EXECUTIVE SUMMARY
CONVERSATIONS WITH CORONATION

SEPTEMBER 2015

POST-RETIREMENT INVESTING IN A CHANGING MARKET

Investors who require both income and capital growth, specifically those in retirement, should pay special heed as the investment environment grows cloudier. Coronation has cautioned for some time that an extended period of lower returns lies ahead, and sharp market corrections have already impacted investment markets, putting many post-retirement clients under pressure.

This requires renewed attention to some of the key considerations when managing post-retirement income, including:

• A prudent initial drawdown rate

If a client's real retirement capital remains intact after the first ten years of retirement, it is very likely that their real living standards will be sustained for the rest of their life. Accordingly, complacency around the initial drawdown rate should be avoided at all cost.

Market valuations at the time of retirement should also play a key role in deciding on an appropriate drawdown rate. Currently equity valuations remain full (with the exception of some parts of emerging markets) and interest rates are still at multi-decade lows, which may result in lower future investment returns.

For relatively healthy retirees in their early sixties, a prudent initial drawdown rate in the current environment is believed to be between 4% and 5%, compared to the average drawdown rate of 6.59% in South African living annuities in 2014. This was unchanged from 2013 (6.63%), unfortunately ending a welcome period of declining drawdown rates. The annuity rate quoted on a guaranteed escalating annuity remains a good starting point for client discussions regarding appropriate drawdown rates.

• A 'Goldilocks portfolio'

The retiree should have a well-constructed portfolio that allows enough risk asset exposure to achieve reasonable real growth over time, but not so much that a near-term market correction will impair the capital base. Between 2008 and 2011, we warned that retirement funding portfolios were too conservative and needed more structural exposure to growth assets. In recent years, investors have taken on much more risk. Indeed, the latest figures from the Association for Savings and Investment South Africa (Asisa) confirm that post-retirement investment flows into fixed income funds are now non-existent. However, what is of concern is that many post-retirement investors have seemingly skipped a risk bracket (income-and-growth funds), and invested instead in multi-asset funds with large equity allocations (the typical Regulation 28-compliant balanced fund).

High-equity funds are not specifically managed with post-retirement clients in mind. While they have generated excess returns over the past six years in a relatively benign environment, we fear that some clients may now be too complacent about the actual risks in these funds. The funds do not offer the same downside risk protection as our income-and-growth funds, and a market slump at the wrong time can have a negative, permanent impact on an investor's standard of living.

• A sensible investment horizon

Studies show that relatively healthy and affluent 60-year olds will, on average, live for another 20 to 25 years. (Half of this group will live longer than the average, meaning that most investors should plan for a longer life expectancy). An advisor can help a client make better investment decisions by applying more intelligence in calculating a client's expected longevity, i.e. moving from standardised actuarial life expectancy to real age-adjusted life expectancy, and taking more variables – including lifestyle, diet and location - into consideration.

All of the aforementioned decision points create significant opportunities for advisors to add value and to differentiate themselves.

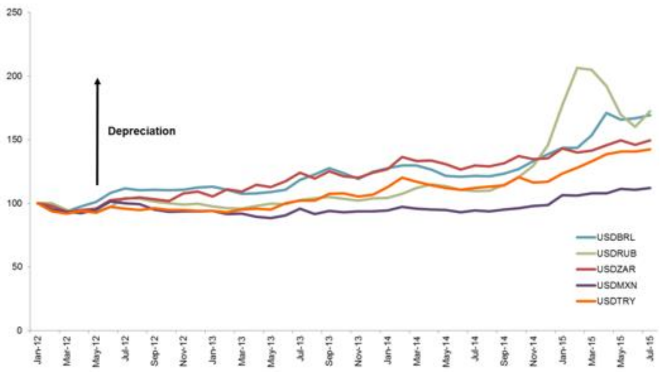
- For an in-depth analysis of investing for income and growth, please refer to the latest edition of Corolab.

INVESTMENT ENVIRONMENT

A number of key global developments have soured sentiment, adding to the turmoil in emerging markets. Chiefly among the concerns is China, where the market fears that a long anticipated economic slowdown may be much worse than previously expected. Chinese data are notoriously unreliable, but according to some estimates the current growth rate may be significantly below the official rate. The slowdown in the Chinese economy and the country's rebalancing away from investment spending are adding to the pressure on commodity prices, and piling misery on resource-exporting emerging markets and their currencies. This has been exacerbated by ongoing concerns regarding the impact that (eventual) US interest rate hikes will have on the investment flow to emerging markets.

