Given how tumultuous 2020 was, it seems scarcely conceivable that the market return was so positive for the year. The scale of disruption to human life was unprecedented in modern times outside of periods of war. Despite the emergence of more highly transmissible variants of Covid-19, we enter 2021 with hope on the horizon for a return to something akin to normal by year-end – if the world is able to roll out vaccines and cover the bulk of the vulnerable population (the elderly and those with conditions that increase their risk of severe outcomes if infected).

PERFORMANCE IMPACTS

In Optimum Growth, the largest positive contributors in the quarter were Disney (+28%, 0.5% positive impact), Mercado Libre (+38%, 0.5% positive impact) and the Housing Development Finance Corporation (HDFC) (+30%, 0.5% positive impact). The Fund incurred unrealised losses on a collection of put options and short-index positions, which provided valuable protection historically, but detracted from performance this quarter due to a buoyant market. Collectively, these put options and short-index positions had a 1.6% negative impact during the quarter, but having them in place continues to provide the Fund with protection should there be a market selloff. Outside of this, the other notable negative detractors were our foreign currency cash holding (-10%, 1.0% negative impact), Alibaba (-28%, 0.8% negative impact) and our physical gold position (-12%, 0.5% negative impact).

Optimum Growth ended the quarter with 73.1% net equity exposure, slightly higher than at the end of September. Our negative view on global bonds remained unchanged, as a large portion of developed market sovereign bonds offer negative yields to maturity, with the follow-on effect that most corporate bonds also offer yields that do not compensate for the risk taken. Only 1.2% of the Fund is invested in bonds, which is largely made up of a 0.5% position in L Brands (owner of Victoria's Secret) corporate bonds.

The Fund also has c.2.2% invested in global property, largely Vonovia (German residential). Lastly, it has a physical gold position of 4%, a 0.9% holding in AngloGold Ashanti and a 0.8% holding in Barrick Gold Corporation, the world's largest gold miner. The physical gold position was added to during the quarter for its diversifying properties, while the AngloGold Ashanti position was a new buy, acting as a more leveraged exposure to gold, after falling c.35% from its high in July versus a roughly flat gold price move. The balance of the Fund is invested in cash, largely offshore. As has been the case for many years, the bulk of the Fund (over 90%) is invested offshore, with very little exposure to South Africa.

BUYING ACTIVITY

Notable buys/increases in position sizes during the quarter were Deutsche Boerse, Netflix and Tencent Music Entertainment.

Deutsche Boerse

Deutsche Boerse is the fifth-largest (by market capitalisation) exchange operator in the world. The business has many attractive attributes, such as exposure to dominant liquidity pools that utilise its proprietary hard-to-replicate products, and a large and growing exposure to recurring revenue streams (48% of group revenue currently). This is further supported by many of its business segments being exposed to secular growth drivers, such as the continued rise of passive investing. This is also a business that enjoys high incremental margins as it grows due to limited incremental costs being associated to this growth. The business currently trades on just over 20 times earnings (which are 100% converted into free cash flow [FCF]), with our expectation that it should be able to grow earnings at high single digits. This, combined with a 2.5% dividend yield, should provide a double-digit hard currency return.

Netflix

Netflix is a business most consumers will be familiar with, as it operates the largest (from a subscriber perspective) video streaming service globally. It is led by a visionary management team, which has disrupted the legacy TV entertainment space. Netflix currently has just under 200 million subscribers globally, which should continue to grow by more than 20 million p.a. over the next few years, as household penetration is still low outside the US. This subscriber growth is further supported by large content investments (dwarfing everyone except Disney) that should enable the continuation of the 'flywheel' of more content driving more subscribers.

Netflix should also exhibit very strong pricing power over the longer term from what we deem to be a low base, and there is some early evidence of this in price increases in the US that have had limited impact on churn levels. Longer term, the economics of the business should improve drastically as the large content investments begin to leverage across its ever-growing subscriber base, resulting in a significant expansion in margins along with a dramatic improvement in FCF generation, which has turned positive this year after many years of cash consumption. Based on our assessment of the normalised earnings power of this business, we feel it is an attractive investment.

Tencent Music Entertainment

Tencent Music Entertainment is the largest music streaming business in China, with more than 600 million users. The business also has a successful live streaming service with a music focus, along with the dominant online karaoke platform. This positions Tencent Music Entertainment as the key player in the music space in China, with significant long-term monetisation opportunities as the company expands its ecosystem and increases monetisation touchpoints. This is further supported by a current low paying ratio (c.8%) for its music streaming business, along with very low average revenue per user (just over $1), which should expand significantly over time as consumers derive value from its products.

The business has been investing aggressively into various products to improve and expand its offerings, and these investments should begin to be harvested this year. Current profitability (and FCF) is significantly depressed; in our view, and, using our estimates of 2022 FCF, the business trades on a 5% FCF yield, which we deem attractive considering the long duration growth the business should experience, coupled with its dominance in its respective markets.

AN AGILE POSITION

The markets remain volatile as the Covid-19 pandemic continues to cause disruption around the world, with various governments responding in different ways, which continues to create a disruptive operating environment for many businesses. However, with vaccines now being formally rolled out, there is light at the end of the tunnel. Exactly when enough people have been vaccinated, which should end the Covid-19 pandemic, is still uncertain, as there remain unknowns relating to various governments' ability to first procure the vaccine, and then inoculate their populations.

