EXECUTIVE SUMMARY
CONVERSATIONS WITH CORONATION

NOVEMBER 2014

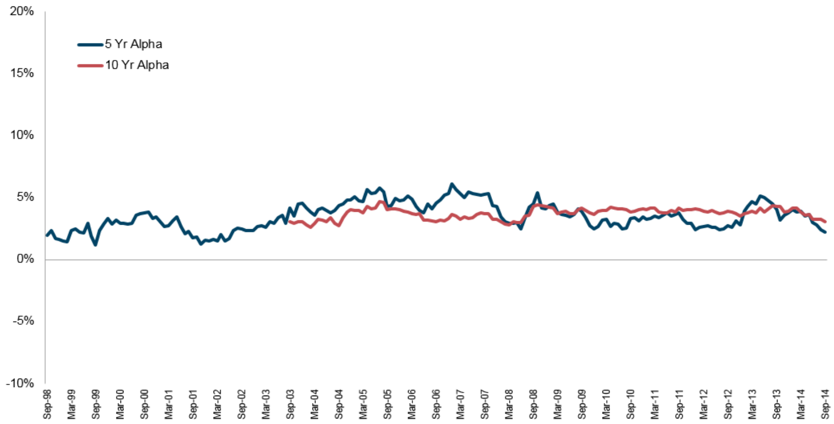
STAYING THE COURSE

In an industry where time horizons have collapsed to converge with reporting periods, many smart people are placed under massive pressure every day to perform well this month, this quarter and this year. When most participants are obsessed with short-term performance, market prices will reflect short-term considerations - inevitably resulting in severe dislocations between these prices and the long-term underlying value of a business. This presents a compelling opportunity for those investors (like Coronation) who have the long time horizon to take advantage of mis-priced opportunities.

Accordingly, a commitment to long-term investing is the defining characteristic of the Coronation investment philosophy. It is also our enduring competitive advantage in a world distracted by short-termism and the latest news release. We are very privileged that our clients understand our philosophy and place their trust in our ability to generate long-term wealth.

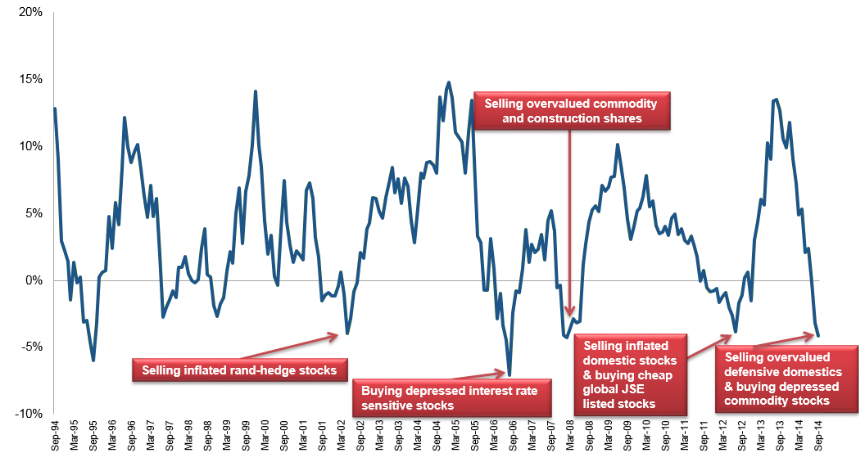
Our clients know that while we don't seek to be contrarian, we often are. Our best long-term investment decisions were at odds with conventional market thinking. This long time horizon was the reason for our dislike of construction and commodity shares during the bubbles of 2008. As the global financial crisis played out later that year and in 2009, we aggressively bought equities and property while others were fleeing. And in 2010 to 2011 when the rand was strong and domestic stocks were flying, we bought offshore assets. These forward-looking decisions contributed to Coronation's consistent track record of delivering long-term outperformance:

Coronation's rolling alpha over five and ten years



Our short-term alpha, however, is lumpy:

