EXECUTIVE SUMMARY
CONVERSATIONS WITH CORONATION

JULY/AUGUST 2012

At the recent round of Conversations with Coronation we discussed our latest views on the current macro environment, shared some insights into the domestic equity market by looking at the positioning of Coronation Top 20, our flagship domestic equity fund, and detailed some of the shares where we currently find value.

OUR INVESTMENT PHILOSOPHY

Coronation is a long-term, valuation-driven investment house, with an investment philosophy that is deeply ingrained in our culture. Our aim is to identify mispriced assets trading at discounts to their long-term business value (fair value). We focus on through-the-cycle, normalised earnings and/or cash flow.

AN UPDATE ON OUR ECONOMIC OUTLOOK

Europe

The crisis in Europe continues to take centre stage. In our analysis we have identified five possible scenarios of how the situation could potentially unfold.

1. The status quo remains. All nations remain members of the common euro currency area and the countries in deficit are required to continue taking the austerity medicine.
2. An exit by Greece only. In such a scenario the European Central Bank will have to take bold steps to assure markets that contagion can be limited.
3. A contained exit from the common currency area by one or two peripheral nations for whom the pain of austerity becomes too great.

The following scenarios are more extreme.

4. An exit by Germany should the country become unwilling to foot the bill for the deficit countries.
5. A complete break-up of the euro currency.

We believe that one of the first three less extreme scenarios is most likely to unfold. A contained break-up of some of the smaller and more unproductive members need not have calamitous consequences for the European or global economy. On the possibility of scenarios 4 or 5 unfolding, we would place a probability of between 5% and 10% - a full break-up would result in very serious consequences for the global economy.

China and the US

Outside of Europe, the Chinese economy is slowing down. This however should come as no surprise as the second largest economy in the world cannot keep growing at 10% indefinitely. We also do not regard 7% economic growth as a hard landing. In fact, in the current world environment, this level of growth is enviable. In China there has been a clear shift in focus from gross domestic fixed investment-led growth (GDFI) to growth in domestic consumption. This is as a result of the country realising it cannot rely on the US and Europe to continue consuming as significant a share of their production; they need to grow their domestic consumer base in order to wean themselves off the demand from developed world nations where conditions are clearly much tougher.

While the US economy continues to grow, many commentators are unhappy with the rate of growth. Given the amount of stimulus that has been pumped into the market, a growth rate below 2% may well be quite disappointing, but there is some positive data as well: unemployment is down from 10% to 8% and house prices have started to stabilise.

South Africa

In South Africa the overall growth rate and inflation experience has been more or less in line with our expectations. While inflation peaked just above the top end of the target range, we remain concerned about some inflationary risks, such as a weaker currency and the potential for an increase in food price inflation. Thus, while we expect CPI to fall further in the short term, it is likely to trough fairly soon, and we believe it will again move above the target range during 2013.

Interest rates are at record lows and the recent 50 basis points cut by the Reserve Bank's Monetary Policy Committee is unlikely to benefit the economy other than perhaps a bit of a spur to consumers. It is important to understand that it is not the interest rate sensitive sectors of the economy that are currently under pressure. Furthermore, the lack of job creation continues to weigh heavily on the domestic economy. While the weaker rand has helped some manufacturers, these gains are rapidly eroded by above-inflation wage increases. Finally, the highly uncertain policy environment, resulting from a lot of posturing by politicians, makes it difficult for businesses to invest.

WHAT ARE THE INVESTMENT IMPLICATIONS OF THE CURRENT MACRO ENVIRONMENT?

Valuations seem to have taken a back seat as most market moves are now being driven by macroeconomic factors, both real and perceived. No day passes without some commentator expressing his/her views on the many problems in Europe, expectations of growth and bubbles in China, or on the anaemic recovery in the US. Positive or negative, market moves are then driven by these comments, often resulting in perverse outcomes.

The bottom line is that very little equity market action can be explained by rational discourse. While frustrating in the short term, this usually creates opportunities for those investors whose decisions are based on fundamental valuations and who are prepared to take a long-term view.
What we have also seen is that policymakers will not simply sit back and watch Europe implode - to-date they have been doing the right things (albeit, only at the eleventh hour in some cases). We also believe that 0% interest rates are here to stay, meaning that there are certain asset classes that should be avoided. Longer term, we continue to be concerned that this experiment of 0% interest rates and ultra loose monetary policy will ultimately be inflationary.