As a result, the outlook for the future remains uncertain and hard to predict, but we take comfort in the fact that Optimum Growth holds a collection of businesses that we feel are attractively priced and can operate in what we deem to be a highly complex and fast-changing environment. Moreover, the fact that the Fund is a multi-asset flexible fund provides us with additional tools to protect (through the use of put options, for example) and grow capital.

We are now approaching the one-year anniversary of Covid-19, with reason to be somewhat optimistic that its devasting effects are closer to coming to an end compared with a few months ago. How consumer behaviour permanently changes, and what the world will look like in the next few years, remain unknowns. However, against this backdrop, we remain positive on the outlook for Optimum Growth, which has been built bottom up, with a collection of attractively priced assets that provide diversification to achieve the best risk-adjusted returns going forward.

GEM CONTRIBUTORS

In the quarter under review, the biggest contributor to outperformance in the GEM Fund was the HDFC, which returned 48%, contributing 83 basis points (bps) to alpha. Earlier in 2020, the HDFC had declined by 40% from pre-pandemic levels as India shut its economy down completely in one of the harshest lockdowns seen anywhere in the world. While most financial services companies could operate digitally during the lockdown, mortgages have a legal requirement to be signed in person on a physical piece of paper. With the HDFC being unable to open its offices during Q2-20, loan origination plummeted. The large decline in the share price didn't make sense to us. Aside from being clearly driven by temporary factors, the mortgage business makes up less than half of the HDFC's valuation, with the balance of its value being its stake in the country's largest private sector bank (HDFC Bank), a life assurer and an asset manager (all listed). None of these were as badly impacted by the lockdown, implying that the market was writing down the mortgage business to a fraction of its former value. As the year wore on, volumes returned to normal and now, despite many localised restrictions, loan volumes are back to 90% of pre-pandemic levels. The worst fears of large-scale defaults and people taking advantage of moratoria mandated by the Reserve Bank of India have also proven to be overblown and, as a result, the HDFC's share price has recovered strongly.

The next-largest contributor to performance was pan-Latin American ecommerce retailer Mercado Libre, up 54% for a 61bps contribution. We wrote extensively about Mercado Libre in our Q2-20 commentary, and how the reasons for the strong share price performance can be put down to operational results far in excess of our (already very positive) expectations. In the Q3-20 results released in November, Mercado Libre saw gross merchandise volume and items sold on its marketplace more than double year on year. Its payments business, Mercado Pago, also saw growth in excess of 100% - both on its network (people using the payments system to buy things on the business's websites) and off its network (people using Mercado Pago at other retailers).

>

Other material positive contributors were Tencent (up 'only' 10%, so the zero weighting in the Fund contributed 56bps of alpha), Wuliangye Yibin (up 37% for 49bps alpha) and HDFC Bank, which makes up roughly 40% of the HDFC's sum of the parts valuation (up 45% for a 45bps contribution).

GEM DETRACTORS

On the negative side, the largest three detractors were all due to underweights or zero weights. Although Samsung is now a 3.5% position in the Fund, we are underweight the benchmark, and Samsung's 50% return in the quarter cost 47bps of alpha. We neither own Pinduoduo (a group buying-themed e-commerce retailer in China) nor NIO (best described as China's Tesla), and both of these stocks more than doubled in Q4-20, costing the Fund 42bps and 40bps of alpha, respectively. Three other detractors of around 35bps each were Naspers, X5 and NetEase, all of which had positive returns in the quarter but lagged the 19.7% return of the index and therefore detracted from relative performance somewhat.

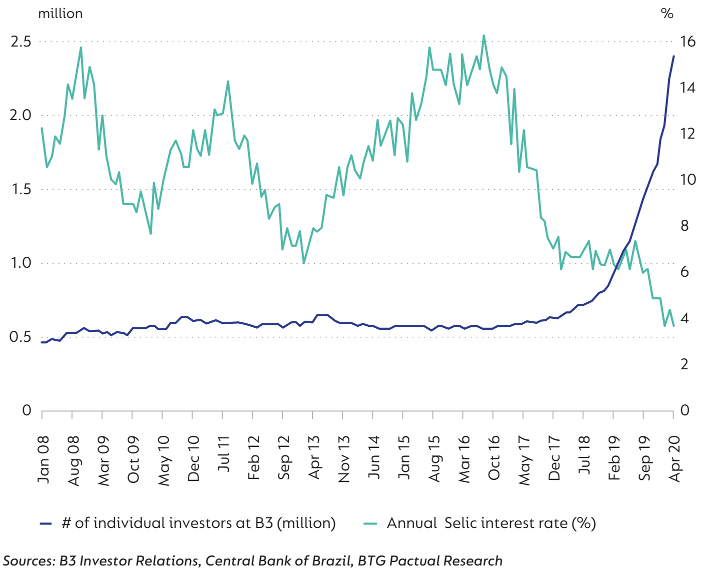
OTHER ACTIVITY

The biggest moves in position size for the quarter in existing holdings were in the two e-commerce players Alibaba (70bps decline in position size) and JD.com (93bps increase in position size). In the case of the former, the decline in the share price of 20% during Q4-20 was the primary driver of the reduced exposure. Alibaba suffered the fallout of the failed initial public offering of its financial services affiliate, Ant Financial, as well as increased regulatory scrutiny of its operational practices by the antitrust authorities. We added slightly to the position, since Ant Financial makes up less than one fifth of our look-through valuation, but this buying was not enough to offset the impact of the share price decline. In the case of JD.com, continued great operational results, coupled with the share lagging the market, resulted in us buying more to increase the position further.