Coronation's rolling alpha over one-year periods



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CORONATION FUND MANAGERS
TRUST IS EARNED

The previous graph shows that our best long-term decisions were made when short-term alpha was negative; when we looked most foolish and often did exactly the opposite to the prevailing sentiment in the market. We consider meaningful periods of performance to be in excess of five years, and thus disregard these short-term downturns in alpha as we wait for underrated assets to unlock value. However, we take great care in limiting volatility in immediate income funds (such as Strategic Income) and living annuity funds (Balanced Defensive and Capital Plus), where short-term losses can have a permanent effect on investors' post-retirement income. These funds and the higher-risk Balanced Plus Fund have delivered a good performance over the past twelve months. In contrast, our equity funds have experienced some underperformance during this period largely due to their exposure to commodity stocks – where we see long-term value.

THE INVESTMENT CASE FOR THE RESOURCE SECTOR

The current down-cycle in commodities is likely to be prolonged given the excesses of the preceding boom period. Yet we have been steadily acquiring resource exposure over time as commodity prices are now below the marginal cost of production and below our estimation of normalised price levels. Commodity prices are ultimately determined by the cost of production.

The platinum price, in particular, has not kept pace with the sharp increase in costs. Some 40% of PGM mines are losing cash (after capital expenditure), with a further 20% that are marginal. We expect the platinum market to be in structural deficit over the long term. Excess inventory will soon be worked out of the system and demand will be supported by tightening emission regulations in the auto industry.

We are avoiding those companies (like BHP Billiton, Assore and African Rainbow) which are most exposed to iron ore and China. However, we are adding to our positions in Anglo American, Exxaro and selected platinum shares. These holdings have detracted from our overall investment performance over the past twelve months, but we think they offer compelling value based on our long-term estimates. We also believe there is sufficient margin of safety in their share prices.

Vastly different fortunes for resources and consumer companies since the global financial crisis

Company	30-Jun-08	17-Oct-14	Price move
	Price	Price	
Anglo American	548.00	244.50	-55%
Northam Platinum	65.50	35.50	-46%
Impala Platinum	309.00	83.99	-73%
SABMiller	178.05	583.99	228%
Truworths	22.95	71.70	212%
Bidvest	98.38	285.02	190%
AVI	12.95	67.01	417%
Mr Price	15.00	203.94	1260%

Anglo American, a high-quality diversified miner with solid assets, has been a major underperformer as its near-term earnings remain under pressure due to falling commodity prices. The market is sceptical on future earnings and returns after many disappointments. Our through-the-cycle valuation methodology shows value in Anglo at current levels. The share is trading at 7 to 8 times normalised earnings, and at less than its price to book value (price-to-book of 0.9). We are also seeing value in Implats and Northam Platinum, which are both currently trading at 7 to 8 times normalised earnings. Both companies are at the end of significant investment programmes and are well positioned to deliver more competitive output. Exxaro has a solid fundamental investment case thanks to the steady margins and the large annuity-style revenue that can be earned from its high quality coal assets. It also has a stake in the iron ore group Kumba and the mineral sands and pigment producer Tronox, which is listed in the US. Exxaro is trading at nine times our assessment of normal earnings.

Our positive view on the long-term potential of resources will require patience as we do not expect the cycle to turn any time soon. China will be key to the sector's prospects. But absent a further shock, our preferred stocks should have significant upside over time. While we have a high conviction in the investment case for the resource sector over time, our positions in the shares are not portfolio-defining given the forecast risks.

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KEY INVESTMENT PRINCIPLES

Given our expectation that market returns will be much lower in the coming decade, the importance of two key investment principles cannot be overstated.