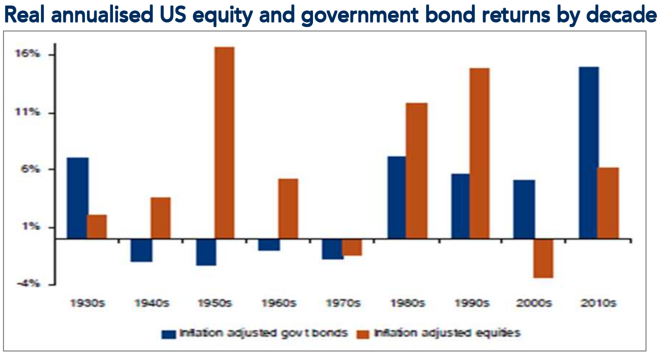
The chart below shows the yield on the US 10-year treasury over the past 220 years. The yield is currently trading at its lowest level in history, and if you invest in this instrument today, you will be locking in a yield of 1.4% for the next decade. While the chances are slim that you will be making any real return on your investment over this period, many investors are flocking to this asset class. Flows into US bond funds are at record highs, while US equity funds are experiencing outflows. This comes at a time when the US debt to GDP ratio has never been higher, except during World War II. Investors are therefore earning the lowest return in history owning an asset issued by a government that is significantly indebted.

US 10-year Treasury yield since 1970

Source: BofA Merrill Lynch Global Equity Strategy, Global Financial Data, Bloomberg

Over the long term we continue to believe that equities will deliver inflation-beating returns. The dividend yields of companies listed on the S&P 500 Index are currently higher than the interest yield on US treasuries, and there is the prospect of growth when investing in these equities. The graph below shows that in the past eight decades there were two 10-year periods during which equities delivered a negative return – in the 1970s and the past decade. There are however four decades during which the returns on bonds were negative. Interestingly one of these periods followed the great depression, a very similar environment compared to the present. During that era many people fled to bonds as a perceived safe asset class, only to end up owning assets that performed very poorly for quite some time after the recovery (see below).

Real annualised US equity and government bond returns by decade



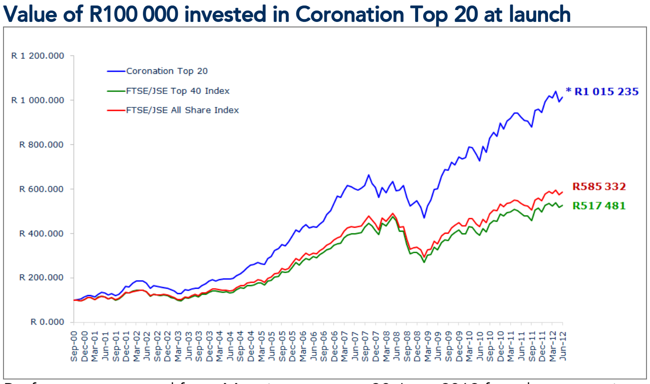
Total returns, USD. 2010's data based on the period 2010 - May 2012
Source: BofA Merrill Lynch Global Equity Strategy, Ibbotson, Bloomberg

THE CORONATION TOP 20 FUND

Coronation Top 20 is a focused portfolio of our top stock picks on the JSE. The fund invests in 15 - 20 shares selected from the 50 largest listed companies (by market cap). It is an actively managed fund that has delivered consistent top quartile performance over all meaningful periods (3, 5, 10 years and since launch) to end June 2012.

The graph below illustrates the fund's outperformance of its benchmark (FTSE/JSE Top 40 Index) as well as the total market (FTSE/JSE All Share Index). By end June, the fund had outperformed the Top 40 index on average by 6.6% per annum, meaning that R100 000 invested in the fund at launch, had grown to just over R1 million. This is nearly double the current value of a similar investment in the benchmark Top 40 Index. By investing in an aggressive equity fund such as Top 20 one would expect a higher return than both the market and the benchmark, but what is noteworthy is that the fund has achieved this outperformance at lower risk.