There were four new buys in the quarter, only one of which has been previously held in the Fund. Not coincidentally, this buy, the Brazilian stock and commodity exchange Brasil Bolsa Balcão (B3), was the largest of the buys and reached a 73bps position by year-end. We have covered B3 since 2008 (when it was known as Bovespa) and have owned it before. Over time, the company has evolved through mergers with complementary businesses that have established a 'moat' around its overall offering, which is now exceptionally difficult to overcome. In its current form, B3 comprises an exchange for the trading of equities, as well as fixed income, currency contracts, over-the-counter derivatives and a lien system that assists with credit provision and the registration of loans. Brazil historically ran very high nominal and real interest rates, a legacy of the country's long fight against inflation, which culminated in the 'real plan' of 1994 that ended hyperinflation. The very high real interest rates made fixed income the investment of choice for domestic investors, to the extent that equity investment was not particularly attractive (why take equity risk when you can earn 5%-8% real returns at very low risk?). As Brazil's economy has stagnated, and as central banks around the world slashed rates to boost economies in response to Covid-19, interest rates have declined to record lows in Brazil and investors have been drawn to equities in search of returns, as illustrated by Figure 1.

Figure 1

THE SEARCH FOR RETURNS AS YIELDS DECLINE



Sources: B3 Investor Relations, Central Bank of Brazil, BTG Pactual Research

RISK ASSET APPEAL

We do not believe this is a once-off move, but rather a structural trend in the country as its financial system evolves toward what is found in other parts of the world. Equities comprise less than 10% of individuals' investment portfolios in Brazil, which is only half the level of neighbouring Colombia, a country with a far less developed financial system.

In the US, for example, the figure is in the mid-30s. Brazilian mutual funds have, in aggregate, only 10% exposure to equities and, for pension funds, barely 20%. Volatility, of which there is plenty right now, benefits the derivatives business and lower interest rates benefit loan provision, which uses B3's infrastructure services. All these suggest many years of strong revenue growth and, with a large portion of B3's costs being fixed in nature, profits are likely to grow far in excess of turnover. In the results published after the end of Q3-20, for example, operating profits grew by 79% for the first nine months of 2020 on the back of a 41% increase in revenue over the same period. Our assessment of fair value for B3 has increased materially as the business and market have evolved and this, coupled with a 20% fall in the share price after a July peak, prompted us to start buying in November.

The next largest new buy was Youdao (54bps position at year-end). Youdao is majority owned by NetEase (3.0% of the Fund) and offers a variety of online education services catering to both adults (foreign languages, professional certification), and primary and secondary school students (K12). Its key selling point is personalised learning, with courses adapting to the progress, and strengths and weaknesses of students. The business has also launched some innovative hardware solutions such as a dictionary pen that simultaneously translates text as the user scans over it. Youdao aims to offer many of the benefits of offline/in-class tutoring online by combining good teachers with its technology.

Already there are over 100 million monthly active users of Youdao's various services and it is spending heavily to convert these into students of its online courses. The association with NetEase provides a structural advantage in customer acquisition and the company's hardware sales should convert into more students over time, in our view. Profits are therefore depressed in the short term, but as spending declines and revenue grows strongly, Youdao is likely to be very profitable and highly cash generative, in our view.

The Fund also purchased a 50bps position in Walmart de México y Centroamérica (Walmex), a majority owned but separately listed subsidiary of the Walmart Group that operates across Mexico and Central America. We started researching and following Walmex in detail back in 2010 and have met the company many times over the years, and have always been impressed by the business. However, this is the first time it has been bought into the Fund, as valuation has never been on our side. Its various formats, ranging from bodegas to Sam's Club (a members-only bulk-buying club), plus its status as an e-commerce operator in Mexico to rival Amazon and Mercado Libre, make it a very attractive business with a presence in all aspects of retail in the region. Walmex's share price has barely moved in dollars over the last 10 years, even though its intrinsic value has consistently increased, and this combination brought it into buying range for us for the first time.

