

corospondent

The Coronation Fund Managers Personal Investments Quarterly



Stay focused.

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July 2010

CORONATION 
FUND MANAGERS


Notes from my inbox

by PIETER KOEKEMOER

It is sometimes said that a wealthy man is one who earns R1 000 more than his wife's sister's husband. I recently re-read this maxim in William Poundstone's excellent book, *Priceless: The Myth of Fair Value and how to take Advantage of it*. It was quoted in the context of behavioural economist Daniel Ariely's theory of coherent arbitrariness, in which he sets out to explain how our choices are often based on a combination of high conviction and significant uncertainty experienced at the same time. This is just a fancy way of saying that, while people are really good at establishing the relative value of different options, we are terrible at estimating fair value in the absolute sense. Regular readers of *Corospondent* will know that the cornerstone of Coronation's approach to investing is premised on remaining resolutely focused on exploiting human frailties such as these to the benefit of our clients.

Providing an example of this theory in practice, Tony Gibson, Charles de Kock and Chantal Valentine highlight different aspects of how recent concerns about the strength of the global economic recovery resulted in poor short-term returns while simultaneously providing good long-term buying opportunities. In a similar vein, Karl Leinberger shows that the concept of risk is too complex to reduce to a simple number, and he explains why we believe that, contrary to what theory may predict, we have been able to deliver superior returns by taking less risk, not more.

We have often repeated the case for increasing exposure to international assets that we believe to be applicable to the majority of our clients. This quarter we focus on the issues for consideration before committing to a specific implementation plan. Whether you want to externalise rands, 'top up' exposure through a rand-denominated international unit trust, or leave the local/international allocation decision to us, we have the right solution for you. As always, if you are uncertain about what course of action is appropriate, we recommend that you seek appropriate and independent professional advice.

Finally, I would like to extend an invitation to all clients to have a look at our recently re-launched website at www.coronation.com. We completely changed the emphasis of our site, with the spotlight now squarely on our fund range. Our objective was to provide more tools to match specific funds to the relevant investor needs, to ensure that you have access to clear and unambiguous product information. Please let us know whether you think that we have achieved this. 

MARKET MOVEMENTS

Economic group	Qtr 2 2010 %	YTD 2010 %
All Share Index R	(8.2)	(4.1)
All Share Index \$	(12.7)	(7.4)
All Bond R	1.1	5.6
All Bond \$	(3.9)	1.9
Cash R	1.7	3.6
Resources Index R	(11.9)	(10.0)
Financial Index R	(7.8)	1.3
Industrial Index R	(4.5)	(0.2)
MSCI World \$	(12.5)	(9.6)
S&P 500 \$	(11.4)	(6.7)
Nasdaq \$	(13.1)	(9.3)
MSCI Pacific \$	(11.6)	(6.0)
Dow Jones EURO Stoxx 50 \$	(18.7)	(24.1)

KEY ECONOMIC DATA: HISTORY AND FORECAST

	2007a %	2008a %	2009e %	2010f %	2011f %
HCE	5.5	2.4	(3.1)	2.2	4.0
GCE	4.7	4.9	4.7	4.7	4.8
GFCF	14.2	11.7	2.3	1.6	4.0
GDP	5.5	3.7	(1.8)	3.6	3.4
Current a/c % of GDP	(7.4)	(7.1)	(4.0)	(5.0)	(5.6)
CPI	7.1	11.5	7.1	4.8	5.5
Prime rate (year-end)	14.5	15.0	10.5	10.0	12.0
R/\$ year-end	6.83	9.92	7.48	8.00	9.00
R/EUR year-end	9.94	13.44	10.89	10.00	11.52



Bad news creates investment opportunity

Economic recoveries do not run at a constant pace

by CHARLES DE KOCK

Reading the financial pages of newspapers has been rather depressing of late. Europe has had to weather nothing short of a major crisis with the large indebted governments of Greece and other southern European nations exposed. It took massive intervention by the International Monetary Fund and the European Central Bank to prevent Greece from defaulting and contagion spreading to others. Adding insult to injury was the volcanic eruption in Iceland that caused massive disruption to air travel across virtually the whole of Europe.

In the US, the promising economic recovery has lost momentum as is evident from the slowing pace of employment gains and weak house sales. The disastrous oil spill in the Gulf of Mexico and subsequent disruption to drilling and fishing activity in the region has, like the volcanic ash in Europe, come at a time when the fragile economy and nervous financial markets are vulnerable to bad news.

China, who had seemed virtually immune to the normal economic cycle, is also showing signs of slowing down.

The combination of all the negative events have resulted in many gloomy headlines predicting a double-dip recession and in the case of one commentator, even a pending depression.

In reaction to the spate of bad news stock markets sold off across the world. Second quarter losses measured in US dollar terms averaged about 12% for the developed world and around 8% for emerging nations. Risk aversion again became the motto of many investors as they fled from equities to the supposed safety of US Treasuries.

Taking stock of where we stand in the economic cycle, and the valuation of financial assets, we at Coronation are less gloomy



CHARLES DE KOCK is a senior portfolio manager with more than 20 years' investment experience. He plays a leadership role in the asset allocation process and is responsible for the management of a number of client portfolios.

than the newspaper headlines would have us all believe. In our view the global economic cycle is behaving more or less as could be expected. It is in the nature of economic recoveries not to run at a constant rate. Initially, the gains are faster often due to restocking. Once inventories have been rebuilt the pace of recovery tends to reduce. This is the stage of the recovery we are in now.