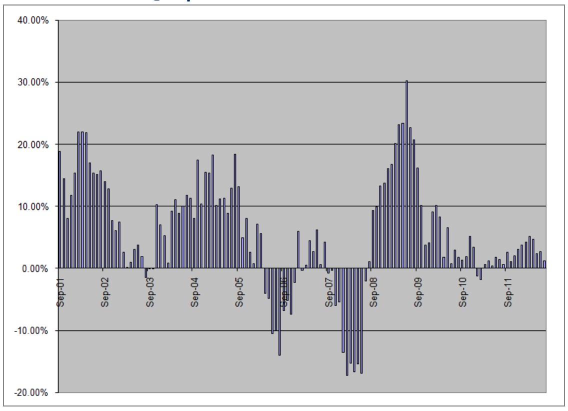
Value of R100 000 invested in Coronation Top 20 at launch



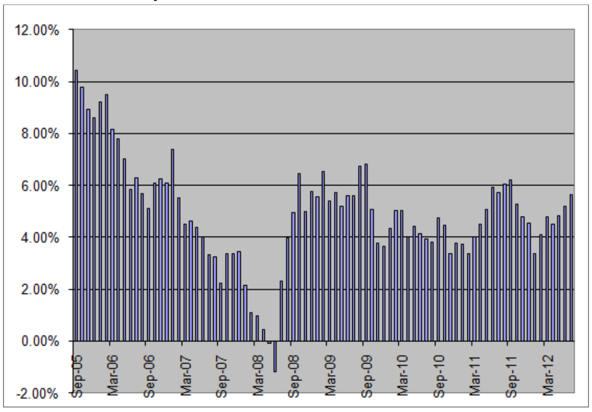
Performance quoted from Morningstar as at 30 June 2012 for a lump sum investment with income distributions reinvested
Source: Coronation Fund Managers

While the fund's outperformance has been phenomenal when measured over the long-term, the short-term alpha has been fairly lumpy. The charts below illustrate the large variations in alpha when measured over one-year periods, compared to the much greater consistency over five-year periods. We therefore emphasise that investors in the fund should have a long-term view and look beyond the short-term volatility.

12-month rolling alpha



5-year rolling alpha



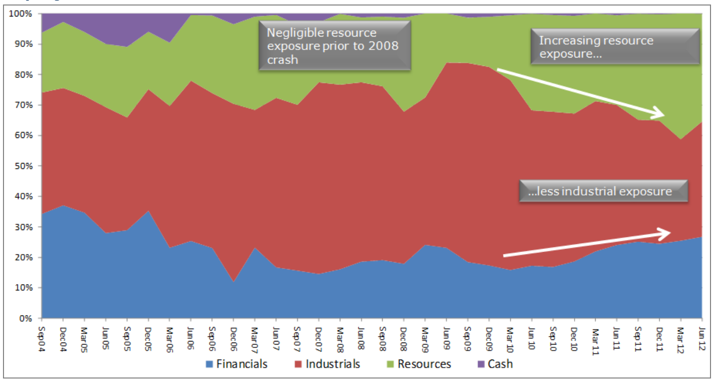
Source: Coronation Fund Managers

CURRENT FUND POSITIONING AND VIEWS

South African equities on an overall level are probably fully priced. We however believe that specific sectors offer value. While industrial shares remain the largest sector exposure within the fund, we have been reducing our exposure. Within this sector our focus is on holding defensive global shares that are able to defend and grow their earnings despite macro uncertainties. These companies are strong cash generators such as MTN, Naspers and British American Tobacco. In the cases of MTN and British American Tobacco they are generating cash and returning it to shareholders in the form of dividend payouts and share buybacks. MTN has however faced a number of negative newsflow items over the past year including unrest in Nigeria, escalating sanctions in Iran as well as the Turkcell litigation. While the share price has been depressed as a result, we don't believe the long-term value of the company has been impaired, and MTN continues to be the largest equity holding in our fund. The ratings of most retail shares have been driven to unsustainably high levels mainly as a result of foreign buying, to the extent that almost every retailer in

South Africa is currently more than 50% owned by foreign shareholders. We have continued to reduce the fund's exposure to the domestic retail shares as the valuations of these companies leave very little room for error.

