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The Coronation Fund Managers Personal Investments Quarterly

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CORONATION
FUND MANAGERS

Coronation client charter

We strive to always put our clients first
We have an unwavering commitment to the long term
We focus on producing top performance over all meaningful periods
We are uncompromising about ethics

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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, above all, strong investment performance.*

'That's great, it starts with an earthquake, birds and snakes, an aeroplane and Lenny Bruce is not afraid. Eye of a hurricane, listen to yourself churn – world serves its own needs, dummy serve your own needs.

It's the end of the world as we know it
It's the end of the world as we know it
It's the end of the world as we know it and I feel fine'
R.E.M., from the album Document, 1987

The inevitable period of reflection at the start of a new year led me to R.E.M.'s dreamscape inspired song that was a regular party favourite in my student days. The song was written in a stream of consciousness style, inspired by Michael Stipe's late nights spent half dozing in front of the then still fairly new phenomenon of 24-hour news channels. Since then the news cycle has continued to accelerate, making it even easier to get sucked into the daily maelstrom of bad news, and much more difficult to keep a proper perspective. When the outlook is especially uncertain and the events of the day even more dispiriting, it is tempting to want to retreat to the sidelines and wait for things to improve. This will unfortunately, in all likelihood, lead to the destruction of wealth in the long run as most investors will be unable to successfully outsmart the markets through their timing decisions. The challenge is therefore, in R.E.M's lyrics, to be content with things as they are; which is much easier to do if we plan our affairs accordingly.

This theme informs much of the content in this quarter's issue. We provide some pointers to assist in checking whether your investment plan is still on track on page 7. The key message is that a sound planning framework makes it easier to achieve desirable outcomes, especially in an environment that makes it necessary to save significantly more to achieve outcomes similar to those that we have become accustomed to over the last 10 to 15 years. It is not all doom and gloom though, with silver linings to be found in reasonably valued investment opportunities across the globe as highlighted in many of the articles.

For financial markets, 2011 was a muted year hallmarked by 'trendless volatility' as explained by Tony Gibson on page 16. The ALSI returned only 2.6% and cash barely beat inflation with 5.8%. Foreign equities managed a decent (rand) return of around 16%, albeit only as a result of the rand declining by more than 20% against the US dollar. Against this backdrop, we are relatively happy with the returns produced by our flagship funds, which all achieved above average returns in their respective peer groups, and most outperforming their benchmarks for the year. This leaves their longer-term track records intact, with all five local flagship funds delivering first quartile results since their respective inception dates and, where relevant, over the last five years. Top 20 and Balanced Plus produced the best available returns over the last five years in the general equity and prudential variable equity categories respectively.

Our international funds continue to build decent track records, and in line with our expectations performed significantly better than their local counterparts over the past 12 months. While the South African-biased Balanced Plus Fund returned 7% in 2011, Global Managed delivered more than 20%. Despite this rand weakness induced outperformance, we believe that relative valuations are still at levels that will support global equities outperforming local equities for the next several years. As a result, we continue to hold close to the maximum 25% offshore allocation in our asset allocation funds (Balanced Defensive, Capital Plus and Balanced Plus). If you are saving for retirement or drawing an income from your portfolio, we have implemented this view on your behalf. However, investors with multiple decade investment horizons and/or large discretionary investments may still want to consider investing a larger share of their portfolios in offshore assets than allowed by retirement investment restrictions. At the time of going to press, the South African Reserve Bank announced that it is no longer necessary to obtain a tax clearance certificate on the first R1 million taken offshore annually, making it even easier to diversify your holdings by externalising rands into a foreign fund.

MARKET DATA

MARKET MOVEMENTS

Economic group	Qtr 4 2011 %	2011 %
All Share Index R	8.4	2.6
All Share Index $	8.7	(15.9)
All Bond R	3.5	8.8
All Bond $	3.8	(10.7)
Cash R	1.4	5.8
Resources Index R	7.3	(6.5)
Financial Index R	8.7	7.4
Industrial Index R	9.2	9.2
MSCI World $	7.7	(5.0)
S&P 500 $	11.8	2.1
Nasdaq $	6.8	1.9
MSCI Pacific $	(0.3)	(13.6)
Dow Jones EURO Stoxx 50 $	3.3	(16.9)

KEY ECONOMIC DATA: HISTORY AND FORECAST

	2008a %	2009a %	2010a %	2011a/e %	2012f %
HCE	2.2	(1.6)	3.7	4.9	3.5
GCE	4.5	4.7	4.9	4.1	4.2
GFCF	13.3	(3.2)	(1.6)	4.3	3.1
GDP	3.6	(1.5)	2.9	3.2	3.0
Current a/c % of GDP	(7.1)	(4.0)	(2.8)	(3.5)	(4.2)
CPI	11.5	7.1	4.3	5.0	6.4
Prime rate (year-end)	15.0	10.5	9.0	9.0	10.0
R/$ year-end	9.92	7.48	6.81	8.19	8.50
R/EUR year-end	13.44	10.89	9.00	10.76	10.80

Macro fatigue, anyone?

by **KARL LEINBERGER**

***KARL LEINBERGER** is CIO and a member of the executive committee. He joined Coronation in 2000 as an equity analyst, was made head of research in 2005 and appointed CIO in May 2008. Karl co-manages the Coronation Houseview portfolios.*

The global economic outlook is clearly pretty grim. Most developed economies face the prospect of a prolonged period of stagnation. We also think the risk of inflation is high. If we are right (sometimes in life you pray you are wrong!), then we all face the daunting prospect of allocating capital in a stagflationary environment.

The crisis in Europe is very much an 'after-shock' from the 2008 financial crisis. In 2009 policymakers threw unprecedented fiscal and monetary stimulus at the problem. In so doing they pulled the global economy back from the abyss. But they did not succeed in reducing total leverage in the system. In bailing out an over-indebted private sector, all they succeeded in doing was to buy some time and shift the debt burden from the private sector to the public sector. Today, the governments of most OECD countries are over-indebted. Massive fiscal deficits are keeping economies ticking over, but doing little to kick-start growth. The flaws in the European Union, described by a sage observer in the 1990s as a burning house with the fire exits locked, have been brutally exposed. And finally, as politicians have dithered, the crisis has spread from the embattled periphery to Italy and Spain.

Not uplifting stuff for investors. And this is after four gruelling years in what has been the most volatile period in market history.

We expect the macro-environment to remain challenging and markets to remain volatile.

But it's not all bad news. I see three things to be positive about:

1. *The news is out.* Most of the bad news and challenges we face have been well flagged, are essentially well understood, and feature in the media headlines on a daily basis.

2. *Out of this crisis will come the structural reforms we so desperately need.* As a sceptical investor, I am sorry to say that I have no faith in my fellow man. I believe that it is only in times of crisis, when there are no other alternatives that politicians can be relied upon to enact the deeply-needed structural reforms that are in all of our long-term interests. Smaller and leaner governments, a sounder and more sustainable European Union, more appropriate retirement ages, better capitalised banking systems and more sustainable entitlement programmes will come out of this crisis and be the foundations for the next upcycle.

3. *Bad news usually produces low prices.* As an investor one needs to be ready for when bad news provides an investment opportunity. As Warren Buffet says, in this game you need to be greedy when others are fearful.

The obvious question for the long-term investor then is: to what extent is the bad news discounted in asset prices? In our opinion, there is not a lot of symmetry out there.

Global Equities are attractively priced with many blue chips trading on 12 – 14 PE multiples and 3% – 4% dividend yields. A decade ago the outlook was good, stock prices were high and investors paid heavily for that, enduring a full decade of virtually no return. Today, bad news has produced low prices. This is always fertile ground for the long-term investor.

Global Bonds are overvalued. At 2% – 3% yields, government bonds present an asymmetrical payoff, in our view. Limited upside with the prospect of heavy losses should any of the following scenarios come to pass: higher inflation; any normalisation in short rates from current crisis levels, or finally any kind of a meaningful economic recovery. In general, credit is also keenly priced as a global search for yield has driven down credit spreads. The one exception to this is high quality financial sector credits that have collapsed as the European banking crisis has intensified.

Global Property offers opportunity. Yields are now at mid-to high-single digits throughout Europe, Asia and Australia and this asset class is one of the best priced inflation hedges available today.

Dollar Cash as an asset class is often overlooked. Crisis-level interest rates and attractive valuations elsewhere argue against a high allocation, but we think that a healthy allocation makes sense nonetheless given the risks in the system. Global equities are up substantially from the financial crisis lows and we think one should keep some powder dry should equity markets again provide an opportunity similar to that of the first quarter 2009.

Local Equities on the other hand, are trading close to fair value. The All Share Index is virtually at its all-time high and many domestic consumer-facing stocks are trading at all-time high ratings. For the biggest building block in a balanced portfolio, this is not a time to be brave.

Local Bonds are overvalued in our opinion. They are anchoring off 30-year low short rates and have been flattered by a desperate global search for yield, sparked by zero cash returns in the world's major cash markets. In addition to this our concerns about inflation are even more marked in South Africa than they are offshore.

In conclusion, we do not expect the world's problems to disappear and we do not expect markets to be any less testing than they have been since the onset of the financial crisis almost four years ago. But we do expect opportunity. Volatility, emotion and newsflow: these are the friends of the long-term investor.

Taking stock of your portfolio

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, above all, strong investment performance.

We associate the start of a new year with reform, fresh starts and the revisiting of our personal goals. While the short-term bias inherent in all of us makes it difficult to stick to lifestyle-oriented resolutions, just a little bit of effort once a year can make a huge difference to enhancing the outcomes from your investment portfolio. In this article, we have posed some questions for you to ponder that will hopefully inspire you to look after your own money better.

Some important assumptions underpin the information set out below – all of which we have detailed in previous issues. In summary they are:

- All local asset classes produced significantly above average rates of return over the past 10 to 15 years. We do not expect this to be repeated in the current decade.
- Offshore assets, especially international equities, were the worst performing asset class over the last decade, disappointing many investors. However, we believe that this is currently the asset class offering the most value to a patient long-term investor.
- The outlook for the world economy remains subdued as many countries work through a painful, drawn-out balance sheet recession. This requires austerity (higher taxes, lower benefits) and depresses confidence, investment and consumer spending. The need to deal with the developed world's debt problems will keep interest rates below average for an extended period and may eventually fuel higher inflation.