Emerging Market currencies versus the US dollar

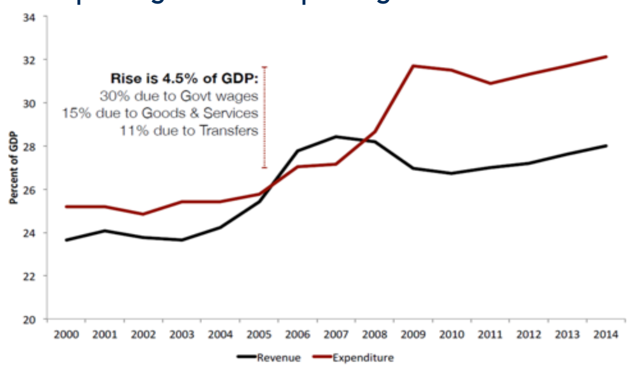
Exchange rates, (index January 2012 = 100)



And while the global environment grew increasingly treacherous, South Africa has added to domestic woes by scoring a number of own goals:

- **Eskom**. The electricity crisis has dealt a major blow to confidence and growth, subtracting an estimated 1% from South Africa's growth rate.
- **Government finances**. All countries suffered income losses in the wake of the global financial crisis. Many governments adjusted to the lower revenues by spending less and keeping their balances intact, however South African government spending continued to grow. This lack of spending discipline has resulted in an ever-larger debt burden. Our debt levels are not yet high enough to warrant a credit downgrade to junk status, but if the government doesn't curb spending, this remains inevitable.

Undisciplined government spending

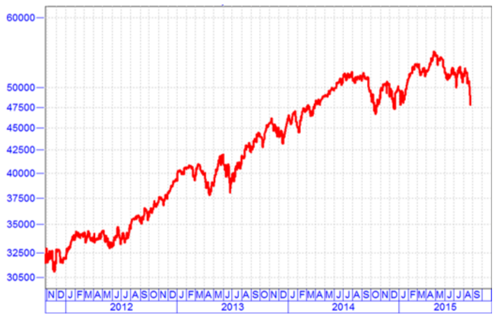


Source: Prescient Securities

- **Corruption and fraud**. Many state-owned enterprises, including SAA, PRASA, PetroSA and others, have wasted billions of rands on unnecessary and fraudulent expenses.
- **Visa debacle**. The introduction of new visa rules is having a large impact on the tourism industry. The sector, a large employer of low-skilled workers, should be booming due to the weak rand. Instead it is severely hampered.

The end result of these 'own goals' is a far lower potential growth rate for the SA economy. However, despite the domestic environment, the JSE All Share index has been surprisingly resilient. This speaks to its composition (with a large number of quality international companies listed in SA), but also to the fact that many domestic companies continue to do well.

JSE All Share index



Still, many quality domestic stocks are trading at very high multiples in a low-growth economy and the downside risks cannot be ignored. While we have started to look at companies like Mr Price and Aspen, which are both down 30% from their peaks, we remain very cautious in the domestic market.

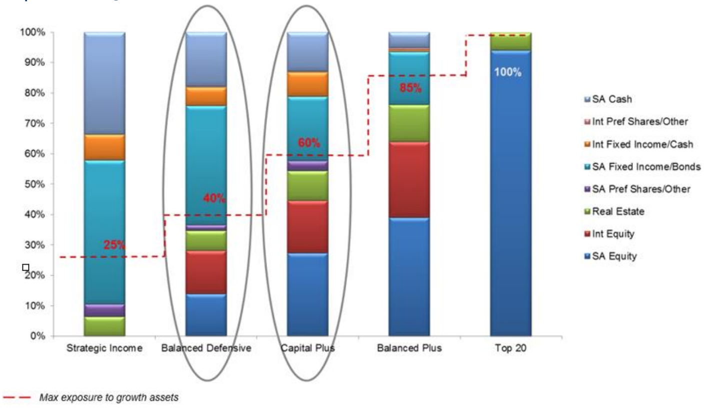
Looking at the global environment, the various parts of different asset markets are not at the same stage of the cycle. We believe emerging markets and their currencies have already experienced a deep down-cycle and while there could be more pain, it is difficult to argue that the correction has only just started. Emerging market equities now offer far more upside than downside in our view, while developed world stocks are trading around fair value. We continue to think that selected resource shares hold considerable value after a massive slump in the prices of commodities, which may be near the end of its down cycle as is evidenced by the many loss-making producers. This will curb production and eventually push prices higher.