One argument in support of a double-dip recession lies in the fiscal austerity being adopted by some European economies as they are forced to repair their poor financial balances. It is true that lower government expenditure and higher taxes are not conducive to economic growth. We do not argue with this reasoning. But, one has to point out that the severe austerity measures have in fact been taken by the smaller, weaker economies. Many of the larger ones such as Germany, France and Italy have not followed.

Acting as a strong counterweight to tighter fiscal policies is the extremely expansionary monetary policy still in place in all the major economies. Interest rates are exceptionally low and will no doubt have to rise at some point. But in our view the upward cycle of interest rates will be very slow indeed. Authorities will only start hiking rates once the pace of economic activity warrants it. The current slow patch in growth data points to central bankers keeping their policy rates at exceptionally low levels for as long as necessary.

We are also of the view that the private sector, not government, is the real engine of economic growth. Corporate balance sheets are in most cases very healthy due to sharply curtailed investment expenditure. Households, who were over indebted have also been repairing their balance sheets by saving more. We expect the corporate sector to start investing again and households to consume more now that the balance sheets of both sectors are much improved. Increased private sector spending should more than offset the expected fiscal tightening of governments.

The glut of bad news headlines and subsequent sell-off of risk assets has resulted in many stocks offering compelling value again. The MSCI trades at a forward price/earnings ratio of 12.3 times and a dividend yield of 2.7%. Historically this is a pretty attractive valuation level. Furthermore, when one considers the alternatives such as cash yielding close to zero and bonds below 3% we certainly have no hesitation in picking global equities as our preferred asset class.

The least preferred asset is global government bonds at today's exceptionally low yields. We are concerned that the consequences of zero interest rates and quantitative easing will lead to unexpectedly higher inflation. History has shown that equities offer investors the best protection against inflation. And when bad news abounds it creates an attractive entry point for the long-term investor who is prepared to look past the near-term uncertainties. 🏠

Dissecting risk

The importance of risk in the investment process

by KARL LEINBERGER

'...now if the stock had declined even further to a price that made the valuation \$40 million instead of \$80 million, its beta would have been greater. And to people that think beta measures risk, the cheaper price would have made it look riskier. This is truly Alice in Wonderland. I have never been able to figure out why it's riskier to buy \$400 million worth of properties for \$40 million than \$80 million.'

Warren Buffett

'Tis funny, all you have to do is say something nobody understands and they'll do practically anything you want them to.'

JD Salinger, *Catcher in the Rye*

Professional investors 'live and die' by their investment performance. We all put enormous effort into building world-class investment teams and sound investment processes. But, at the end of the day, we also all understand that it is only the score on the scoreboard that counts...

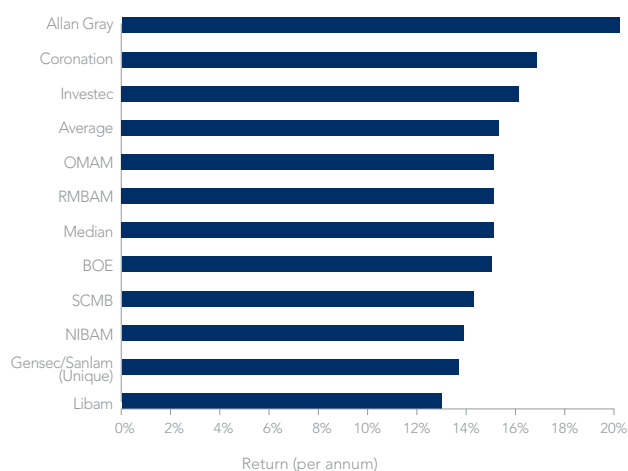
A quick review of the comings and goings in the Alexander Forbes Large Manager Watch over the last decade shows just how much the industry landscape has changed over time. In some respects the performance pressures of our industry are misplaced:



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 Equity and Balanced Plus Funds as well as the Houseview portfolios.

1. **Time horizon:** assessment periods are almost always too short (when this is the case you risk confusing luck with skill).
2. **Quality of return:** although performance ranking tables are heavily scrutinised, we generally find that we aren't asked enough questions about where our returns came from and how much risk was taken to deliver them.

ALEXANDER FORBES LARGE MANAGER WATCH 5 YEARS TO 30 APRIL 2000



Source: Alexander Forbes

We believe that the returns we have delivered over time have been high quality in nature because of:

- **Consistency and persistency:** our alpha has been remarkably consistent over long periods of time (assuming the assessment period is long enough to be meaningful).
- **Quality:** our alpha does not come from thematic investing, where a single macro or thematic view can 'make or break' a portfolio. As bottom-up stock pickers, our portfolios always reflect a myriad of opinions on the merits of each and every asset in the market. This makes our alpha higher quality and more robust (in our view).
- **Risk:** we believe that our returns have been delivered by taking less risk, not more.

The final statement is quite bold and needs to be substantiated. After all, efficient market theory dictates that higher returns can only be delivered by taking more risk. We, however, believe that financial theory still has some ground to cover before it satisfactorily resolves the question of risk:

- Many of the assumptions underlying Modern Portfolio Theory, such as the assumption that markets are efficient and that all investors are rational are deeply flawed (in our view).
- A key departure point in financial theory is the assumption that risk solely equals volatility.

