EXECUTIVE SUMMARY
CONVERSATIONS WITH CORONATION

MAY 2014

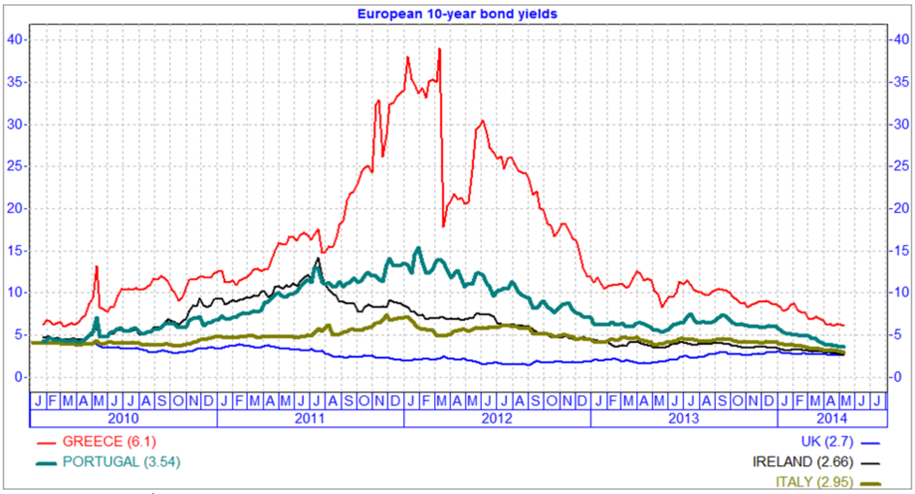
GLOBAL ECONOMIC OVERVIEW

Caution is still warranted, particularly as the closing stages of quantitative easing and the start of a global interest rate hike cycle have yet to play out.

However, the US is unquestionably in recovery mode. Europe is also strengthening, with peripheral countries like Spain, Portugal and Ireland growing for the first time since the eurozone crisis. Austerity measures and a decline in real wages are bolstering competitiveness and manufacturing.

Following a surge during the crisis, European bonds yields have again converged at the fairly low levels seen post the 2008 crisis. Strikingly, after facing bankruptcy just two years ago, Ireland can now borrow money in the bond market at lower rates than the UK. Lower financing costs free up money that can be spent on social services and infrastructure, which will aid European growth.

All back to normal?



Source: I-Net Bridge

While it is too early to state unequivocally that Japan has exited its two-decade long economic slump, indications are positive. Its very large stimulus programme is driving growth and Japanese car manufacturers have become more competitive. After a stark period of deflation, inflation has made a tentative return.

The situation in Australia is concerning. The country capitalised on the boom years in China, and as a result its currency strengthened and its labour grew very expensive. This, however, contributed to a demise of manufacturing in Australia. As commodity prices normalise and mining falters, the country is becoming more vulnerable and remain incredibly reliant on China. The Chinese economy is now definitely cooling amid government interventions to rein in the property market and close down inefficient manufacturers. While painful now, these steps should support sustainable long-term growth.

There are rising levels of unrest in other emerging economies, including Turkey, Argentina, Ukraine and Brazil. The valuation differential between developed and emerging markets has been growing as investors consider these and other risks. But while vigilance is still required, we believe that emerging markets will outperform as the positive long-term demographic trend of young, upwardly mobile populations remains intact. Equity valuations are now priced for significant political risk.

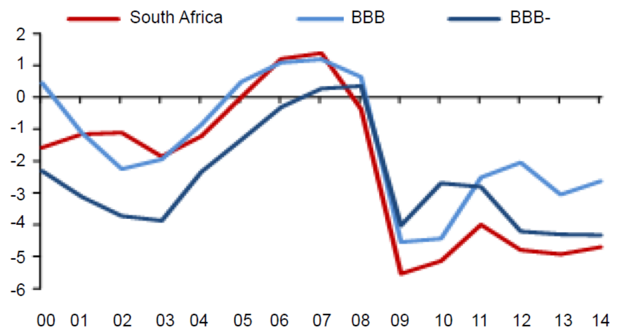
BLEAK SOUTH AFRICAN OUTLOOK

A founder member of the 'Fragile Five' due to its large budget and current account deficits, South Africa is in a perilous position ahead of the expected global rate hike cycle. Higher global rates will stem the flow of capital from the developed markets to SA and make the servicing of our deficits more expensive.

Our budget deficit is already significantly larger than the average of other countries who hold a BBB rating, and even compared to those with the lower BBB- rating. Without a sustainable improvement in the budget deficit, the resulting credit rating downgrades will contribute to put pressure on the economy.