We therefore believe the greatest upside can be found in bombed-out cyclical sectors, but uncertainty around global and domestic growth limits our appetite for these stocks. What is clear, is that an environment of lower investment returns has arrived. It will be much more difficult to achieve large margins above inflation in this low growth, low interest rate world.

CORONATION BALANCED DEFENSIVE FUND

The fund is a lower risk option for post-retirement investors, providing a stable income and capital preservation in real terms.

Coronation Balanced Defensive
Exposure to growth assets limited to 40%



Growth assets are defined as domestic and foreign equities, listed property and commodities. As at 30 June 2015.

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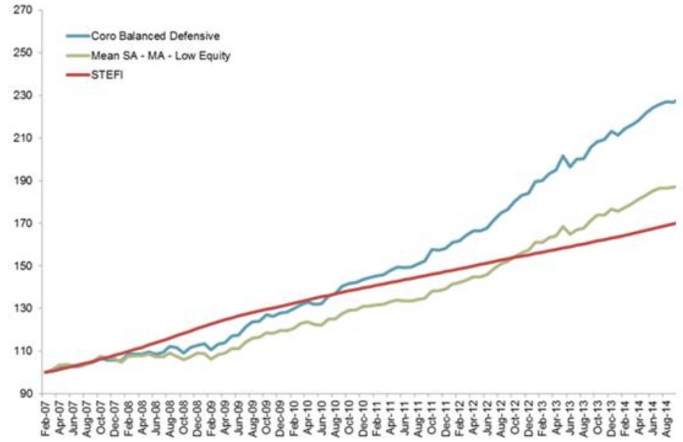
Balanced Defensive has been a top-performing conservative fund in South Africa since its inception in February 2007 and over the past five years. It has not suffered capital losses over any 12-month period over its more than eight-year history. The fund will discount fees if performance is negative over any rolling 12-month period.

Coronation Balanced Defensive

Value of R100 000 investment of 1 February 2007 to 31 July 2015



Performance quoted from Morningstar as at 31 July 2015 for a lump sum invested with income distributions reinvested.

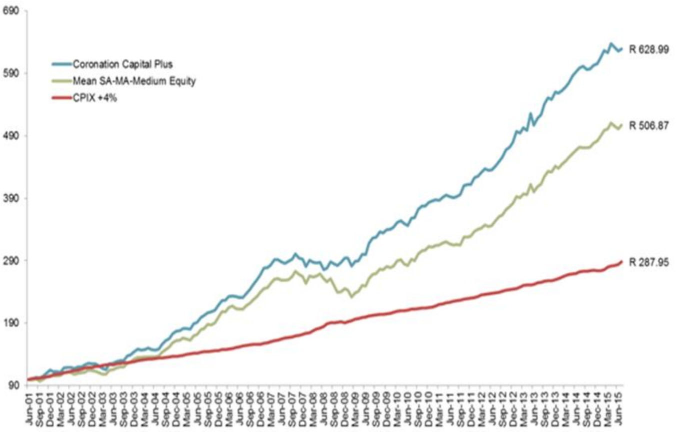
CORONATION CAPITAL PLUS FUND

Capital Plus has a higher allocation to growth assets (60%), making it an ideal portfolio for investors in the first half of retirement. This fund has delivered solid inflation-beating returns over the long term, outperforming inflation by around 8% p.a. since its launch in July 2001.

We are as serious about capital protection as we are about beating inflation. The fund's annual management fee will be discounted if the fund produces a negative return over any 24-month period (previously 12 months). Capital Plus has produced positive returns over rolling 12-month periods more than 90% of the time.

Coronation Capital Plus

Value of R100 000 investment of 2 July 2001 to 31 July 2015



Performance quoted from Morningstar as at 31 July 2015 for a lump sum invested with income distributions reinvested.