GMO Asset Management recently argued that risk is a concept, not a number. We agree with this. Notwithstanding the fact that our portfolios look good in most return/volatility analyses, we think that one needs to recognise that volatility alone is an incomplete measure of risk. How should one then measure risk? Although we may not have all the answers, we do have strong views on how risk should be defined and how important it is to weave risk into the investment process:

- As an independent asset manager, with all of our assets on 24-hours' notice, we understand that a reputation takes decades to build and just a few minutes to destroy. For this reason, both our research and portfolio construction processes emphasise the need to manage risk and weigh up expected returns in the context of the risk that every asset brings to the portfolio.
- We define risk as the permanent loss of capital. While this is less tangible than simply using volatility or tracking error as a proxy for risk, we think it is more robust. A good example of this is the 2006/2007 period when volatility in global markets was close to an all-time low and yet risk was high (as banks were lending recklessly and sowing the seeds for the 2008 global financial crisis).

VOLATILITY DOES NOT ALWAYS EQUAL RISK



Source: GMO Asset Management

How should one measure risk? Unfortunately we don't believe that there is any single metric. When we assess our own performance we look at it through the cycle. It is the easiest thing in the world to construct a portfolio for the world as it is today. Any high school graduate could have filled a portfolio in early 2008 with the hot stocks of the day (construction and commodity shares). But what happens when the world changes? When the rand moves by 30%, when the interest rate cycle turns, or when commodity prices suddenly double or halve...

We have made our fair share of mistakes over the years, but we are unwavering in our long time horizon and our commitment to look through the cycle. It is the easiest thing in the world to get sucked into buying at the top of the cycle. Things always look good when prices are high. But the real test comes when the tide goes out. It is only at these points that you will really know where returns came from and how much thought went into managing risk.

Key inflection points that have stress-tested our portfolios and illustrate the merits of a long-term, valuation-driven investment philosophy that pays as much attention to risk as to potential return include:

- The first rate hike in 2006 which came after four years of declining interest rates. Banks, retailers, bonds and property stocks got hammered and this presented an excellent opportunity to the long-term investor.
- The turn in the commodity cycle in the second quarter of 2008 after five years of unrelenting outperformance.

- The turn in the construction cycle in the third quarter of 2008, which came after four years of strong outperformance.
- The global financial crisis in late 2008 which punished leveraged businesses and eventually presented an extraordinary buying opportunity.
- The subsequent recovery in global markets in early 2009, which came just when everyone least expected it and when a wall of money was invested in bonds and cash.

While we may not always get it 100% right, our performance at major inflection points in the last few years should give you comfort that our returns have been delivered by taking less risk, not more. We are acutely aware of the fact that we are in the serious business of managing our clients' retirement capital. Investing is not a game. Risk therefore deserves just as much attention as return. 

After the V: what next?

Take a big picture view

by CHANTAL VALENTINE

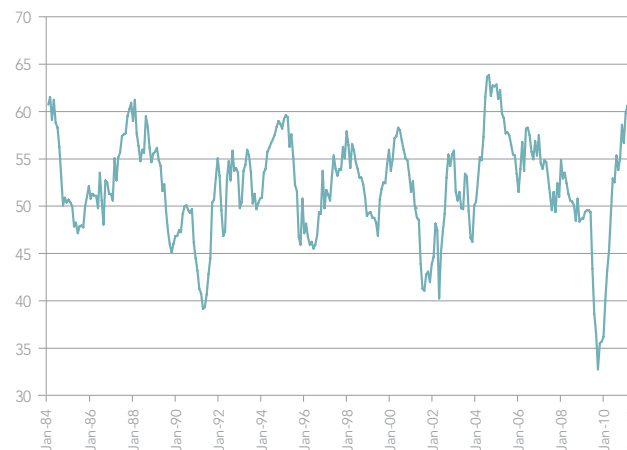
At the time of writing, optimism about the global recovery has started to fade on a slew of weaker-than-expected indicators. Opinions are divided as to whether the glass is half-full or half-empty: is this a 'normal' slowdown in growth as could be expected after the initial boom phase, or is the world headed for a double-dip?

For much of the past year or so global economic indicators surprised on the upside. The doomsayers were silenced as the much-vaunted 'V' shaped recoveries in a variety of indicators became evident. More recently, however, a number of macro indicators have disappointed markets, coming in below expectations. This has led to much talk of double-dips, depressions and deflation. In this debate, we find ourselves more on the glass half-full side.

The growth optimists (and 'optimists' is perhaps a relative term, as no-one expects growth to get back to the level of the boom years) would argue that following such a sharp upward trajectory, some slowdown in momentum was inevitable – possibly even desirable. The US ISM is a good example to use, as it is one of the most up-to-date numbers, and it is generally a good leading indicator for a number of other closely watched indicators (among them, global growth, commodity prices and even South African manufacturing).

The ISM disappointed markets with its last print, coming in below expectations at 56.2 in June, below levels of around 60 the previous two months. However, as can be seen from the chart below, the latest level is hardly a bad number! Any number above 50 indicates expansion in the manufacturing sector in the US; numbers above 55 are generally taken to be strong (the long-term average is below 53) and consistent with robust US growth.