Taken together, this means that a low double digit annual average return from an asset allocation fund – such as Coronation Balanced Plus – will be a great outcome over the next decade, compared to an annualised return of more than 15% over the past decade. If you compound at 11% rather than 15%, your final capital value will be 30% less after 10 years.

Do you know what you want to achieve?

It is very difficult to assess whether you are investing successfully if you have not given careful thought to what you want to achieve. The most important elements required to setting an appropriate investment framework are to define your objectives and time horizon(s), and understand your ability to take risk – then stick to it. A long-term perspective is the best defence against suboptimal investment decisions. You may find it useful to split your portfolio into multiple buckets defined by time horizon, as this is the most important determinant of the level of risk that you can take. To illustrate the point, let's look at two examples.

If you are around 45 or younger and employed, you are likely to be most concerned with optimising the value of your portfolio for retirement in 15 – 30 years' time. With time on your side you can take on more risk in the quest to optimise returns. This allows you to own more of the growth assets that currently offer the best expected returns over time, as you are able to stomach any short-term market fluctuations. Currently, we believe that selected international equities present the best 10-year plus growth opportunities. These assets can be accessed through funds such as Coronation Global Managed and Coronation Optimum Growth. You may also have a shorter-term objective, such as accumulating a deposit for a new home in two or three years' time. For this part of your portfolio, it does not make sense to take on too much risk. In this case, funds which emphasise short-term capital preservation – such as Coronation Strategic Income and Coronation Balanced Defensive – would be more appropriate.

For those who are 65 and depend on your investment portfolio as a primary source of income, your objectives are a little more complex. You need to balance a current income with long-term growth that will protect your purchasing power in the second half of retirement. To meet these objectives, you need a portfolio that can still keep pace with inflation and provide protection against short-term capital losses. This can best be achieved in a fund that balances growth assets and income assets while retaining a strong focus on capital preservation, such as Coronation Capital Plus.

Are you dealing with uncertainty appropriately?

The year 2011 confirmed that the world is not in a good state of health. This was reflected in fairly mediocre returns produced by most asset classes, and there is not much reason to think that 2012 will be much better. All the major intractables remain, especially the developed world's sovereign debt problems compounded by decidedly underwhelming politicians. And it may get worse. The BRICs' continued super-growth may finally start to slow down, the economic recovery in the US may underwhelm and the European debt crisis may not be resolved in an orderly fashion. In addition, 2012 will bring its own market-rattling events equivalent to last year's Japanese triple scare (earthquake, tsunami and nuclear meltdown) and popular protests against the status quo from Algiers, Egypt and Damascus through Athens, Madrid and Santiago, to New York and London all the way to Moscow.

A focus on all this negative newsflow makes it much easier to make poor investment decisions. Arguably the easiest way to destroy value is to make big 'risk on/risk off' switches informed by the current mood of the markets. Moving everything into growth assets as soon as there's a bit of positive news or switching all your assets into cash at the hint of negativity is in most cases a sure way to lose money – inevitably resulting in buying high or selling low. Part of the problem is that the market rarely moves in a straight line – today's despair-induced losses are often followed by tomorrow's hopeful gains.

For most people poor timing decisions can be avoided by setting clear objectives, buying appropriate asset allocation funds and finding a trusted adviser with whom to discuss investment decisions. It is important to remember that one of the few investment certainties in an uncertain world is that market declines are inevitable. Unfortunately, no one has ever been able to call market declines or recoveries consistently. But that is no reason to despair – the best opportunity to acquire quality assets below their long-term fair value is most often when sentiment is at its most negative.

And this leads us into the next point – make sure you are invested in the right mandate managed by the right manager, then stick with it.

Do you own the right mix of assets?

Investment is not speculation. Your goal is to consistently accumulate returns rather than hit a string of successive sixes. This is best achieved by carefully considering your needs before attempting to decide on the right fund/s. If you do enough homework to give you conviction, it is a lot easier to commit for the long term. Investing in asset allocation funds with clear objectives that are aligned to your personal goals is a very efficient way to implement an appropriate investment strategy, as long as you are comfortable to rely on your investment manager to make most day-to-day decisions on your behalf. (Review the objectives of our flagship range on page 26).

How tax-efficient is your portfolio?

The following considerations should be taken into account when optimising your portfolio for tax:

- **Capital gains and dividends are more tax-efficient than interest or rental income.**
  Investors can earn a return in the form of income (interest, rental income or dividends) or capital gains. Income and rental income are taxed as part of normal taxable income. For most investors with a regular source

of income, this means tax at the maximum marginal rate of 40% (at the time of writing) on these forms of investment income. Dividends are taxed at a lower rate of 10% because the company declaring the dividend has already paid company tax on the profits which made the dividends possible. Capital gains are also currently taxed at 10%.

From a tax perspective, it is more efficient to receive dividends and capital than interest or rental income. Table 1 indicates how funds with more equity exposure (Coronation Balanced Plus and Coronation Capital Plus) – where dividends and capital gains represent a larger component of the total return – have historically been significantly more tax-efficient than a fund investing primarily in fixed income and property assets such as Coronation Strategic Income. Note that this is not an argument to only be invested in equity assets – the asset allocation decision should primarily be driven by your risk profile and time horizon as previously mentioned.

TABLE 1

Fund	Typical equity exposure	Before tax	After tax	Gross return converted
Balanced Plus	65%-75%	15.8	14.8	94%
Capital Plus	40%-45%	13.6	12.5	92%
Strategic Income	<5%	10.7	7.3	68%

Note: The calculations above assume an individual taxpayer paying the maximum marginal rate of 40% and does not take into account the general interest rate exemption (R22 800 at the time of writing). If the latter is taken into account, an investment of up to R350 000 in Coronation Strategic Income (assuming a yield of 6.5%) will achieve similar tax efficiency to the two asset allocation funds listed above.

- **Frequent switching between funds reduces the tax-efficiency of your portfolio.**

  Investing in a unit trust is relatively tax-efficient, especially if you hold your investment in the same fund/s for the duration of your investment horizon. In this scenario, the payment of capital gains tax (CGT) is deferred to the end of your investment horizon. Table 2 compares the before and after tax outcomes for two investors earning a before tax return consisting only of price appreciation (i.e. capital gains) of 8% p.a. over their 10-year investment horizon. The first investor remains in one fund throughout the 10 years and therefore only pays CGT at the end of the 10-year term. The second investor switches to a new fund at the end of every year, pays the CGT due and reinvests the balance. This calculation indicates that investor one, by deferring CGT, increased the final value of his portfolio by 7%. It should also be noted that frequent switching may lead to you being deemed a speculator rather than an investor. In this case you will pay the higher income tax rate on your gains.

TABLE 2

	Before tax return	Investor 1 After tax, no switches	Investor 2 After tax, 1 switch per year
	100.0	100.0	100.0
Year 1	108.0	108.0	107.2
Year 2	116.6	116.6	114.8
Year 3	126.0	126.0	122.9
Year 4	136.0	136.0	131.4
Year 5	146.9	146.9	140.4
Year 6	158.7	158.7	149.8
Year 7	171.4	171.4	159.6
Year 8	185.1	185.1	169.8
Year 9	199.9	199.9	180.4
Year 10	215.9	204.3	191.3
Decline in final value as a result of tax		11.6	24.6
Tax efficiency ratio		95%	89%

Assumptions:
The full 8% return is earned consistently in the form of capital gains only.
The effective CGT rate for individuals paying maximum marginal rate (10%) has been used.
The calculation assumes that tax rates will remain unchanged for the duration of the investment. The efficiency ratio equals after tax return divided by before tax return.
No primary CGT allowance is taken into account.

- **Product wrappers (retirement annuities, living annuities, preservation funds and endowments) can increase the tax-efficiency of your investment.**

  When you invest in a retirement savings vehicle (such as a retirement annuity), you obtain two tax advantages at the cost of restricted liquidity. Your investment (up to a limit set by government, currently 15% of earnings) is deductible from tax in the current year. You also do not pay any taxes on income earned within the fund, and CGT is not applicable to your investment. You will eventually pay normal income tax on the pension withdrawn from your retirement savings, but this will in many cases be at a lower marginal rate than applicable while still employed. The deferment also enables your money to grow faster, as you get additional compounding benefits on the portion of the portfolio that would otherwise have been taxed.

Are you saving enough?

Lower expected returns unfortunately mean that you need to commit more capital to achieve the same outcomes. At a 15% annual rate of return, nominal capital doubles roughly every five years, while it will take six and a half years for capital to double at a rate of return of 11%. The real world impact of this is significant. If you invest R10 000 for 30 years and earn 15% p.a., your final capital value will exceed R660 000; if your rate of return drops to 11%, your final value will be R229 000 which is just more than a third of the former value. The implication of this is that it is probably necessary to increase savings rates by 3% – 4% of income to achieve a similar level of retirement capital than would have been available in a higher return environment.

Another way to contextualise this question is to consider the amount of capital required at retirement to purchase a sustainable income that can keep pace with inflation. Historically, around 15 times of the required pre-tax income level was typically quoted as a rule of thumb for someone retiring at 65 in reasonable health. This multiple implies a sustainable income withdrawal rate of around 7%. Given our more muted outlook for returns and the likelihood that inflation may be somewhat higher, we think that an initial income withdrawal rate of 5% is more appropriate. This implies that you would require around 20 times your required income level in retirement capital, or 25% more than the 'old normal' rule of thumb.

Do you have access to good advice?

If some of these questions appear daunting, it may mean that you need to consult your financial advisor. It is important that you make the right choices to ensure that your investment plan is still appropriate given the outlook for the markets and your own changing personal needs and circumstances.

