CORONATION
FUND MANAGERS

Executive summary from Conversations with Coronation

February/March 2012

At our recent Conversations with Coronation presentations we painted a picture that quite clearly illustrates our preference for global growth assets, and equities in particular. Below we briefly discuss why we believe investors should have above average levels of exposure to global growth assets in their portfolios, and explain why they should not avoid investing in emerging market assets purely on the basis that they already have exposure to South African assets. We also look at those circumstances that justify an offshore exposure beyond the 20% - 25% that is currently held by most South African balanced funds, and provide some details and performance highlights from our international flagship fund range.

The sentiment tug of war continues

There is no doubt that the global investment environment continues to face many headwinds: the ongoing European debt crisis, the chronic US budget deficit, consumer deleveraging and concerns around slowing growth in China. However, the case for growth assets is supported by strong tailwinds, including very low interest rates and undemanding equity valuations. Central bankers around the world (even the European Central Bank) have committed to keeping their collective 'foot on the accelerator' - and not give up until the global economy recovers. Furthermore, employment numbers and consumer confidence is improving in the US and company earnings and balance sheets are strong.

Where do the best offshore investment opportunities currently lie - cash, bonds or equities?

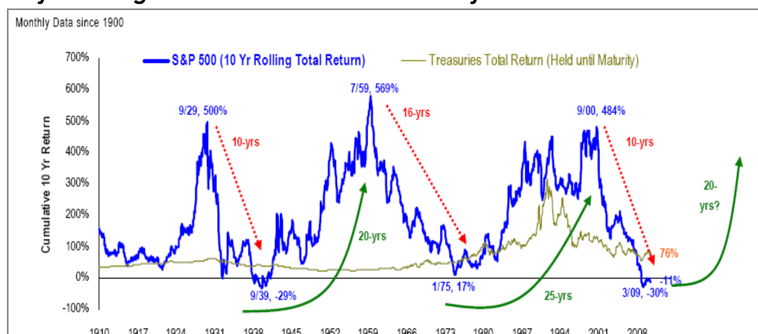
With so many known unknowns in the global investment environment, where should investors be placing their capital? Normally, when the level of uncertainty is elevated, the best way of protecting one's capital would be to invest in cash. However, investors in US cash are currently earning a negative real return, which has been the case for a number of years - and we don't expect this to change in the foreseeable future.

Investors could then move up the yield curve into a 10-year global government bond, the winning asset class over the past 12 years (returning 7% p.a. versus the 2.1% p.a. from global equities). Yet, even here the current real return is close to zero at best. However, bonds are only likely to remain the winning asset class if the world were to enter a period of deflation. This might happen if the global monetary authorities fail to deal with the major headwinds in a proper fashion. We are attaching a low probability to such a scenario based on the aggressively accommodating monetary policy stance adopted by both the US Fed and the European Central Bank.

A consequence of the amount of liquidity that has been pumped into the system to-date is that the probability of higher inflation over time is increasing. We believe that in for example, the US, inflation is likely to remain within the current consensus range of between 0% and 2.5% for the next five years, but would not be surprised to see inflation tick up to between 2.5% - 5% over this period. In this scenario, where central banks are very unlikely to respond to rising inflation in a hurry, we don't believe that bonds are a good place for investors' capital. Instead we believe that investors should have more capital exposed to global equities.

One of the important points to remember is that the price you pay for an investment is crucial in determining the eventual success of your investment. The share prices of global equities have done very little over the past 12 years because valuations at the start of the period were very stretched, yet the earnings of most companies have continued to grow. Today you can buy a portfolio of global blue chip companies at very reasonable valuations as a lot of the bad news has already been discounted in their share prices. Investors should also remember that even during bear markets equities keep growing their dividends. During the bear market of the 1970s companies continued to pay dividends, and while dividends were cut by around 15% in the non-banking sectors of the S&P500 more recently (in 2008), these dividends have recovered sharply and today are 20% higher than where they were pre-2008. Investment markets also tend to move in cycles and tend to revert to their long-term means over time. As is clear from the graph below, we believe that we may be entering another 20-year period of positive equity market growth.

10-year rolling total return – S&P 500 versus 10-year US Treasuries



Source: J.P. Morgan and Shiller. S&P 500 total return includes dividend and the return for US Treasuries assumes bonds will be held until maturity.
Note: Past performance is not indicative of future results.

What about global property?