US ISM SIGNALS STILL-ROBUST GROWTH



Source: I-Net Bridge

Concerns about growth seem to be very much focused on short-term momentum in indicators, and we believe one should rather focus on the big picture. It is clear that any sustained time at the peaks of the index is rare indeed. While we have used ISM as the example, it should be made clear that this is not an isolated indicator. Rather, there are a number of indicators across the globe that show a similar picture: indicators have lost momentum, but remain at levels consistent with decent growth rates. There is concern over the effects of the withdrawal of

fiscal stimulus, but this will be partly offset by continued low-for-long interest rates in the US in particular, which will keep global liquidity ample. Growth is bound to slow from recent levels eventually, and looking forward a couple of years it could well be at a lower trend pace than the world has become accustomed to over the past decade. However, this is a long way from falling into recession. We believe that US policymakers in particular will only begin withdrawing monetary stimulus when they are convinced that growth is sustainable.

This is also what differentiates the current situation from Japan, which many of the double-dip/deflation proponents are using as a template: the Federal Reserve acted much faster (a decade faster, in fact) than Japan in providing extra stimulus via quantitative easing and preventing deflation taking hold. It would be constructive not to forget that the Federal Reserve has spent a lot of time studying the Japanese example and has learnt the lessons.

What does all this mean for South Africa? As we have stated repeatedly, the South African cycle is driven by the global cycle. In the last issue, we were already able to report that we had started seeing evidence of South Africa's own 'V' in some sectors. That 'V' started in manufacturing (closely linked to the ISM cycle) and has now pulled through to other sectors. Notably, we have seen a dramatic recovery in consumer spending momentum. Although year-on-year growth has just broken even, seasonally adjusted annualised growth has shot up to almost 6% (as can be seen from the chart, annualised growth leads year-on-year growth). This growth is even more impressive if one looks at goods only, because services have been rather flat: excluding services, annualised growth was over 14%!

SOUTH AFRICAN CONSUMER SPENDING MOMENTUM SURGES




Source: SA Reserve Bank

One should caution that as with all other Vs, momentum is unlikely to keep surging, but the first quarter's numbers bode well for consumer spending over the rest of this year. Historically, low interest rates, robust wage settlements and a renewed surge in house prices (already almost 15% year-on-year) should all help support consumer spending further this year.

However, as with overseas markets, there have been some disappointments locally, and these have been centred on the manufacturing sector. Indeed, not only has the South African PMI dipped recently, but it has fallen below the 50 mark – indicating a contraction in output. This is a worrying development, but it is difficult at present to get a clear picture of underlying manufacturing momentum – the Transnet strike in May was swiftly followed by the World Cup effect in June and July (where production hours have been shortened and – almost certainly – there will have been a dip in productivity). So unfortunately it may take till August before we get a clear idea of underlying growth rates in manufacturing. In the meanwhile, we take some positive heart from continued relatively robust global data, but will watch carefully to ensure our optimism here is not overwarranted. Manufacturing production has a strong relationship with exports, and if the recent manufacturing numbers prove to be more than just a temporary soft patch, then that could spell potential trouble for the balance of payments.

On that subject, the current account deficit widened somewhat in the first quarter, to 4.6% of GDP (annualised rate). While positive global growth should support exports, improving momentum in domestic growth will also put upward pressure on import growth, and better company performance will lead to higher dividend outflows to offshore holders of South African equities. We expect a current account deficit of around 5% of GDP this year, a little wider than the 2009 deficit. Whether or not this puts pressure on the rand will depend on capital inflows; so far, the capital flows picture remains promising. The first quarter deficit was easily funded, and inflows into South Africa remain strong – a function of generally strong flows into emerging markets globally, helped by low yields in developed markets and ample liquidity. However, the flipside of this is that capital flows remain very dependent on global conditions, and a rise in risk aversion as well as eventual withdrawal of monetary stimulus, therefore remain risks to the rand outlook.

So far, the rand has continued to hold up relatively well, and this performance is reflected in a good inflation outcome. Our bullish inflation outlook has come to pass, with CPI down to 4.6% in May. It could fall a little further in the near term, but base effects on the rand, wage increases and potentially higher global inflation down the road combine with the administered prices outlook to make us think we are near the bottom in inflation. With this outlook and with evidence of domestic

recovery, we think the SARB is done on the rate-cutting cycle. At present we see rates rising next year, with the timing probably dependent on global factors (unless we see a more rapid-than-expected turn-up in CPI from its trough). The downside risk to the interest rate outlook is also linked to the global picture – if we are wrong on our glass half-full outlook and global growth double-dips, the impact on domestic growth may be enough to spur another rate cut. On our baseline view, however, we expect to see interest rates at current levels for quite a while yet. 



CHANTAL VALENTINE joined Coronation as economic and fixed interest strategist in 2003. With 18 years' experience in analysing local and global markets, she plays a critical role in the investment decision-making process.

