corospondent

The Coronation Fund Managers Personal Investments Quarterly

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CORONATION
FUND MANAGERS
TRUST IS EARNED

Coronation Asset Management (Pty) Limited is an authorised financial services provider.
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Notes from my inbox

by **PIETER KOEKEMOER**

***PIETER KOEKEMOER** is head of the personal investments business. His key responsibility is to ensure exceptional client service through a combination of appropriate product, relevant market information and strong investment performance.*

In 2014, equity markets produced real (after inflation) returns of around 5.5% and 4% for local and global markets respectively. Some investors may perceive these outcomes as anaemic, especially when framed against the heady performance of 2012 and 2013, when real returns of approximately 20% were the norm. However, the 2014 achievements are actually very close to the 4.5% average real return achieved over the past 114 years by the 23 equity markets tracked in the annual Dimson, Marsh and Staunton survey. Importantly, it is also more in line with the average returns we expect for the next several years than the high rates achieved in the post-financial crisis recovery period. We continue to caution investors to ensure that return expectations used in planning their financial affairs remain prudent. A good starting point for a pre-retirement savings programme is a real rate of return of around 3% – 4% p.a., while new retirees who are starting to draw an income should ideally aim for an initial income rate of no more than 4% – 5% of their portfolio value.

We also continue to argue that most investors are better served by leaving the capital allocation decision to their fund manager. Accordingly, investing in multi-asset class (or balanced) funds makes more sense for most of our clients, as explained in detail by our chief investment officer, Karl Leinberger, on page 5. Our fund range includes multi-asset class funds aimed at a variety of investor needs, including saving for retirement (Balanced Plus); drawing an income over a long period of time (Capital Plus and Balanced Defensive); discretionary long-term saving (Market Plus); looking for the best long-term opportunities across domestic and international markets (Optimum Growth); or looking for an alternative to 36 – 60 month term deposits (Strategic Income).

Despite our more muted return expectations, we still believe selected equities remain the assets most likely to beat inflation over time. For examples of specific equities currently included in portfolios, read Siphamandla Shozi's explanation of the investment case for Distell on page 10 and David Cook's article on luxury car makers (page 25).

Regular readers of *Corospondent* may notice the absence of Chantal Valentine, who wrote the economics and fixed interest update in recent years. After more than a decade with Coronation, she decided to emigrate to the United States with her family. She will be missed and we wish her well in this new chapter of her life. We take this opportunity to introduce her successor, Marie Antelme, who joined the Coronation team during November 2014. She is an experienced economist, having spent most of the last decade covering South Africa, Nigeria, Kenya and Israel for investment bank UBS AG. You can read her maiden contribution on page 13. There have also recently been two fund manager changes. Analyst Adrian Zetler has succeeded Dirk Kotzé as co-manager of the Industrial fund. Dirk will focus on managing an institutional fund and on research. Analyst Nicholas Stein will replace Duane Cable, who co-manages the Equity and Balanced Plus funds, as co-manager of the Resources fund.

It remains our aim to match excellent investment performance with the best client service in the South African industry. We have recently refreshed our website, and we hope you find the new format and functionality useful in your engagements with us. As cybersecurity breaches make headlines around the world, we are determined to remain at the forefront of security technology and to enhance our safeguards. This will necessitate new validation steps in our transactional processes, especially when you request changes to your banking and/or contact details. While we are careful not to add unnecessary complexity, these additional requirements are a necessary trade-off to ensure against fraud.

As always, we welcome your feedback. Please contact our client services team on 0800 22 11 77 or email clientservice@coronation.co.za.

MARKET DATA

MARKET MOVEMENTS

	Qtr 4 2014 %	2014 %
All Share Index R	1.4	10.9
All Share Index $	(0.2)	0.2
All Bond R	4.2	10.1
All Bond $	2.7	(0.4)
Cash R	1.5	6.0
Resources Index R	(19.3)	(14.7)
Financial Index R	10.8	27.3
Industrial Index R	7.0	16.8
MSCI World $	1.1	5.5
MSCI EM $	(4.4)	(1.8)
S&P 500 $	4.9	13.7
Nasdaq $	4.9	18.6
MSCI Pacific $	(2.1)	(2.5)
Dow Jones EURO Stoxx 50 $	(6.2)	(8.7)

KEY ECONOMIC DATA: HISTORY AND FORECAST

	2010a %	2011a %	2012a %	2013a %	2014e %	2015f %
HCE	4.5	4.9	3.4	2.9	1.4	2.8
GCE	3.0	1.7	3.4	3.3	1.9	2.1
GFCF	(3.9)	5.7	3.6	7.6	(0.6)	2.2
GDP	3.0	3.2	2.2	2.2	1.4	2.6
Current a/c % of GDP	(1.5)	(2.2)	(5.0)	(5.8)	(5.5)	(4.3)
CPI	4.3	5.0	5.7	5.8	6.1	4.2
Prime rate year-end	9.0	9.0	8.5	8.5	9.3	9.3
R/$ year-end	6.8	8.2	8.6	10.4	11.5	10.6
R/€ year-end	9.0	10.8	11.3	14.2	14.0	13.1

HCE: Final household consumption expenditure
GCE: Final government consumption expenditure
GFCF: Gross fixed capital formation
GDP: Gross Domestic Product
CPI: Consumer Price Index

Asset allocation

The most important decision in investments

by **KARL LEINBERGER**

***KARL LEINBERGER** joined Coronation in 2000 as an equity analyst. He was made head of research in 2005 and appointed chief investment officer in 2008. Karl co-manages the Coronation Houseview portfolios.*

The merits of investing in single asset class or building-block funds, instead of a multi-asset class fund, has been one of the perennial debates in our industry ever since I joined it. When Coronation opened its doors in 1993, balanced funds were the fund of choice for most of our clients. In the late 1990s, significant allocations were made away from these funds into building-block funds, only for the pendulum to swing back to multi-asset funds over the last few years. These developments have largely mirrored the same trends in international markets.

All clients are different, each with differing needs and risk budgets. Some have the appetite and the ability to make active asset allocation decisions (both are needed!); others do not.

For this reason, we believe that we need to offer a complete fund range that includes both building-block and multi-asset funds. This empowers our clients to select the fund that best meets their needs at a specific point in time.

The arguments made in favour of a building-block strategy typically are:

1. *It gives clients the ability to tailor asset allocation to their needs at a specific point in time.*

2. *It allows clients to allocate capital to fund managers who specialise in certain asset classes.* Some of the greatest fund managers on the planet only offer products in one asset class. If you are to allocate capital to those managers, then investing in a multi-asset fund is simply not an option.

3. *Few managers have skills in both asset allocation and security selection.*

At Coronation, a key differentiator in our investment philosophy is the emphasis on a *generalist* investment perspective and skill set, rather than a *specialist* one. In my opinion, a good equity analyst should be able to give a well-considered view on the merits of an investment in an inflation-linked bond against any stock that they may analyse. This *generalist* perspective builds better investors, drives better debate and results in better investment decisions. A positive spin-off from this is that it has resulted in Coronation delivering excellent long-term outcomes in both building-block and multi-asset funds.

I do not think that this is a debate that can be resolved in a vacuum. Too much depends on the unique needs of clients and the quality of the multi-asset and building-block funds available to clients in any given market.

But I do think that clients with the opportunity to invest in a credible multi-asset fund should take it. We think that an investment in our multi-asset funds makes more sense for most of our clients than an investment in our underlying building-block funds. Our reasons are as follows:

1. The opportunity to achieve higher returns

Asset allocation is the most important decision that you make in investments.

The ultimate value added by good asset allocation decisions dwarfs the alpha that can be delivered in the underlying building blocks. This is *the* big call and you need to get it right. I think it makes sense to leave the asset allocation decision to someone who has the appropriate skill set and then to hold them accountable for those decisions. This will be even more important in the years ahead, if our expectations of lower real returns are correct. In such an environment, alpha becomes a 'must-have' and not a 'nice to have'.

In addition to this, I have some concerns about the way in which asset allocation decisions are made in practice when clients follow the building-block strategy.

In the case where asset class weightings are rebalanced to certain long-term target weightings, the rebalancing exercise is typically rule-based and mechanistic. It does not take into account risk/return considerations at that point in time and is typically performed fairly infrequently (often quarterly). The target weightings are usually formulated by anchoring off historical returns. This is a risk. The future is unlikely to look like the past and this is even more likely to be the case in the unchartered waters that we currently find ourselves (in which a commodity super-cycle was followed by a global financial crisis, only to be followed by a period of unprecedented quantitative easing, a commodity meltdown and then finally a crisis in some emerging markets!).

In the alternative scenario, where an investment committee makes active asset allocation decisions, those committees often end up 'sitting on their hands' and making very few active decisions. The concern with 'sitting on your hands' as an asset allocation committee in times of uncertainty and volatility is that these are often the times when the opportunity to add value is greatest. Active managers are going to get some calls right and some wrong. But in these unique times, I would rather have a team with skill and experience making bold and decisive decisions on my behalf.

Multi-asset funds can make full use of all the asset classes, including in-the-gap assets.

These assets have contributed meaningfully to our portfolios over time. Often the building-block approach involves a simple allocation to vanilla bonds, equity and cash. Many of these funds end up without meaningful allocations to important asset classes like property and inflation-linked bonds and to some of the smaller asset classes like commodity exchange-traded funds and preference shares.

2. The opportunity to better manage risk and, in so doing, reduce risk

Risk is best managed by a manager who has sight of the overall portfolio. I do not think that the trade-off between risk and return can be fully understood in the asset allocation process if you do not have a deep understanding of the exposure to the underlying building blocks. For example, a domestic equity building block heavily invested in resource stocks has very different fundamentals to one heavily invested in either rand hedge dual-listed stocks or domestic stocks. The same applies to a domestic bond portfolio. One heavily invested in long-duration fixed rate bonds would respond completely differently to interest rate changes than one heavily invested in floating rate bonds.

Without that level of granularity, the task of managing risk is almost impossible.

In our multi-asset funds, we spend enormous amounts of time:

- thinking through the risk of unintended positions that can occur in the overall portfolio from views taken in each of the underlying building blocks; and
- identifying the best risk-adjusted returns across all asset classes and sectors, and across the capital structure of every company.

A good example of this would be 2006, when all interest rate sensitive assets collapsed at the beginning of the rate hiking cycle. In equity funds, we bought banks and retailers and in our bond funds, we bought fixed-rate bonds. However, in our multi-asset funds we were empowered to sift through the entire spectrum of interest rate sensitive assets and identify those that offered the best risk-adjusted returns. At the time, the best opportunities were in retailers and property stocks. Only in a multi-asset fund could one have taken full advantage of the opportunity.

The ability to allocate capital across the full spectrum of asset classes simply gives a manager a bigger toolbox to add value in client portfolios. Another example would be three years ago, when we believed that the rand was overvalued. In managing a multi-asset fund, we could apply our minds as to whether the risk-return profile was most attractive in inflation-linked bonds, food retailers or dual-listed stocks. Some of these are obvious beneficiaries of a weaker rand, others less so. The point is that in these funds, someone is thinking about these things. With the building-block strategy, I do not think anyone can.

3. Multi-asset funds can be tailored and flexed

In the 1990s, the classic balanced fund, with a risk budget that reflected requirements of the typical pre-retirement investor, was all that was available to clients. However, in the early 2000s the category grew with the launch of absolute return multi-asset funds, with risk budgets aimed at the typical retired investor.

In addition to this, most managers who run multi-asset funds will manage bespoke funds with risk budgets and return targets that differ from the classic pre- or post-retirement funds.

In the South African market, significant capital has moved back to multi-asset funds. We think this is a healthy development. The local market is fairly unique in global terms in that it has quite a few managers with good track records in both asset allocation and security selection. In these volatile and uncertain times, active asset allocation is needed.

Proving its worth

Listed property in a multi-asset portfolio

by **ANTON DE GOEDE**

__ANTON DE GOEDE__ has 17 years' investment experience. He joined Coronation in 2008 as a property specialist and manager of the Coronation Property Equity Fund. He is a member of the fixed interest investments team with specific responsibility for listed property-related research.

The strong run in the listed property sector last year contrasted sharply with the sell-off in mid-2013 that was triggered by the Federal Reserve's decision to start phasing out quantitative easing. The market expected a resultant sharp rise in interest rates, and consequently punished the property sector in a volatile period during the second half of 2013 and into the start of 2014.

Many of our multi-asset class portfolios increased their exposure to property into this sell-off as we believed that the negative interest rate view priced into the sector was excessive, and as property holdings' expected medium to long-term internal rate of return (IRR) reached the mid-teens. This asset allocation decision stood the portfolios in good stead during 2014. The property sector rallied by 36% after reaching a low point in January, and returned in excess of 26% for the year.

It benefited from two key drivers: lower bond yields (inflationary risks abated, supported by a less aggressive interest rate outlook) and dividend growth that surprised on the upside. The sensitivity of listed property to the movement in interest rates, and consequently to the bond market, is due largely to its income-yielding characteristics. These characteristics fit perfectly into a multi-asset class portfolio.