Bond outlook

by **MARK LE ROUX**

***MARK LE ROUX** is responsible for the fixed interest investment process and portfolio management functions for both institutional and retail portfolios. Mark has more than 20 years' experience in managing both traditional and alternative portfolios.*

For the local fixed income market, 2011 was characterised by rising inflation, a depreciating currency (the rand lost 22% against the dollar), rocketing food prices and a materially increasing fiscal deficit. Under 'normal' circumstances such a combination would be hugely negative for a bond market, but 2011 was far from normal; concerns over global growth continued, global bond yields plunged (US 10-year now below 2%), worries over the fiscal situation of a number of European countries persisted and the foreign bond investor appetite for yield was heightened by record low domestic short rates. All of which resulted in a decent offset to the fundamental negative backdrop for bonds.

The bond market performed largely in line with its yield to maturity (YTM) for the year. The long dated benchmark government bond (R186 2026 maturity) started at a YTM of 8.30% and ended slightly weaker at 8.47%. The All Bond Index recorded 8.80% for the year, with the star performer being the shorter dated R203 (2017 maturity) at 10.80%, and the ultra long dated R209 (2036 maturity) the worst performer with a return of only 2.70%.

Inflation-linked bonds (ILBs) performed strongly, with the index returning 13% for 2011. The five-year government ILBs produced the top return of 16.5%. For the first time in South African history the very short dated ILBs saw their real yields decline into negative territory (R189 2013 maturity declined to -0.15% real yield). This was driven by the sharp increase in demand for inflation protection as headline inflation breached the upper end of the South African Reserve Bank's (SARB) target range and short rates on money market instruments now in negative real territory.

Themes and expectations for 2012

Inflation

We expect inflation to remain elevated and above the 6% upper end of the target range during the course of 2012. The main drivers of this are food prices and the depreciation in the currency. The maize price again made new highs in December 2011, with this very important soft commodity's year-on-year rate of change now running at 99%.

SAFEX WHITE MAIZE PRICE % YEAR-ON-YEAR

Source: I-Net Bridge

Short rates

The next move in short rates, we believe, will be upwards. However, given the recent relatively dovish stance of the Monetary Policy Committee, this will most likely only take place in the second half of the year. With a repo rate at 5.50% and inflation (in our view) averaging above 6%, negative real returns can be expected in money market assets.

Yield curve

Government needs to borrow in excess of R150 billion from the bond market to fund the budget deficit in the new fiscal year. This is a sizeable issuance for the market to absorb and is likely to place upward pressure on bond yields during the course of the year, especially at the back end of the curve where most of the issuance is expected to take place. With the SARB trying to keep short rates unchanged for as long as possible, this may result in the yield curve continuing to steepen in the early part of the year. However, as soon as the first rate hike is signalled and believed by the market, the yield curve should flatten quite quickly.

Looking forward

Global government bond yields at below 2% are unsustainable. A sell-off in global bonds would be a major risk to our bond market, particularly when combined with the large funding overhang that we face this year. In addition, any delay by the SARB to take action against the rising inflation trend could have major ramifications for the local bond market – the longer they wait the more entrenched higher inflation expectations become.

Across our bond portfolios, we continue to run lower than benchmark duration positions coupled with a holding in inflation-linked bonds.

US GOVERNMENT 10-YEAR BOND

Source: I-Net Bridge

Equity market update

Global equities discounting some probability of a global downturn

by **QUINTON IVAN**

***QUINTON IVAN** joined Coronation in April 2005 as an equity analyst. He currently analyses retail, construction and pharmaceutical stocks. Quinton co-manages the Coronation Equity and Industrial funds as well as the Houseview portfolios.*

The past year was characterised by periods of extreme volatility. In the first half financial markets had to digest the implications of the political unrest in North Africa and the Middle East as well as a devastating earthquake and risk of possible nuclear meltdown in Japan. The second half was dominated by continued political wrangling which saw policymakers fail to resolve the ongoing euro crisis. This fuelled uncertainty as global investors reduced exposure to growth assets.

The global economy and financial system remain unbalanced and are being distorted by unprecedented monetary and fiscal stimulus. The precarious state of the global economy has a bearing on market sentiment. In volatile times, emotion often trumps reason resulting in investors mispricing assets. As a valuation-driven, bottom-up stock-picker, Coronation remains resolute in its philosophy of investing for the long term. While this may result in periods of short-term relative underperformance, we believe it will produce superior returns for our clients over the long term.

Given the current global and domestic economic outlook, equities remain our preferred asset class for producing inflation-beating returns. Following the panic that consumed markets in the third quarter of 2011, equity markets recovered in the final quarter, which created the opportunity to reduce exposure to what we consider to be a neutral equity exposure. The All Share Index is currently very near to an all-time high and is certainly not pricing in a sharp correction in the global economy. This coupled with our view that domestic equities are fairly valued does not justify higher exposure. Global equities on the other hand are discounting some probability of a global downturn. Domestic equities have outperformed global equities significantly over the last decade (15.1% p.a. for the All Share Index versus 0.1% p.a. for global equities in rand terms). We remain of the view that global equities are far more attractively valued than domestic equities. This view was vindicated in 2011 with the MSCI World Index (in rand terms) comfortably outperforming the All Share Index by 13.2% for the year (15.8% for the MSCI World Index versus 2.6% for the All Share Index). Our domestic balanced funds remained close to their 25% offshore limit for the duration of the year.

After a prolonged period of strength, the rand (together with other emerging market currencies) experienced a sharp sell-off towards the end of the third quarter. Given our long-held view that the currency was overvalued, our rand hedge investments such as MTN, SABMiller and British American Tobacco contributed to overall equity performance. We continue to favour global businesses that happen to be listed in South Africa. They remain attractively valued relative to pure domestic businesses and are diversified across numerous geographies and currencies. At the end of 2011, approximately 63% of our equity portfolios were invested in rand hedge counters.

The All Share Index returned 8.4% for the quarter. Industrials were the best performer with a 9.2% return. Financials returned 8.7% and resources lagged with a 7.3% return. Resource stocks have now underperformed financials and industrials over a three-year period. Having remained underweight resources for most of the year, we moved slightly overweight in our equity and balanced funds during the quarter. Although most commodity prices remain high, we believe that resources currently offer value, with selected resource shares trading at less than 10 times our assessment of normal earnings. The great imponderable impacting commodity prices and therefore the valuations of resource shares remains demand from China. China has been the single largest consumer of commodities, responsible for, on average, approximately 40% of global demand for most commodities (and even higher in the case of iron ore where China constitutes 60% of global demand). The Chinese economy is extremely unbalanced having been driven by significant investment in infrastructure and very little domestic consumption. The country is also in the process of attempting to cool an overheated property market. Any Chinese hard landing will have dire ramifications for commodity prices and consequently, the pricing of resource shares. It is for this reason that we remain only marginally overweight. Our preferred resource holdings are Sasol, the diversified miners (specifically Anglo American) and Mondi Limited (see the article overleaf). We remain underweight gold shares as we believe they are over-valued based on our assessment of normal earnings. We are also concerned over declining grades and enormous cost pressures faced by these businesses (labour, electricity and water).

Banks returned 7.8% for the quarter, underperforming other financials. Banks have been very poor performers; however, we continue to hold our overweight position on the basis that valuations are attractive at nine times our assessment of normal earnings and price-to-book ratios of 1.7 times. We believe earnings are low as a result of low net interest margins and high bad debts. This, coupled with a low rating, represent a highly attractive investment proposition.

In contrast, we remain concerned over the earnings base for the average industrial company, especially consumer-facing businesses. These businesses have benefitted from significant tailwinds such as falling inflation, declining interest rates, an emerging middle class and significant social grants. These benefits are in the base, which will make it challenging for these businesses to defend and grow off their current earnings. Consequently, we own very little retailers, other than Woolworths and Mr Price and remain defensively positioned. We continue to find value in selected small caps.

It remains our view that the global economy will face an extremely difficult period in the years ahead. The investment environment is therefore likely to remain volatile and challenging for the foreseeable future. However, global equities discount many of these concerns and we believe offer good value. In an environment fraught with uncertainty, we remain focused on investing for the long term.

Mondi

A highly attractive investment case

by **DUANE CABLE**

***DUANE CABLE** joined Coronation in July 2006 as an investment analyst focusing on the resources sector. His current research responsibilities include paper and packaging, gold, steel and various companies within the industrial sector. Duane is the co-manager of the Coronation Resources Fund.*

'The best-performing stocks are not in industries that are at the cutting edge of the technological revolution, rather they are often in industries that are stagnant or in decline. These firms are headed by managements that find and pursue efficiencies and develop competitive niches that enable them to reach commanding positions no matter what industry they are in. Firms with these characteristics, which are often undervalued by the market, are the ones that investors should want to buy.' Jeremy Siegel

We have a material position in Mondi across client portfolios and it is one of our highest conviction ideas at present. Mondi is an integrated paper and packaging producer with key operations located in Central Europe, Russia and South Africa. Although the paper and packaging sector is not particularly cutting edge, we believe that Mondi is an asset displaying the characteristics quoted by Jeremy Siegel and presents a great investment opportunity for long-term investors.

History

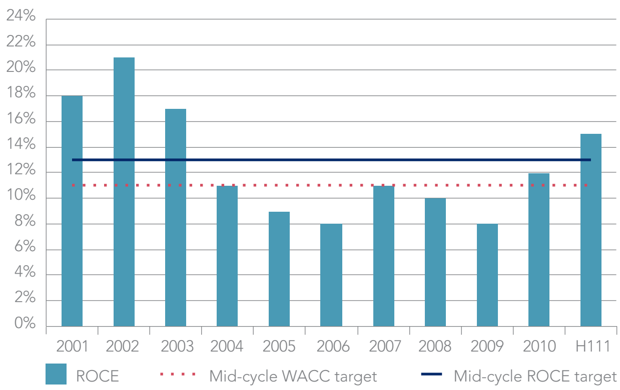
The roots of Mondi were first planted in South Africa in 1967 when its former owners, Anglo American, built the Merebank Mill. Following more than two decades of growth and consolidation in South Africa, Mondi entered Europe in the early 1990s to pursue expansion through acquisition. Over a long period of time Mondi acquired businesses in Austria, the UK, France, Russia, Slovakia, Poland, Hungary, Denmark, the Netherlands, Bulgaria and Italy.