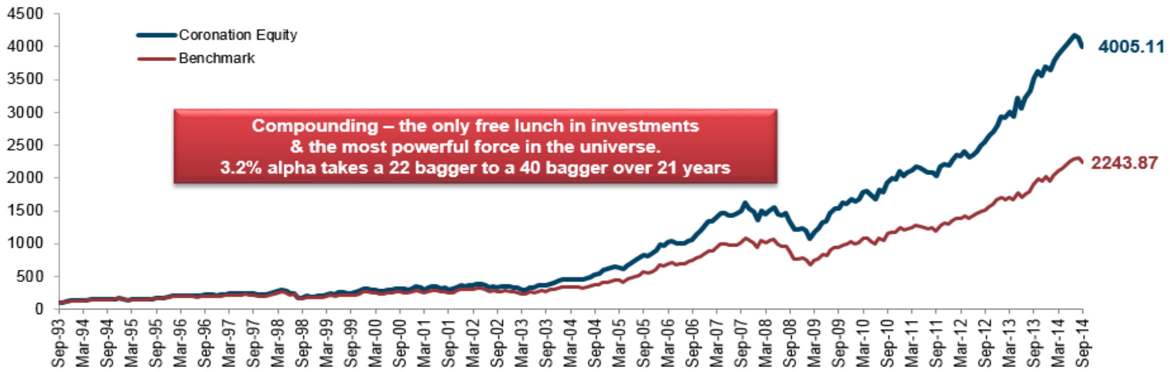
The first rule of investing is: Don't lose money. Downside protection is worth a lot more to clients than outperformance in rising markets. Take this example of two fund managers over a three-year period:

	Market performance	Manager A	Manager B
Year 1	-50%	-30% (Alpha of 20%)	-50%
Year 2	+40%	+40%	+50% (Alpha of 10%)
Year 3	+10%	+10%	+20% (Alpha of 10%)
Accumulated capital growth:		**+8%**	**-10%**

Manager A outperformed the market in the first year only, delivering the same returns as the market for the following two years. Manager B's performance was in line with the market in the first year, and outperformed over both the next two years. In the end, Manager A offered capital growth of 8% over the three years, while Manager B never recovered from the sharper loss in the first year and suffered an accumulated decline of 10%. This illustrates the danger of negative numbers in a return sequence that accrues in a geometric manner. Capital preservation in a bear market can be more important than outperformance in bull markets.

The second key principle of investing is compounding. The concept is simple: The returns you earn on your investment also start earning returns, resulting in your money growing at an ever-increasing rate. While our goal of alpha of 3% p.a. over the long term may sound relatively unambitious, small numbers can get big on you over long periods of time (and be retirement-changing) due to compounding:

Long-term annualised performance in rand



	Coronation Houseview Equity Fund	Benchmark*	Outperformance
Since inception*	19.2%	16.0%	3.2%
20 years	17.4%	14.5%	2.9%
10 years	22.4%	19.4%	3.0%
5 years	21.2%	18.9%	2.3%
3 years	25.5%	23.4%	2.1%
1 year	13.8%	18.0%	-4.2%

** September 1993. Benchmark composite: South African country index. Note: Performance is gross of fees in rand.*

If we are right that expected returns over the next decade will be more muted than what was experienced over the past ten to fifteen years, alpha will increasingly become a must-have – not a nice-to-have. It bears reminding that giving up even a small percentage of alpha will result in a much reduced investment value over time.