Dividend growth strengthened as a result of the weaker rand (which provided a yield pick-up for those companies with offshore exposure) as well as due to operationally strong management teams that extracted good growth from the underlying local property portfolios. In addition, throughout the year, forward guidance was better than anticipated. In the two most recent reporting seasons, South Africa-focused listings delivered weighted average dividend growth in the region of 10%, with expectations of high single-digit dividend growth for 2015. Unlocking the value in these forward yields renders listed property critical to a multi-asset class portfolio. In addition, the growing income stream offers risk diversification benefits as it is accrued from various underlying property sectors, tenants and geographical areas.

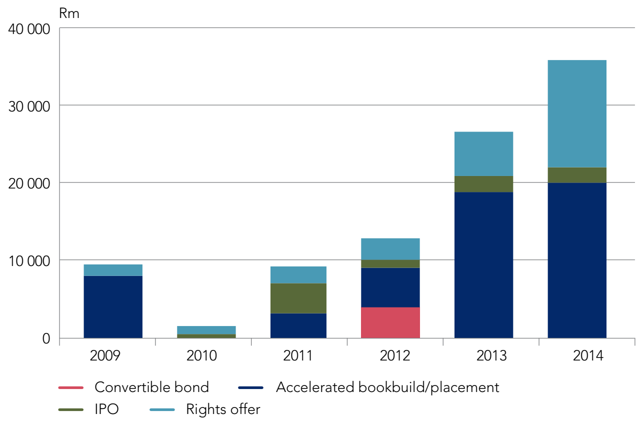
Some interesting operational trends are emerging in the sector. Particularly in the retail sector, positive reversions (new rental agreements on lease expiry) are being maintained. Negative reversions in the office sector are seemingly being contained to the minimum. Industrial reversions continue to be more mixed, with expiries on leases greater than 10 years having a negative impact on overall renewal rates. Despite the impact of the weak economy on tenant demand, vacancies are also being contained. This is, in part, due to the quality of the listed sector's property portfolios compared to privately or institutionally owned properties. Tenant rotation into properties owned by listed companies, at the expense of other properties, has been noticeable. Some listed property holdings have also decreased their vacancy rates following the sale of properties with higher vacancies.

Management teams continue to impress by containing increases in property operating costs relative to income growth. While the filling of vacancies has provided some support, it does seem as if the sector has come to grips with the management of increases in administrative prices. The improved management of overall operating costs has, in part, been achieved through new property management contracts or negotiating service contracts at national level. Furthermore, some companies benefited from one-off events during the year, such as share buybacks, fees earned on the unbundling of BEE structures or yield-enhancing property acquisitions.

The tightening of the corporate credit market has gradually priced property companies out of this source of funding. In fact, some companies have made complete U-turns, opting for bank funding rather than the debt market. Bank funding has once again become more competitive.

The lower interest rate cycle and introduction of Real Estate Investment Trust (REIT) legislation in South Africa during 2013 have sparked a flurry of new sector listings. In the month of December 2014 alone, three new listings came to market. Excluding London-based Intu Properties and Capital & Counties, estimated total capital of R22 billion was raised in 2014 (disregarding dividend reinvestments as well as shares issued to vendors or for the acquisition of stakes in peers), approximating 8% of the sector's total market capitalisation at the start of the year. Coronation successfully secured highly attractive lines of stock in companies like Investec Property, Accelerate, Attacq and Fortress A on behalf of client portfolios.

SA LISTED PROPERTY SECTOR'S PRIMARY CAPITAL RAISING



Source: Dealogic, RMB Morgan Stanley
Numbers include offshore-based property companies with South African listings.

A trend in the sector that has been building momentum since the end of 2013 is exposure to non-traditional sectors. Residential exposure, which has long been the domain of Octodec and the formerly listed Premium, has gained recognition as an alternative to the three traditional sectors. Besides being able to acquire portfolios with yields above 10%, residential rental growth and occupancies tend to be more defensive – although more intensive management and specialist skills are required. Thus the trend has been to acquire (or enter into a joint venture with) established players in the residential sector. In addition, self-storage has gained some traction, while increased exposure to the healthcare sector also appears to be on the agenda. This may prove a little more difficult due to the already concentrated ownership of hospitals by the listed operators, as was seen with the failed listing of a specialist healthcare property fund a few years ago.

Following the sector's strong performance in recent months, its relative value proposition compared to other asset classes has reduced. However, expectations for continued double-digit medium- to long-term IRR rates affirm its long-term value. Shareholders have benefited from good operational discipline exhibited by management teams in a tough environment. The prospects for the sector remain finely balanced between dividend growth expectations and the yield relative to long bonds. Expectations that interest rates will take longer to normalise, and through smaller-than-expected increments, continue to provide some support for the sector, and the correlation with bond yields remains fairly intact. While dividend growth prospects remain relatively positive, the sector's performance should be driven by the fixed income market rather than sector-specific issues.

Distell

A quality long-term investment

by **SIPHAMANDLA SHOZI**

***SIPHAMANDLA SHOZI** is an analyst in the investment team. His current responsibilities include analysing a range of small cap shares and co-managing the Coronation Smaller Companies Fund.*

At Coronation, we like fast-moving consumer goods (FMCG) businesses with strong, dominant brands in their respective markets. Strong brands create moats around businesses, which allow them to earn returns significantly above their cost of capital through the cycle. Previously we have held large stakes in companies such as SABMiller, AVI and Tiger Brands, which all bear testimony to this fact. We believe that Distell is an investment that offers very similar characteristics, with arguably superior long-term growth opportunities. The company boasts a diversified portfolio of top alcohol brands, suited for different occasions across the affordability spectrum, including Savanna, Hunter's, Amarula, Klipdrift and Nederburg.

Distell was created in 2000 through the merger of Stellenbosch Farmers' Winery (SFW) and Distillers Corporation. At that time, the spirits and wine businesses represented the bulk of the group's earnings, while its unsung cider (or alcoholic fruit beverage) business was still relatively small. The group's forays into regions outside South Africa were also in the formative stage. Fast forward 15 years and things look very different. The cider business has grown to such an extent that it now constitutes just under two-thirds of group earnings. One-third of group earnings is derived from outside the country. It is these two areas, combined with proven management ability, that make Distell an attractive opportunity for the long-term investor.

Cider opportunity

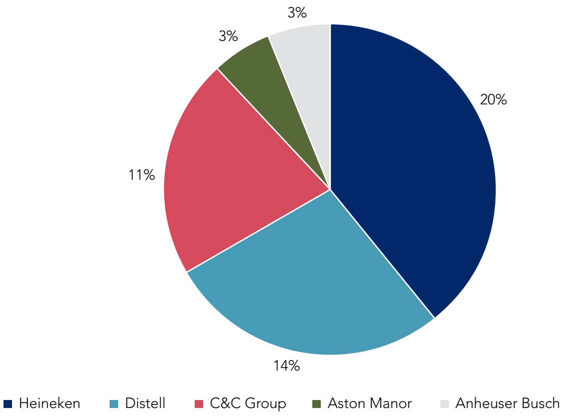
Worldwide, the growth in cider sales over the last 10 years has outpaced all other major categories of alcoholic beverages (i.e. wine, beer and spirits), averaging 5% – 6% p.a. against an average of 1% – 2% for the sector. Locally, the trend has been no different, with volumes having grown three times the average of the overall market. Consequently, the category's share of the market has doubled in the past five years to 6% – 7%. While the penetration levels remain relatively low, we believe a number of secular drivers will lead to cider increasing its market share:

- Demand from the growing black middle class, a group that has shown strong affinity to aspirational brands.
- Strong appeal of cider to female drinkers.
- Rising health consciousness among drinkers looking for alternatives to mainstream beer.
- The taste of cider appeals to young drinkers.

It is perhaps not widely known that Distell is the second largest producer of cider in the world (see the following graph). Its two home-grown brands, Hunter's and Savanna, occupy the second and fourth (possibly now the third) positions respectively in the world.

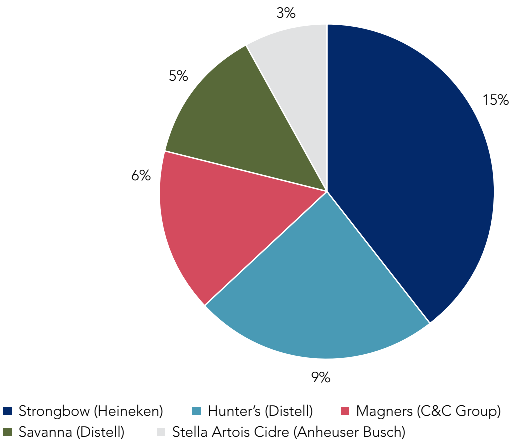
Global cider market

MARKET SHARE OF TOP 5 CIDER PRODUCERS



Source: Euromonitor

MARKET SHARE OF TOP 5 CIDER BRANDS



Source: Euromonitor

Local consumers do not differentiate between cider and flavoured alcoholic beverages (FABs), tending to use the word 'cider' as a generic term for both. However, cider is made from real fruit concentrate, while artificial flavours are used in FABS. Ready-to-drink (RTD) alcoholic beverages include both cider and FABs.

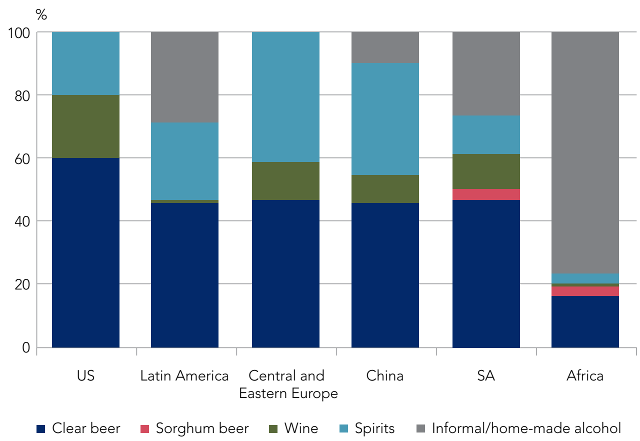
Distell dominates the local cider category, approximating a market share of 90% (under the RTD grouping, its overall stake drops between 50% – 60%). The group's cider business is four to five times bigger than its nearest competitor. Such scale has allowed Distell to generate good profits, invest in its brands and grow the category while continuing to produce strong free cash flows. This provides a solid base for Distell to expand in the township/informal market where it remains under-represented. This vast market, dominated by traditional beer players, is tough to penetrate. However, we believe that through smart interventions by management in distribution and route to market, there is no reason why cider should not take share in this market too.

African prospects

As mentioned previously, Distell derives one-third of its earnings from outside South Africa. Of this, 60% is earned in other African countries. Over the past decade, this region has consistently achieved high double-digit growth, which has led management to accelerate infrastructure investments to support growth.

While South African consumers have become accustomed to branded alcohol, the situation on the rest of the continent is quite different. On average, informal unbranded alcohol makes up close to 80% (see graph below) of alcohol consumption in Africa. The continent's branded beer consumption per capita is a quarter of the world average. We expect rising incomes to drive formalisation of this market, benefiting branded players.

GLOBAL ALCOHOL MARKETS



Source: Industry sources

Distell's portfolio of brands has already, through its extensive distribution network, established a presence in many African countries. Some brands have achieved critical mass, which has warranted further investment in sales force, distribution and production infrastructure. While this has dampened short-term profitability, we believe the investment in Africa places Distell in a strong position to capitalise on the long-term growth in the region.

Distell has also invested in building a good management team. Richard Rushton took over as managing director in November 2013 when Jan Scannell retired. A former SABMiller executive, Rushton, was involved in running a very successful operation in South America. He brings a wealth of knowledge on distribution, route to market and efficient production – skills that are critical when faced with the many challenges of operating in Africa, specifically given the lack of readily available logistic infrastructure. We believe he adds vitality and experience to the team.

While many well-known international premium brands have already made headway in Africa, we believe ample opportunity remains in the value space for a player such as Distell to consolidate and create significant scale. The group's ability to offer a basket of brands gives it a significant advantage over more specialised competitors. Partnering with large players like SABMiller (a major shareholder) would also offer great opportunities.

As a long-term investor, we like management teams who are prepared to take a long-term view and back it up with investments. While near-term ratings look expensive, our approach to investing allows us to look past this and arrive at what we believe is the true earnings power of the business. As such, Distell trades at a multiple of 11.8 times our assessment of normal earnings, certainly very attractive for such a high-quality business. Capevin Holdings, whose sole asset is a 27% stake in Distell, trades at a multiple of 10 times to our assessment of normal earnings, providing a preferred entry into Distell.

Striking out

Eskom and an unstable labour market are undermining the SA economy

by **MARIE ANTELME**

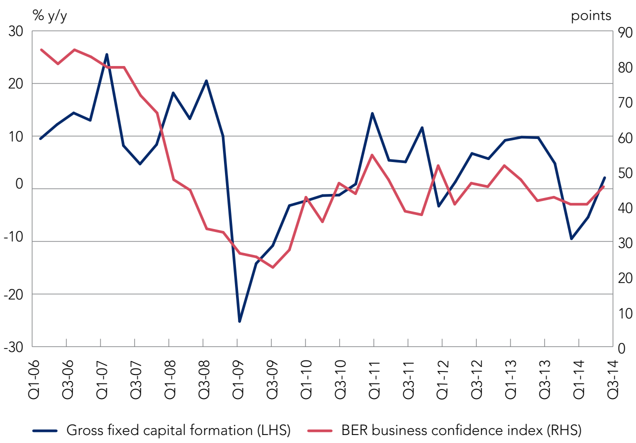
__MARIE ANTELME__ is an economist in the fixed interest team. She joined Coronation in 2014 after working at UBS AG, First South Securities and Credit Suisse First Boston.