It is interesting to note that Tony Trahar, former Group CEO of Anglo American was in fact CEO of Mondi prior to handing over the reins to current Mondi CEO David Hathorn in 2000. In 2002 Mondi was the biggest division within Anglo American based on contribution to headline earnings, and between 2001 and 2003 was a top three contributor to headline earnings from a total of nine operating divisions within Anglo American. In the period between 2004 and 2006 markets for paper and packaging products were challenging, characterised by production overcapacity and moderate demand growth. For European producers, the situation was exacerbated by the significant weakening of the US dollar against the euro, which reduced euro revenue generated from exports and encouraged competition from importers. In 2007, after a very difficult period for Mondi, Anglo American decided it was no longer a core asset and should be unbundled to shareholders. Given the improved outlook for the business it appeared to be the perfect time for a separate listing; unfortunately the global financial crisis put a premature end to the anticipated recovery in earnings. Mondi listed in July 2007 at R65, peaked at R70 in April 2008, and thereafter pretty much fell in a straight line to bottom at R17.51 by March 2009, trading at 40% of tangible book value.

Mondi is currently trading at R59, only 18% below its peak of R72 reached in July 2011. Why are we still big holders of Mondi going into another period of global economic uncertainty – which many market commentators are comparing to the 2008 global financial crisis? The simple answer is that we believe the intrinsic valuation of Mondi to be materially above the current share price, and short-term macro-economic uncertainty has to some extent already been reflected in the current share price. While it is understandable that many investors are fleeing risky assets in these uncertain times, particularly those with exposure to Europe, we strongly disagree with the view that the risk to

Mondi in the current scenario is comparable to that of 2008. Today, Mondi is stronger from both a financial and asset mix perspective. Going into the crisis the company was at the start of a three-year €850 million investment programme in two growth projects in Poland and Russia. Both these projects are now complete and shareholders will start to reap the benefits of these high-return investments made in the down-cycle. In addition, Mondi permanently closed a material proportion of its high cost capacity during the crisis, which further improved its cost position and industry demand/supply fundamentals. The balance sheet is now significantly stronger and with no major capital expenditure planned, free cash flow generation going forward is likely to be materially above historical levels. Overall, the industry is in better shape with inventory volumes generally lower and permanent capacity closures made during the crisis having improved industry demand/supply fundamentals.

CHART 1: HISTORICAL RETURN ON CAPITAL EMPLOYED (ROCE) COMPARED TO MID-CYCLE ROCE AND WEIGHTED AVERAGE COST OF CAPITAL (WACC) TARGETS



Source: Company reports

Investment case

Some of the highlights which attract us to the Mondi business model are:

- Leading market position across key paper and packaging grades to which it is exposed.
- Generally one of the lowest cost producers in the industry, allowing it to generate superior returns relative to competitors. Mondi has generated return on capital employed (ROCE) almost double that of its listed peers through the cycle.
- Mondi has also been able to deliver ROCE above its weighted average cost of capital (WACC) through the cycle (refer to Chart 1), which many of its peers have been unable to achieve.
- A highly-rated management team. The culture of the group is one of continuous productivity improvements and a relentless focus on cost control. Their uncompromising focus on generating adequate returns on invested capital through the cycle will ultimately reward long-term shareholders.
- Management is aligned with shareholders and have a material proportion of their own wealth invested in Mondi shares. At current prices, the three executive directors' personal shares are worth almost R100 million, excluding unvested long-term incentive shares. We like it when a management team has skin in the game.
- Mondi is exposed to faster growing emerging markets rather than developed markets like many of its peers.
- The company has a more defensive product mix, i.e. office printing paper and packaging, which is less exposed to the secular shift to electronic media that is impacting graphic paper grades like coated paper.
- Having come to the end of a period of heavy investment in growing the business, ongoing capital expenditure is likely to return to more normal levels. We estimate this to be around 60% to 80% of depreciation, compared to 150% over the last seven years, which allows for significantly increased free cash flow generation.

In our assessment, Mondi is trading at six times our assessment of normalised free cash flow, which we find extremely attractive. At current prices one is buying Mondi at book value. This means that the market assumes Mondi will not deliver returns in excess of their WACC through the cycle, which, as illustrated in Chart 1, has not been the case historically. Looking at consensus earnings for 2012 (already cut 35% over the last six months), Mondi is trading on a nine times PE and a 5.2% dividend yield to December

2012. The combination of a low earnings multiple on low earnings (free cash flow multiple even lower), definitely ticks the right valuation boxes, and as an added bonus you get an attractive forward dividend yield. One of management's priorities for improved free cash flow generation going forward is increased shareholder distributions. The likelihood of either a special dividend or share buybacks over the next two years is therefore extremely high.

The investment case for Mondi is certainly not without risk. However, we believe investors are to some extent cushioned by the large margin of safety to our assessment of intrinsic value. The two primary concerns in the market currently are the macro-economic uncertainty and risk to near term earnings, and concerns that management might make a value destructive acquisition. The latter, we are less concerned about given management's excellent track record in building the company through value enhancing acquisitions. The clouds on the economic front are certainly dark, but in the words of Warren Buffett: *'the future is never clear, and you pay a very high price in the stock market for a cheery consensus. Uncertainty is the friend of the buyer of long-term values.'*

International outlook

When will the trendless volatility end?

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 Coronation Global Equity Alternative Strategy Fund since launch in 1996.*

As 2011 drew to a close it certainly felt as if the trend for the year was a pretty dire bear market; such was the ongoing arrival of negative news – especially out of Europe. In reality, the outcome for 2011 – from an equity index point of view – was fairly benign, with equity markets in aggregate falling by a relatively small amount for the year. Unfortunately, the most noticeable upward trend was that of volatility. Even though US stocks were flat for the last three months of 2011, the average daily move in the S&P 500 Index was 1.6%. A level normally only seen during crises. In the history of the S&P 500, there has never been a day when all 500 names were either positive or negative. However, on just eleven days in its 55-year history have 490+ stocks been either positive or negative. Six of those eleven days occurred since July 2011. This trendless volatility was of course a consequence of the fears in relation to sovereign debts in Europe, and the resultant risks to the global financial system. It would be easy to dismiss the extreme volatility experienced during 2011 as irrational, but the current liquidity concerns are very real. The recent statements from the governor of the Bank of England indicating that the situation is 'extraordinarily dangerous' should not be dismissed as unnecessary hyperbole. Recent events in Europe have been extraordinary; not just due to the severity of the situation, but also due to the sometimes comical lack of decisiveness from European politicians.

Most commentators – and there is no shortage of them at present – believed that the rescue package agreed in late October looked like a credible solution, which would remove some of the tail risk of a eurozone collapse. However, this was quickly undone by the news that the then Greek Prime Minister planned to call a surprise referendum on whether or not to accept the newly agreed austerity package; thus calling into question the eurozone/IMF rescue package agreed upon just days before. The markets went into shock and risk aversion returned immediately. The Greek government quickly fell and was soon followed by Silvio Berlusconi in Italy; both countries subsequently appointing technocratic replacement governments with the mandate to cut spending and restore health to public finances. This was in turn followed by a change of government in Spain; with the winning party being elected on an unambiguous ticket of severe austerity measures. The gravity of the situation – as illustrated by a sharp increase in the Italian and Spanish bond rates – has elicited continued dramatic responses from both the leading European politicians and global central banks. In late November a co-ordinated action was taken by central banks to reduce near term bank liquidity concerns, while in early December important steps on the road to fiscal union were announced.

There seem to be three overlapping schools of thought regarding the best remedy for the eurozone problems. There are those who think that the European Central Bank (ECB) should be the ultimate guarantor of eurozone debt; using the printing press to achieve this if necessary. Essentially, this is quantitative easing as recently practiced by the US Federal Reserve Bank. Secondly, there are those who think that the profligate southern European countries should get a grip on their irresponsible spending. They – Germany being the most significant – argue that no progress can be made on joint debt guarantees by the ECB until this requirement is first fulfilled. Thirdly, there are those who think that the euro is bound for a bust-up. Their belief is that the euro was an ill-conceived project from the outset, and that its demise is both inevitable and desirable.

The Foreign Minister of Poland put the position of the first school of thought in a powerful article in the Financial Times, stating 'We ask Berlin to admit that it is the biggest beneficiary of current arrangements and that it therefore has the biggest obligation to make them sustainable. Germany is not an innocent victim of others' profligacy. The biggest threat to the security and prosperity of Poland is not terrorism, and is certainly not German tanks, not even Russian missiles. It is the collapse of the eurozone.' He added 'I fear German power less than I fear its inactivity.' This view seems to be in the ascendancy, with the likelihood that Germany, abetted by France, will ultimately allow large scale ECB easing, possibly IMF intervention, in conjunction with austerity packages.

Coronation's view is that thus far all rescue attempts have merely bought more time by dispensing medicine to a sick patient. The inescapable issue is that the rate of unemployment in Spain is 23%, and nearly 50% among 18 to 25 year olds, while in Germany it is 6%. The eurozone's fundamental problem is the 30% gap in competitiveness between the north and south. In the medium term, the only positive outcome is therefore for European policymakers to force the necessary sovereign debt losses to be taken, and for the troubled banking systems to be recapitalised. Only this action, albeit dramatic and painful, will allow the investing world to take Europe off their newspaper headlines.

In the meantime, the good news for investors is that, although there is great disagreement about which is the right scenario, unanimity that the position in Europe is bleak has resulted in this gloom already being reflected in low valuations.

While the investment world remains fixated on the problems in Europe, a more positive trend appears to be emerging on the other side of the Atlantic. The indications are that the US economy is getting back on track. Job prospects are improving, home prices are stabilising, and the US consumers are opening their wallets a bit more freely. More importantly, for the first time during the economic recovery, banks are lending more. After a tentative recovery earlier in 2011, bank credit rose at a 3.9% annual rate in the third quarter and has been accelerating in the fourth quarter. As we know, banks' greater willingness to lend – particularly to job creating small business – is crucial for any improvement in real GDP growth in 2012. Although well short of the high growth levels experienced five years ago, consensus forecasts are for real US GDP growth to accelerate (from 1.7% in 2011) to 2% and 2.6% in 2012 and 2013 respectively.