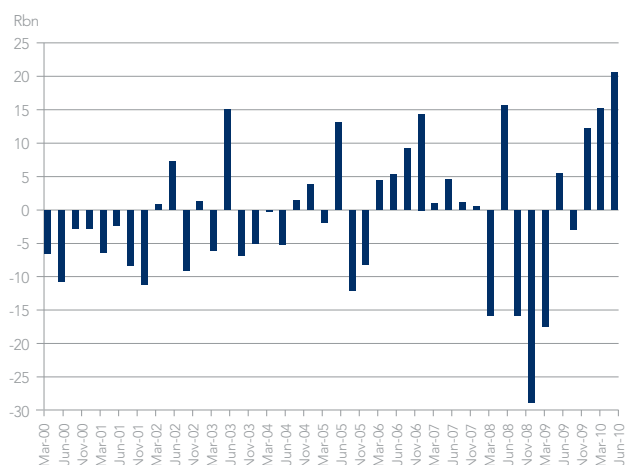
Bond outlook

Weighting local inflation against global risk aversion and supply

by MARK LE ROUX and CHANTAL VALENTINE

Support for local bonds over the past few months has come from a number of sources. As with other emerging markets, South Africa has also seen inflows from offshore. Foreigners bought a net worth of R33 billion in local bonds in the first six months of 2010, of which R18.8 billion came in the second quarter and R6.4 billion in June itself. As can be seen from the chart below, these net purchases compare very favourably historically. This has clearly been a source of support for local bond yields, helping offset the increased supply associated with South Africa's currently large budget deficit.

FOREIGN NET PURCHASES OF BONDS



Source: I-Net Bridge


Local news has generally been positive for bonds. The 'Goldilocks' outlook that we alluded to some time ago has materialised, with CPI inflation surprising most initial 2010 forecasts on the downside while growth has exceeded initial expectations. In May CPI printed at 4.6%, comfortably in the middle of the target range. GDP grew by 4.6% in the first quarter, with export sectors as well as domestic consumption showing a rebound. This in turn has been positive for fiscus, and the indications so far this year are that the budget deficit will come in significantly below the initial Treasury estimate of 6.2% of GDP. This in turn should help relieve funding pressure.

However, looking ahead, the outlook might not be so rosy. Firstly, while funding pressure may be less than initially presumed, weekly bond supply remains high and cumulatively is likely to continue to weigh on the market. While CPI is expected to still fall a little from current levels, we think the bottom is near. One of the main drivers of lower inflation had been the stronger rand, but simple base effects mean that the rand influence will start waning within the next few months even if the rand moves largely sideways from here – and clearly there would be worse news ahead were the rand to weaken significantly. Leading indicators of inflation, including PPI, also support the view that CPI will have troughed by early in the final quarter of this year. With a potential rise in CPI combined with stronger domestic demand and already very low real interest rates, we think it is unlikely that further interest rate cuts are on the table.

We are also concerned about the potential impact on domestic bonds from global bond developments. While emerging market bonds have generally performed well this year, this is in no small part due to low interest rates and abundant liquidity flowing from developed markets – a situation that will turn at some point, and we would expect the strong flows into South Africa to reverse at the same time they do internationally. This will be especially concerning if domestic funding is still large.



Withdrawal of stimulus in the US in particular is also likely to see US and global bond yields rise, and it is unlikely that South African bonds will be immune. While none of this is likely to be in the near term, these are some clearly significant risks for the market that cannot be ignored.

Our positioning in the bond portfolios remains largely neutral from a duration perspective, as we still consider risks balanced between a positive short-term inflation outlook on the one hand, and supply issues and global risk aversion on the other. And we continue to hold a material position in inflation-linked bonds. 



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 18 years' experience in managing both traditional and alternative portfolios.

Equity market update

Financial markets remain finely balanced

by **QUINTON IVAN**

In the April issue we cautioned that markets were likely to remain volatile for some time to come. In the past quarter the sovereign debt crisis in Europe, with Greece at the centre, dominated global financial markets. Fears of contagion within Europe resulted in significant euro weakness and heightened risk aversion triggered a sell-off in equity markets worldwide. In response, the European Union and International Monetary Fund agreed to an unprecedented rescue package of approximately \$1 trillion.

The quantum of the bailout demonstrates the lengths that governments and regulators are prepared to go to prevent a reoccurrence of the financial crisis. This means that economic policies will be unambiguously geared to stimulating growth. Interest rates are therefore likely to remain lower for longer and while this increases the risk of higher inflation in the future, it supports the pricing of risk assets in the short term. Equities remain our preferred asset class for producing inflation-beating returns. We have added to our equity positions on the back of market weakness and hold what we consider to be neutral exposure. We continue to favour global over local equities and have taken full advantage of this opportunity, during a period of rand strength, across client portfolios.

The All Share Index returned -8.2% for the quarter. Resources led the market lower returning -11.9%, industrials returned -4.5% and financials -7.8%. While we remain underweight resources, valuations have become more reasonable. Diversified miners were particularly hard hit during the quarter over concerns that the draconian resource super profit tax mooted in Australia would spread to other geographies. Anglo American now trades on 10 times our assessment of normalised earnings including production growth, and we have added to our holding. It has long-life, high quality assets and after the \$2 billion convertible bond, the balance sheet has been strengthened. Following a sustained period of high commodity prices, inefficiencies had crept into the business. Management have embarked on a significant cost-cutting initiative and this will be supportive of growth in future earnings. We previously had zero direct exposure to platinum, but have started buying Impala Platinum. After the sell-off it trades on 12 times our assessment of normal earnings with the optionality of achieving greater production in Zimplats, its low-cost, high grade Zimbabwean operations. We remain underweight in gold counters, with our only exposure being a 3% position in AngloGold.