Fiscal discipline will be critical. Unfortunately key cabinet appointments following the elections have not been encouraging in this regard.

Downgrade risk: SA's fiscal deficit compared to the average of countries with BBB and BBB- ratings



Source: Merrill Lynch

WHY IS THE SA EQUITY MARKET DOING SO WELL, THEN?

For the year to end-April, the JSE delivered a return of 30%. This was partly due to currency movements (stripped out, the market returned 15% - 16% in US dollars) but also because international investors viewed SA as a safe haven amid geopolitical volatility, specifically due to the events in the Ukraine. In times of uncertainty, investors also tend to favour companies run by world-class management teams. We believe local managers remain head and shoulders above those in most other emerging markets, particularly in their appreciation of shareholder returns and return on equity.

Still: the local market's returns are untenable. A contracting economy cannot sustain recent return levels. We have consistently warned that the returns seen over the past ten years are abnormal.

OUR ASSET ALLOCATION

Our continued preference is for global stocks, with a bias towards emerging markets.

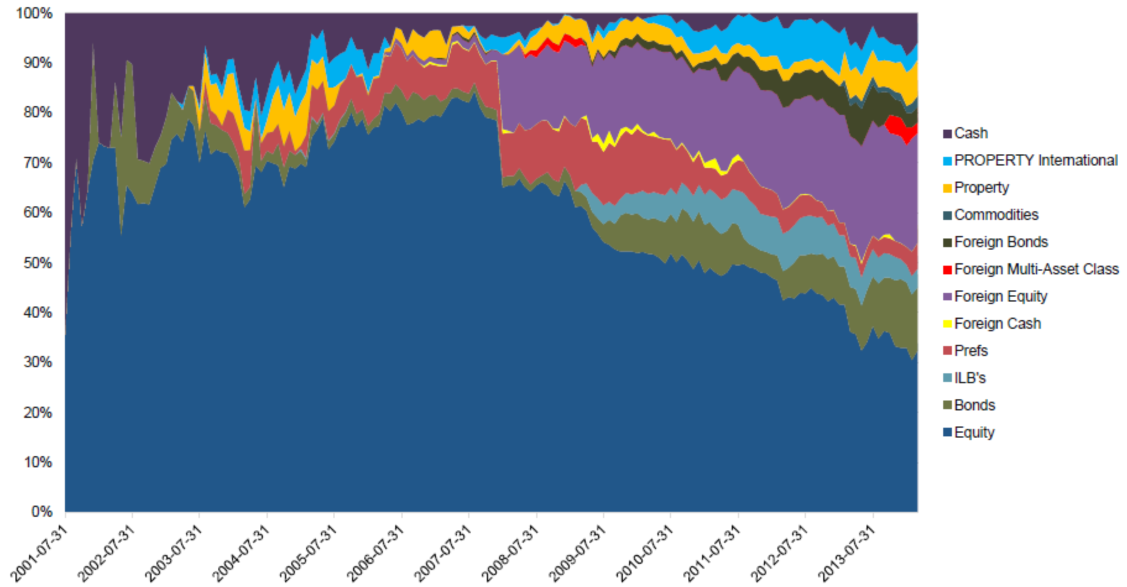
We believe that equity valuations in emerging markets have priced in an adequate level of risk. Despite a strong quarter we have identified many stocks with healthy balance sheets and attractive dividend yields. However, we have reduced our exposure to some global businesses, including SABMiller, British American Tobacco, Naspers and Mondi, which we believe now price in much of their growth prospects.

Although South African bonds are starting to approach more attractive levels, we are avoiding global bonds, and believe that yields are still not compensating for the risk of the approaching higher rates. We do however see long-term opportunities in listed property, particularly in Europe, which offer dividend yields of between 5% and 8%.

We remain very cautious about domestic equities. Much of the local market looks fully valued – particularly compared to global shares. However, for the first time in three years, we have started to pursue selected domestic opportunities. This followed a sharp rerating of some shares, particularly in retail, as earnings began to disappoint and investors came to terms with the tough economic conditions. The shock interest rate increase at the start of the year triggered a further slump, as the market priced in a severe rate hike cycle.