While fundamentals in the US look solid, the question is whether continued strain in Europe will hamper US corporate profits. Broker forecasts for 2012 are suggesting earnings growth by US companies – based on US fundamentals alone – of around 10%. However, due to anticipated weakness in Europe, these forecasts have been pared back to low single digit increases. It is our opinion that the risks to these forecasts lie to the upside. One reason for this could be if the most dire forecasts for Europe do not materialise. However, an upward revision is more likely to occur due to a positive surprise from the level of economic activity in the US, as domestic growth continues to recover. If so, earnings would come in significantly stronger than expected. In addition, if the outlook for earnings improves or there is more certainty regarding economic outcomes, we would expect valuations to receive a significant lift as improved prospects for 2013 are factored in.

Taking a line through the Coronation World Equity Fund of Funds' performance in 2011, it is clear that this has not been an easy environment for our managers to add alpha. Collectively in fact they have generated negative alpha. We believe that, in time, the present volatility will settle back to historical levels, and investors will intimately assess the value of equities based upon fundamentals – not momentum or the perceived crisis of the hour. We remain optimistic regarding the potential returns from the equities in our portfolios and believe that the value of these companies will eventually be reflected in their stock prices, and accordingly returns will be more consistent with our historical performance.

While we are of the opinion that the current environment presents buying opportunities for the patient investor, we remind ourselves that careful stock selection is needed to identify attractive investment opportunities. Investors cannot ignore the fact that profit margins for companies in the S&P 500 are at or near their historical peaks. Similarly, the business models of many businesses are now under threat – either from technological innovation or new international competition. As a result, the profit margins currently achieved by many leading companies are unsustainable, leading us to conclude that those companies that **do** have robust business models will materially outperform the market average.

It would seem that now, more than ever, extraneous factors are driving short-term market performance. This is often referred to as 'noise' in financial jargon and can include comments from a politician in a European nation, or a rumour regarding the exposure levels of a global financial institution. Fundamental investors attempt to avoid such 'noise' and focus on individual companies within the context of the global economy. Of course, ignoring such short-term manias can result in underperformance over short periods of time. However, attempting to react to and trade based on such events will almost assure long-term underperformance simply due to the trading costs involved. Equity markets are currently rife with shares that are broadly misunderstood by the investment community, and it would appear that the widespread adoption of ETFs is only acting to increase these pricing anomalies. As investors have slowly returned to equity markets after the markets recovered from the crisis of 2008, they have increasingly been utilising ETFs as the preferred vehicle to gain market exposure. The large majority of ETFs are passively managed indexation strategies that attempt to capture broad market returns. Such indices often exclude the best performing shares because of size and/or liquidity constraints. Additionally, there are increasingly focused ETFs that invest in a specific sector or country. For example, an investor can own an ETF of a certain index excluding financials if one were disinclined to own financial companies.

We prefer to invest via active managers, who base their investment decisions on sound, long-term, and proven investment fundamental analysis.

Global emerging markets

by **PIETER HUNDERSMARCK** and **GAVIN JOUBERT**

***PIETER HUNDERSMARCK** joined Coronation in November 2007 as a member of the emerging markets research team. Prior to joining Coronation, he spent two years in Corporate Finance at ABN AMRO bank.*

***GAVIN JOUBERT** is head of the Coronation Global Emerging Markets team and has 14 years' investment experience. He has managed a wide range of South African equity and balanced portfolios and currently co-manages Coronation's range of Global Emerging Market funds.*

China represents the single largest country exposure in the Coronation Global Emerging Markets (GEM) Fund and makes up 32% of the portfolio. We are frequently asked if we are worried about China – specifically about the sustainability of the Chinese economy and whether there is a property bubble. The answer is that both issues do worry us. On the first point we don't believe that the current consumption of commodities by China is sustainable, and as a result we believe that current commodity prices are in many cases unsustainable at current levels (iron ore and copper in particular). This consumption of course, through infrastructure spend, makes up a large part of the Chinese economy and we would therefore naturally expect China's infrastructure spending to moderate. In terms of a property bubble, we do believe that there is a property bubble in certain of the larger cities (Shanghai in particular), but we don't believe that it is a nationwide issue. Partly because of these concerns we don't own any Chinese commodity companies, banks or property companies.

We certainly don't believe that the Chinese economy will continue to grow at 10% p.a., as it has over the past 30 years. However, even an average annual growth rate of 5% to 6% over the next five years would make it one of the healthiest economies in the world, and would provide a nice tailwind for consumer businesses in China. At the same time, we believe that the mix of the Chinese economy over time will shift, with infrastructure and exports becoming smaller and consumption becoming bigger. We also hold the view that in 5 and 10 years' time the average Chinese individual will spend a lot more on cars, clothes and food than he or she does now. Today, China already contributes 40% of the group revenue of KFC (owned by YUM! Brands); more cars are sold in China than in the US (China is Rolls Royce's single largest market); Apple already generates 12% of its revenue from the country and yet only 1% of Chinese mobile subscribers have an Apple iPhone, and the list goes on. The key point is that already the Chinese consumer is a significant force, and it is the Chinese consumer that attracts us. We spend a large amount of time researching Chinese consumer stocks, valuing these businesses and investing in those that are trading well below what we think they are worth.

So while we do have concerns about China, we believe the prospects for many Chinese consumer companies over the next several years are extremely promising. Importantly, we also believe the valuations of a number of Chinese consumer companies are very attractive. Our entire 32% exposure is invested in Chinese consumer companies across a range of very different industries, with the common thread that they all sell goods to consumers in China. We are invested in the second largest local supermarket retailer; a high-end clothing retailer; two car manufacturers (including the only BMW China joint venture); the second largest beer company; three consumer-focused internet companies; a department store; two Macau casino operators; a branded food and beverage company, and a ladies footwear retailer named Daphne.

Daphne

The ability to invest with a long-term time horizon, beyond the noise of the short term where the majority of market participants spend their time, is one of the anchors to our investment philosophy. Because we look out over long time periods we aim to identify and invest in businesses that can survive the test of time – ideally ones that have a leading position in a promising business space, a growing business value, have enduring competitive advantages, a clear strategic focus, a robust balance sheet, and above all an attractive valuation.

Many of these attractive qualities can be found in Daphne. Established in 1987 as a family owned shoe manufacturing company, today it is the market leader in affordable branded ladies fashion shoes in China, with 4 000 outlets under its *Daphne* brand and 1 300 outlets under its *Shoebox* brand. Unlike other Chinese-listed companies that focus on mid- to high-end footwear, Daphne competes in the mass-market segment with its *Daphne* brand (72% of sales and 84% of operating profit (EBIT)) and the low-end family segment with its *Shoebox* brand (21% of sales and 18% of EBIT). Today the company is still controlled by the original founding family.

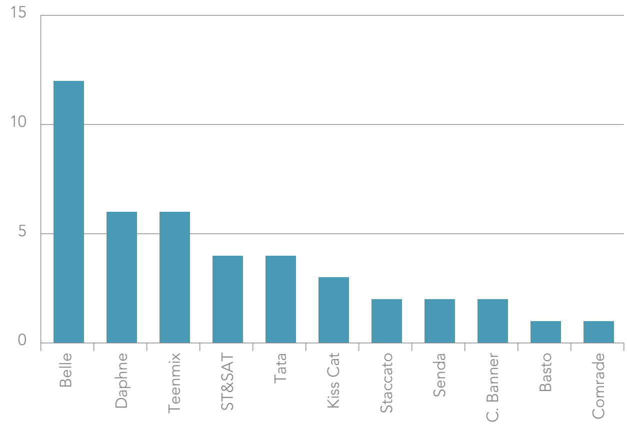
The size of the business opportunity facing Daphne is significant. In 2010, Daphne sold about 26 million pairs of shoes. Assuming no repeat purchases by the same customers, Daphne is presently only serving 26 million customers, or about 8% of the total addressable urban Chinese female population (of about 300 million). More importantly, it is highly likely that its target market (young, middle class working women) will buy more than one pair of shoes a year. As such, Daphne is still only scratching the surface of arguably the largest shoe market in the world.

Daphne's competitive position within the shoe market is strong. It owns two powerful brands – the *Daphne* brand is ranked no. 2 by market share and *Shoebox* is no. 1 in the lower income category. Daphne's competitive arena is highly fragmented, and consists mainly of unbranded and/or unlisted regional players with presence in either mid- or high-tier cities. Daphne has extensive nationwide coverage of cities from tier 1 all the way through to tier 6 cities. By casting its net wide, Daphne has gained first move advantage into the lowest-tier cities where there are few mass market aspirational brands.

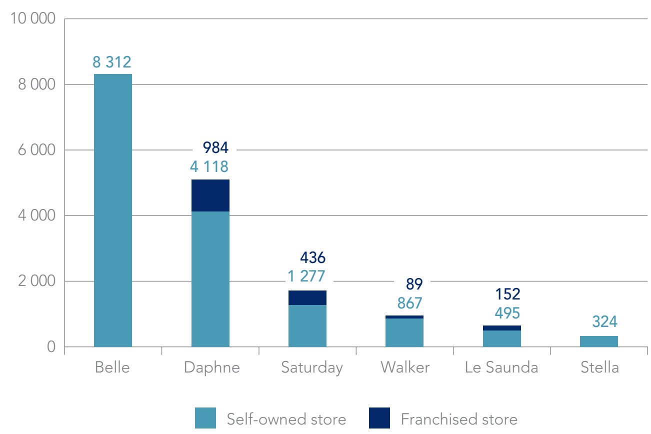
Daphne produces the vast majority of products at its own manufacturing facilities, from where they are shipped to its retail distribution network. This sales network allows Daphne the leverage against suppliers for bulk buying and better rental contracts than peers. The low cost production model and management pedigree of building and maintaining market leading brands makes Daphne a powerful force in the retail shoe market.