There are only three ways to achieve sustainable growth in the South African economy. The country has to either accumulate jobs through private sector job creation; accumulate capital through investment; or boost productivity by combining employment and investment in a more efficient manner. Last year demonstrated how poorly the economy manages to achieve any of these.

The year started with reasonable growth expectations following the strike-ridden 2013, and the aftermath of the Marikana tragedy in 2012. Consensus expectations were for real GDP growth to accelerate to 2.5%, from 1.9% the year before. But in January, workers in the platinum belt near Rustenburg downed tools, demanding a 250% increase in wages. The strike continued for five months before an agreement was reached, by which time 1.2 million ounces of production was lost and the mining sector was in recession. Lost mining production affected the manufacturing sector, and a strike by steel and engineering workers pushed that sector into recession, too.

The lost production, labour uncertainty and an increase in operating costs had a negative impact on fixed investment. Gross fixed capital formation (GFCF) contracted in the first half of 2014, led by a reduction in capital commitments by the private sector and exacerbated by strike-related interruptions at Eskom and Transnet projects. This in turn contributed to the delay in the synchronisation of the first unit of the Medupi power station that was scheduled (after a number of delays) for end-December. By the fourth quarter of 2014, Eskom acknowledged the delay and warned both industrial and private sector users that the power grid was severely constrained and that rolling outages should be expected for a considerable period. All of these developments have contributed to very poor business confidence, which is at the heart of the weak investment performance and dire employment growth. The Bureau for Economic Research's (BER) business confidence index (BCI) has been below the breakeven level of 50 since early 2013, with only a small recovery to 51 registered in the fourth quarter of 2014. While this may be the start of an improvement, business confidence needs to move significantly higher for the economy to grow, and for a sustainable increase in job creation.

BUSINESS CONFIDENCE AND INVESTMENT



Source: South African Reserve Bank, Bureau for Economic Research, UBS

Job creation remains weak. Employment in the formal non-agricultural sectors grew just 1% year-on-year in the third quarter, with employment in government expanding by 3% compared to only 0.2% in the private sector. Job losses in mining continued for the ninth consecutive quarter, and have been ongoing in manufacturing since 2009. Together the mining and manufacturing sectors account for 20% of employment. Low employment growth and income losses associated with strikes put households under pressure, and rising food and fuel costs at the start of 2014 bit into take-home pay. Real household spending has slowed meaningfully as a result, undermining consumer-led growth.

REAL INCOME GROWTH AND PERSONAL CONSUMPTION EXPENDITURE (PCE)

Source: South African Reserve Bank, UBS

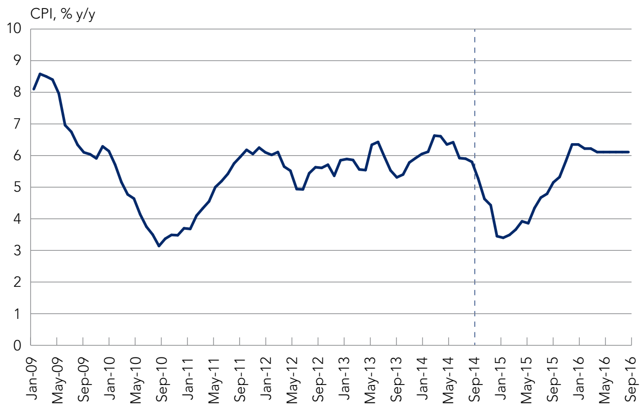
Productivity gains are hard to measure, but some growth in investment implies an improvement in productivity given the failure of private employment growth after the recession, and against the background of above-inflation wage and production costs.

The current account was adversely affected by lost mining and manufacturing production, and this further undermined the performance of the domestic currency. The deficit on the current account of -5.8% in 2013 widened to -6.3% by the second quarter of 2014, with only a modest recovery to -6.0% in the third quarter. For the year as a whole, the deficit is forecast to be about -5.5%, despite the rand's depreciation of 36.6% over the past two years. While the trade deficit was a little smaller in the third quarter of 2014, there has been a slow pick-up in activity following the strike-related losses.

Disappointing economic activity has put pressure on profits and revenue collection, leaving government with another large fiscal deficit and a rising debt stock. Growth in 2014 is expected to reach just 1.4%, from 1.9% in 2013. Ratings agencies responded to this bleak series of events by downgrading South Africa's credit ratings in mid-2014. Both Standard & Poor's (S&P) and Fitch made adjustments in June; S&P downgraded the sovereign credit rating by one notch to BBB-, while Fitch left the credit rating unchanged and downgraded the country's outlook from stable to negative. Moody's downgraded its credit rating in November to Baa2 from Baa1. All three agencies cited worsening growth prospects, the weakened fiscal position as well as the long-term growth constrains of limited electricity capacity, fragile labour relations and low employment growth.

Against this very weak performance it seems reasonable to expect an improvement in activity in 2015. In addition to a normalisation in post-strike production – which has been slow in coming – the lower oil price will provide a welcome boost to real incomes and lower production costs. Consumer inflation forecasts have been slashed as the oil price fell, and headline inflation is expected to average 4.2% in 2015, from 6.1% in 2014. The lower oil price should also help food inflation moderate in the early part of the year, contributing to annual inflation reaching 3.4% by April. Some of the disinflationary momentum will be constrained by the weaker currency, wage growth in excess of inflation and higher electricity prices. An increase in VAT might also add to inflation pressures. By the end of 2015, we expect CPI to be above 5% and rising. The slower pace of inflation also implies a slower pace of monetary policy normalisation. Having raised interest rates by 75 basis points to a repo rate of 5.75%, we expect the SARB Monetary Policy Committee to pause while inflation moderates, but to resume rate hikes as price pressures re-emerge next year.

CONSUMER INFLATION, HISTORIC AND FORECAST



Source: Statistics South Africa, Coronation estimates

The lower oil price should also improve domestic terms of trade and help the trade account, but the extent of its contribution will depend on the resilience of the prices of South Africa's key exports, notably precious metals, iron ore and coal. The current account deficit is expected to narrow from -5.5% of GDP in 2014 to about -4.3% this year. The improvement suggests that there will be less pressure on the currency from domestic funding requirements, but the overall deficit still remains large and at risk of slowing portfolio flows.

Sadly, this seems to be where the good news ends. These more positive prospects are likely to be constrained by patchy global growth, particularly dim prospects for growth in China. At home, multi-year wage agreements in platinum and gold mining, vehicle manufacturing as well as steel and engineering should avert industrial action in these sectors, but the public sector wage negotiations are already underway in preparation for the end of the current agreement in March. The fiscal envelope is constrained, and ratings agencies have warned National Treasury that spending efficiency needs to improve, or further downgrades will follow. Treasury has committed to lowering expenditure by R25 billion over the next two years and allocated a 6.8% increase in total consolidated compensation for the coming fiscal year. It warned that a higher-than-budgeted wage agreement would result in job losses. In October 2014, 16 participating unions tabled an opening demand of a 15% increase. Negotiations are likely to be complicated by the recent turmoil within alliance partner Cosatu and the emergence of smaller public sector unions, and there is considerable risk that public servants could strike early in the year.

Treasury has also committed to raising revenue by R27 billion over the next three years. The improvement in terms of trade could provide a fillip for nominal growth, but the risk of tax increases – both VAT and income taxes – remains high and would offset some of the real income gains provided by the lower oil price.

Eskom's failure to provide sufficient electricity capacity will keep industrial growth capped, and continues to undermine both consumer and business confidence. We expect the first unit of Medupi to be synchronised in the first half of 2015, but for remaining units to only follow a considerable period later. This raises the threat of patchy maintenance and ongoing demand management, with heightened risk of rolling outages.

Taken together, the longer-term economic benefit promised by falling oil prices is at risk of being undermined by the domestic challenges. These include an unstable and strike-prone labour market, exacerbated by political dynamics; rising pressure on commodity prices in general, which limits the terms of trade gains and weighs on the exchange rate and inflation; cautious consumers, and even more cautious business owners; as well as capacity constraints, with Eskom as the major contributor. Until these factors subside, business confidence – and with it investment, job creation and innovation – cannot help the economy to a sustainable, stronger growth path.

We expect a modest recovery in domestic growth in the year ahead and forecast growth of 2.6% in 2015, from an expected 1.4% in 2014. Depending on the improvement in global and domestic constraints, growth should recover further to about 3% by 2016.

Bond outlook

by **NISHAN MAHARAJ**

***NISHAN MAHARAJ** co-manages the Coronation Bond and Strategic Income Funds. His responsibilities also include the trading of all fixed interest instruments, both domestically and internationally.*

2014 closed on a positive note for the South African bond market as the continued fall in energy prices – combined with expectations of further monetary policy easing in the developed world (specifically Japan and Europe) contributed to a compression in global and local bond yields, which supported other fixed income assets. This was despite some negative local news as Eskom's inability to keep the lights on in South Africa added to mounting concerns over the entity's financial sustainability, and the broader implications for domestic economic growth. However, falling inflation expectations proved to be the stronger driver of local bond performance. Nominal bonds managed to outperform both cash (1.5%) and inflation-linked bonds (2.2%) for the quarter, registering an impressive 4.2% for the final three months of 2014. However, for the year, inflation-linked bonds (11.1%) still outperformed nominal bonds (10.1%), albeit marginally.

BOND MARKET RETURNS (%)

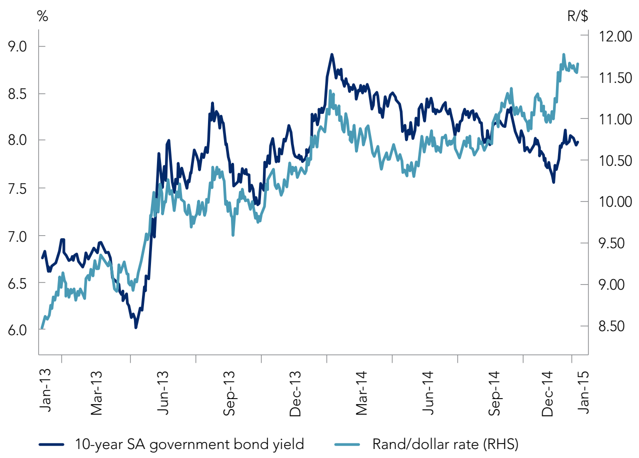
Name	Dec 2014	3 months	6 months	2014
All Bond	**(1.6)**	**4.2**	**6.6**	**10.1**
Government Bond index	(1.5)	4.1	6.4	9.8
Other Bonds Index	(1.6)	4.9	7.3	11.8
Bonds 1 – 3 years	(0.5)	2.5	3.6	6.2
Bonds 3 – 7 years	(1.4)	3.3	5.3	7.9
Bonds 7 – 12 years	(2.0)	4.1	6.0	8.3
Bonds 12+ years	(1.7)	5.4	8.0	12.9
Cash	**0.5**	**1.5**	**3.1**	**6.0**
Barclays/Absa Govt Inflation-Linked Bonds	(0.1)	2.2	3.3	11.1
Preference Share Index	(2.0)	(5.8)	(7.2)	(5.6)

Source: Deutsche Bank

The positive quarterly performance masked some of the volatility during the period, both in fixed income and in the currency market. Local bonds traded in almost a straight line from a high yield of 8.35% at the start of the fourth quarter, down to an intraday low of 7.50%, before an abrupt turnaround in December, which saw yields ending the year around the 8% level. This was despite a further 2.5% weakening (in the fourth quarter) in dollar/rand spot levels, as the dollar strengthened against almost all developed and emerging market currencies. Sentiment over the strength and vigour of the US economic recovery remains quite buoyant, which should support the dollar for the better part of 2015. Economic data releases and rhetoric from the Federal Open Market Committee (FOMC) still suggest marked improvements in underlying economic fundamentals and that the rate hiking cycle should start towards the middle of 2015. Still, the breadth of this cycle remains a topic of much debate.

Emerging market currencies, the rand included, continued to weaken in sympathy with rate hike expectations. This in contrast with bond markets, which benefited from expectations of a new leg of quantitative easing by the European Central Bank amid subdued inflation and growth on the continent. This compressed both developed market (DM) and periphery country yields in the EU, while providing an anchor for DM bond market yields. Adding to the fixed income rally was the slump in oil prices, which almost halved in 2014 and dampened inflation expectations. South African bond yields remain relatively low, pricing in a very benign inflation and growth outlook, supported by low yields in developed markets (particularly the EU and US) and a much-improved inflation outlook on the back of lower oil prices. The rand remains the pressure valve; the chosen instrument to reflect any negative sentiment towards the local economy, while local bonds reflect a more constructive outlook.