We remain overweight in banks, which returned -9.9% for the quarter. South African banks are well-managed, well-capitalised, conservatively provisioned and trade on attractive ratings of 9 times 1-year forward earnings and price-to-book ratios of 1.7 times. Future earnings growth prospects are good, supported initially by an unwinding of the impairment provision and then by advances growth as consumers respond to lower interest rates.

The South African economy is healing and inflation is now well within the target band, driven by rand strength and lower food prices. As long as inflation is contained, monetary policy will remain supportive. While we expect inflation to remain benign in

the short term, we are concerned for the longer term given the underlying pressures from higher labour settlements, increased electricity tariffs and rising property rates and levies. Rand strength continues to be supported by global risk appetite. We believe that the rand would have to weaken in the longer term – South Africa is simply uncompetitive at current levels. Consequently, we maintain a significant rand-hedge element in our portfolios, owning attractively valued, globally diversified businesses that happen to be listed in South Africa such as MTN, British American Tobacco, Naspers, Richemont, SABMiller and Bidvest.

Naspers remains a top five holding and the Pay-TV business (a third of which is Africa) is a large component of its valuation. This is an annuity-based, defensive business that generates large amounts of cash and continues to show good subscriber growth despite increased competition. The remaining businesses largely comprise the internet assets, Tencent and Tradus and the print business, Media24. Tencent is a 36%-owned associate and is principally engaged in the provision of internet value-added services, including online games, to users in China. It has been a spectacular acquisition with its value increasing nearly one hundred fold over a period of six years. Recently, however, the Chinese Ministry of Culture has issued new regulations impacting providers of online games. These included the requirement for users to register for services using their identity document (similar to RICA in South Africa) and restricting the playing time of minors. The regulations have caused uncertainty among Tencent's investors which has weighed heavily on the Naspers share price. We have thoroughly assessed the proposed changes and believe the impact to be minimal. Carrying Tencent at roughly half the current share price, our valuation of Naspers offers a considerable margin of safety. We have thus used this opportunity to add to our existing position.

MTN remains the largest holding in our portfolios. It has performed poorly on concerns over increased competition with the imminent entry of Bharti Airtel in Nigeria and uncertainty over corporate action; the most recent example being the failed

acquisition of Orascom Telecom. We continue to believe that MTN presents an attractive opportunity and have added to our holding during the quarter. It trades on an undemanding rating 2 – 3 years out and should enjoy many years of above-average growth given its dominant position in many under-penetrated mobile markets.

Our local exposures remain weighted towards quality counters with strong franchises and good management such as the Spar Group, Woolworths and Mr Price. Despite a period of strong share price appreciation for retailers, the above counters remain attractive based on our assessment of fair value using mid-cycle earnings. That said, we have used the recent run to take profits in Shoprite, Truworths and Foschini. We believe small caps present a compelling opportunity to the long-term investor and hold many quality companies trading at 6 times our assessment of normalised earnings.

In conclusion, financial markets remain finely balanced. Globally, policy makers are united in their goal of deficit reduction, but differ as to the best path to follow. The United States plans to spend big to stimulate growth whereas Europe has introduced significant austerity measures to rein in costs. This has created enormous uncertainty and at the time of writing, financial markets have once again sold-off on concerns that the world may be headed for a double-dip recession. Uncertainty is the friend of the patient, rational, long-term investor as it very often presents opportunities. 🏰



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, Balanced Plus and Industrial funds as well as the Houseview portfolios.

The market is missing an opportunity

Listed property: the benefits of A share class structures

by ANTON DE GOEDE

Before the sub-prime crisis, the term financial engineering was largely unknown to the majority of investors. But as has since been revealed, financial engineering was pervasive across the entire financial system, with banks' loan books being sliced and diced into investment vehicles with different risk/reward profiles for onward distribution. Further, the majority of investors in these instruments had very little, if any, understanding of the risk/reward profiles of such instruments.

That said, when used in a transparent manner the principles of financial engineering can be highly rewarding for investors; providing appropriate risk/reward investment outcomes that match return expectations. Since 2001 the local listed property sector has successfully applied these principles through the creation of A and B share class structures. ApexHi were the first, offering A, B and even C (in 2006) share classes, each with a different level of exposure to the earnings base and subsequent growth in earnings.

At present there are two locally listed property companies with A and B share class structures:

- Hospitality Property Fund, which listed in 2006, invests in hotel properties as well as in hotel operations. Its portfolio includes the Radisson Blu Hotel Waterfront, Holiday Inn Sandton and Mount Grace Country House and Spa. In addition, it is currently in the process of acquiring the Westin Grand Cape Town and the Arabella Western Cape Hotel in Kleinmond.
- Fortress Income Fund, which listed in 2009 out of the Resilient stable, is invested in all three commercial property sectors, with the majority of exposure to non-metropolitan retail properties anchored by the national supermarket chains.



ANTON DE GOEDE is a member of the Absolute Investments team, with specific responsibility for listed property-related research. He has 12 years' investment experience and manages the Coronation Property Equity Fund.