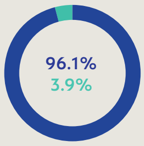
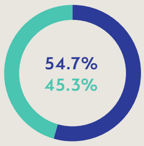
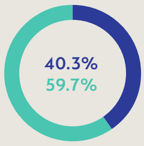
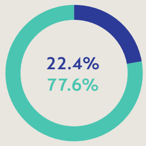
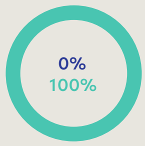
Our last new buy (40bps) was Taiwanese e-commerce operator Momo.com, which focuses on the business-to-consumer sector. Despite having many of the same drivers of e-commerce that South Korea has (high per-capita income, densely populated urban areas, and high internet and smartphone penetration), e-commerce penetration in Taiwan is only 12% versus 31% in South Korea. Mainland China has 32% e-commerce penetration, partly driven by the very poor infrastructure for physical retail. We believe Momo.com will benefit disproportionately from rising e-commerce penetration, thanks to its heavy investment in warehousing and logistics – Momo.com has outspent its main competitor PCHome by almost three times on a like-for-like basis, and now has an automated distribution centre near the capital Taipei and 13 satellite warehouses across the island. On delivery, although e-commerce operators in Taiwan outsource to third parties, Momo.com is investing in its own dedicated delivery infrastructure to gradually increase this over time from the 10% of orders being fulfilled directly right now to 20%-30% within the next few years. It also aims to get delivery times down to three hours for the capital, which will be far superior to any competitor offering.

Finally, we sold our last remaining exposures in Chinese spirits firm Jiangsu Yanghe (43bps position) and Indonesian broadcaster Media Nusantara (17bps position) to make way for the buys above and, in the case of Jiangsu Yanghe, a very strong run in the share price to in excess of fair value. ✚

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	 96.1% 3.9%	 54.7% 45.3%	 40.3% 59.7%	 22.4% 77.6%	 0% 100%
LAUNCH DATE	Jul 2001	Feb 2007	Jul 2001	Apr 1996	Oct 2000
ANNUAL RETURN[2] (Since launch)	9.9% 7.6%†	9.1% 5.7%†	11.3% 5.6%†	13.9% 12.8%†	16.7% 13.0%†
QUARTILE RANK (Since launch)	1st	1st	1st	1st	1st
ANNUAL RETURN (Last 10 years)	8.2% 6.0%†	8.8% 5.1%†	7.7% 5.1%†	9.7% 10.6%†	9.8% 9.4%†
STANDARD DEVIATION (Last 10 years)	2.1% 0.3%†	5.5% 1.3%†	7.0% 1.3%†	9.5% 8.7%†	14.1% 13.8%†
FUND HIGHLIGHTS	The Fund remains the top performing fund in its category since launch in 2001 and outperformed cash by 2.3% over this period.	Outperformed inflation by 3.4% p.a. (after fees) since launch, while producing positive returns over 12 months more than 95% of the time.	The Fund remains the top performing fund in its category since launch in 2001 and outperformed inflation by 5.7% p.a. (after fees) over this period.	No. 1 balanced fund in South Africa since launch in 1996, outperforming its average competitor by 1.9% p.a. Outperformed inflation by on average 7.8% p.a. since launch and outperformed the ALSI on average by 1.2% p.a. (since launch).	The Fund added 3.7% p.a. to the return of the market. This means that R100 000 invested in Top 20 at launch in October 2000 grew to more than R2.2 million by end-December 2020. The Fund has been a top quartile performer since launch.

1 *Income versus growth assets as at 31 December 2020. Growth assets defined as equities, listed property and commodities (excluding gold).*

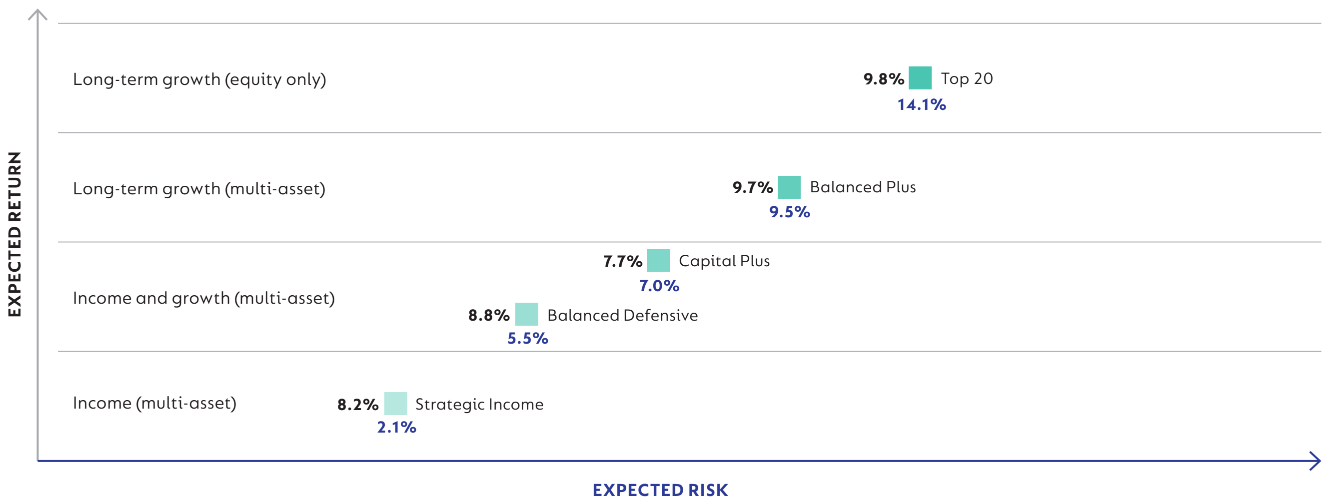
2 *Highest annual return*
Balanced Defensive: 21.2% (Jun 2012 - May 2013); Balanced Plus: 49.3% (Aug 2004 - Jul 2005); Capital Plus: 33.8% (Aug 2004 - Jul 2005); Strategic Income: 18.7% (Nov 2002 - Oct 2003); Top 20: 68.9% (May 2005 - Apr 2006)