Comparative performance for periods ending 31 July 2015

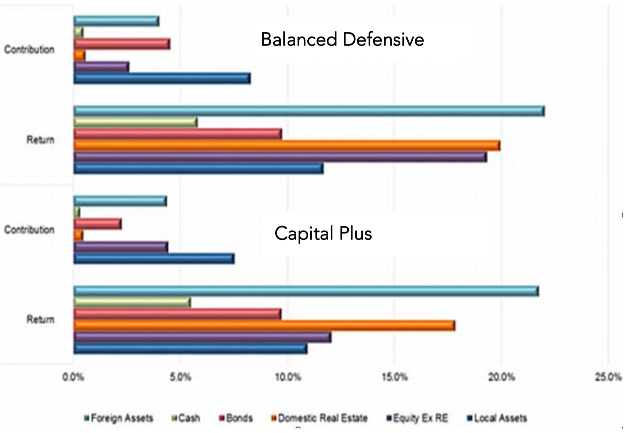
	Balanced Defensive	Capital Plus	Balanced Plus
7 years	12.1%	12.4%	14.2%
5 years	12.3%	11.9%	15.6%
3 years	12.2%	12.5%	17.9%
1 year	7.5%	5.0%	8.0%

In a rising market, it would have been expected that Capital Plus would outperform Balanced Defensive by a larger margin as it can hold more equities (the funds have growth asset limits of 60% and 40% respectively). However, both funds have produced largely similar returns as indicated in the table, meaning that investors in Capital Plus did not receive the expected risk premium. Its relative underperformance was due to exceptional returns from domestic equities in Balanced Defensive, and a comparatively weaker performance by the equities in the Capital Plus portfolio. A number of shares contributed to this difference, with Naspers key among them. Balanced Defensive owned relatively more Naspers, which was the biggest contributor to the difference in equity performance achieved in the two funds.

Balanced Defensive's focus on quality companies paid off in an environment where cyclical shares were heavily penalised. Investors sought the safety of stable businesses that produce cash returns. Two cyclical shares owned by Capital Plus that declined sharply, Aveng and Altron, were not included in the Balanced Defensive portfolio, while Capital Plus also held more exposure to companies in the embattled resource sector, including Anglo and Exxaro.

Defensive equities have outperformed

Performance contribution (as at 31 July 2015)



Since the current portfolio managers took responsibility for both funds in January 2014, we have been systematically aligning the Capital Plus and Balanced Defensive portfolios; buying and selling a number of shares across both portfolios:

Aligning portfolios

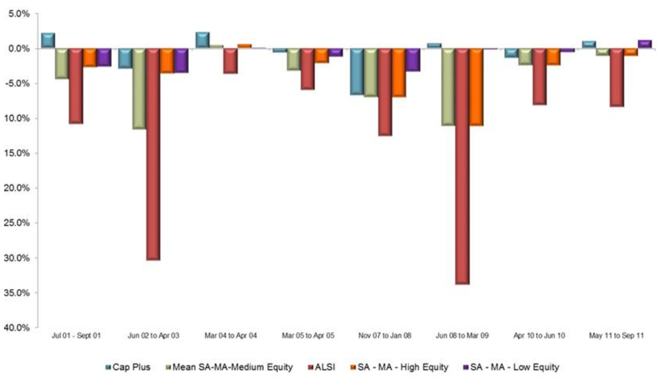
Balanced Defensive	
Buys	**Sells**
Spar	
Distell	
Murray & Roberts	
Capital Plus	
Buys	**Sells**
FirstRand	Sappi
Sasol	Anglo American Plc
Woolworths	Barclays
	Aveng
Balanced Defensive and Capital Plus	
Buys	**Sells**
Steinhoff International	AVI
Old Mutual	Foschini
Richemont	BHP Billiton
Northam	MTN
Standard Bank	Investec
Nedbank	Pioneer Foods
Vodacom	
Impala Platinum	

The alignment of the portfolios should also result in a closer correlation between their returns, however given its larger risk budget, Capital Plus will always own some shares with a higher 'heartbeat'. Currently, this is reflected in a larger exposure to resources, which represent 20% of equities (5.2% of total portfolio). This compares to 18% of equities in Balanced Defensive (2.2% of total portfolio).

It is worth noting that Capital Plus is managed to offer downside protection; put options and other forms of portfolio 'insurance' are permanent features in the fund to reduce the impact of market declines. Consequently, it is in bear markets that the fund usually performs materially better than the mean of peer funds.

