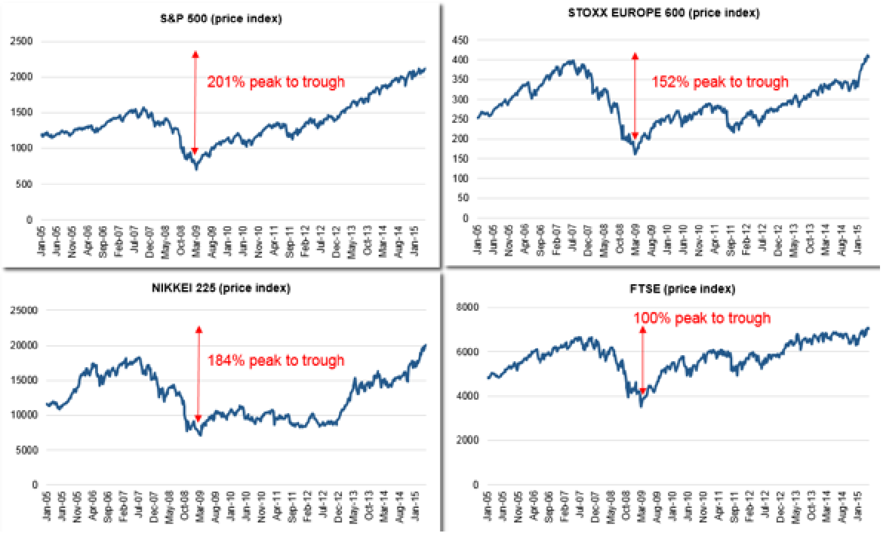
EXECUTIVE SUMMARY
CONVERSATIONS WITH CORONATION

JUNE 2015

INVESTING IN AN UPSIDE DOWN WORLD

Record-low bond yields and interest rates have fuelled a phenomenal rise in almost all asset prices over recent years. Equities in particular have rallied as corporate profitability benefited from the low cost of borrowing. Also, companies have been doing record levels of share buybacks, raising money in the debt market at very low rates. Value accretive mergers and acquisitions have followed, specifically in the property sector, where companies have profited from buying properties at a higher yield than the low borrowing cost.

Equities at all-time highs



However, the tailwind of low rates could suddenly turn into a destructive headwind. When rates start rising, the era of cheap money will come to an end and a powerful propellant of asset prices will fall away. Companies won't be able to borrow money at sometimes absurd levels. Higher rates will have negative implications for all asset classes; equity, listed property, private equity, commodities and housing.

Amid this looming volatility and the threat of probable rerating, we believe the central tenets of our investment philosophy have never been as relevant:

1. A long-term investment horizon

As markets become frothier, the noise and the pressure to focus on short-term positions are growing. Pressure to perform in the short term may expose investors to significant long-term investment risk. A case in point: most European bonds, which offer absurdly low yields. Over the long term, clients exposed to these bonds are likely to lose out as they lock in record low interest rates.

At Coronation, our long time horizon (of more than five years) allows us to make the best investment decisions for our clients, and to ensure that long-term capital is preserved and grown. We believe that being able to focus on the long run gives us a substantial advantage, and drives our ability to deliver superior long-term returns.

2. A valuation-driven investment process

Our investment process does not fixate on current share prices, focusing instead on the real value of a business.

The two most important aspects in valuing a business is determining its future earnings streams and deciding on the correct discount rate. The discount rate determines the premium an investor should demand to compensate for the opportunity cost and

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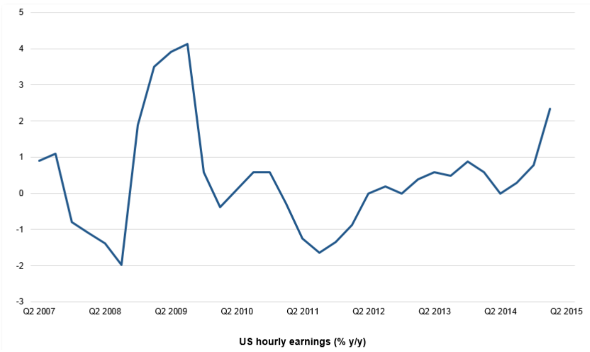
risks associated with the investment. While many analysts spend much of their energy trying to forecast earnings, it is equally important to use the right discount rate. Small changes in the discount rate can have a big impact on the valuation of a company.

The discount rate for most asset valuations is based on the US 10-year bond yield, which serves as the key global risk-free rate. For investors who use the current near record-low yield (of around 2.5%) as the building block for their valuations, virtually every investment out there looks like a 'buy'. However, the historic average of the US 10-year bond is between 4% to 5% and this level is more appropriate. We believe using a normalised, higher rate is prudent and more appropriate, particularly ahead of an era of rising interest rates.