Daphne market share and network size

DAPHNE RANKS NUMBER 2 BY BRAND MARKET SHARE IN CHINA, 2009



SECOND LARGEST FOOTWEAR SALES NETWORK



Source: BAML

Despite their high market share in the formal retail market, both the *Daphne* and *Shoebox* brands are underpenetrated in China, with *Shoebox* (1 300 stores) the least penetrated of the two. The company is well funded, with over 15% of its market capitalisation in cash and zero debt, and is poised to expand its network strongly in the coming years. Each year, for the next five years, Daphne plans to roll out approximately 500 *Daphne* stores, 300 *Shoebox* stores and 150 of its newly acquired mid-tier brands. This store rollout will allow the *Daphne* brand to deliver nearly 20% revenue growth in our view, from a combination of 14.5% space growth and same-store-sales-growth (SSSG) of 6% on a normalised basis, while the *Shoebox* brand will expand space by 30% and will see 9% SSSG, leading to just under 40% revenue growth.

With 19% and 13.5% operating margins for the *Daphne* and *Shoebox* brands respectively, Daphne enjoys the second highest profitability among listed ladies footwear companies in China. The company earns these margins on the lowest average selling prices in the peer group, which further speaks to its low-cost business model. We believe these margins have room to expand as the business matures, selling prices increase ahead of inflation, and scale advantages are further defined.

In summary, Daphne offers us an attractive opportunity to invest in a well-run, growing, branded Chinese consumer company that will benefit from the consumption shift taking place in the Chinese economy over the next decade. We believe the business is worth in excess of HK$13, versus a share price of just over HK$8 today. At a 10.4x rolling forward price earnings multiple (and 9x forward when accounting for the cash), we believe the opportunity is very attractive. Daphne is a 2.5% position in Coronation's GEM funds.

Africa

Nationalisation – cheap politics and costly mistakes

by **PETER TOWNSHEND**

***PETER TOWNSHEND** joined the Africa team in July 2008. He currently co-manages the Coronation Africa and Africa Frontiers Funds. Prior to joining Coronation, he worked as an analyst with an African hedge fund.*

While our Africa funds are not directly accessible to individual investors, they are used us underlying building blocks in some of our managed funds, namely Coronation Market Plus and Coronation Balanced Plus.

Mining is in many ways a unique business. For a start, miners exploit finite resources. Once a mineral deposit has been exhausted, it is gone forever. This immediately puts miners in the firing line as what they exploit today is taking from future generations. Mining is also messy. While the actual area affected is often insignificant in relative terms and mines are typically in very remote locations where few will ever see or feel their impact, there is something about a big, untidy hole in the ground that can fire up opposition, even in another continent. Miners can also experience periods of what seems to be obscene profitability. Coca-Cola cannot increase the price of its fizzy drinks by 1 000% over a period of a few short years but this is precisely what has happened to iron ore miners, and their current margins are eye watering. But most of all, mining is possibly unique in terms of the scale of investment required and the time horizon that mining firms must consider.

From initial exploration to discovery, then through construction and to full production is typically measured in decades. And large mining projects can cost tens of billions of dollars. Commodity cycles can be a lot shorter than the mining investment cycle, so mining companies are never sure as to what sort of markets they will be bringing on new projects. And when you have committed billions of dollars to a project with no certainty that your product will sell for $100 or for $10, making big investment decisions is a leap of faith. The last thing a mining executive then wants to worry about is security of tenure or tax and royalty regimes. But, this is exactly what is happening around the world currently.

And Africa is no exception. In many African countries, commodities constitute a significant portion of GDP and dominate export earnings. In addition, the companies that exploit them are often among the only foreign investors of any size. So, whether it is oil in Nigeria and Angola, copper in the Congo and Zambia, gold in Tanzania and Ghana or diamonds in Namibia and Botswana, mining is a high profile business on the continent. Having committed enormous amounts of capital in establishing mines or oil fields and being reliant on the state for mineral rights, mining companies are soft targets for politicians of all stripes. In South Africa, Zambia, Zimbabwe and Tanzania we have seen populist politicians find an eager audience when they start bashing the miners and calling for a bigger slice of the pie – or for outright nationalisation.

Nationalisation does not work. Africa is littered with the corpses of state mining companies that in a few short decades destroyed what were once vibrant private sector-led mining industries. But memories are short. Barely a decade has passed since Zambia privatised its bankrupt state mining firm. In that time, copper output has exploded and recently surpassed the previous peak output levels. But a new (populist) government is now looking to renegotiate the mining tax regime for the second time in less than five years. And a little further south in Zimbabwe, the country's leaders are trying to force mining companies to give up 50% of their assets. Closer to home, calls for the nationalisation of the mining sector in South Africa are growing louder ahead of what is likely to be a bitterly fought leadership race within the ruling party in 2012.

All of this is particularly galling given that the solution is in fact relatively simple – write a fair mining code the first time and then stick to it through thick and thin. Ideally the state should own mineral rights and should retain a carried stake in all mining projects (perhaps between 10% and 20%). Royalties based on revenue also make sense for the state as they are simple and the effective tax take is significant (somewhere between 1% and 3% feels about right). Another possibility is a variable tax rate such as that under which the gold mining industry in South Africa has traditionally operated, where the tax rate moves according to profitability. This gives the miners some relief in tough times and allows governments a bigger slice of the pie in boom times. For the miners, some tax exemption in the early years allows faster recovery of the huge capital invested, as does the ability to write capital off against early profits. The precise levels of taxation need to be debated in each country, but once settled they need to be cast in stone. Certainty has real value and we would argue that for mining companies the absolute numbers are less important than a degree of certainty. Evaluating an investment with a 50% effective tax rate is easily done. Evaluating an investment where you are not certain whether the tax rate will be 50% or 75%, is far more difficult.

The Republic of Mali in West Africa illustrates this point. It comprehensively rewrote its mining laws in the early 1990s, and to the best of our knowledge has not meaningfully tampered with them since. In the decades since, it has come from nowhere to be the third largest gold producer in Africa, is among the top 15 gold producers in the world, and one of the most favoured gold investment destinations on the continent. Unfortunately, common sense seldom dominates political discourse so the current uncertainties are unlikely to be the last that we see. This is just one of the tragedies of Africa and it does very real damage to the industry and has a very real impact on development. The mining industries in the Congo and Zimbabwe, for example, remain a shadow of what they could (and should) be and the mineral wealth of dozens of other African countries remains underutilised.

Despite this rather gloomy picture, Africa does still provide enormous opportunity for commodity companies as it hosts some of the last of the world's great, undeveloped orebodies. In our opinion, markets are not always very good at pricing uncertainty, yet when it strikes it can provide attractive opportunities for the long-term investor. We have significant investments in mining companies that operate in Tanzania, Egypt and Zimbabwe. In all three countries there is significant uncertainty around either politics (Egypt), taxes (Tanzania) or ownership (Zimbabwe). And in all three instances, if we allow for even our most negative potential outcome, there is still a large gap between our fair value and the current market price. There will undoubtedly be further surprises and more negative headlines. But, looking through the noise, we think our investors will be amply rewarded for taking a longer-term view and then showing that rarest of investment skills – patience.

Personal investments update

New fund: Coronation Global Strategic Dollar Income Fund

This recently launched fund is aimed at offshore investors looking at a viable alternative to dollar-denominated bank deposits. This fund invests primarily in shorter-term government, bank, and corporate paper traded in the major global debt markets. It can also invest up to 25% of its assets in selected listed property stocks and other hybrid debt and equity instruments such as preference shares to enhance returns. It is managed by our head of fixed interest, Mark le Roux, and international bond specialist Stephen Peirce.

Most investors will be familiar with the fund's local sibling, the Coronation Strategic Income Fund, which is part of our flagship fund range and positioned as an intelligent alternative to short-term rand-denominated bank deposits (see page 26). Our aim is to replicate the local fund's objectives – achieving at least 110% of cash returns over time, while producing positive returns over any 12 months – for US dollar-based investments.

Easier offshore investment process

The South African Reserve Bank (SARB) recently announced that investors wishing to externalise rands no longer need to obtain a tax clearance certificate from the South African Revenue Service (SARS) on the first R1 million in any given year. This will simplify the process of investing offshore for the majority of investors. Please note that the clearance-free allowance applies to forex transactions for a variety of reasons, including overseas travel, study and gifts. Investors can still take an additional R4 million p.a. offshore subject to obtaining a tax clearance certificate. Amounts larger than R5 million can only be externalised if prior approval has been obtained from SARB.

Introduction of a dividend tax levied on shareholders

The way dividend income is taxed will change from 1 April 2012. While the change will make no difference to the economic substance of your investment, it will have an impact on how we administer your investment from 30 June 2012.

Historically, companies declaring dividends paid secondary tax on companies prior to paying out the dividend to shareholders. In future, taxpaying shareholders will be responsible for this tax. Where you are invested through a unit trust or endowment, your fund manager or administrator will pay this tax on your behalf by deducting it from any distributions declared and paying it over to SARS. If you are invested in a retirement annuity, preservation fund or living annuity, no dividend tax will be payable as retirement funds are exempted from paying tax. We will shortly be communicating with all investors to confirm their tax status to ensure that withholding taxes are appropriately collected.

Prudential limits: now applicable at member level

If you are an existing investor in a Coronation retirement annuity fund and you are planning to make a top-up investment, you may be confronted with a request to adjust your desired investment options to ensure that your portfolio is brought into compliance with the investment restrictions required by the Pension Funds Act. Strict compliance with these limits is a relatively new regulatory requirement and we are aware that this may create confusion and frustration. We are focused on simplifying our processes to ensure that you receive appropriate information to make managing your investment simpler. The easiest way to ensure that your portfolio always meets the prudential limits is to invest in a compliant fund such as Coronation Balanced Plus (see page 26), where Coronation takes responsibility for meeting all the regulatory requirements.

Additional 'Know Your Client' requirement: Tax registration details

We are required by the Financial Intelligence Centre (FIC) to keep detailed records providing proof that we have confirmed the identity of all our clients. Historically, we have only required clients to provide us with proof of identity, banking details and residential address. Unfortunately, the FIC also requires that we obtain your tax registration details, as indicated on any communication that you would have received from SARS. If we do not have your tax details on file, you will shortly receive a request from us to provide this information. Please note that the implication of incomplete client documentation is that we may be prevented from processing your switch or withdrawal instructions until the relevant documentation has been provided.