Asset allocation view

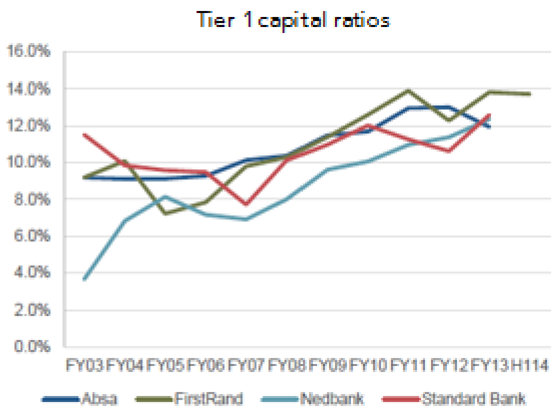
Coronation Market Plus fund since inception to 30 April 2014

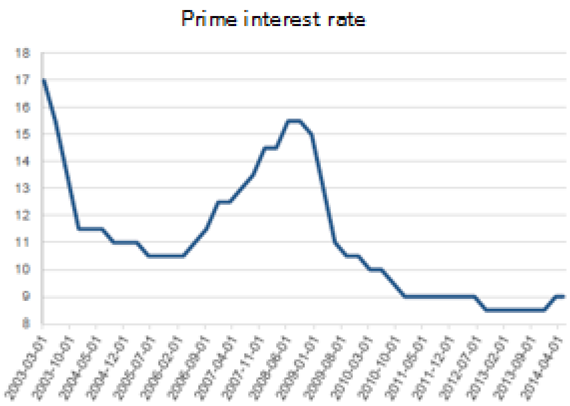


During the sell-off, we increased our exposure to some domestic banks. In contrast to their global counterparts, South African banks have performed relatively well since 2008, offering much higher rates of return than global banks.

Rising interest rates should be positive for the banks. Following the global financial crisis, banks have been forced to accumulate more capital and local banks now hold Tier 1 capital of 12%, far exceeding the minimum (9%) as per Basel III requirements. Domestic banks have gathered more than R200 billion in extra capital, which earns very low cash rates of return. As interest rates rise, increased returns will be positive for earnings growth going forward.

Piles of cash





Two domestic banks offer value:

Standard Bank. Over the past three years, Standard Bank sold its overseas holdings in Argentina, Turkey and Russia, as well as its global markets business in London. The capital released from these exits has been redeployed into its African businesses, which are starting to gain real traction. The continent's financial sector remains under-penetrated and Standard is benefiting from fast growth. It is also the preferred banking partner of many South African corporates venturing into Africa, including MTN and Tiger Brands. Despite a relatively bloated cost base due to increased spending on IT, the South African business is doing reasonably well. The business should produce good earnings growth as IT spending subsides post 2015. On 11.2 times forward normalised earnings, with a dividend yield of 4.6%, Standard looks attractive.

Nedbank's valuation of 11 times normalised earnings, with a 4.7% dividend yield, is equally undemanding, but unlike Standard Bank, it does not have a solid footprint on the continent. (It does have the option, which expires in November 2014, to acquire 20% of the pan-African financial institution Ecobank.)

However, Nedbank has done very well in recent years and we believe it is in a good position to grow its credit card and vehicle finance activities. Nedbank's very conservative management team deserves credit for identifying the emerging risks in unsecured lending early on, and pulling the handbrake at the start of last year. As a result, while all other banks are currently suffering deteriorating credit loss ratios, Nedbank's improved debt ratios allows it to focus on growing its business.

In contrast, African Bank (Abil) took on too much risk by extending loan sizes and increasing repayment terms. As unsecured lending slowed, its bad debts increased meaningfully. Its return on assets and margins were already too low to absorb this sharp rise in bad debt. In addition, the quality of credit extended through Ellerines was worse than expected. In the past, Coronation has stayed far away from the direct and indirect beneficiaries of unsecured lending. However, Abil's share price, currently trading at five times our assessment of normalised earnings, is pricing in a lot of risk and a large margin of safety. Given the risk of its business model, the Coronation Balanced Plus Fund's exposure to Abil remains less than 0.3% of the value of the fund, while the position represents only 1.5% of the more aggressive Coronation Top 20 Fund. We hold no Abil exposure in our lower risk multi-asset funds (Balanced Defensive and Capital Plus).

The Foschini Group

We have started to increase our exposure to The Foschini Group (TFG) after a significant de-rating of its share price. The consumer outlook remains challenging, but we believe the current share price more than prices in these risks. TFG is trading at only 10.3 times our assessment of forward earnings, and with a forecast dividend yield of 5.2%. Its current share price is 20% lower than our assessment of intrinsic value, which provides an ample margin of safety.