SA BOND YIELD VS CURRENCY

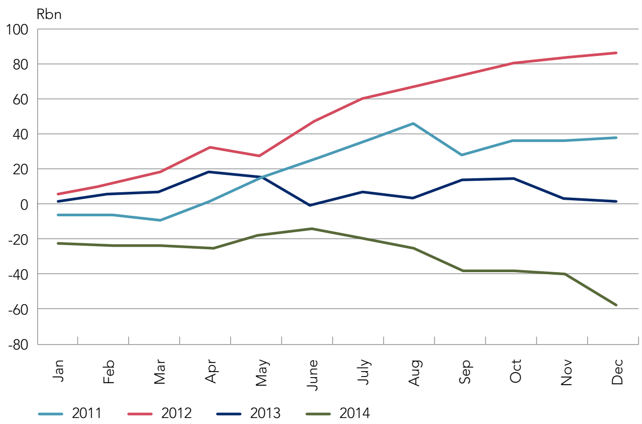


Source: Bloomberg

2015 will be an important year for South Africa, as markets (and rating agencies) will be looking for some indication that the twin deficits are being rehabilitated. The trade balance continues to weigh on the current account, but exports should find support as mining and manufacturing are now almost back to full production and wage settlements have been concluded for at least the next two years. However, Eskom's ability to ensure a constant electricity supply remains the major risk that could derail export recovery expectations. The Medium Term Budget Policy Statement (MTBPS) in October showcased the new finance minister's commitment to fiscal consolidation. Adherance to the nominal expenditure ceiling, monetary support for government agencies (mainly Eskom) from deficit-neutral sources (the sale of non-strategic state assets), and a possible increase in taxes were the main takeaways from the 'mini budget', which bolstered sentiment in the fourth quarter. For this to be maintained in 2015, the budget in February would have to show a continuation of these actions. In particular, the public sector wage negotiations will be closely watched, as unions have already indicated demands of wage increases of up to 15%.

Despite the positive outcome from the MTBPS, the bond market registered close to R20 billion in outflows in the fourth quarter. This brings the total outflows for 2014 to R57 billion, following inflows of R38 billion, R87 billion and R500 million for 2011, 2012 and 2013, respectively. Last year's outflows came even as US government bonds gradually rallied back close to 2% over the course of 2014, providing an anchor for global yields. This trend has not been specific to South Africa; most emerging market bond markets saw outflows, indicating a gradual decrease in risk appetite for high-yielding assets. However, the lack of recovery in South Africa's twin deficits, combined with the renewed negativity around Eskom, intensified the outflows from the domestic market, and market positioning remains quite negative and underweight going into 2015. On the flipside, this provides an interesting backdrop for the year, as it suggests that any positive surprises resulting from a recovery in the twin deficits, Eskom, inflation and/or risk sentiment might result in a scramble for duration assets.

NET FOREIGN PURCHASES OF SA BONDS (Cumulative, per year)



Source: I-Net Bridge

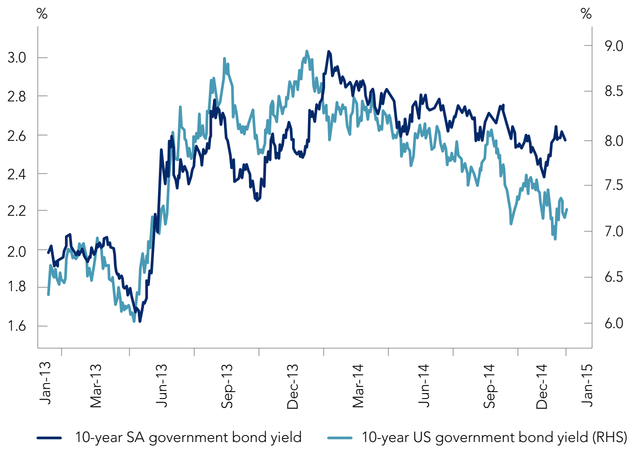
The two major drivers for the local bond market in 2015 will be local inflation expectations and US 10-year bond yields. CPI has decreased from 6.4% to 5.8% over the quarter, primarily due to lower fuel and food prices. Given the recent continued fall in oil prices, we expect CPI to continue on this path towards a low of 4% by the second quarter of 2015 before gradually ticking back up to 6% by the end of the first quarter of 2016, leaving the CPI average for 2015 around the mid-point of the 3% to 6% band. This should provide a meaningful anchor for bond yields for the major part of the year as the SARB, despite reiterating that South Africa is in an upward rate cycle, will find it difficult to hike rates given anaemic growth and falling inflation. At current levels of around 8% on the 10-year bond, this implies a real rate of more than 3%, which is in line with the historical real rate average in South Africa. Furthermore, using a one-year forward implied 10-year rate of 2.5% for US 10-year bonds (off the US bond curve), a South African one-year inflation average of 4.6%, a US one-year inflation average of 1.7% and a risk adjustment spread of 245 basis points (South African 10-year credit default swaps), our fair value metric suggests that, at worst, South African 10-year bonds are fairly valued.

US 10-year bond yields pose the single biggest risk to the local bond market. Currently the market is pricing in a benign hiking cycle in the US, with the Fed Funds rate expected to rise to 1% by the end of 2015, in line with Fed projections. However, there is considerable divergence on the breadth of the hiking cycle. The market is expecting the Fed Funds rate to reach 2.5% in 2017, compared to the Fed's projections of 3.5%. If Fed projections are to be believed, the market is underestimating the US hiking cycle and US 10-year bonds are too low (by about 50 to 100 basis points). If US rates were to reprice, the impact on local bond yields and the dollar/rand rate should be considerable. However, comparing recent moves in the US and South African bond yields, South African bonds have been diverging, suggesting an increasing cushion starting to develop between South African and US bond yields. This cushion will by no means save South African bonds from a violent repricing in US bonds, but the magnitude of the sell-off might not be as large as recorded in the 'taper talk'-induced sell-off in May/June 2013. Overall, the risk from a protracted sell-off in US rates should not to be disregarded – especially given the market's general comfort around expectations of a terminal Fed Funds rate that is lower than the historical average.

RAND OIL PRICE VS SA BONDS

Source: Bloomberg

SA VS US BONDS



Source: Bloomberg

The yield on South African government bonds is now 90 basis points lower than the peak reached in January 2014. Liquidity in global markets is set to linger a bit longer given easing inflation and growth expectations in Europe and the fall in energy prices has removed a large part of the inflation premium required to hold local bonds. The risks to the local economy remain the twin deficits and a further deterioration in government agency finances. However, the dollar/rand rate has continued to reflect this negative sentiment and remains fairly priced for the current difficult environment. The outlook for the bond market is much more constructive for at least the first half of 2015, given low global yields and a falling inflation profile. Thus far, compression in yields has been quite aggressive, but going into 2015 it is hard to ignore the attractive real return offered by South African government bonds.

Market review

by **DUANE CABLE**

***DUANE CABLE** joined Coronation in 2006 as an investment analyst and was appointed Head of SA Equity in 2013. He co-manages the Coronation Equity and Balanced Plus unit trust funds as well as the Houseview portfolios and Multi-Strategy Arbitrage hedge fund.*

Looking back, 2014 certainly presented some choppy waters for investors to navigate. Some of the challenges included slowing economic growth in China, the demise of African Bank, disruption caused by load shedding, the outbreak of the Ebola virus, the collapse of commodity prices, the Russia/Ukraine conflict and the continued weakening of emerging market currencies. Despite the many challenges we faced, the year turned out to be another good one for most asset classes worldwide. Markets continued to benefit from record-low interest rates and a benign outlook for inflation. Locally, the JSE All Share Index returned 10.9%, although the second half was much tougher for investors as the index declined almost 5% from the highs reached in July. Global markets also had a decent year, with the MSCI World Index returning 5.5% in US dollar terms. The rand weakened by 10.3% against the US dollar over this period.

MARKET SUMMARY

Index	Qtr 4 2014	1 year	3 years	5 years	10 years
All Share	1.4%	10.9%	19.5%	15.8%	18.0%
Resources	(19.3%)	(14.7%)	(3.8%)	(1.3%)	(11.2%)
Financials	10.8%	27.3%	27.9%	21.2%	16.7%
Industrials	7.0%	16.8%	30.4%	25.3%	22.6%
Property Unit Trusts	10.1%	31.1%	20.3%	19.6%	18.1%
All Bond	4.2%	10.1%	8.7%	10.0%	8.5%
Cash	1.5%	6.0%	5.6%	5.9%	7.6%

Source: Deutsche Bank

On the global front, the economic and geopolitical outlook remains uncertain. Although the US is on the path to recovery, the rest of the world is in varying degrees of distress. China remains the most important economy for resource demand and recent data confirms it is slowing. The weaker macro environment, the strengthening of the US dollar and increase in mine supply across key commodities have generally been negative for resource prices.

Locally, the decline in the oil price is positive for our inflation outlook. It eases pressure on the new South African Reserve Bank governor to hike interest rates and provides a much-needed 'tax cut' for consumers. The challenges at Eskom and the impact of load shedding are clearly negative for economic growth and companies' earnings are likely to be adversely affected. The relatively stable power supply during the festive season provided a false sense of security and we remain concerned about the serious problems we face over the short term, given the challenges at Eskom. To quote Charlie Munger, '*If you jump out of the window at the 42nd floor and you're still doing fine as you pass the 27th floor, that doesn't mean you don't have a serious problem.*'

The All Share Index returned 1.4% for the quarter. Financials and industrials gained 10.8% and 7.0%, respectively, while resources declined 19.3%.

The decline in commodity prices continues to weigh on the resource sector. Short-term profit forecasts are abysmal and companies have cut staff, reduced exploration spend and cancelled capital expansion projects in an attempt to reduce costs. As painful as it has been, the market has been very quick to price in the bad news. Many commodity prices are now below the marginal cost of production and we are starting to see the supply response needed to improve the demand/supply balance. In the long run, commodity prices are determined by the cost of production. Our assessment of normalised commodity prices is based on a detailed analysis of the cost structure of each commodity, the demand/supply outlook, incentive prices and long-term industry margins. Given the inherent risks in forecasting, we look at various scenario analyses to 'sense check' our assumptions and ensure our investment cases for individual positions are robust enough for more bearish scenarios.

We maintain a healthy exposure to resources in our equity and balanced funds. Our preferred holdings are still Anglo American, Mondi, Sasol and Exxaro. We continue to favour platinum over gold producers and our preference remains the low-cost platinum producers Impala Platinum and Northam. In addition, we also have a healthy weighting in platinum and palladium exchange-traded funds.

Domestic equities, in general, remain fairly valued. We continue to favour the quality global stocks that happen to be domiciled in South Africa, such as MTN, British American Tobacco, Richemont, Steinhoff and Naspers. Although these shares have performed extremely well relative to the broader market, they remain attractive based on our assessment of their intrinsic value and particularly attractive relative to pure domestic businesses.

We have owned very few domestic businesses in the past, especially consumer-facing ones, on the basis that valuations were not attractive. However, we will hold our positions in The Foschini Group and Clicks Group despite recent strong performances. We believe these companies trade on undemanding ratings based on our assessment of their normalised earnings. We have also used the sell-off in Woolworths following the announcement of its takeover of the Australian department store chain, David Jones, to build a sizeable position in the South African company. We think the market underestimated the positive impact of this transaction. We believe Woolworths is a quality business with a world-class management team, trading at an undemanding rating based on our assessment of normalised earnings.

Banks returned 15.8% for the quarter, outperforming the broader financial index. Net interest margins should benefit once interest rates are eventually hiked. While this will be offset by rising credit loss ratios, banks have used the current environment to bolster general provisions, which should blunt some of the impact. The large commercial banks' current earnings approximate our assessment of normalised earnings. Valuations are reasonable and we have maintained our weighting. Life insurers, on the other hand, currently trade on premiums to their embedded value and do not offer value in our estimation.

In terms of asset allocation, our global balanced funds remain at the maximum offshore limit of 25%. Given the global macroeconomic uncertainties, we believe that interest rates are likely to remain lower for longer. In such an environment, equities remain our preferred asset class for producing inflation-beating returns. We continue to favour global over domestic equities. The valuation of global equities remains attractive, with some of the world's best companies trading on reasonable price earnings (PE) multiples, and with fortress-like balance sheets – all the while growing their earnings and dividends at a steady rate.

The bond market returned 4.2% for the quarter, outperforming cash (1.5%). Inflation-linked bonds underperformed nominal bonds with a return of 2.2% for the quarter. We believe the real returns from cash and bonds are likely to be relatively poor over the long term, both from a local and global perspective. As a result, we have no exposure to global government bonds in our portfolios. However, given the improved outlook for inflation, we have reduced our underweight in local government bonds. We continue to hold a significant position in inflation-linked bonds and also maintain a good exposure to local corporate bonds.

Listed property returned 11.1% for the quarter. The returns from this asset class over the last decade have been exceptional as yields declined in line with falling interest rates and property rerated relative to nominal bonds. We remain exposed to some of the higher-quality property stocks, which we believe will offer better returns than bonds and cash over the long term.

We have reduced cash holdings across balanced portfolios to fund the increased equity exposure and purchasing of local government bonds. Although we believe the longer-term real returns for cash will be poor, we view it as an underrated source of tail risk protection that provides us with the flexibility to respond in a market correction.

Over the past decade, almost all asset classes have generated significant returns. We have cautioned investors for some time to moderate their return expectations going forward. As we start a new year, we are bombarded with predictions from numerous financial experts about what lies ahead in 2015. The investment waters certainly appear choppy, with many uncertainties and unknowns. History has taught us that our ability to forecast the immediate future is limited. If you waste much of your time worrying about questions that cannot be answered, you lose focus on the few things that can be answered.