Both companies have sliced the underlying earnings stream (structured their share class) in a similar way:

- The A share class has first option on the growth in underlying earnings, with a prescribed 5% growth per annum for six years after listing for Hospitality A, and five years after listing for Fortress A. Thereafter the growth is the lower of CPI and 5% per annum.
- For both companies, the B share class only participates in earnings once the prescribed growth of the A share class has been achieved.

The result of such a structure is that the A share class enjoys a very stable growing income stream, while the income stream of the B share class is volatile but experiences exponential growth in the good times. The flipside is that in times of mediocre earnings growth, the B share class runs the risk of not achieving any growth in earnings coupled with the risk of earnings going backwards for that given year. As with bonds, the relative value of listed property is dependent on the yield at which it is trading, with an inverse relationship between price and yield.

The listed property sector currently trades at a forward yield of just below 9%, achieved with an estimated distribution growth of 7%. With both companies' A share classes trading at yields close to 10% and the Fortress B at 5.7% and Hospitality B at 9.7%, we believe that the market has mispriced these share classes:

- We believe that the A shares carry substantially less risk than the listed property sector as a whole. While they have hybrid qualities, they are more like an annuity rather than a pure property stock. An annuity with 5% growth discounted at the required rate of return (determined by Coronation for the property sector) should trade at a lower yield, which we see as 7%. This is significantly ahead of where the shares currently trade.

- The B shares offer explosive growth in the good times but can go to zero, and even negative, in tough times. The earnings stream is volatile and should therefore offer higher yields to compensate investors for the risk. Yet, even taking into account positive earnings growth in the medium term, we forecast Fortress B to trade at a 7.2% forward yield and Hospitality B at a 12.3% yield three years out.

To understand the risk/return profile of the two earnings streams there are two key points to consider:

- *The initial split in earnings between the A and B class:* the greater the initial participation of the B class in earnings, the larger the buffer for the A class prescribed growth to be achieved in years of mediocre earnings growth.
- *The characteristics of the overall income stream,* i.e. the quality and volatility of earnings (exposure to retail, office or industrial tenants; the leasing profile, etc.)

Given the current scenario, we believe that the market is not fully appreciating the fundamental differences in the underlying income streams for both the A and B structures of these companies.

- The initial split in earnings at listing of the Hospitality Property Fund was 50/50, thus the current earnings stream needs to decrease by 46% before the prescribed 5% growth of the A class is impacted.

- Fortress Income Fund only listed last year with a 90/10 earnings split in favour of the A share class. This implies that the fund's earnings stream needs to decrease by only 4% before the prescribed 5% growth of the A class is impacted. Although this buffer is relatively small, the underlying earnings stream is less volatile than that of Hospitality due to it holding most of the major leases with national retailers. Further comfort is derived from the listed property sector not having delivered a negative annual distribution growth on a weighted average basis over the last 15 years.

To analyse the structures one needs to stress-test the income stream for both share classes under various scenarios, ensuring that the financial engineering process has not resulted in the sum of the parts being greater (or less) than the whole. Having thoroughly researched both companies' share structures we believe that the A shares present a highly attractive risk/return profile for investors. As such, we have built significant exposure across many of our client portfolios, including our more risk averse portfolios within the absolute return fund range. We believe that a much more likely 5% distribution growth provides comfort from the current yield levels. It may take time for the market to recognise the very different qualities of the two earnings streams, but as long-term investors we are confident that the fundamentals will assert themselves. They always do... 📊

International outlook

Is the global bear market still very much alive?

by TONY GIBSON

The past quarter has seen a resumption of mayhem in equity markets. Although not as severe as that experienced in September 2008, it was significant in the one way that matters most to investors; sharply declining prices and rapidly rising volatility. The US stock market actually suffered its worst May in 48 years. In retrospect the market had become vulnerable to a correction in mid-April as investor sentiment indicators revealed levels of optimism normally associated with intermediate market tops in the market. The market itself became extended. Market volatility then returned with a vengeance, evoking nightmares of 2008 and sending individual investors – who had just recently started to tentatively re-enter the market – running for the perceived safety of cash and US Treasuries. Looking at the late April and May period, the Dow posted triple-digit point losses 17 times, and managed to advance two days in a row only once.

The causes of this disruption, according to the newspapers and commentaries, was the apparently new discovery that certain European Union members are in dire fiscal straits and that nearly all of them have been manipulating their national accounts so as to hide debt and deficits. For anyone with access to the internet and a newspaper, it strains credibility to believe that investors and markets were unaware that most European Union countries have run up deficits above the target range. This behaviour is not new and has been going on since the creation of the European Union. The sudden rise to prominence of these 'sovereign risk' stories to explain recent volatility seems more of a reflection of investors need and ability to rationalise everything, rather than a sensible reflection of risk. In reality, the euro traded at an all time high against the US dollar in April 2008, when the deficits, debts and manipulations of the countries were not so different than what existed in May 2010.

The rest is history. The rich eurozone countries are essentially bailing out the profligate. The quid pro quo is unambiguous:



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.

fiscal restraint. Following the publication of the European Financial Stabilisation Mechanism, Spain immediately announced new austerity measures to help bring down its deficit from 11.2% of GDP to 6% by 2011. Public sector wages are to be cut by 5% in 2010 and will remain flat in 2011; pensions will be frozen in 2010; public investment spending is to be reduced by €6 billion between 2010 and 2011. This is illustrative of the attitude and actions elsewhere in the periphery of Europe such as Greece and Portugal.