As a house, we have been increasing our exposure to global listed property stocks in recent months, driven by attractive opportunities in Asia, continental Europe and Australia. These quality assets trade on dividend yields of between 6% and 10%, which in most cases are equal to or higher than comparable property companies in South Africa, providing an excellent entry point.

In the table below, the yield gap (the difference between the clean forward dividend yield on listed property and that of the corresponding country's 10-year government bond) illustrates the current attraction over investing in the risk-free rate of the respective countries. The bigger the yield gap, the bigger the value in listed property. While global bond yields remain low at present, we believe that the listed property holdings in which we are invested will continue to offer value (even if bond yields start to rise in future). This is due to the large margin of safety implied by the current yield gap compared to the historical average.

Country name	Market Cap (USD m)	Clean Yield	Yield Gap*
Netherlands	9 154.5	8.40%	5.90%
Singapore	34 268.8	6.20%	4.70%
Japan	41 743.3	5.40%	4.50%
France	44 150.7	6.30%	3.30%
Canada	33 531.3	5.30%	3.30%
Australia	77 352.7	6.80%	2.80%
Germany	6 693.7	4.80%	2.80%
United Kingdom	37 114.0	4.40%	2.20%
United States	432 718.4	0.36%	1.50%
South Africa	20 748.2	7.90%	-0.10%

Source: Reuters as at 28 February 2012
**Difference between the clean forward yield on listed property and that of the 10-year government bond in the respective countries.*

The case for investing in emerging markets

Many people continue to argue that because they already have a large portion of their investments exposed to the South African market, why should they also invest in other emerging markets? One of the key reasons we believe investors should not be ignoring these markets is that the emerging market universe is roughly 12 – 15 times the size of the South African market, which means that the opportunity to find attractively priced equities is significantly larger. The following table provides some perspective of where South Africa lies in the universe of major emerging markets.

Country	Population (m)	GDP (PPP$bn)	GDP/capita ($, PPP)	Unemployment	Current Account (% of GDP)	Life Expectancy
South Africa	**50**	**526**	**10,518**	**25.10%**	**-4.10%**	**49.3**
China	1,338	10,119	7,544	4.10%	3.90%	73
India	1,171	4,058	3,408	9.40%	-3.70%	64.7
Indonesia	240	1,033	4,347	6.60%	0.60%	70.7
Brazil	195	2,179	11,273	5.80%	-2.20%	72.4
Russia	142	2,231	15,612	7.60%	5.00%	65.5
Mexico	113	1,565	14,406	5.50%	-2.10%	76.2
Turkey	73	969	13,577	9.10%	-10.00%	71.8

Source: IMF, World Bank, United Nations. 2010 or latest available data.

In terms of population size, South Africa is clearly small (50 million compared to more than 1 billion for the larger emerging market countries). The table also shows the size of the respective economies. China, for example, has an economy 20 times the size of ours, while the Brazilian economy is more than four times our size. Probably the more worrying column is unemployment, followed by life expectancy. South Africa's unemployment rate currently lies at 25%, while the rest of the emerging markets displayed all have single-digit unemployment figures, ranging from as low as 4% - 9%. Even the average life expectancy is around 70 years in all the other emerging market countries, while in South Africa it is 49.

As an illustration of the opportunities that are available in emerging markets, we can offer the Brazilian clothing retail sector as an instructive example.

South African 'Big Six' Clothing Retailers (Year ended March/June 2011)						
Company	**# Stores**	**Total Square Metres**	**Revenue (USD m)**	**Revenue/Sq M (USD)**	**EBITDA (USD m)**	**EBITDA %**
Edgars	261	1 321 000	2 710	2 051	490	18%
Foschini	1 063	405 086	818	2 019	304	37%
Mr Price	578	319 395	989	3 096	189	19%
PEP	3 046	1 356 000	2 936	2 165	331	11%
Truworths	543	256 044	1 023	3 994	389	38%
Woolworths	245	374 636	1 118	2 984	223	20%
Total	**5 736**	**4 032 161**	**9 593**	**2 718**	**1 926**	**24%**
Brazilian 'Big Six' Clothing Retailers (Year ended Dec 2010)						
Company	**# Stores**	**Total Square Metres**	**Revenue (USD m)**	**Revenue/Sq M (USD)**	**EBITDA (USD m)**	**EBITDA %**
Cia Hering	443	44 815	590	13 175	161	27%
C&A	182	350 000	1 748	4 994	280	16%
Le Lis Blanc	57	17 993	205	11 368	43	21%
Lojas Renner	134	274 700	1 435	5 223	224	16%
Marisa Lojas	277	295 500	992	3 357	153	15%
Riachuelo	123	314 500	1 276	4 057	340	27%
Total	**1 216**	**1 297 508**	**6 245**	**7 029**	**1 201**	**20%**