Vincent van Gogh once remarked that the fishermen know that the sea is dangerous and the storm terrible, but that they have never found these dangers sufficient reason to remain onshore. As stewards of your capital we will seek to cut out the noise and we remain focused on long-term valuations. We will look to take advantage of whatever attractive opportunities present themselves in 2015 as we strive to continue delivering superior long-term returns relative to our respective benchmarks.

International outlook

by **TONY GIBSON**

***TONY GIBSON** is a founder member of Coronation and a former CIO. He was responsible for establishing Coronation's international business in the mid-1990s, and has managed the various Coronation global equity fund of funds products since their inception.*

'*In economics things take longer to happen than you think they will, and then they happen faster than you thought they could.*' This well-known quote from the late German economist Rüdiger Dornbusch sums up events during the last quarter of 2014.

Global equity markets moved sideways during the three-month period, following their correction in early October. The MSCI World Index produced a positive total return in US dollar terms of 1.1% for the quarter. This brought the year-to-date gain to a moderate 5.5%, well below the US equity market's 13.7% gain for the year. The relatively disappointing performance of non-US equity markets in 2014 has largely been due to the strength of the US dollar, which has risen by 11% against the currencies of other developed market nations and by 10% against emerging market currencies. The result is that, despite both the MSCI Europe Index and the MSCI Emerging Markets (EM) Index gaining in local currency terms by about 5.2% and 5.6% respectively during 2014, in US dollar terms, the MSCI Europe lost 5.7% for the year, while the MSCI EM fell by 1.8%. Lower oil prices, geopolitics and the opaque outlook for the Fed Funds rate were some of the headwinds facing the broader emerging markets as 2014 closed. In dollar terms, the MSCI EM Index posted its first back-to-back annual decline in 12 years, while the rouble had its worst year since the Russian default in 1998.

The most notable currency and commodity moves during the fourth quarter were the dramatic collapse in the oil price, down by 41.6%, and the slump (-34.1%) in the Russian rouble. The oil price and rouble both ended 2014 down by a massive 45%. The iron ore price also fell sharply; down by 16% for the quarter and 49% for the full year, mainly as a consequence of increased production and weak steel demand. Other notable commodity movements during the quarter were a 7% fall in the platinum price (down 12% for 2014) and a 5% decline in copper (down 14% for 2014).

As mentioned, currency movements in 2014 were a one-way bet, with the US dollar outperforming all global currencies. In developed markets, both the euro and yen fell by 12% over the 2014 year, while among the smaller currencies the biggest fallers were the Norwegian krone and Swedish krona, down 18% and 19% respectively. Bond markets performed surprisingly well (particularly when measured in local currencies) in 2014; this was mainly due to ongoing deflationary pressures across most of the globe. The developed bond markets that produced the best returns in 2014 (in dollar) were the UK (up 7.4%) and the US (up 6.1%), while the poorest performers were Japanese bonds (down 8.1%, mainly due to yen weakness).

Looking at equity markets, the usual wide dispersion in returns was seen during 2014. In the developed market universe, the strongest performer (in local currencies) was Japan (up 6.7%), while the weakest was Portugal (down 19.6%) following more disruptions within its banking sector. In emerging markets, the worst performers were Greece, down 25.5% due to further election uncertainty, and Russia, down by 5.9%. It should be noted that, when converted into US dollar, Russian equities fell by a staggering 32.8% and 45.9% over the past quarter and year, respectively. Greece followed closely with falls of 28.8% and 39.9% over the same periods. Within equity market sectors, the clear loser was the energy sector (down 24.5% for the quarter and 29.4% for the year), while the winning sectors were insurance (up 14.5% for the quarter) and pharmaceuticals (up 23.7% for the year). This trend is similarly illustrated when looking at the returns of high versus low beta stocks. In 2014, low beta shares very decisively outperformed high beta shares.

Economic data released during the fourth quarter of 2014 continued to show significantly divergent trends in global growth. The US economy performed well, while growth in China, Japan, and the eurozone remained disappointing.

In the US, third quarter real GDP grew at an annual rate of 3.9% while the unemployment rate hit a new low (5.8%) for the cycle. In contrast, the HSBC China manufacturing survey fell right to the 'boom or bust' line of 50 in November. Meanwhile, Chinese inflation pressures continued to abate, with consumer inflation (CPI) up by only 1.6% from a year earlier, while producer inflation declined by 2.0% over the same period. In response, the Bank of China cut benchmark deposit rates to 2.75% from 3.0%, signalling the depth of concern among China's leaders about fading growth. Many economists now expect more rate cuts in coming months as China tries to support growth.

Japan technically entered a recession last year as third-quarter growth declined at an annual pace of 1.6%, following a sharp 7.1% decline rate in the second quarter. The third-quarter decline took most economists by surprise, since a variety of monthly data suggested that Japan had started to post a modest gain following the second-quarter consumption tax shock. The weak GDP data helped justify the Bank of Japan's aggressive quantitative easing (QE) measures announced at the end of October, which now target an annual balance sheet expansion of ¥80 trillion. The measures contributed to the sharp decline in the value of the yen in late-2014.

The eurozone continued to post tepid growth data in recent months. Real GDP rose by only 0.8% in the third quarter from a year earlier, little changed from the previous quarter's 0.7% pace. Reflecting weak growth, CPI inflation in the eurozone has far undershot the European Central Bank's (ECB) target just shy of 2%, with the headline rate in November running at only 0.3%. Moreover, recent weak Purchasing Managers' Indices (PMI) data suggests further anaemic growth in the fourth quarter. Against this backdrop, the ECB is apparently considering additional asset purchases to further expand its balance sheet and broaden the type of assets it will purchase under its QE programme. Expectations of further QE from the ECB also helped weaken the euro against the dollar in late-2014, bringing its year-to-date decline to nearly 12%.

Perhaps the biggest economic development in 2014 came in November when the Organisation of Petroleum Exporting Countries (OPEC) failed to cut production to ease a growing supply glut created by sluggish global growth and rapid increases in shale oil output by the US. This development helped push the benchmark Brent crude price to $56 a barrel at the end of 2014, down from nearly $116 in June 2014. Assuming that the effective price war against disparate oil producers continues for some time, this is good news for businesses and consumers in most oil-importing nations. In addition, it could extend the life of the global recovery by keeping inflation and interest rates low. But it is obviously unwelcome news for oil producers, and intensified the sharp slide in the Russian rouble as well as downward pressure on the currencies of other oil producers like Brazil, Mexico and Norway.

If Brent crude oil prices remain below $60 per barrel into the first half of 2015 – an outcome that seems reasonable absent production cutbacks by OPEC – global inflation will plumb new post-crisis lows. Forecasts already anticipate global consumer price inflation to slide to 1.5% during the first half of 2015, about a percentage point lower than its level in mid-2014. However, some top-down estimates point to an even lower turning point of 1%, should crude oil prices remain at current levels. Eurozone inflation would likely sustain negative numbers, while the US, UK and Japan would each see average first-half CPI slide to about 0.5%. Emerging market inflation would also likely move lower, but pass-through to the retail level might be muted by currency declines and energy policies.

Predicting the large inflation consequences of an oil price shock is relatively straightforward, but gauging its impact on global growth and monetary policy is more complex. Almost certainly the fall in oil prices relates to three distinct factors that have varied implications for global growth. First, 2014 delivered a negative demand shock that should generate a positive correlation between lower oil prices and growth. Second, falling oil prices reflect the rising trajectory of global production (up roughly 1.3 million barrels per day last year), which should boost growth. Finally, there has been a shift toward less energy-intensive demand – reflecting emerging market underperformance and relatively weak US energy consumption. Overall, this relative demand shock should be positive for global growth, but it also implies significant shifts in sectoral and regional performance. It seems that the negative global demand shock occurred primarily during the first half of 2014 and that the declines in oil prices since then largely reflect the lagged impact of this demand shock, alongside positive supply side developments. As such, the collapse in oil prices is a positive global event that should tip the balance in favour of above-trend growth. Reasoned estimates suggest that sustained $60 crude oil prices will add 0.5% to global GDP.

The actual boost to growth from a positive oil price shock also depends on how oil price declines influence monetary policy. Looking back, the two periods in which large declines in oil prices precipitated a global growth spurt – the late 1980s and 1990s – also saw significant monetary easing. In both these periods, plummeting oil prices sparked a fall of close to 200 basis points in global official policy rates. It certainly cannot be argued that the current period of monetary easing has led to any noticeable inflationary knock-on effects.

There is no doubt that for above-trend global growth to be sustained, the US economy needs to deliver positive outcomes. However, we do not expect the US to sustain its recent performance. Following two quarters in which GDP grew at an average pace of 4.8%, we are expecting growth to settle closer to 3% as we move through the first half of 2015. US households are expected to be among the biggest beneficiaries of the fall in energy prices, and personal consumption forecasts have moved higher. Forecasts now look for real consumption to rise 3.8% in the year ending in the second quarter, which would represent the fastest gain in a decade. However, recent support from business spending and net trade is expected to fade as a result of a rising dollar and cutbacks in energy sector spending.

A solid US performance will thus need to be accompanied by a stronger euro area expansion for improved global growth to be achieved. And it is not impossible that the biggest potential acceleration in growth could come from the eurozone in the coming quarters, especially if accompanied by a large shift in monetary policy were the ECB to announce a sovereign purchase programme in January. These developments need to be balanced against the political uncertainty in Greece, where questions about its Economic and Monetary Union (EMU) membership are resurfacing, and by the deep recession in Russia. For now, we are assuming that the contagion from Greece is limited, but if that country looks to be sliding toward an exit from the monetary union, this would likely have some macro consequences for the region. Meanwhile, a much deeper recession in Russia would have limited impact on the eurozone through trade and banking channels. But, as with sanctions, the key will be how eurozone business confidence evolves. This will depend, in part, on how a severe recession influences Russian foreign policy.

The currency market is signalling trouble ahead, and a collapse of the rouble and a depletion of the Russian currency reserve will not fade away without implications. Among the chief risks to the 2015 outlook is the potential fallout in EM credit markets from declining oil and Fed tightening. Recent weeks have brought a setback in global credit markets associated with the collapse in oil prices. US high-yield spreads have widened materially, driven by concerns about firms related to the energy sector. In the emerging markets, the focus has been on Russia, although the turmoil has extended further. As mentioned, there was a fairly broad-based slide in emerging market (EM) currencies and a corresponding rise in interest rates, notably in the Fragile Five (Turkey, Brazil, India, South Africa and Indonesia), and in net commodity exporters. A large factor behind these moves is the pressure building on EM businesses following the sharp escalation in EM private-sector leverage this past decade. A good deal of this borrowing has been taken up by corporates. If the Fed commences with a mid-2015 policy rate liftoff, investors need to be on guard for an unexpected tightening in EM financial conditions, especially in countries where a large portion of private debt is denominated in US dollars.

Therefore, looking into 2015, we believe that volatility will increase further. Although the US economic outlook still points to a rise in US interest rates by mid-2015, most central banks continue to pursue highly accommodative monetary policy. The QE baton is being handed from the US and the UK to Japan and the eurozone. Also, China and a number of other emerging market nations have joined the deflation-fighting brigade, which suggests a concerted effort to stimulate the global economy over coming quarters. With the MSCI World Index and the MSCI EM Index trading at reasonable forward PE multiples of 15.5 and 10.7 times respectively, the stage seems set for further equity market gains over the next year. That said, we would not be surprised to see equity and credit market volatility rise somewhat as the US moves towards modestly tighter policy after a long period of pushing investors toward risky investments.

The case for luxury car companies

by **DAVID COOK**

DAVID COOK is an analyst in the emerging markets team. He is a qualified chartered accountant and CFA. David joined Coronation in 2009.

'*Take nothing on its looks; take everything on evidence. There's no better rule.*' Charles Dickens, *Great Expectations*

Many investors do not view car companies in a particularly positive light. Given that a weighty 17% of the Coronation Global Emerging Markets (GEM) fund is invested in these 'OEMs' (original equipment manufacturers) – what gives us such substantial conviction in their appeal?

The answer lies in an attractive combination of inexpensive valuations, solid growth opportunities and the market's underappreciation of the innate quality of a premium OEM.

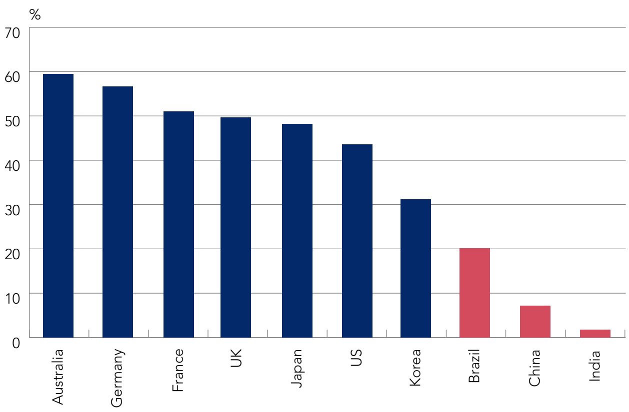
TABLE 1: GEM FUND'S CAR COMPANY HOLDINGS

	Financial metrics			Operating metrics	
	% of fund	Price/ earnings (1 year forward)	Dividend yield	Operating margin (last financial year)	Return on capital (average over 3 years)
Porsche Automobil*	6.6%	5.6x	3.6%	5.9%	10%
Tata Motors*	6.2%	7.8x	0.5%	13%	14.8%
Brilliance Auto*	4.7%	8.5x	1.4%	13.3%	23.7%

** Operating metrics are for the underlying operating subsidiary where appropriate.*

The first key point to make is that the fund's three holdings – Porsche Automobil, Tata Motors and Brilliance Auto – derive the majority of their earnings from their luxury auto brands. Secondly, they all have substantial exposure to emerging markets. Combined, these factors represent an exceptionally strong investment case as vehicle ownership grows in emerging markets (where penetration is low) alongside gains in market share by premium luxury brands in both emerging and developed markets. Furthermore, premium brands deliver superior economic returns when compared to mass market vehicle brands.