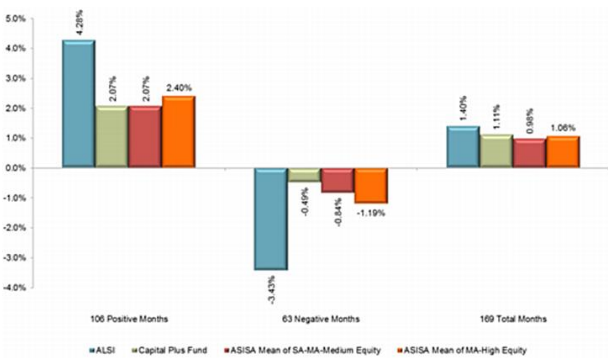
Coronation Capital Plus:

Performance in bear market cycles…



As at 31 July 2015

Resulting in excellent long-term outcomes



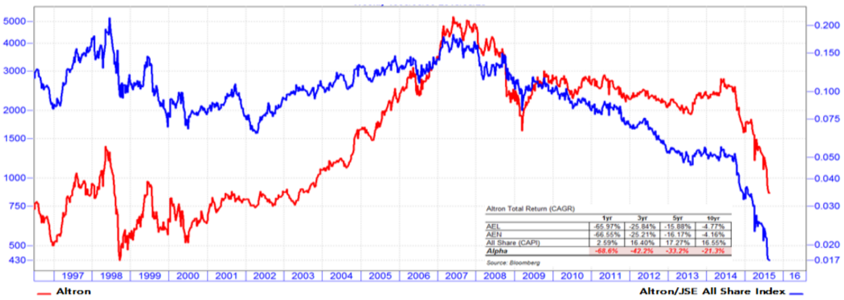
ALTRON

Altron has seen a collapse in its share price in recent years, largely due to the underperformance of its subsidiary Powertech, a leading supplier of power transformers. We established a position in the company in 2009/2010 after a 50%-slump in its share price. However, the recovery in Powertech has taken much longer than anticipated due to Eskom's cash flow constraints. In addition, Altron's previous management made poor capital allocation decisions – including acquisitions - that destroyed significant shareholder value.

We continue to believe there is sufficient margin of safety and significant upside potential to warrant a place for Altron in our portfolios. Investors have lost sight of the very good businesses in the group, including the IT services company Bytes and the vehicle tracking business Netstar, which offer strong annuity payments. Powertech is cyclically depressed due to reduced Eskom spending, which is not sustainable in the long run - maintenance will be needed to keep the lights on. In addition, government plans to adopt new measures to force the utility to use more local content, which will be a boon for Powertech as it is one of only two domestic businesses that can produce large transformers. We value the replacement cost of Powertech's two transformer facilities at more than R1bn each – however, at Altron's current share price, investors are effectively getting Powertech for free.

Trading at all-time lows relative to the market, we believe Altron's share price has significant upside.

Altron vs. the JSE All Share Index



While at the time of writing it trades at less than 700c, our estimate of the company's fair value is more than R20 a share. It is trading at four times our assessment of normalised earnings, with a forward dividend yield of 3.5%.

We have built up a large stake (c. 30%) in the company that allows us to engage with the new management, who are open to our input. Some of our proposals are being implemented, and can unlock value over time.

RICHEMONT

Richemont is one of the best businesses in our market, and trading at very undemanding levels. It has massive moats in the form of enduring brands that cannot be replicated easily, creating large barriers to entry.

It also offers exposure to aspirational emerging market consumers with an affinity for luxury goods – as wealth levels rise, this offers an attractive long-term structural growth story. However, Richemont's share price has been underperforming due to its exposure to this market in China, which accounts for 40% of the company's sales. While the Chinese economy is slowing, we believe this exposure will ultimately be positive for Richemont. As China moves from being export-led to consumer-driven, clients will grow wealthier and able to spend on aspirational brands.

Richemont continues to be an impressive business, with strong financial metrics, including a free cash flow conversion rate of 78% and return on equity of 18% over the past ten years. The company also has the strongest balance sheet in the global luxury goods sector. It is sitting on €4.5bn in cash (15% of current market capitalisation), offering it tremendous fire power in a tougher global market. The management team (led by Johann Rupert) will employ the capital to pursue value-enhancing opportunities, but has a track-record of not overpaying for acquisitions. Excess cash will be paid back to shareholders, supporting a healthy growth rate (double digits) in dividends going forward.

Its valuation is quite attractive. Richemont, which in essence is a growth stock, is trading on a forward price earnings ratio of 16.2 times, or 12.5 times when its cash holding and the value of its online fashion portal Net-A-Porter are excluded.

For South African investors, Richemont also offers a rand hedge, with virtually no exposure to the challenged domestic economy.

21 September 2015