Source: Coronation Fund Managers research

South Africa's six biggest clothing retailers currently occupy roughly three times the amount of store space occupied by the six biggest clothing retailers in Brazil (4 million square metres in South Africa versus 1.2 million square metres in Brazil). If one looks at revenue, South African retailers currently earn roughly double the amount that Brazilian retailers earn, and profit is roughly three times that of the Brazilian retailers. In our view, for a country with a population of almost 200 million compared to South Africa's 50 million and an unemployment rate of 6% compared to our 25%, this does not make sense. We therefore believe the Brazilian clothing sector finds itself more or less where the South African clothing sector was 15 - 20 years ago, and in our view presents a massive opportunity.

A key advantage of the Brazilian clothing retailers is the current mix between the formal and informal sector. Today the six biggest clothing retailers in South Africa make up 70% of the total clothing market, more or less double the market share it had 15 years ago. In Brazil the big six clothing retailers make up 20% of the total clothing market, and is therefore far less developed. We expect that over time the big six clothing retailers in Brazil will become bigger and more powerful in terms of buying power, and as a result will start to squeeze out the mom-and-pop stores. Given that the government in Brazil has already started clamping down on the those mom-and-pop stores that to-date have often evaded paying tax, we believe that for the next 15 years the overall market share of the big six clothing retailers, along with their earnings growth, is set to increase.

We have taken advantage of this opportunity by investing in the Brazilian clothing retailer Marisa, currently representing a 3.2% holding in the Coronation Global Emerging Markets Fund. The company trades on 13x this year's earnings and a dividend yield of 2.6%.

Is the 20%-25% offshore exposure in balanced funds not enough?

While South African investors may feel comfortable with the current level of offshore exposure achieved through a domestic balanced fund, we believe there are certain circumstances which may justify a higher allocation in a client's discretionary or private portfolio. These include the fact that your client's future basket of goods and services may have more foreign currency influenced buying than the average South African pension saver, your client's children may not live in South Africa, or your client still has a multi-decade investment horizon ahead. While the number would differ for each client, we believe that for most affluent clients one can justify holding two thirds of their portfolio's growth component in offshore assets rather than local assets.

Our international fund range

When you are contemplating investing in one of Coronation's international flagship funds, you will find exactly the same DNA and objectives that we employ in our domestic portfolios. In other words, the same investment philosophy and same ambition to produce top performance in the available peer group categories over meaningful periods of five to ten years. Below we include some details and performance highlights from the range.

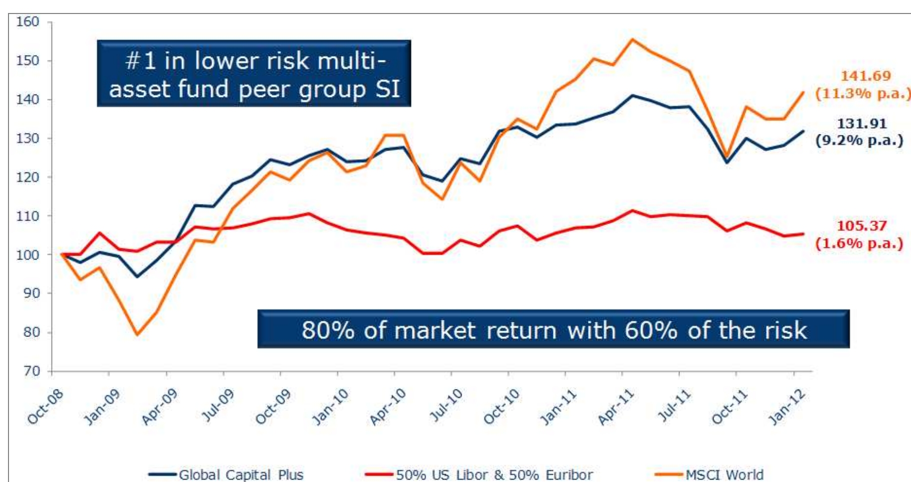
Coronation Global Strategic Dollar Income

At the start of 2012, we completed our international flagship fund range with the launch of the Coronation Global Strategic Dollar Income Fund, a sibling to our domestic flagship Coronation Strategic Income Fund which has been in existence for nearly 11 years. What we aim to achieve in this fund is to provide an intelligent alternative to dollar bank deposits, specifically term deposits of 12 - 36 months. We believe this fund is a very valuable financial planning tool as it enables financial advisors to assist clients in moving their capital from bank deposits, where they currently earn very low returns, into a vehicle that takes a considered level of risk to produce a better return than available from cash holdings. From a financial advisor's perspective, it enables you to manage a portion of a client's balance sheet that would otherwise not have been available.