DOMESTIC FLAGSHIP FUND RANGE

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.	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 ASSETS[1] VS GROWTH	94.8% / 5.2%	68.9% / 31.1%	42.5% / 57.5%	32.5% / 67.5%	0.3% / 99.7%
LAUNCH DATE	Jul 2001	Feb 2007	Jul 2001	Apr 1996	Oct 2000
ANNUAL RETURN (Since launch)	**11.5%** †8.8%	**10.0%** †7.0%	**14.4%** †6.2%	**16.2%** †13.9%	**22.1%** †15.3%
QUARTILE RANK (Since launch)	1st	1st	1st	1st	1st
ANNUAL RETURN (Last 10 years)	**10.7%** †8.8%	**–** –	**13.6%** †6.3%	**15.8%** †14.5%	**19.4%** †14.1%
QUARTILE RANK (Last 10 years)	1st	–	1st	1st	1st
ANNUAL RETURN (Last 5 years)	**9.5%** †8.3%	**–** –	**9.0%** †7.0%	**9.5%** †8.7%	**12.0%** †7.5%
QUARTILE RANK (Last 5 years)	1st	–	1st	1st	1st
STANDARD DEVIATION (Last 5 years)	**2.4%** †0.6%	**–** –	**6.9%** †1.8%	**10.6%** †11.8%	**17.2%** †19.9%
FUND HIGHLIGHTS	Outperformed cash by on average 2.7% p.a. (after fees) since launch.	Outperformed inflation by 3% p.a. (after fees) since launch, while producing positive returns over 12 months 100% of the time. No. 1 conservative fund in South Africa over 3 years and since launch.	Outperformed inflation by more than 8% p.a. (after fees) since launch, while producing positive returns over 12 months more than 90% of the time.	Produced a total return 23% greater than its average competitor since launch. No. 1 balanced fund in South Africa over 5 years and since launch.	Outperformed the equity market by 5.8% p.a. over the past decade with less than market level risk. No. 1 equity fund in South Africa over 5 years.

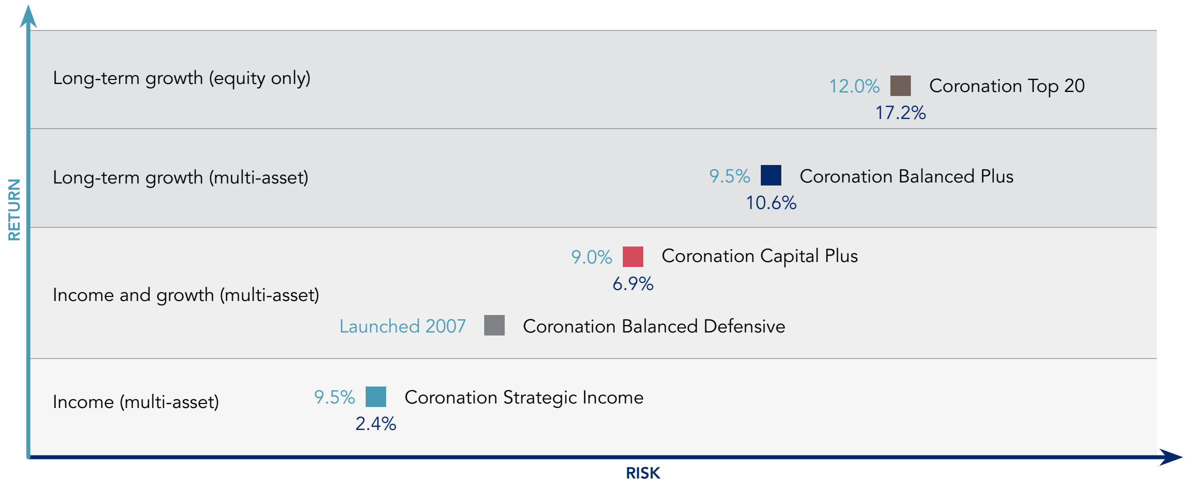
▪ Income ▪ Growth

1. Income versus growth assets as at 31 December 2011. Growth assets defined as equities, listed property and commodities.

Figures are quoted from Morningstar as at 31 December 2011 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

Risk versus return

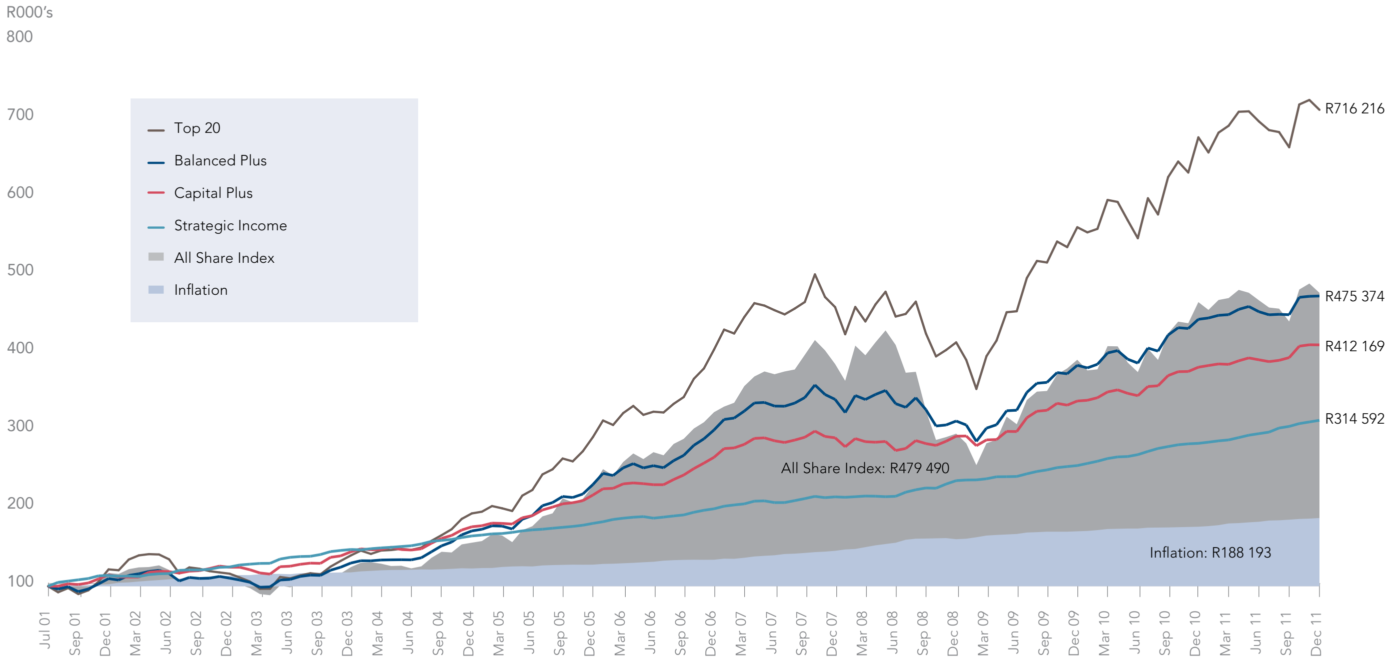
5-year annualised return and risk quoted as at 31 December 2011. Figures quoted in ZAR after all income reinvested and all costs deducted.



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 the Coronation Capital Plus Fund on 1 July 2001 as at 31 December 2011. 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			
	CAPITAL PRESERVATION	LONG-TERM CAPITAL GROWTH (MULTI-ASSET)	LONG-TERM CAPITAL GROWTH (EQUITY ONLY)	
FUND[1]	**Global Capital Plus [ZAR]** ***Global Capital Plus [USD]*** Global cash† (50% USD and 50% EUR)	**Global Managed [ZAR]** ***Global Managed [USD]*** Composite† (equities and bonds)	**World Equity [ZAR] FoF** ***Global Opportunities Equity [USD]*** MSCI World Index†	**Global Emerging Markets Flexible [ZAR]** ***Global Emerging Markets [USD]*** MSCI Emerging Markets Index†
FUND DESCRIPTION	A low-risk global balanced fund reflecting our best long-term global investment view moderated for investors with smaller risk budgets. While still focused on earning an attractive rate of return over time, the fund is managed to minimise the risk of losing capital over any 12-month period (measured in dollars).	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.
GROWTH VS INCOME ASSETS[1]	49.3% / 50.7%	18.4% / 81.6%	2.1% / 97.9%	4.7% / 95.3%
LAUNCH DATE	Sep 2008 *Sep 2009*	Oct 2009 *March 2010*	Aug 1997 *May 2008*	Dec 2007 *July 2008*
ANNUAL RETURN (Since launch)	**8.2%** †1.5%	**5.5%** †5.6%	**5.4%** †3.5%	**(1.0)%** †(4.9)%
QUARTILE RANK (Since launch)	1st	1st	1st	1st
FUND HIGHLIGHTS	Both funds have produced a dollar return 3 times that of its foreign cash benchmark since launch.	Single investment solution for investors seeking long-term growth from the best investment opportunities around the globe.	Both dollar and rand funds have outperformed the MSCI World Index since launch, by 2.3% and 1.9% p.a. at less than market-level risk.	Both the dollar and rand funds have outperformed the MSCI Emerging Markets Index since launch by 4.5% p.a. and 3.9% p.a. respectively.

▪ Income ▪ Growth

1. Rand and dollar-denominated fund names are included for reference.
2. Growth versus income assets as at 31 December 2011. Growth assets defined as equities, listed property and commodities.
3. Returns quoted in USD for the oldest fund.

Figures are quoted from Morningstar as at 31 December 2011 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).