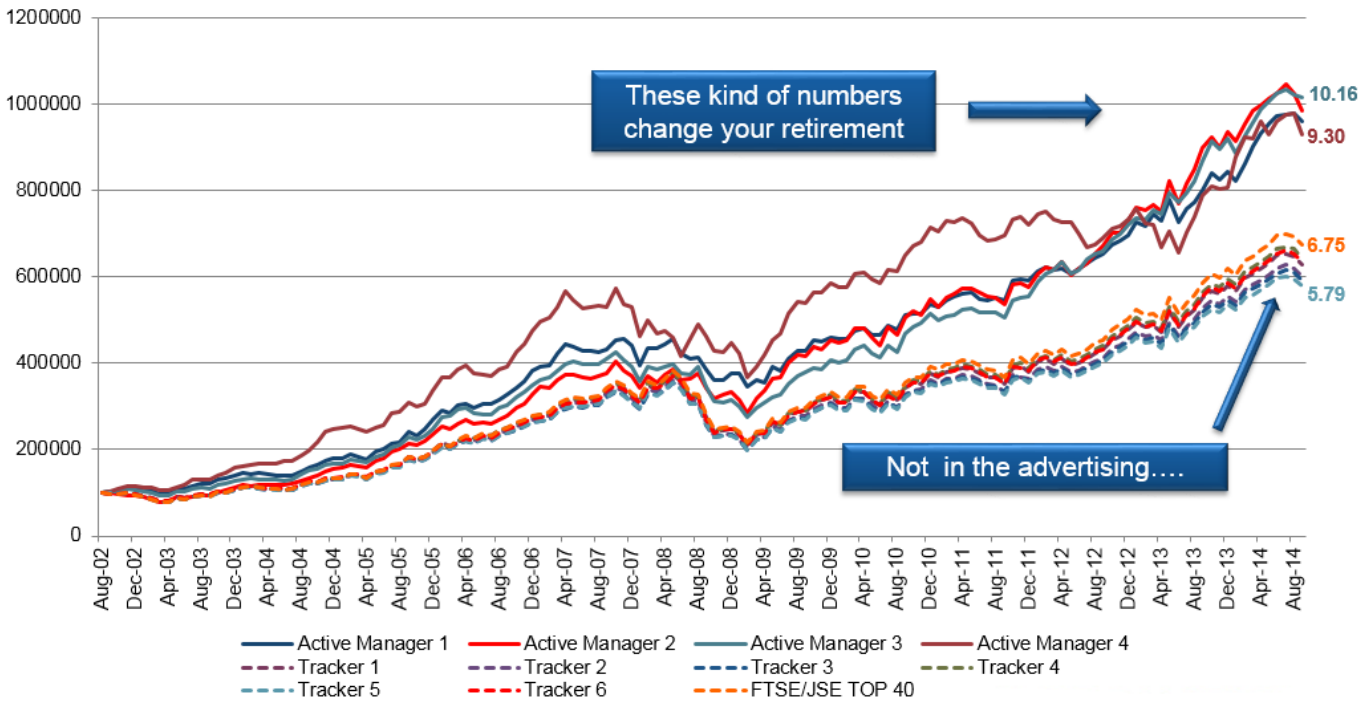
ACTIVE VERSUS PASSIVE

The growth in the passive investment industry should be welcomed as it creates greater inefficiency in the market, and thus more opportunities for active long-term investors. For example, when benchmarks are rebalanced, tracker funds are forced to buy and sell at any price – and end up buying high and selling low.

It shouldn't be a surprise that only a third of active managers beat the market given the failures of the industry, including short-termism, benchmark-hugging and high fees not justified by value added. But the fact remains that 100% of passive managers underperform the market. The historical average underperformance of all Top 40-tracking passive funds with a five-year track record is 1.05% p.a. This is due to indefensibly high fees of passive products in the retail market, which are currently 'active-like' at an average of 0.68% p.a. This makes a big difference over time. Over the last three decades, the JSE was an 11.6-bagger (in real terms), while a tracker fund underperforming by 1.05% p.a. would have been up 8.4 times, delivering only 72% of benchmark returns.

We don't think it is difficult (in the South African context at least) to identify the 'good' active managers. Splitting an investment among four managers with a fairly solid long-term track record would have delivered a sensational outcome – particularly compared to passive investments:

Long-term annualised performance in rand



Crucially, a passive approach also cannot credibly address asset allocation, which remains the most important investor decision. Capital allocation requires good judgement and experience. Quantitative solutions are unfortunately always retrofitted for the past, not the future.

The great irony of passive investing is that it always require an 'active' call. The decision about which benchmark (ALSI, SWIX, etc.) to track, is currently the single biggest active judgement call in the domestic market, as your choice of benchmark will define whether you are under- or overweight resources.