PASSENGER VEHICLE OWNERSHIP



Source: All China Marketing Research (ACMR)

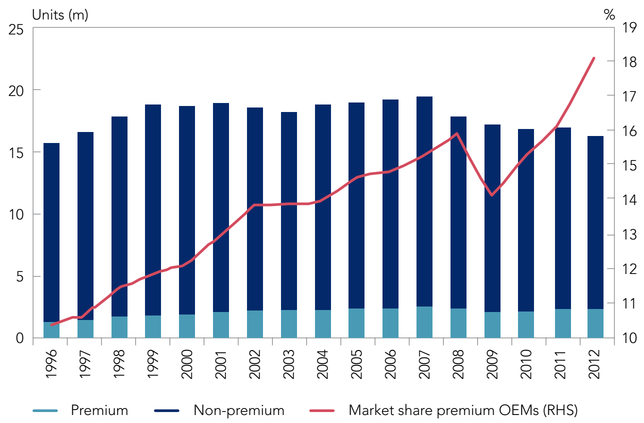
TABLE 2: LUXURY PASSENGER VEHICLE SALES (AS % OF TOTAL PASSENGER VEHICLE SALES)

	2010	2011	2012	2013	2014
US	11.9%	11.3%	11.2%	11.5%	11.6%
China	4.1%	5.7%	6.7%	7.0%	7.8%
South Korea	5.7%	6.6%	7.8%	9.9%	11.1%
Western Europe	19.1%	20.6%	22.3%	22.5%	22.0%
Japan	4.2%	5.6%	5.1%	6.2%	6.0%
Thailand	1.4%	2.0%	2.0%	2.1%	3.0%
Brazil	2.0%	2.6%	3.3%	3.4%	4.6%

Source: IHS Global Insight data

There is much speculation about 'peak car' – the point at which growth in vehicle ownership tops out, due in part to increased self-drive technologies and car sharing.[1] While we acknowledge that these developments will most likely result in smaller populations of car owners in the developed world, a number of mitigating factors will support premium auto sales. We believe that as car sharing increases, vehicles will be subjected to greater wear and tear. And with this increased use comes shorter replacement cycles, followed by greater consumer demand for more robust, premium vehicles. Wealthier people are also more likely to continue owning cars rather than sharing. In addition, the economics of sharing will allow consumers to afford more expensive vehicles. Indeed, the experience in western Europe, which has experienced a decline in auto penetration over the past seven years, confirms that luxury cars will continue taking share from mass models.

MARKET SHARE OF PREMIUM BRANDS IN WESTERN EUROPE



Source: IHS Global Insight data

In emerging markets, luxury OEM brands have also been growing faster than mass manufacturers. Due to rising incomes and the highly aspirational consumers in these markets, we believe this trend is set to continue for the foreseeable future. Consequently, we do not anticipate slowing growth for premium OEMs – instead we expect these companies to deliver superior growth, particularly compared to the average multinational company.

When deciding which companies to invest in, we look at a number of factors to assess the quality of a business. Some of these are quantitative, including good (and improving) returns on capital employed, comfortable operating margins that can be sustained or expanded, and high free cash flow generation. Based on these quantitative metrics alone (as set out in table 1 of the article), our selection of OEMs look of reasonable quality. However, we believe that while these metrics are important, quantitative indicators are driven by qualitative factors, and we spend most of our time evaluating the latter. We look for companies with strong competitive advantages and good management teams that deliver market share gains and will compound growth at high rates of return over the long term. If in our assessment a company offers greater quality, we are prepared to pay more for it.

OEMs, being subject to cyclical demand, capital intensive investment and technology changes, clearly would not be considered high-quality businesses. However, luxury OEMs have almost unmatched (and difficult to replicate) brand power, which allows for premium pricing, and hence higher operating margins and return on capital. For example, while the Volkswagen Group's margins are around 6%, its luxury brands generate margins well in excess of this level: Porsche and Audi have operating margins of close to 20% and around 12%, respectively. This illustrates their brand strength and resultant pricing power. There are also significant barriers to entry in terms of distribution and scale. In many ways, a premium OEM has as much in common with a luxury goods company as it has with a mass car manufacturer.

We believe the fund's holdings are of reasonable quality and offer substantial growth prospects, as discussed in more detail below:

Porsche Automobil

Porsche is the holding company of Volkswagen Group (VW), which accounts for more than 90% of the value of Porsche's assets, the remainder is mainly cash. Porsche currently allows for a discounted entry into VW. There is a low

[1] *Car sharing is a model of short-term vehicle rental; users typically book a vehicle for a couple of hours, for example for a supermarket trip.*

probability of litigation risk (following its attempts to take control of VW), but this is more than compensated for by its discounted share price. Porsche's current market value is 40% lower than the combined value of its stake in VW and its cash holdings. The total maximum litigation liability is far smaller than this discount. In addition, we expect VW to continue taking share in key markets while improving its profitability and cash flow returns. A total of 55% of VW's earnings are generated from its premium brands (Porsche, Audi and Bentley) and we estimate that just more than half of its earnings are from emerging markets. VW is in the middle of a heavy investment phase as it rolls out modular production technology. Profitability should improve as savings from the new technologies feed through and as its model replacement cycle moves into a more favourable phase. The exceptional performance of Porsche and Audi, in particular, looks set to continue for the fore-seeable future.

Tata Motors

More than 90% of our fair value for Tata comes from its Jaguar Land Rover (JLR) subsidiary. Premium brands represent 86% of Tata's sales and 60% of sales are from emerging markets. Currently, JLR is struggling to build capacity fast enough to meet demand, with waiting lists of between three and six months for its key Range Rover vehicles. The capacity-constrained growth will continue for the foreseeable future. And with a raft of new key models (Discovery Sport, Discovery and new Jaguars), we believe that JLR is still only starting to unlock the potential of its brands.

Brilliance Auto

Brilliance is the local joint venture manufacturing partner of BMW in China. The company will benefit from BMW sales growth in China, and also from its increased share in the manufacturing of BMW models (Brilliance only earns income on models licensed for local manufacture). Currently, Brilliance only manufactures 55% of the BMW vehicles sold in China. According to BMW, this is targeted to increase to 75% in the next five years.

Quality and growth prospects of a company are only one part of the equation when it comes to a great investment; the other of course is the price you pay. We believe that OEMs – and premium OEMs in particular – are extremely mispriced. This is as a result of concerns about China and the world economy at large, as well as the historical underperformance of US and European mass OEMs, which became uncompetitive due to overly generous employee benefits and wages. With the average forward price earnings ratio of the S&P 500 at 16.4 times, and decent quality OEM part suppliers trading at mid-double-digit PEs, the premium OEMs we own are comparatively very cheap on 5.5 to 8.5 multiples (on earnings that do not appear unusually high).

While we recognise our limited ability to forecast what lies in store for the global economy in the short term in particular, we are confident in the medium- to long-term prospects of our chosen holdings. In our view, they offer great quality at these prices, justifying the fund's large positions.

One man's meat

Africa and the oil slump

by **PETER LEGER**

***PETER LEGER** joined Coronation in 2005 as a portfolio manager. He has 15 years' experience in the financial markets in Africa as both a portfolio manager and research analyst. Today he heads up the Global Frontiers unit and manages the Global Frontiers portfolios.*

So you thought a six-month break on a desert island looked appealing and spent long hours in silent meditation, reflecting on self-actualisation, harmony and humanity's ceaseless race to consume the planet. Now you've just made the return journey to find that the oil price collapsed from over $110/barrel to less than $50. Peak theorists having turned into piqued theorists. You didn't see that coming. And, frankly, neither did we. Nor did we expect to see the Swiss franc jump 28% – in a single day – as it did recently.

The lesson being that extreme volatility has to be an assumption when building portfolios, and doubly so when investing in frontier markets, where volatility is often amplified.

For now, the main question is what an oil price that remains below $50 will mean for investments in Africa. We have good news and we have bad news.

First, the bad news. For Nigeria, oil at $50 is extremely challenging. And Nigeria tends to be large in any Africa fund out there. While Coronation's Africa portfolios are significantly underweight in Nigeria (at around 20% of fund exposure), this is little consolation as that market is still very important to us. And while we have a naira currency hedge in place that helps dull the pain, some discomfort has been endured – with the risk of more to come. Why are we concerned?

Nigeria is an oil economy with very restrictive capital flows. To date, the exchange rate has been managed by the central bank, with a number of measures taken to control pressure on the currency, including a step-change weakening of the exchange rate. Restricting the ability to take capital out of the country in the hope that the oil price will recover is not a viable strategy. Our sense is that pressure is building and another step change in the exchange rate is likely. We have hedged 20% of our currency exposure and won't consider removing this hedge despite the naira's significant depreciation.

The Nigerian sector most at risk, other than oil companies themselves, is the banking sector. The banks' total loan book exposure to the oil sector ranges from 17% to 40%. Yes, 40%. To make matters worse, the bank with 40% exposure (First Bank of Nigeria) has the largest loan book in Nigeria. Its exposure to the oil sector is double the central bank's maximum limit (20%) allowed to any sector. Currently, bad debts in the oil sector are low, but we don't believe that this will persist. And the very sharp drop in share prices over the last three months suggests that we are not alone.

NIGERIAN BANKS' OIL EXPOSURE

	Oil sector as % of loan book	Non-performing loans (NPLs) related to oil sector as % of total NPLs	Group bad-loan ratio
Access Bank	24.7%	35.3%	2.5%
FBN Holdings	40.0%	19.5%	2.9%
Guaranty Trust Bank	28.0%	10.0%	3.7%
Stanbic IBTC	19.0%	5.0%	4.4%
United Bank for Africa	16.0%	–	1.6%
Zenith Bank	17.9%	10.4%	2.8%

Source: Bloomberg

The Nigerian banking sector's over-reliance on oil is nothing new, and we have so often expressed our concerns about this distortion that our regular readers may be stifling yawns. We do, however, think that valuations have now sufficiently discounted a large amount of bad news and, with prices trading well below half of book value for a number of banks, this has us interested. There are many dynamics to consider. Firstly, a further risk of currency depreciation must be taken into account. Where will oil settle and for how long? Elections take place in February and are expected to be colourful. The banks' books are in much better shape than during the crisis of 2009 due to stringent central bank controls. And, on the whole, banks are well capitalised, although regulations around this are tightening further, suggesting that equity will be issued at lower prices. But on balance, now would be the time to buy Nigerian banks, not sell them.

On to the good news. Some countries will benefit considerably from lower oil prices. Top of the Africa list is Egypt. An International Monetary Fund report in January 2013 shows that in 2011, Egypt's energy subsidies were the largest in the emerging market universe, at over 10% of GDP. It has already started cutting energy subsidies and raising prices. This will go a long way to reducing the pressure on its finances. The likes of Kenya, Zambia and Zimbabwe will also benefit. This is significant as energy is a large component of spending in those countries.

Commodity markets tend to take longer than most markets to self-correct. Supply and demand dynamics are long in duration, and weather dislocations in prices for much longer than investors have the patience for. We have estimated a normalised price for oil of $78 a barrel for quite some time. Short-term prices look likely to drop further, but with time, market dynamics will be self-correcting. And with this, there are some very attractive returns to be made. Getting this one right will be a major differentiator, and we have to invest calmly through this storm. A return trip to that desert island might be just the thing.

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 Top 40 Index†
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 less 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 focused portfolio of our top stock picks on the JSE. Invested in 15–20 shares selected from the 50 largest companies listed on the JSE, compared to the 40–60 shares held by the average equity fund. This concentration means that investors must have a longer time horizon.
INCOME VS GROWTH ASSETS[1]	92.7% / 7.3% 	65.8% / 34.2% 	45.4% / 54.6% 	22.8% / 77.2% 	0.3% / 99.7% 
LAUNCH DATE	Jul 2001	Mar 2007	Jul 2001	Apr 1996	Oct 2000
ANNUAL RETURN (Since launch)	**10.9%** †8.1%	**11.3%** †6.4%	**14.3%** †6.0%	**16.6%** †14.4%	**21.7%** †16.1%
QUARTILE RANK (Since launch)	1st	1st	1st	1st	1st
ANNUAL RETURN (Last 10 years)	**9.4%** †7.2%	**–** –	**13.1%** †6.0%	**16.6%** †15.4%	**20.4%** †17.6%
QUARTILE RANK (Last 10 years)	1st	–	1st	1st	1st
ANNUAL RETURN (Last 5 years)	**9.7%** †5.6%	**12.6%** †5.2%	**12.3%** †5.2%	**15.6%** †14.8%	**17.1%** †15.2%
QUARTILE RANK (Last 5 years)	1st	1st	2nd	1st	1st
STANDARD DEVIATION (Last 5 years)	**1.5%** †0.2%	**3.6%** †1.2%	**5.0%** †1.2%	**7.0%** †8.1%	**12.7%** †13.4%
FUND HIGHLIGHTS	Outperformed cash by on average 4.0% p.a. over the past 5 years and 2.9% p.a. since launch (after fees). Note that outperformance is expected to be less in periods of stable or rising interest rates.	Outperformed inflation by 4.9% p.a. (after fees) since launch, while producing positive returns over 12 months 100% of the time. A top performing conservative fund in South Africa over 5 years.	Outperformed inflation by 8.2% p.a. (after fees) since launch, while producing positive returns over 12 months more than 90% of the time.	No. 1 balanced fund in South Africa since launch, outperforming its average competitor by 2.7% p.a. Outperformed inflation by on average 9.7% p.a. over all rolling 5-year periods since launch.	The fund added on average 5.6% p.a. to the return of the market. This means R100 000 invested in Top 20 at launch grew to more than R1.6 million by end December 2014 – nearly double the current value of a similar investment in the FTSE/JSE Top 40 Index.