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

Figures are quoted from Morningstar as at 31 December 2020 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

RISK VERSUS RETURN

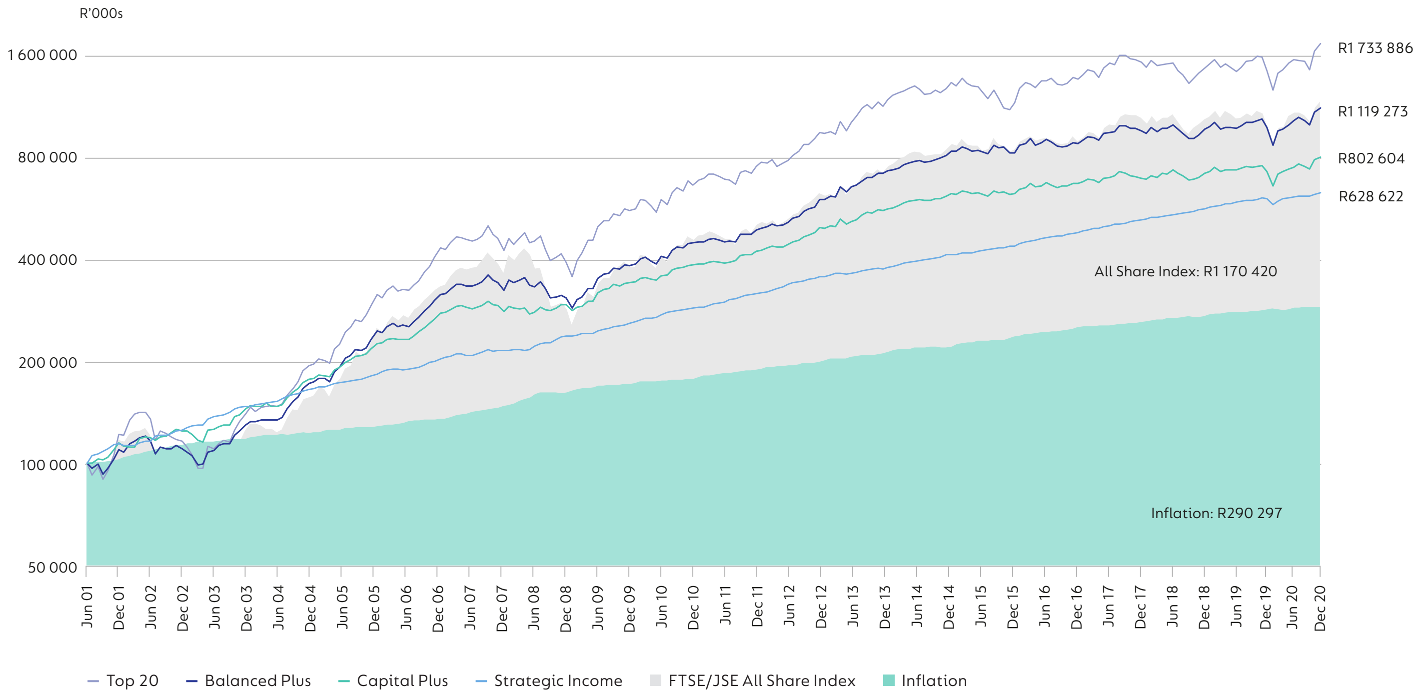
10-year annualised return and risk (standard deviation) quoted as at 31 December 2020.
Figures quoted in ZAR after all income reinvested and all costs deducted.



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 December 2020. 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)†	**OPTIMUM GROWTH** Composite: 35% JSE CAPI. 15% ALBI. 35% MSCI ACWI. 15% BGBA	**GLOBAL EQUITY SELECT** MSCI All Country World Index
FUND DESCRIPTION	An intelligent alternative to dollar-denominated bank deposits over periods of 12 months or longer.	A low-risk global balanced fund reflecting our best long-term global investment view moderated for investors with smaller risk budgets. We offer both hedged and houseview currency classes of this fund. In the case of the former, the Fund aims to preserve capital in the class currency over any 12-month period.	A global balanced fund reflecting our best long-term global investment view for investors seeking to evaluate outcomes in hard currency terms. Will invest in different asset classes and geographies, with a bias towards growth assets in general and equities in particular.	The aim of the Fund is to maximise long-term investment growth by investing in a range of opportunities available in public asset markets from both South Africa and around the world. Our intent is to provide competitive after-inflation returns measured in rand over all five-year periods.	The Fund aims to give investors access to the best opportunities in global equity markets. The Fund is biased to developed markets and actively seeks out attractively valued shares to maximise long-term growth. Our intent is to outperform the global equity benchmark over all periods of five years and longer.
INCOME VS GROWTH ASSETS[2] ● INCOME ● GROWTH	96.9% 3.1%	58.6% 41.4%	31.0% 69.0%	20.6% 79.4%	0.4% 99.6%
LAUNCH DATE OF OLDEST FUND	Dec 2011	Nov 2008	Oct 2009	Mar 1999	Jan 2015
ANNUAL RETURN[3] (Since launch)	2.4% 1.0%†	5.1% 0.9%†	7.0% 7.6%†	10.1% 7.1%	8.1% 10.1%
QUARTILE RANK (Since launch)	–	1st	1st	1st	2nd
ANNUAL RETURN[3] (Last 5 years)	2.0% 1.5%	4.7% 1.5%	7.8% 9.6%	11.9% 9.8%	11.8% 12.3%
ANNUAL RETURN[3] (Last 10 years)	–	3.2% 0.9%	6.4% 7.2%	8.0% 4.4%	- -
QUARTILE RANK (Last 5 years)	–	2nd	2nd	1st	1st
FUND HIGHLIGHTS	Outperformed US dollar cash by 1.4% p.a. (after fees) since launch in December 2011.	The Fund has out-performed US dollar cash by 4.9% p.a. (after fees) since launch in 2008.	No. 1 global multi-asset high equity fund in South Africa since launch in October 2009.	The Fund has out-performed the composite benchmark since launch and was a top quartile performer in the Worldwide MA Flexible category since launch in 1999.	The Fund continues to seek attractively valued shares to maximise long-term growth.