Coronation Global Capital Plus

As is the case with its local sibling, the Coronation Capital Plus Fund, Coronation Global Capital Plus is a portfolio with dual objectives. It aims to produce a reasonable rate of real growth over time but mitigated by a strong focus on capital preservation in the short term. The fund is designed to assist clients in increasing their risk exposure slightly, but remains consistent with shorter investment horizons for investors with more conservative profiles.

In terms of performance, we are very happy that since its inception in September 2008 the fund has managed to deliver the majority of the market return (80%), but with just more than half the market risk. That is exactly what you would expect from an absolute return portfolio – to enhance risk-adjusted outcomes, but to deliver more than merely 50% of the market returns as would be implied by its growth asset cap of 50%.



Source: Morningstar. Cumulative return (in US dollars) since inception in September 2008 of the rand-denominated fund

Coronation Global Managed

This fund has been in existence for almost two years (launched in October 2009). It is a classic multi-asset fund with a bias towards growth assets (around 80% growth asset exposure). The fund aims to deliver the best possible rate of return available across the different asset classes in global markets.

In terms of performance, the fund has delivered an annualised return since inception ahead of the MSCI World Index (blue bar in the graph below). We are also very proud that the fund has managed to deliver top decile performance since inception from a universe of 50 rand-denominated global equity and multi-asset funds. Only three funds have delivered a better performance over this period - and all three are pure equity funds, one being our Coronation Global Emerging Markets Flexible Fund.

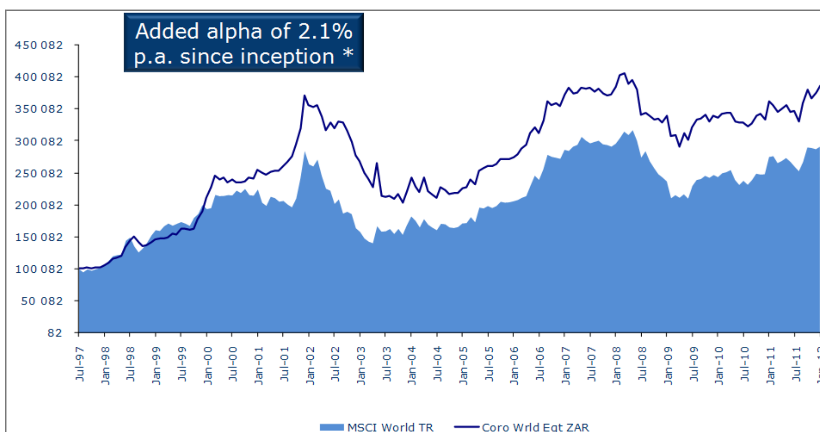
Fund	Return
Old Mutual Global Equity Fund	11.21%
RE:CM Global Feeder Fund	8.89%
Coronation Global Emerging Mkts Flexible Fund	7.61%
Coronation Global Managed Fund	7.15%
Investec WorldWide Equity	6.95%
IS Global Equity	6.94%
Discovery Global Equity	6.90%
Old Mutual Intl Growth FoF	6.53%
Discovery Global Balanced Fund	6.19%
Marriott First World Equity	5.82%
Nedgroup Inv Global Equity (Veritas)	5.65%
Foord Intl Feeder Fund	5.52%
Sanlam Global Index FoF	5.38%
Marriott Intl Growth	5.36%
Momentum Intl Equity FoFs	5.33%
Sanlam Intl Equity FoF	5.19%
Investec Global Strategic Managed	5.16%
MSCI World	**5.14%**
Investec Global Equity FoF	4.99%
STANLIB MM Global Equity	4.93%
STANLIB Global Equity Feeder Fund	4.90%
Coronation World Equity FoF	4.78%
Momentum Intl Balanced	4.28%
Oasis Crescent Intl	4.26%
Oasis Intl	3.75%
Momentum Global Fund	3.74%
Momentum Intl Conservative	3.56%
ABSA Intl Fund A	3.34%
Verso Long Term Intl Equity FoF	3.28%
Allan Gray Orbis Global Equity	3.28%
STANLIB Intl Bal FoF	3.27%
PSG Konsult Intl FoF	3.15%
Kruger Global FoF	3.02%
Coronation Global Capital Plus	2.98%
Plan IP Sarasin Equisar	2.78%
STANLIB Intl Aggressive FoF	2.62%
Prudential Global Value FoF	2.58%
Sanlam Global Equity Fund	2.49%
Nedgroup Inv Global Bal (Sarasin)	2.48%
RMB Private Bank Global Flexible FoF	2.46%
PSG Alphen Foreign Flexible FoF	2.46%
Lynx Global Diversified FoF	1.63%
Sanlam Intl Cautious FoF	1.62%
Sanlam Intl Moderate FoF	1.59%
Select Manager Global Growth FoF	1.53%
FG International Flexible FoF	1.21%
Metropolitan Intl Equity FoF	1.06%
Prescient Global Growth	0.48%
STANLIB Intl Conservative FoF	0.44%
SIM Global Best Ideas Feeder Fund	-0.11%
Allan Gray Orbis Global FoF	-0.20%
Ankh Foreign Flexible FoF	-1.17%
Prescient Global Cautious	-1.46%
Plexus Intl Allrounder FoF	-2.25%