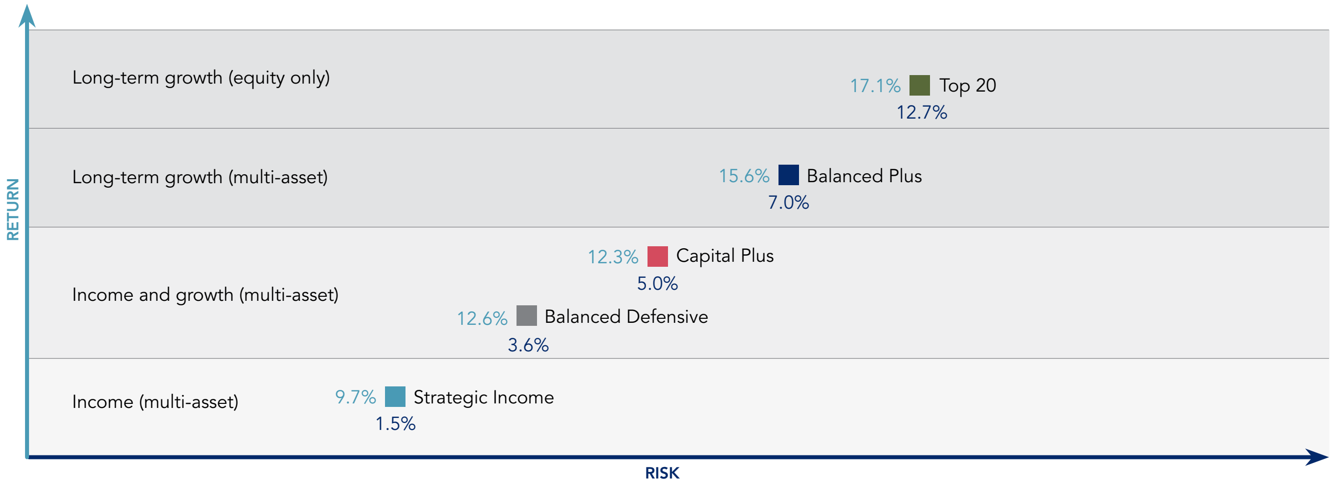
▪ Income ▪ Growth

1. Income versus growth assets as at 31 December 2014. Growth assets defined as equities, listed property and commodities.

Figures are quoted from Morningstar as at 31 December 2014 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

Risk versus return

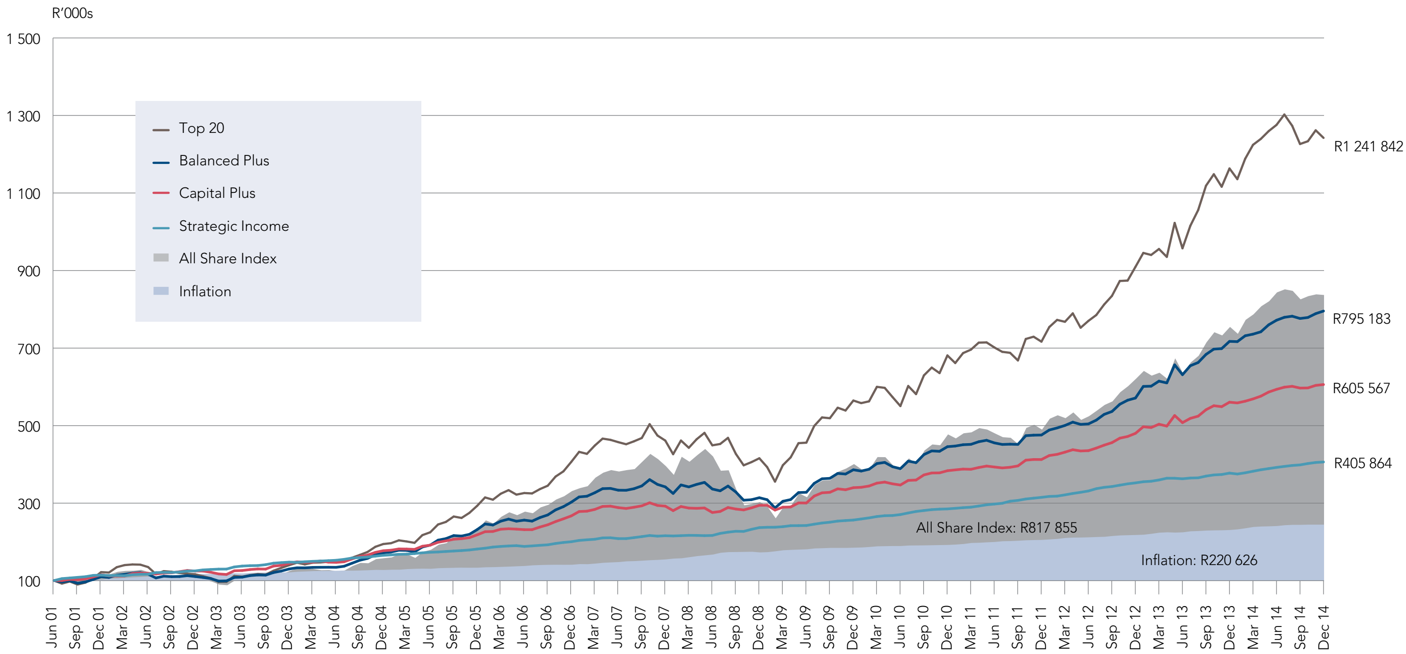
5-year annualised return and risk (standard deviation) quoted as at 31 December 2014. Figures quoted in ZAR after all income reinvested and all costs deducted.



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 1 July 2001 as at 31 December 2014. 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 2 February 2007.



Sources: Morningstar and I-Net Bridge

	INVESTOR NEED				
	CASH ALTERNATIVE	CAPITAL PRESERVATION	LONG-TERM CAPITAL GROWTH (MULTI-ASSET)	LONG-TERM CAPITAL GROWTH (EQUITY ONLY)	
FUND[1]	**Global Strategic USD Income [ZAR] Feeder** ***Global Strategic USD Income*** 110% of 3-month Libor†	**Global Capital Plus [ZAR] Feeder** ***Global Capital Plus [USD]***[4] Global cash (50% USD and 50% EUR)†	**Global Managed [ZAR] Feeder** ***Global Managed [USD]*** Composite (equities and bonds)†	**Global Opportunities Equity [ZAR] Feeder** ***Global Opportunities Equity [USD]*** MSCI World Index†	**Global Emerging Markets Flexible [ZAR]** ***Global Emerging Markets [USD]*** MSCI Emerging Markets Index†
FUND DESCRIPTION	An intelligent alternative to dollar-denominated bank deposits over periods of 12 months or longer.	A low-risk global balanced fund reflecting our best long-term global investment view moderated for investors with smaller risk budgets. We offer both hedged and houseview currency classes of this fund. In the case of the former, the fund aims to preserve capital in the class currency over any 12-month period.	A global balanced fund reflecting our best long-term global investment view for investors seeking to evaluate outcomes in hard currency terms. Will invest in different asset classes and geographies, with a bias towards growth assets in general and equities in particular.	A focused portfolio of the best global equity managers. We will typically invest with 6-10 managers who share our valuation-based and long-term oriented investment philosophy. The fund can invest in all equity markets around the world, and is actively managed across geographies and currencies.	Our top stock picks from companies providing exposure to emerging markets. The US dollar fund remains fully invested in equities at all times, while the rand fund will reduce equity exposure when we struggle to find value.
INCOME VS GROWTH ASSETS[2]	96.3% / 3.7%	58.7% / 41.3%	33.2% / 66.8%	0.5% / 99.5%	0.7% / 99.3%
LAUNCH DATE	Jan 2012	Sep 2008 *Sep 2009*	Oct 2009 *March 2010*	Aug 1997 *May 2008*	Dec 2007 *July 2008*
ANNUAL RETURN[3] (Since launch)	**2.4%** †0.3%	**6.9%** †0.4%	**9.1%** †7.6%	**7.1%** †5.6%	**3.1%** †(1.0%)
QUARTILE RANK (Since launch)	1st	1st	1st	1st	1st
ANNUAL RETURN (Last 5 years)	**–** –	**3.5%** (1.0%)	**8.1%** 7.3%	**9.3%** 10.8%	**4.8 %** 2.1%
QUARTILE RANK (Last 5 years)	–	1st	1st	1st	1st
FUND HIGHLIGHTS	Outperformed US dollar cash by 3.6% (after fees) since launch in January 2012.	The houseview currency class of the fund has outperformed its composite cash benchmark by 4.5% p.a. since launch.	No 1 global multi-asset high equity fund in South Africa since launch in October 2009.	Both the rand and dollar versions of the fund have outperformed the global equity market with less risk since their respective launch dates. Outperformed the global equity market at less than market risk.	Both the rand and dollar versions of the fund have outperformed the MSCI Emerging Markets Index by more than 4% p.a. since their respective launch dates.

▪ Income ▪ Growth

1. Rand and dollar-denominated fund names are included for reference.
2. Income versus growth assets as at 31 December 2014. Growth assets defined as equities, listed property and commodities.
3. Returns quoted in USD for the oldest fund.
4. Available in USD Hedged, GBP Hedged, EUR Hedged or Houseview currency classes.

Figures are quoted from Morningstar as at 31 December 2014 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

Collective Investment Schemes in Securities (unit trusts) are generally medium- to long-term investments. The value of participatory interests (units) may go down as well as up and past performance is not necessarily an indication of future performance. Participatory interests are traded at ruling prices and can engage in scrip lending and borrowing. Fluctuations or movements in exchange rates may cause the value of underlying investments to go up or down. A schedule of fees and charges is available on request from the management company. Pricing is calculated on a net asset value basis, less permissible deductions. Forward pricing is used. Commission and incentives may be paid and, if so, are included in the overall costs. Coronation is a member of the Association for Savings and Investment SA (ASISA).

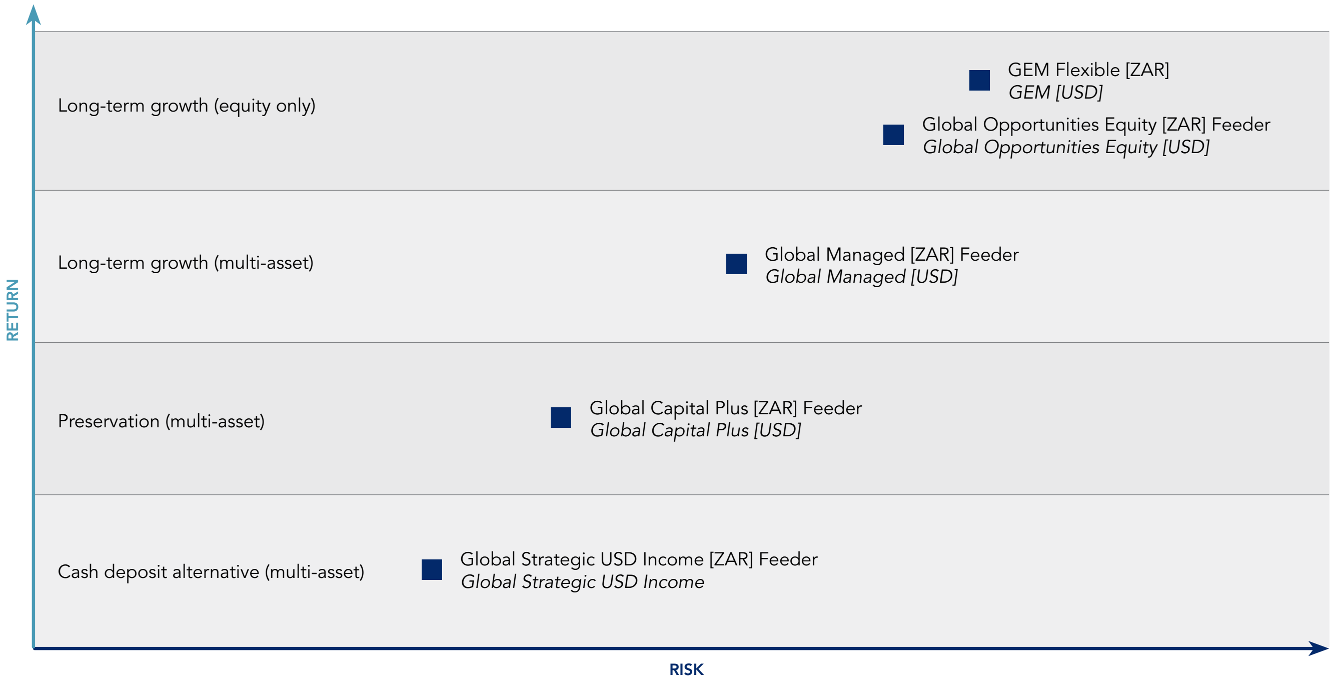
HAVE YOU CONSIDERED EXTERNALISING RANDS? IT'S EASIER THAN YOU MIGHT THINK.