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

[2] Income versus growth assets as at 31 December 2020 (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.

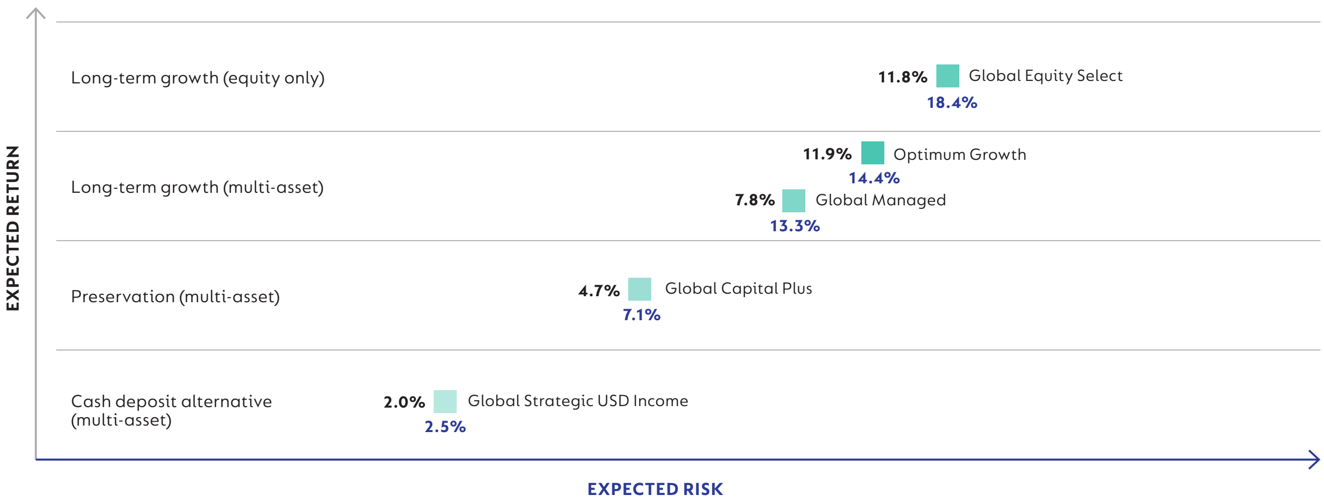
Highest annual return
Global Strategic USD Income: 7.1% (Jan 2012 - Dec 2012); Global Capital Plus [ZAR] Feeder: 31.4% (Mar 2009 - Feb 2010); Global Managed [ZAR] Feeder: 23.1% (Jul 2010 - Jun 2011); Global Equity Select: 37.5% (Jan 2019 - Dec 2019); Optimum Growth [ZAR]: 72.8% (Mar 2009 - Feb 2010)

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

Figures are quoted from Morningstar as at 31 December 2020 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