Equity sector allocation as at 30 June 2012

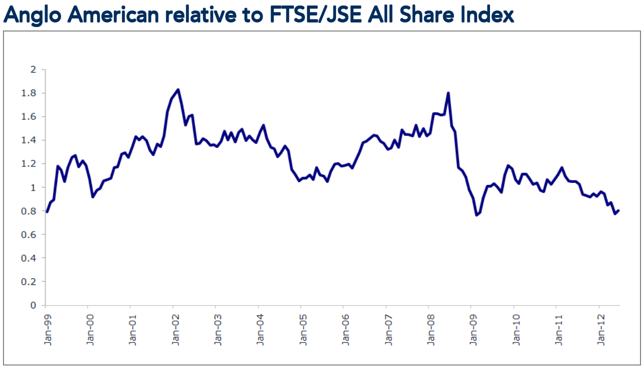


Source: Coronation Fund Managers

Looking at the asset allocation graph above, we had negligible exposure to resources prior to the global financial crisis. Today 35.3% of the fund comprises resources shares (the fund has no exposure to gold), representing the highest weighting in this sector since 2002. We believe that many of the commodity counters offer very good long-term value, even at significantly lower commodity prices. Markets hate uncertainty and we don't think they do a good job of evaluating future production growth in these companies. As production comes through from new projects, we expect the market will start to recognise the value in these companies.

Our preferred resources holdings are the diversified miners (specifically Anglo American). The market rates Anglo American at a discount to its peers as management has made some errors in the past, such as buying expensive assets at the top of the cycle. However, the company still owns a number of very attractive assets. Anglo American is the largest producer of platinum in the world, the world's largest miner and marketer of diamonds, owns excellent base metal assets in South America and high-quality coal assets in South Africa, Australia and Columbia. If you look back at its share price relative to the market (see graph below), it is currently as cheap as it was at the peak of the 2008 financial crisis. We don't believe the world is in the same position as it was back then when shiploads of commodities were floating around the ocean without any buyers in sight. Yet the market is pricing these assets as if we are in that same position.

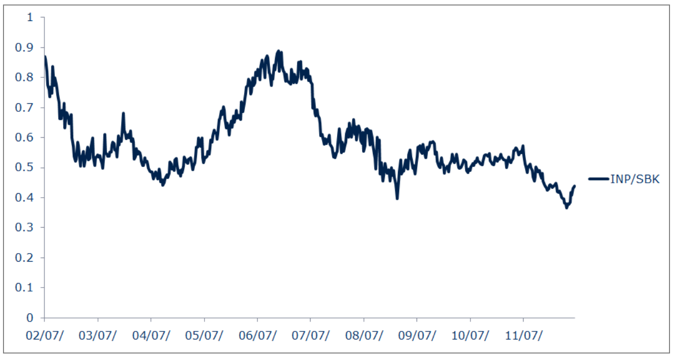
Anglo American relative to FTSE/JSE All Share Index



Source: Coronation Fund Managers

The banking sector, which was not regarded favourably in 2011, has been a very strong performer this year and we have started reducing our large exposure to the big four banks. South African banks are currently trading at a 30% premium versus other emerging market banks. One exception has been Investec, a share that has been lagging its peers on concerns over its exposures outside of South Africa, namely Australia and the UK. Global banks, as we all know, have been facing very tough macro conditions, topped with the regulatory burden of increasing capital and liquidity requirements at a time when interest rates are at all-time lows, which has also hampered their growth. In addition, the company has had a few missteps as a result of their large property exposure in the UK, aggressive expansion into the Australian market and an ill-timed acquisition of the sub-prime mortgage lender Kensington shortly before the subprime crisis took hold. It is therefore possible to dismiss it as a bank with very poor fundamentals. The following slide shows how Investec derated compared to Standard Bank, and the derating from the pre-crisis levels has been quite dramatic. We however believe that it is not all doom and gloom. We think the market is ignoring the quality of its wealth management franchise and the value that can ultimately be unlocked from its UK banking operations. We have therefore increased our exposure at attractive levels.

Investec relative to Standard Bank



Source: Coronation Fund Managers

In conclusion, in an environment where markets oscillate wildly depending on the news of the day, our investment strategy remains unchanged. By 'cutting out the noise' our continued aim is to deliver exceptional long-term investment returns for our clients.