The SARB allows each adult South African citizen to invest up to R5 million per year in foreign assets. This is an attractive option for investors seeking to further diversify their investment holdings. If you want to invest more than R1 million, the process is as easy as:

1. Obtain approval from SARS by completing the appropriate form available via eFiling or your local tax office. Approvals are valid for 12 months and relatively easy to obtain if you are a tax payer in good standing.
2. Pick the mandate that is appropriate to your needs from the range of funds listed here. You may find the fund selection journey or comparison tool on our website helpful, or you may want to consult your financial advisor if you need advice.
3. Complete the relevant application forms and do a swift transfer to our US dollar subscription account. Your banker or a specialist forex broker can assist with the forex transaction, while you can phone us on 0800 22 11 77, or read the FAQ on our website, at any time if you are uncertain.

Expected risk versus return

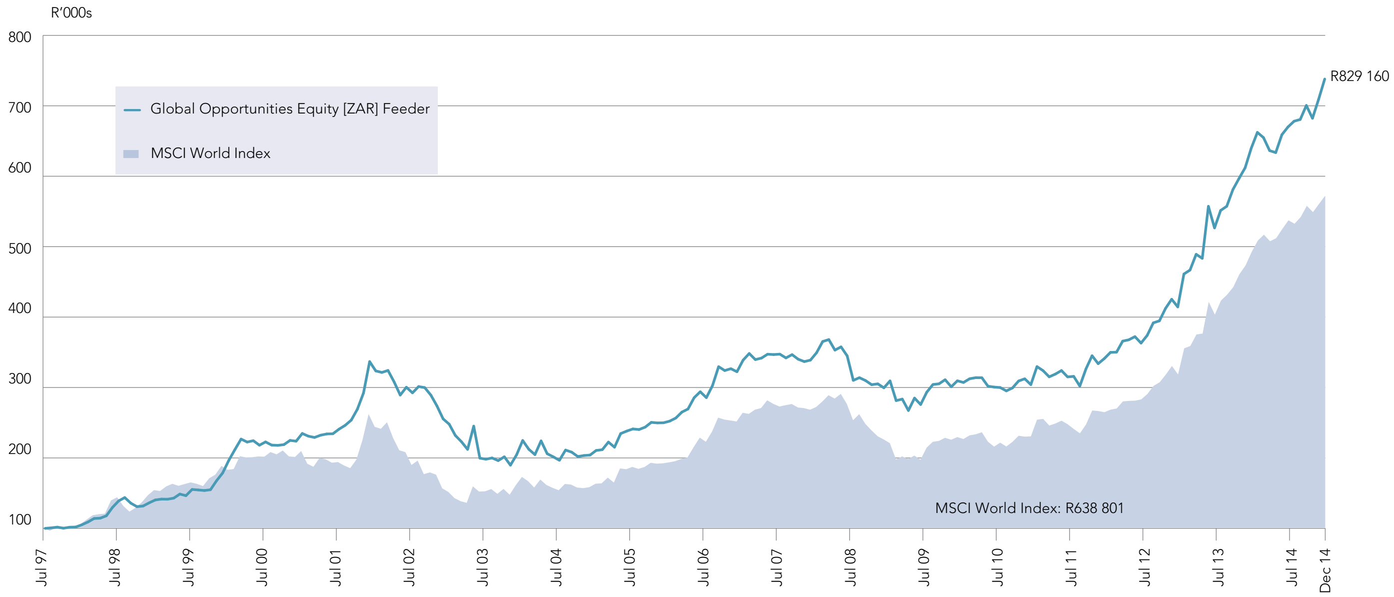
Expected return and risk positioning for both rand and dollar-denominated funds after all income reinvested and all costs deducted.



Source: Morningstar

Growth of R100 000 invested in Global Opportunities Equity [ZAR] Feeder on 1 August 1997

Value of R100 000 invested in Global Opportunities Equity [ZAR] Feeder on 1 August 1997 as at 31 December 2014. All income reinvested for funds; MSCI World Index is on a total return basis. Global Capital Plus [ZAR] Feeder, Global Emerging Markets Flexible [ZAR], Global Managed [ZAR] Feeder and Global Strategic USD Income [ZAR] Feeder, which were launched between 2007 and 2012, have not been included.

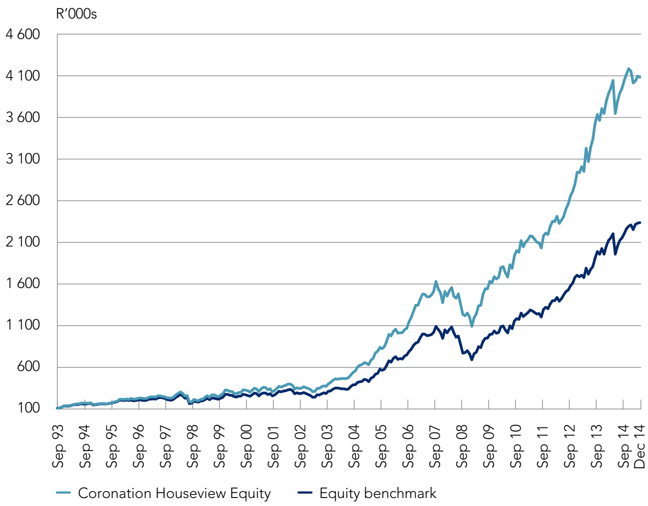


Sources: Morningstar and I-Net Bridge

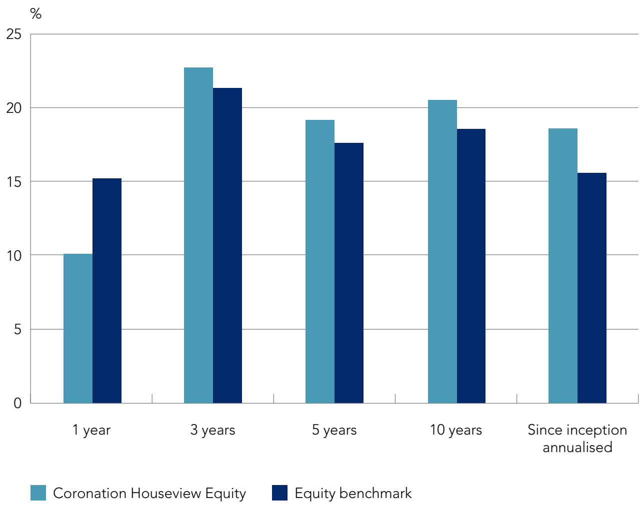
CORONATION HOUSEVIEW EQUITY* RETURNS VS EQUITY BENCHMARK

5-YEAR ANNUALISED RETURNS	CORONATION HOUSEVIEW EQUITY	EQUITY BENCHMARK	ALPHA
1998	8.15%	6.49%	1.66%
1999	14.23%	10.91%	3.33%
2000	10.93%	7.52%	3.41%
2001	10.95%	9.38%	1.57%
2002	9.46%	7.14%	2.32%
2003	18.02%	13.49%	4.53%
2004	14.12%	9.35%	4.78%
2005	23.35%	18.63%	4.72%
2006	28.38%	23.07%	5.31%
2007	33.79%	29.52%	4.28%
2008	23.36%	19.28%	4.09%
2009	22.23%	19.77%	2.45%
2010	18.55%	15.12%	3.42%
2011	11.58%	8.65%	2.93%
2012	13.39%	10.61%	2.79%
2013	24.37%	20.60%	3.77%
2014	19.39%	17.78%	1.61%
ANNUALISED TO 31 DECEMBER 2014			
1 year	10.2%	15.4%	(5.3%)
3 years	23.0%	21.6%	1.4%
5 years	19.4%	17.8%	1.6%
10 years	20.8%	18.8%	2.0%
Since inception in October 1993 annualised	19.1%	16.0%	3.1%
Average outperformance per 5-year return			3.35%
Number of 5-year periods outperformed			17.00
Number of 5-year periods underperformed			–

CUMULATIVE PERFORMANCE



ANNUALISED RETURNS TO 31 DECEMBER 2014



An investment of R100 000 in Coronation Houseview Equity on 1 October 1993 would have grown to **R4 072 627** by 31 December 2014. By comparison, the returns generated by the Equity Benchmark over the same period would have grown a similar investment to **R2 328 046**.

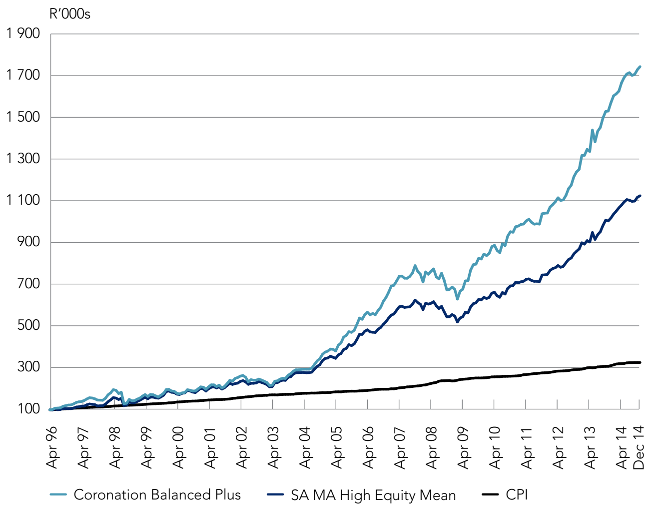
* *Coronation Houseview Equity, which is an institutional portfolio, has been used to illustrate Coronation's investment track record since inception of the business in 1993.*

CORONATION BALANCED PLUS FUND VS INFLATION AND AVERAGE COMPETITOR†

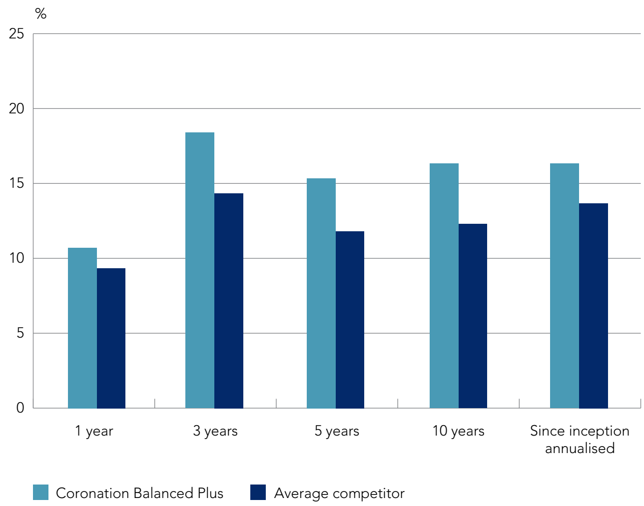
5-YEAR ANNUALISED RETURNS	CORONATION BALANCED PLUS	INFLATION	REAL RETURN
56 months to 31 December 2000	16.00%	7.90%	8.10%
2001	14.38%	7.41%	6.97%
2002	10.73%	8.04%	2.69%
2003	14.68%	7.33%	7.35%
2004	13.82%	6.68%	7.14%
2005	20.53%	5.85%	14.68%
2006	22.43%	5.54%	16.89%
2007	25.35%	5.17%	20.18%
2008	19.28%	6.41%	12.87%
2009	17.60%	6.82%	10.77%
2010	13.97%	6.71%	7.26%
2011	9.49%	6.94%	2.55%
2012	10.81%	6.36%	4.45%
2013	17.98%	5.39%	12.58%
2014	15.57%	5.23%	10.34%

ANNUALISED TO 31 DECEMBER 2014	CORONATION BALANCED PLUS	AVERAGE COMPETITOR	ALPHA
1 year	10.9%	9.5%	1.4%
3 years	18.7%	14.6%	4.2%
5 years	15.6%	12.0%	3.6%
10 years	16.6%	12.5%	4.0%
Since inception in April 1996 annualised	16.6%	13.9%	2.7%
Average 5-year real return			9.66%
Number of 5-year periods where the real return is >10%			7.00
Number of 5-year periods where the real return is between 5% – 10%			5.00
Number of 5-year periods where the real return is between 0% – 5%			3.00

CUMULATIVE PERFORMANCE



ANNUALISED RETURNS TO 31 DECEMBER 2014



An investment of R100 000 in Coronation Balanced Plus fund on 30 April 1996 would have grown to **R1 746 325** by 31 December 2014. By comparison, the Mean return of the South African Multi Asset High Equity sector over the same period would have grown a similar a similar investment to **R1 126 822**.

† *Average competitor return is the mean of the South African Multi-Asset High Equity sector.*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