RISK VERSUS RETURN

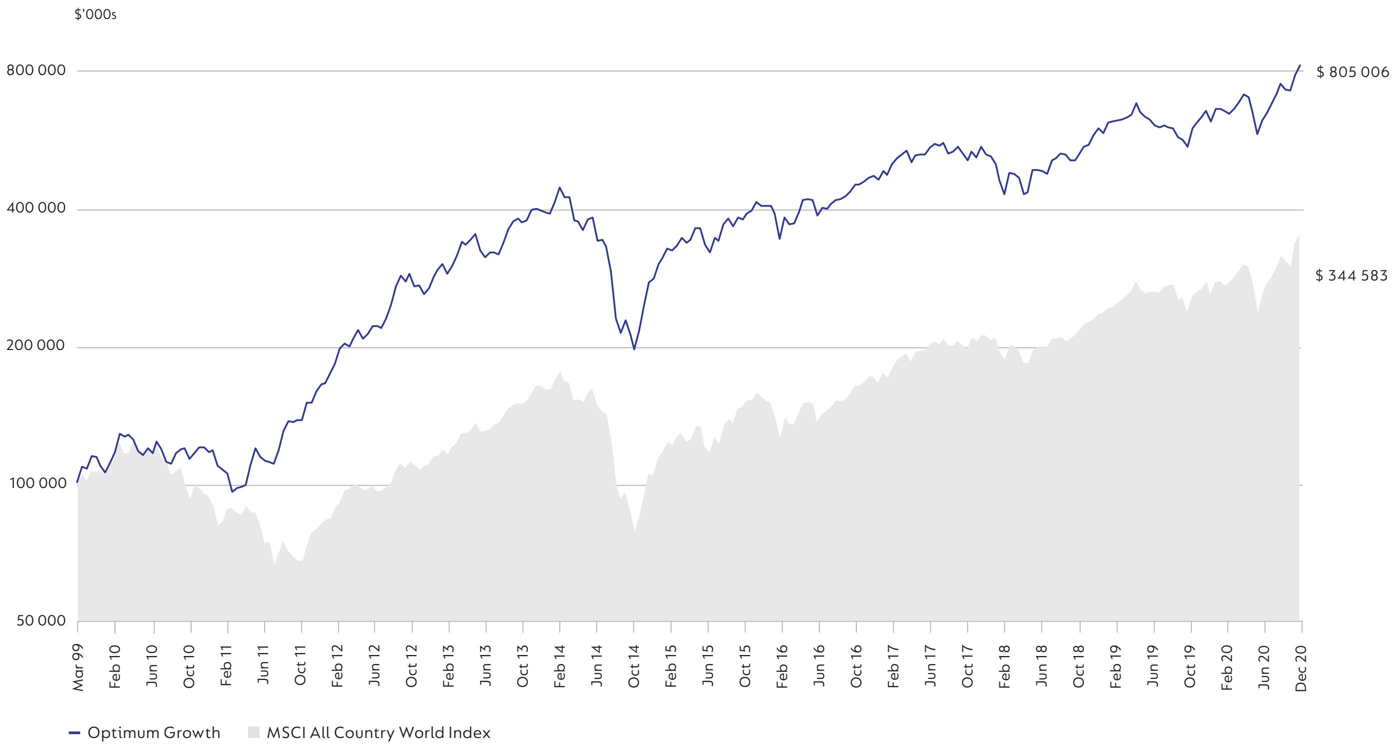
5-year annualised return and risk (standard deviation) quoted as at 31 December 2020. Figures quoted in USD (for the oldest fund) after all income reinvested and all costs deducted.



Source: Morningstar

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

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



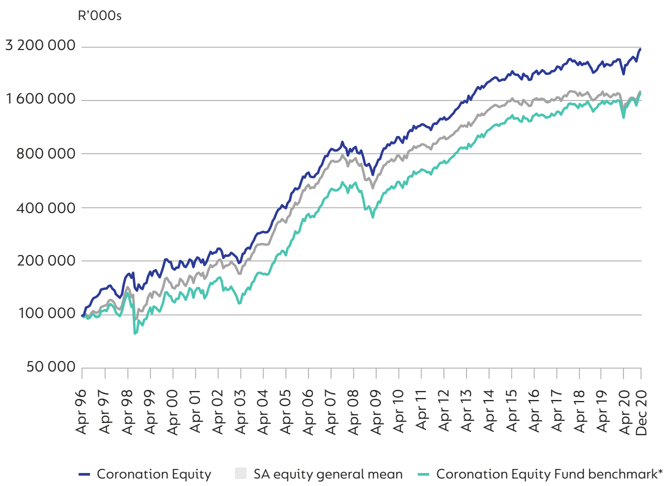
Source: Morningstar

Long-term investment track record

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

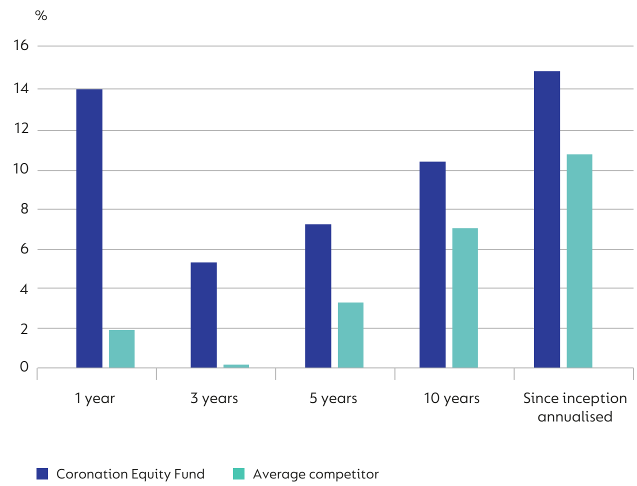
10-YEAR ANNUALISED RETURNS	CORONATION EQUITY	AVERAGE COMPETITOR	OUTPERFORMANCE OF AVERAGE COMPETITOR
2006	19.38%	17.09%	2.30%
2007	21.45%	19.23%	2.22%
2008	17.62%	18.47%	(0.84%)
2009	16.53%	16.68%	(0.15%)
2010	19.59%	19.14%	0.45%
2011	18.03%	16.98%	1.05%
2012	21.12%	18.94%	2.19%
2013	21.60%	18.68%	2.92%
2014	18.44%	16.32%	2.12%
2015	14.86%	12.62%	2.24%
2016	11.95%	9.54%	2.41%
2017	11.99%	8.90%	3.09%
2018	12.77%	10.54%	2.23%
2019	11.35%	8.71%	2.63%
2020	10.48%	7.10%	3.38%
ANNUALISED TO 31 DECEMBER 2020	**CORONATION EQUITY**	**AVERAGE COMPETITOR**	**OUTPERFORMANCE**
1 year	14.15%	1.92%	12.23%
3 years	5.36%	0.15%	5.21%
5 years	7.29%	3.31%	3.98%
10 years	10.48%	7.10%	3.38%
Since inception in April 1996 annualised	15.08%	10.84%	4.24%
Average outperformance per 10-year return			1.88%
Number of 10-year periods outperformed			13.00
Number of 10-year periods underperformed			2.00