Source: Morningstar
Note: Annualised performance shown in rands. Period since inception in October 2009 to end January 2012 (2 years and 3 months).

Coronation World Equity FoF/Global Opportunities Equity FoF

The Coronation World Equity Fund of Funds is the fund with the longest track record in the range (launched in August 1997), and the only fund of funds. Coronation World Equity is a building block fund for investors who prefer to do their own asset allocation and want a reliable source of alpha in the region of 2% per annum.

The following performance graph illustrates what an excess return of 2% per annum over the last 14 years has meant: For every R100 000 invested in the portfolio at launch, an investor would have earned R100 000 more than those investors who merely invested in the market (MSCI World Index) over the same period. We believe this is a very compelling argument for active management.



Source: Morningstar. Since inception in August 1997. Performance shown for14.5 years.

Coronation Global Emerging Markets Flexible Fund

The Coronation Global Emerging Markets Flexible Fund has been in existence for almost four years (launched in December 2007). Emerging markets, in our view, offer an attractive alternative to growth assets, not only in developed markets but also South African equities and listed property, particularly in discretionary portfolios where there are no restrictions on offshore exposure. In short, we believe that because emerging markets are highly correlated to South Africa it is a good proxy for South African equity exposure, but with a higher expected return profile given the fundamentals of the different markets presently.

In the graph below we compare the fund to its global peer group of (in our view) the top emerging markets managers, predominantly based in Europe, the UK and US. Again, we are very proud to have delivered a top decile outcome against these roughly 50 managers listed below.

Manager	Return
Aberdeen	10.8%
First State	8.6%
Vontobel	8.1%
Coronation GEM	**7.7%**
Oppenheimer	7.7%
AGF	7.3%
Genesis	5.6%
SKAGEN	5.4%
Lazard	4.3%
DFA	4.2%
Arrowstreet	3.9%
Dimensional	3.8%
Baillie Gifford	3.7%
Laudus Mondrian	3.6%
Driehaus	3.5%
UBS (Lux)	3.4%
JPM	3.0%
MSCI	**2.9%**
Carmignac	2.5%
Russell	2.2%
Delaware	2.2%
Comgest Growth	2.1%
Schroder	2.1%
GMO	1.5%
Baring	1.4%
Dreyfus/The Boston Company	1.4%
BlackRock	0.9%
Henderson	0.7%
JP Morgan	0.7%
Capital Intl	0.6%
Harding Loevner	0.5%
Templeton	0.2%
Goldman Sachs	0.1%
Robeco	0.0%
Sarasin	-0.1%
Thames River	-0.2%
Acadian	-0.5%
Morgan Stanley	-0.6%
T Rowe Price	-0.6%
AXA Framlington	-1.0%
Invesco	-1.2%
F&C	-1.8%
Artisan	-1.8%
Martin Currie	-1.9%
Legg Mason Batterymarch	-2.1%
Fidelity	-2.3%
Julius Baer	-2.7%
ING (L)	-2.8%
Alliance Bernstein	-3.4%
HSBC GIF	-3.5%
Pictet	-3.6%
Gartmore	-5.1%
Pioneer	-6.2%

Note: Annualised. To 13 February 2012. Since inception (3.5 year) return p.a. in US dollars shown for the offshore Global Emerging Markets Fund

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