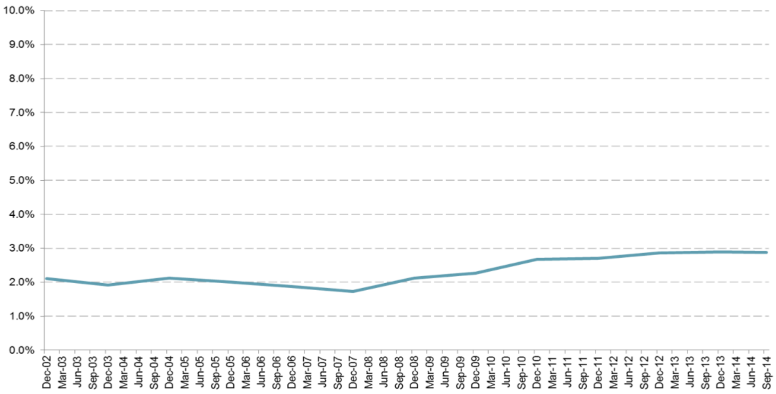
Lastly, index trackers in South Africa are seeking to replicate dangerously concentrated benchmarks. While benchmarks in other markets typically have single stock weightings of a maximum of 3%, passive funds that track the JSE's Top 40 will end up with 11% invested in each of the two largest stocks (BHP Billiton and SABMiller) and large weightings in other companies, like Naspers (9%) and Richemont (8.4%).

IS CORONATION TOO BIG?

Large managers can use their size for the benefit of their investors, not least through their ability to secure attractive investments for client portfolios. As a large shareholder Coronation has been able to underwrite and negotiate the terms of a number of deals. Recently, we were involved in structuring the Northam preference share funded BBBEE deal, which we believe presents a sound opportunity for our clients. As a large manager we also have a sizable investment team with industry-leading skills and the resources to conduct proprietary research into investment opportunities.

However, we recognise that being too large can detract from performance in terms of the investible universe and agility. The question that should be asked is: Can you trust your manager to put clients before profits? Coronation has a track record of protecting its ability to generate alpha by consistently closing areas of its business to new clients. We have shown we are not asset gatherers. In 2012, we closed our SA equity and balanced institutional funds to new clients and our absolute return funds were closed in the mid-noughties. These actions should contribute to a decline in our SA pension fund asset base in the next few years. Already, in the 2014 financial year we experienced an outflow of R16bn from domestic pension funds, which offset the bulk of the net inflows experienced in our unit trust funds. In addition, Coronation's domestic equity exposure, in terms of size, still represents only approximately 3% of the JSE.

Coronation local equity as a percentage of the JSE



As at 30 September 2014. Source: Bloomberg, Coronation.

REGULATORY UPDATE

RETAIL DISTRIBUTION REVIEW

The recently released recommendations could result in the most fundamental and comprehensive intervention in the retail investment and risk protection industries since the introduction of the Financial Advisory and Intermediary Services (FAIS) Act in 2002.

Some of the key proposals include:

- Advisory services may be redefined to include other intermediation services, such as platforms and the direct-to-consumer (execution-only) parts of a product provider's business. For example, call centre operators will be subject to the same Fais fit and proper requirements and exams as financial advisors. While there won't be a requirement to provide advice, these services will be subject to much tighter regulation.

- Measures will be introduced to ensure platforms are unbiased and don't impede the provision of unprejudiced advice.

- Financial planning will become a regulated activity, separate from product implementation advice. Financial planners will face new requirements, which will differ from those applicable to other advisors.

- The relationship between a product provider and advisor will be 'simplified' in an effort to expose any biases. All advisors will be divided into three categories, according to their relationship with product providers:

- Tied advisors are employed by a product provider, or work for an advisory business which is part-owned by a product provider. These advisors can by definition not be independent, and may be restricted to only advise on products provided by their associated product provider.
- Multi-tied advisors offer products from different providers, but do not meet the independence and choice criteria to be fully independent. It is proposed that advisors should be obliged to disclose their allocations to different product providers and product types, so that any bias is clearly apparent to clients.
- Independent advisors maintain a complete distance from product provider influence. A wide range of activities, commitments or engagements with a product provider could exclude an advisor from this category. Independent advisors will also be required to provide advice on a wide selection of products (the level of choice required for independence has not yet been defined and will be a key consultation topic).