While the timing of the first interest rate hike in the US may be uncertain, a normalisation of abnormal monetary policy remains inevitable. The US economic recovery is on track, and the first real signs of inflation pressure are emerging as wages start to climb in a tightening labour market.

The missing piece of the puzzle falls in place
Rising US wages



As a result, we are using a higher discount rate in our asset valuations – and expecting lower investment returns in the future. A large portion of the returns generated across asset classes the past few years has been driven by re-rating as opposed to fundamental earnings growth.

Expected asset class returns (as at 30 April 2015)

	Last 10 years (ZAR)	10 year forecast (ZAR)
Local equity	19.9%	7 – 10%
Global equity	14.8%	10 – 13%
Local property	22.1%	7 - 10%
Local bonds	8.6%	7 – 9%
Global bonds	10.1%	5 - 7%
Cash	7.6%	6 – 8%
Inflation	6.1%	6% +

Coronation Fund Managers forecasts.
While these forecasts are not guaranteed to occur, they are based on our best estimates of possible future returns and represents a more prudent basis for informing planning assumptions than historical results achieved over the past decade.

Investors should be warned to expect the unexpected. As asset prices tend to extreme levels, volatility and the scope for sharp losses will increase. Patience and a focus on the long term are necessary to avoid getting caught up in the hype and making a mistake.

BLEAK SOUTH AFRICAN OUTLOOK

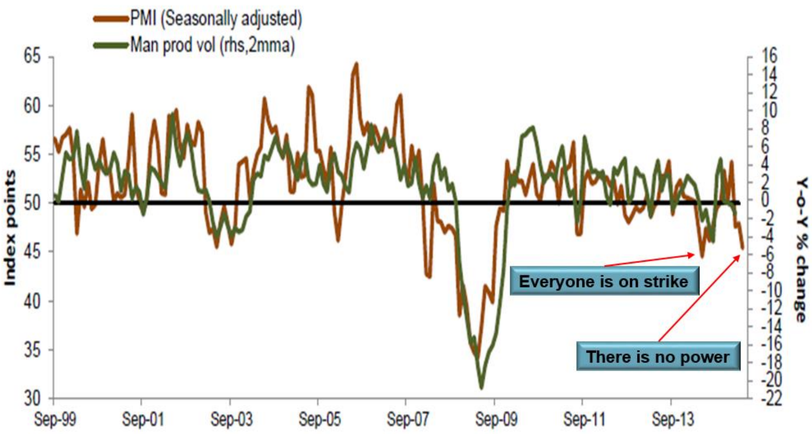
Despite the domestic market's strong performance over recent years, it is difficult to be optimistic about local prospects.

The damage to the economy caused by Eskom's failure to provide sufficient power cannot be underestimated. It will be significant and long lasting.

The inadequate government response during this crisis is indicative of lack of urgency or concern for the economic wellbeing of SA. Businesses are discouraged from making investments and job opportunities are being destroyed, compounding social unrest. Even when power is finally restored, it will be prohibitively expensive due to enormous cost overruns and escalating debt. This will put further pressure on prices, and on the economy.

In the past, a weaker rand would serve as a pressure valve in times of domestic difficulty. This time is unfortunately different; the rand won't help to bolster exports given the lack of electricity supply and the ongoing threat of industrial action.

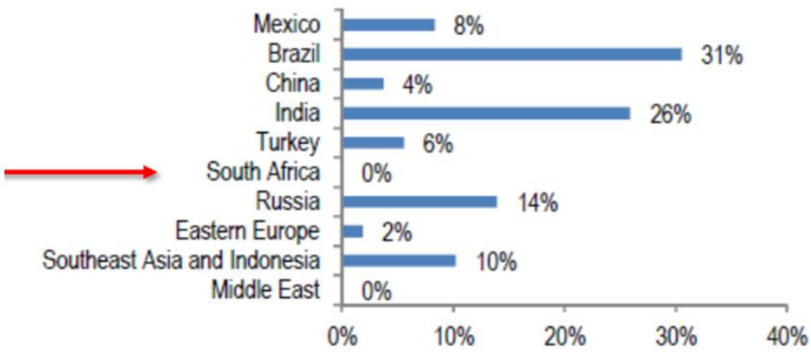
A weaker rand doesn't help when...



In addition, inflation threats are looming. The oil price has gained 25% from its recent lows, while the rand has remained weak. Rising administered prices, and above-inflation wage settlements will add to pressure. Cellphone costs, which have decreased in recent years, are starting to rise again and won't be able to offset other inflationary pressures. We see inflation breaching the 6%-level at the end of the year, reaching a peak of 7% in 2016.

All of these factors are not going unnoticed by international investors. At a recent JP Morgan conference, analysts were asked which emerging market country offered the biggest investment opportunity over the next two years. Not a single analyst named South Africa:

Which is the biggest EM investment opportunity over the next two years?