CUMULATIVE PERFORMANCE



Source: Morningstar

ANNUALISED RETURNS TO 31 DECEMBER 2020



Source: Morningstar

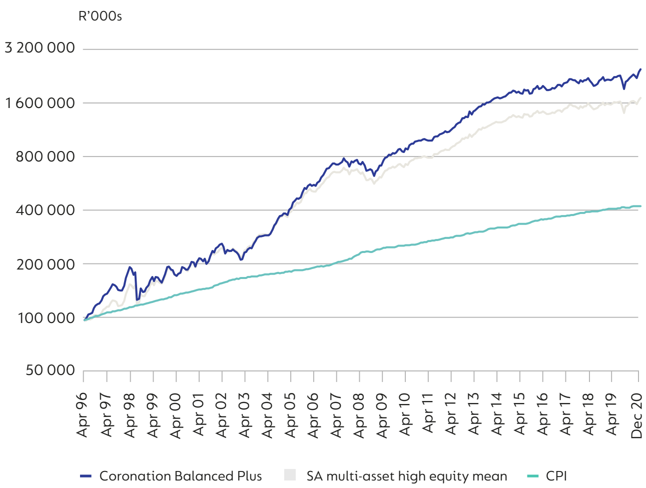
An investment of R100 000 in Coronation Equity on 15 April 1996 would have grown to **R3 195 335** by 31 December 2020. By comparison, the returns generated by the Fund's benchmark over the same period would have grown a similar investment to **R1 787 895**, while the South African equity general sector would have grown a similar investment to **R1 837 303**.

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

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

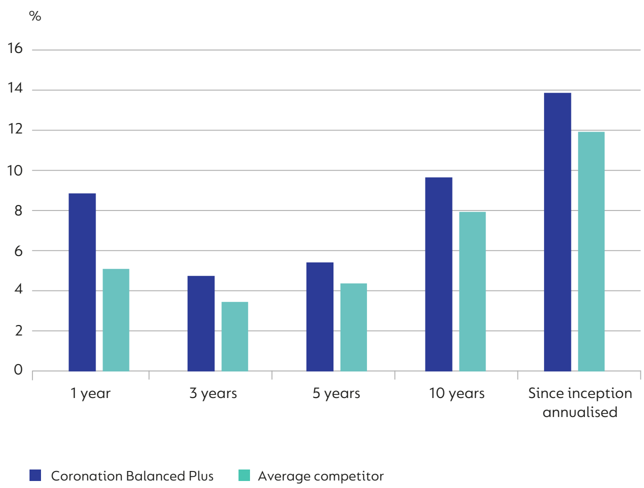
10-YEAR ANNUALISED RETURNS	CORONATION BALANCED PLUS	INFLATION	REAL RETURN
2006	18.33%	6.47%	11.86%
2007	17.81%	6.59%	11.22%
2008	16.96%	6.87%	10.09%
2009	15.69%	6.75%	8.94%
2010	17.20%	6.28%	10.93%
2011	15.78%	6.24%	9.54%
2012	17.85%	5.76%	12.09%
2013	18.63%	5.90%	12.73%
2014	16.58%	6.00%	10.57%
2015	14.01%	6.12%	7.89%
2016	11.08%	6.30%	4.77%
2017	11.04%	5.92%	5.12%
2018	11.26%	5.34%	5.92%
2019	10.30%	5.11%	5.19%
2020	9.66%	5.07%	4.58%
ANNUALISED TO 31 DECEMBER 2020	**CORONATION BALANCED PLUS**	**AVERAGE COMPETITOR**	**OUTPERFORMANCE**
1 year	8.87%	5.10%	3.76%
3 years	4.76%	3.46%	1.31%
5 years	5.43%	4.39%	1.04%
10 years	9.66%	7.93%	1.72%
Since inception in April 1996 annualised	13.86%	11.93%	1.93%
Average 10-year real return			8.76%
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%			2.00

CUMULATIVE PERFORMANCE



Source: Morningstar

ANNUALISED RETURNS TO 31 DECEMBER 2020



Source: Morningstar

An investment of R100 000 in Coronation Balanced Plus on 15 April 1996 would have grown to **R2 458 070** by 31 December 2020. By comparison, the South African multi-asset high-equity sector over the same period would have grown a similar investment to **R1 710 837**.

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