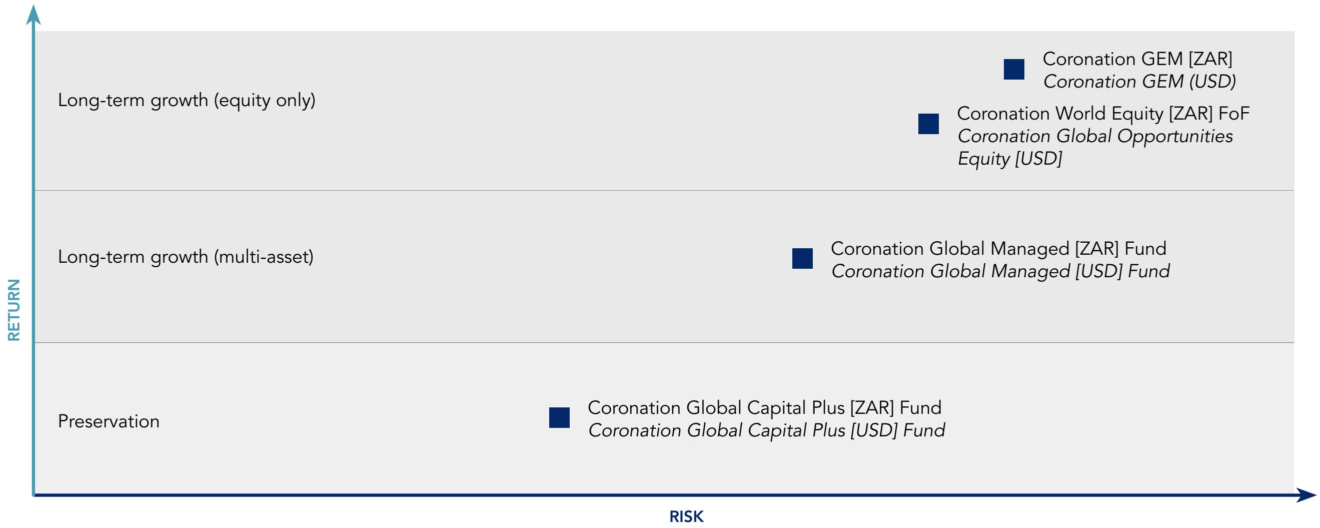
HAVE YOU CONSIDERED EXTERNALISING RANDS? IT'S EASIER THAN YOU MIGHT THINK.

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

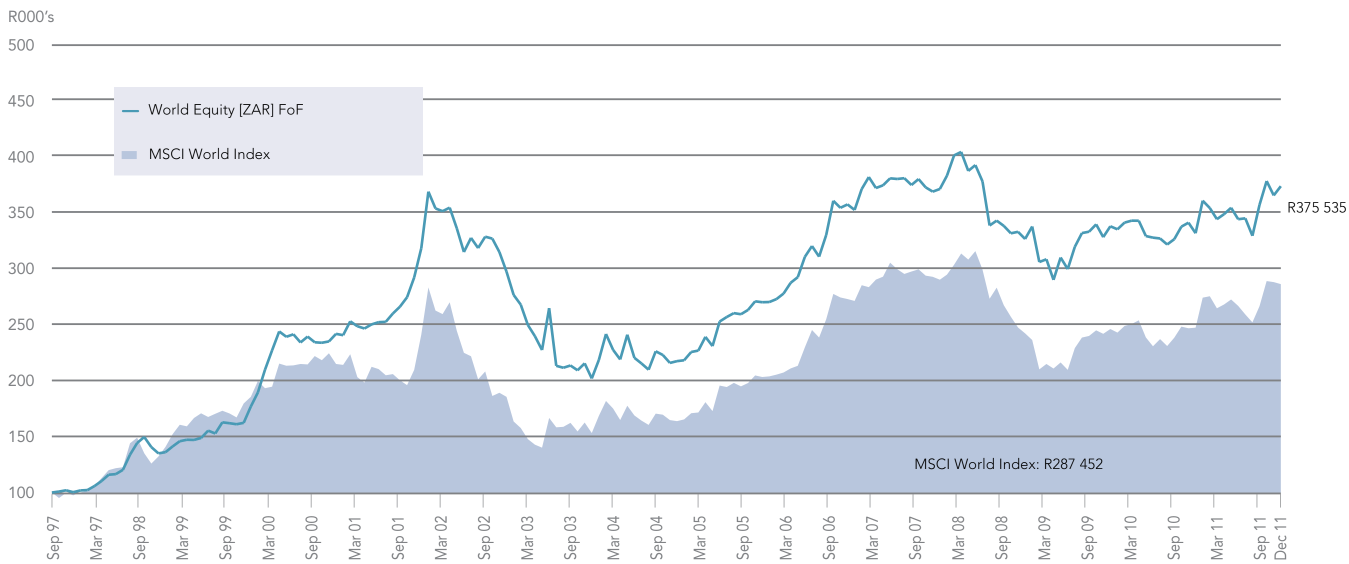
Expected return and risk positioning for both rand and dollar-denominated funds after all income reinvested and all costs deducted.



Source: Morningstar

Growth of R100 000 invested in the Coronation World Equity Fund of Funds on 1 August 1997

Value of R100 000 invested in the Coronation World Equity [ZAR] Fund of Funds on 1 August 1997 as at 31 December 2011. All income reinvested for funds; MSCI World Index is on a total return basis. Global Capital Plus [ZAR], Global Emerging Markets Flexible [ZAR] and Global Managed [ZAR] are excluded as they do not have meaningful track records.

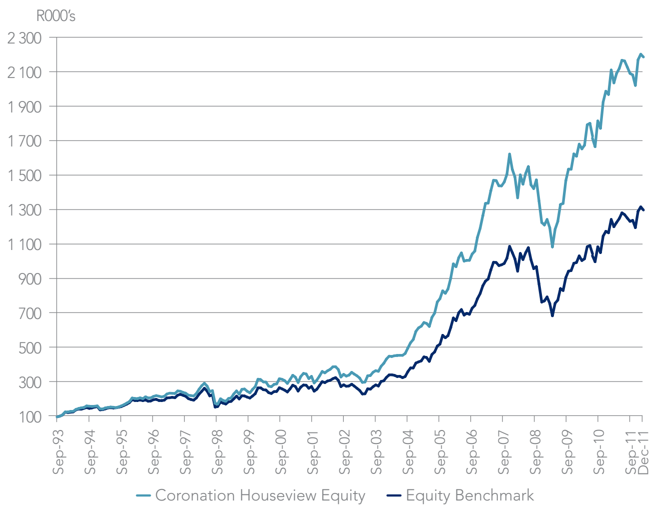


Sources: Morningstar and I-Net Bridge

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	10.42%	7.32%	3.10%
ANNUALISED TO 31 DECEMBER 2011			
1 year	3.5%	4.3%	(0.8%)
3 years	20.7%	17.9%	2.9%
5 years	11.6%	8.6%	2.9%
10 years	19.7%	15.6%	4.0%
Since inception in October 1993 annualised	18.4%	15.1%	3.4%
Average outperformance per 5-year return			3.50%
Number of 5-year periods outperformed			14.00
Number of 5-year periods underperformed			–

CUMULATIVE PERFORMANCE



ANNUALISED RETURNS SINCE INCEPTION

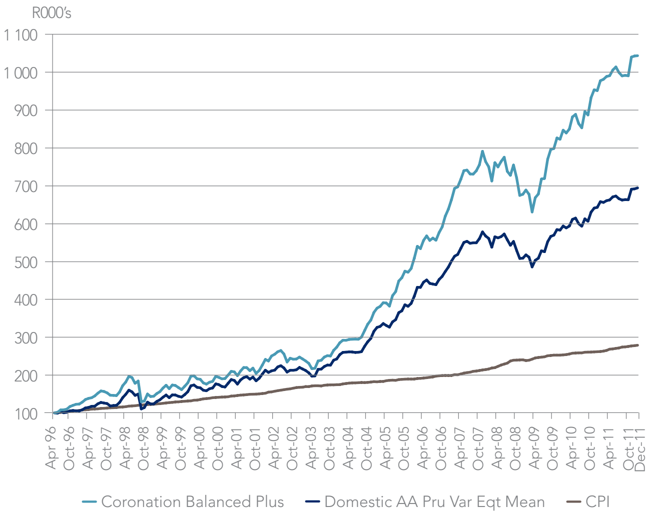
An investment of R100 000 in Coronation Houseview Equity on 1 October 1993 would have grown to **R2 186 401** by 31 December 2011. By comparison, the returns generated by the Equity Benchmark over the same period would have grown a similar investment to **R1 294 440.**

** 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.*

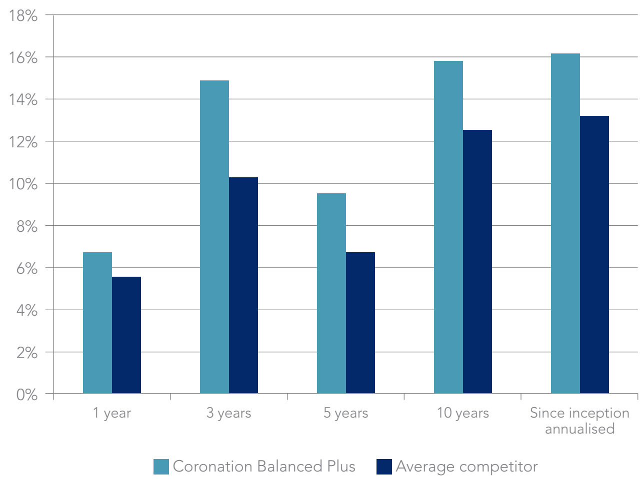
CORONATION BALANCED PLUS FUND VS INFLATION AND AVERAGE COMPETITOR†

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%	6.99%	2.50%
ANNUALISED TO 30 SEPTEMBER 2011	**CORONATION BALANCED PLUS**	**AVERAGE COMPETITOR**	**ALPHA**
1 year	6.8%	5.5%	1.3%
3 years	14.9%	10.3%	4.6%
5 years	9.5%	6.7%	2.7%
10 years	15.8%	12.6%	3.2%
Since inception in April 1996 annualised	16.2%	13.2%	3.0%
Average 5-year real return			9.78%
Number of 5-year periods where the real return is >10%			5
Number of 5-year periods where the real return is between 5% – 10%			5
Number of 5-year periods where the real return is between 0% – 5%			2

CUMULATIVE PERFORMANCE



ANNUALISED RETURNS SINCE INCEPTION



An investment of R100 000 in Coronation Balanced Plus on 15 April 1996 would have grown to **R1 043 984** by 30 September 2011. By comparison, the mean return of the ASISA Domestic Prudential AA Variable Equity sector over the same period would have grown a similar investment to **R694 510.**

† *Average competitor return is the mean of the ASISA Domestic AA Prudential Variable Equity sector*