OUR ASSET ALLOCATION

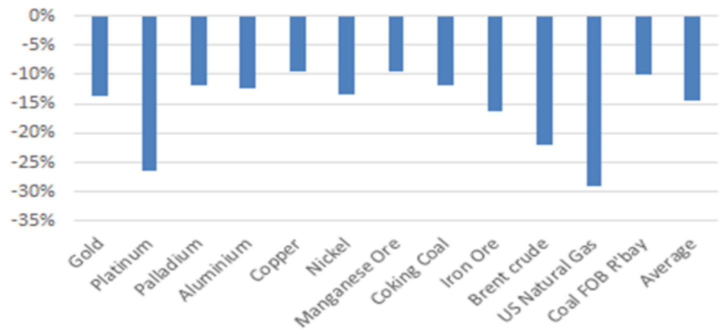
Notwithstanding the gloomy prospects for the local economy, the domestic equity market has continued to deliver phenomenal returns. We continue to caution about expecting much lower returns in the future and have low exposure to the domestic market in our multi-asset funds. We prefer selected global equities, particularly in emerging markets, which are offering value. However, the sharp movements in the local market have highlighted some opportunities, as a wide valuation gap opened up between industrial shares and the commodity sector:

Resources versus Industrials

Company	30-Jun-08	31-Mar-15	Price move
	Price	Price	
Anglo American	548.00	183.75	-66%
Exxaro	144.45	100.50	-30%
Impala	309.00	58.83	-81%
SAB	178.05	636.00	257%
Truworths	22.95	88.26	285%
Bidvest	98.38	328.68	234%
AVI	12.95	82.55	537%
Mr Price	15.00	260.01	1 633%
Spar	49.50	188.70	281%

Despite the uncertainty in the resource sector, we are finding compelling value in some of these companies. Due in part to a glut of supply in recent years, commodity prices (and mining shares) have been under pressure and are currently trading below our assessment of normalised levels. As suppliers cut back their output, we expect commodity prices to revert to normal.

Commodity prices – deviation from normal estimate



Source: Coronation, INet and Reuters

While we don't know how long and deep the current cycle will be, we believe three companies in particular offer investment value:

Anglo American has exposure to a diversified range of underlying commodities - including diamonds, platinum and copper. The demand for these commodities is driven more by consumers than by Chinese industrial growth, which has faltered in recent times. Anglo's current management team has done a lot to increase operational efficiencies and production, and we expect that some of its major assets will be restructured (and its underperforming assets sold off) over the next 12 to 18 months.

Exxaro is trading at below 50% of our assessment of its fair value. Its low-cost coal business is quite robust, with good margins and steady revenues. It also has exposure to iron ore through its stake in Kumba, which has been under pressure to adjust its cost base amid a slump in prices. In addition, it has a stake in a US-listed pigment producer Tronox, which is trading at a low earnings multiple and has a large deferred tax asset.

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Implats is our preferred holding in the platinum sector. The metal is currently trading at 25% below our estimate of normalised levels. The long-term fundamentals are encouraging thanks to sustained consumer demand for jewellery, as well as from vehicle manufacturers who have to comply with stricter emission requirements. We expect the global platinum supply to move into deficit as excess inventory, built up in anticipation of industrial action at SA mines, is worked out of the system.

We have also added to positions in the following investments:

Mondi, our largest holding, earns 74% of its profits from packaging for fairly defensive products, including fruit, vegetables, cement and pet food. Following its unbundling from Anglo, the company has invested extensively in its capacity in Russia and Eastern Europe, improving efficiencies and dramatically lowering its costs. Its return on capital employed improved from about 9% in 2007 to 17% in 2014. Its balance sheet remains strong. It is currently offering a dividend yield of 3%, which may be supplemented by further share buybacks and special dividends. The share is trading at 13 times our estimate of normal earnings.

Standard Bank has seen relative good earnings growth, but we believe its current earnings are not a true reflection of the real potential of the business. Management has been strategic in exiting its Russian and Turkish businesses, and sold a controlling stake in its lossmaking London-based business to the Chinese bank ICBC. Standard retained a 40%-stake in the business and should realise future value as ICBC takes control and attracts international inflows. Standard has earned $360 million from its disposals that will be deployed in fast-growing markets in Africa, which should be positive for its return on equity.

PASSIVE VERSUS ACTIVE

Given the multitude of indices in the market, which are all constructed differently, it can be expected that some passive investments will outperform active funds over shorter periods - but not consistently, and not over meaningful timeframes. We focus on delivering sustainable investment growth over five years and longer. Over these periods, and longer, we have consistently outperformed indices, net of fees.

Coronation Top 20 vs. indices
Since inception