- Intermediary remuneration: It is proposed that all commission on investment products (regardless of the issuing product provider) should be outlawed and only client-agreed advice fees will be allowed. The authorities are proposing that product providers should facilitate the collection of advice fees, much like the most popular current approach in the platform industry. As the fee collection agent, product-providers will be more accountable for mitigating mis-selling risks. While this shared responsibility for good client outcomes is a good principle, it is debatable whether some of the proposals aimed at achieving it will be implementable.

RETIREMENT REFORM

The gradual phase-out of provident funds and the harmonisation of tax breaks on retirement saving contributions were supposed to be enforced from next year, but have been postponed. The delay results from disagreement between organised labour and government on whether adequate consultation took place regarding tighter preservation rules in the retirement system. However, one proposal of the reform process will still become effective on March 1, 2015: the delinking of a retiree's retirement date and the tax-accrual date (i.e. electing the lump sum and the start of pension payments). This will allow retirees to choose the date at which they retire from their pension or provident fund, which could be years after they officially retired from an employer.

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TAX-FREE SAVINGS ACCOUNTS

These products should be passed into law early next year, and the first accounts may be launched from March 2015. Some of the larger product providers will most likely wait until more details about product requirements and the tax implications are issued.

The accounts will cap annual contributions at R30 000 and at R500 000 over a lifetime, with a penalty tax of 40% levied on contributions above these amounts. All contributions need to be new investments, and can't be switched from an existing product. Investments directly into shares won't be allowed, and only collective investment schemes, Linked Investment Service Providers, life offices and banks will qualify as product providers. Full portability between all providers will be a prerequisite. It appears from the draft rules that there will not be additional restrictions on the eligible asset allocation of investment portfolios other than those already contained in the Collective Investment Schemes Control Act (CISCA).

It is unfortunately likely that, at least initially, investors will only be allowed to invest in funds with fixed fees, which will exclude funds with performance fees. We believe fees must be commensurate with the value added over the longer term, but do not believe that there is a case for effective fee regulation in this context. The after-fees track record of many of South Africa's most popular unit trusts makes a strong case for including funds with performance fees. More clarity will become available post further consultation with National Treasury.

NEW DISCLOSURE REQUIREMENTS

Unit trusts fact sheets ('minimum disclosure documents') will be regulated for the first time from March next year. More emphasis will be placed on a detailed explanation of the risks and the potential downside of a product. Managers will have to disclose portfolio holdings at least every quarter.

From January 2016, **Total Expense Ratios** will include actual expenses over the past three years, not the last twelve months as is currently the case. This is to better reflect the real cost of performance fee funds. In addition, all managers will be required to disclose their transaction costs from the start of 2016.

Industry players recently agreed on a universal disclosure standard that will allow investors to compare different product types before investing(for example, an endowment with a platform-based product). From April 2016, product providers will provide an **effective annual cost measure** for all their products.

Example of an effective annual cost measure calculation

	1 Year	3 Years	5 Years	Term to maturity
Investment Management Charges	1.1%	1.1%	1.1%	1.1%
Advice Charges	0.5%	0.5%	0.5%	0.5%
Administration Charges	0.9%	0.9%	0.9%	0.9%
Other Charges	0.3%	0.3%	0.3%	0.0%
Effective Annual Cost	2.8%	2.8%	2.8%	2.5%

Source: Coronation

The measure will form the basis of **pre-contractual disclosure documents** that will be required for all products. Before investing, clients will have to be presented with a personalised quotation of what they can expect to pay for all the services associated with a product. Once a year, an actual cost statement will be issued to compare against the pre-contractual disclosure document, with the implication that the product provider or advisor will have to explain any difference in co