TFG has a very strong track record compared to domestic and global peers, with superior sales and earnings growth over the past ten years. Despite tough economic conditions, the group is improving its margins and it will continue to capitalise on gaining market share from Edcon, which has been struggling under private equity ownership. (In fact, most SA retailers have benefited from its slow but consistent decline.)

TFG has also implemented a number of operational interventions which will reduce lead times and lower the need for markdowns. In addition, it released R1.4bn in capital (6% of its market capitalisation) through the sale of its stake in RCS, which will be used to buy back shares. This should enhance shareholder value.

CORONATION TOP 20 FUND

A concentrated equity fund, it follows a focused strategy of investing in no more than 20 large shares selected from the top 50 JSE-listed stocks by market capitalisation. Globally diversified companies remain the fund's preferred investments, but SABMiller and Sasol have been reduced meaningfully following strong performances. These shares are now no longer among the top-ten holdings. There has also been some profit-taking in Mondi and Naspers.

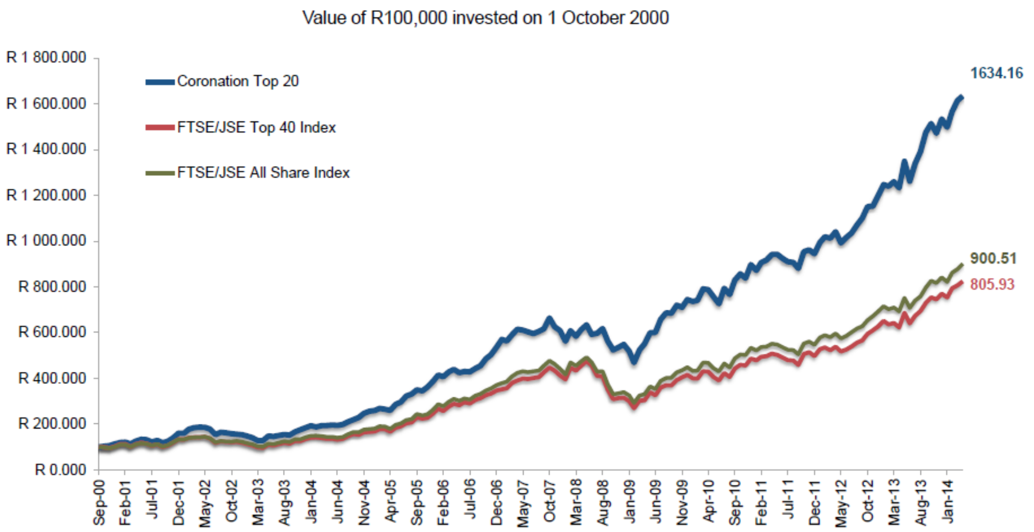
While its short-term performance can be quite volatile, the fund's return since inception has been double that of the benchmark, which we think is remarkable, given the strength of the market. The Top 20 fund has also comfortably outperformed the biggest domestic index funds, including the Satrix 40, the Satrix Swix Top 40, the Satrix Divi Plus and the BettaBeta Equally Weighted Top 40 ETF. This outperformance was net of fees, belying the standard pro-passive argument that fees should be paramount in an investment decision. We believe that clients should focus on after-cost returns, not only on fees. Compounding excess returns over long periods create substantial wealth.

Another contention is that passive investing is less risky than active. This is categorically refuted by the track record of the Top 20 fund, which has a lower standard deviation (a key risk measure) than its benchmark. In addition, the fund also tends to outperform in negative markets, which provides investors with some downside protection.

We believe that the flaws of index investing - buying a randomly determined basket of shares - are becoming increasingly apparent. First and foremost, investors in index funds are inadvertently buying more of the expensive shares, and less of the cheap shares. After all, the more expensive a share becomes, the bigger its weighting in a basket.

Also, given the plethora of exchange-traded funds on offer, the passive investor is making a complex and difficult 'active' decision in choosing an index fund that will outperform the market.

Beating the benchmark



OUR INVESTMENT PHILOSOPHY

A commitment to the long term remains the critical factor driving our investment approach. Through in-house proprietary research, we calculate the underlying value of a business by understanding its potential and what it can earn many years into the future.

We will often buy businesses when they appear to be struggling and the newsflow is bad. This is typically the point in the cycle when the best investments are made; when the market is only looking at the short term and not recognising the true value of a company. Volatility and short-term prospects create the opportunities to identify these long-term winning investments. As a result, performance may be volatile in the short term. But we are patient.

We have the conviction to hold positions through periods of underperformance and encourage our investors to measure our performance over meaningful periods, which we define as five years or longer.