When we add all this to the extensive measures already implemented by Ireland, and the big spending cuts announced by the UK's new coalition government, it is clear that much of Europe is serious in addressing the overhang of excessive government debt. This stands in contrast to the remainder of the developed world including the US and Japan, both of which have far greater public debt and fiscal problems than the eurozone in aggregate. Fears over the cumulative effect of high levels of public debt in Europe and the longer-term implications of significant fiscal tightening had two further consequences during the quarter. First, interbank rates increased, mirroring instability in the banking market and fears over heightened counterparty risk. Second, the euro continued to weaken.

The other major event that occurred during the May period was the 'Flash Crash'. This occurred during a 30-minute period on 6 May, amidst concerns regarding Europe's fiscal irresponsibility as discussed above. The crash featured the biggest intraday high-low swing in the Dow's history – falling by 9.2%. A preliminary report on the crash released by the SEC suggested that the primary culprits are changes in the structural framework of the US markets and the prominent role of high frequency traders. Either way, this event was particularly unsettling to the average investors who were shocked at what passed for 'market' prices on the afternoon of 6 May. It certainly was a troubling event that further undermined the public's already fragile confidence in the share market.

At the macro level the news has also severely undermined investor confidence. This is clearest in the US, where the inventory cycle had been particularly pronounced up until recently. In the last two quarters national output rose by a seemingly healthy rate, but two-thirds of the increase in US gross domestic product was restocking inventories. The fear is that this growth now looks more like a temporary surge than the start of a strong economy. Recent data shows that private consumption and exports have both been weak – and neither is gathering strength. Surveys of manufacturers have registered slowdowns in the rate of new orders from home and abroad, while employment numbers have also been below expectations. Adding fuel to the fire, the existing home sales figure was released on 22 June. This indicated that sales of existing homes fell to 5.66 million in the month of May, 2% below the previous month, and 8% below expectations. The other area causing concern is the contraction in government expenditure in the US, with the IMF predicting that the US will cut its budget deficit by 2.7% in the next year.

Also worrying investors is the impact of faltering global demand on the Chinese economy; as China remains the global driver of demand for many resources and commodities. The HSBC purchasing managers index for the country shows that the recovery has stalled and that factory output is starting to fall.

There is a creeping uneasiness among investors, concerned that the world may return to recessionary conditions. Articles in the press are not helping sentiment. A typical example of this is a recent editorial in the Financial Times headed 'Recession is still a looming menace', reminding readers that the economic crisis is far from over. Evidence is mounting that the recessionary forces gripping the global economy have yet to be conquered.

What is clear and indisputable is that investor sentiment has turned sharply negative towards the equity market in recent weeks; reflecting the loss of confidence due to the factors highlighted above.

In the face of all this uncertainty, can the equity market actually go up? We think that the answer is yes, but that the progress could be slow and grudging. Our conviction is based on the following logic:


- We think that the current fears of a global double-dip recession are overdone. A rollover in economic lead indicators and analyst earnings revisions are normal for this point in the cycle. Yes they do predict an inevitable slowdown from the dramatic rise of the past year, but not

a reversal of the global economic recovery that began last year. A significant soft-patch over the quarters ahead should come as little surprise due the fading impulses received from the initial credit and fiscal led bounce in growth. We have two major reasons for believing this. Firstly, we expect monetary policy to remain expansionary, with earlier expectations of an exit from the low interest rate policy now being shifted well into 2011. The second is the fact that private discretionary spending on durables has already been cut to the bone and therefore has much less room to be compressed than it did before the crisis began. This will inevitably lead to pent up demand materialising. We believe that global economic activity still appears to be expanding at a reasonably firm pace – and will continue to be buoyed by robust growth in emerging markets. In our view the main cyclical driver of the current recovery, the large gap between final demand and corporate activity levels, remains and will continue to drive corporate spending and hiring.

- Despite the recent unwelcome spike in volatility, one thing that should give investors considerable confidence that they are not seeing a replay of 2008 in 2010, is the behaviour of credit spreads. Credit markets led equity markets lower in 2008. Whenever it looked like the equity market might be trying to stabilise, the clear message from the continued widening of credit spreads was that there was more pain to come. In contrast to 2008. US credit markets this year have reacted relatively calmly to the eurozone sovereign debt crisis thus far. Credit spreads have widened a little, but nothing like they did in 2008. For example, junk bond spreads have widened by 125 basis points or so, to a little over 9%, versus their late 2008 peak levels of about 22%. As long as credit spreads remain comparatively well behaved, we think that there is a very good chance that further damage to the equity markets will be relatively minor.
- The outlook for corporate earnings continues to look positive, despite recent pessimism. Consensus earnings are notoriously unreliable. Most often they become too optimistic, but after deep recessions they can be far too pessimistic for a time. Recently, analysts have collectively been erring on the side of pessimism. Certainly for the past five quarters we have seen persistent and sizable positive surprises that have averaged 10%; well ahead of consensus forecasts. By comparison, at present the bottom-up consensus S&P earnings is expected to be flat compared to the prior quarter; or a seasonally adjusted decline of 4% quarter on quarter. We will be surprised if the actual outcome is not well ahead of current consensus estimates.

- We remain convinced that there is still exceptional value in equity markets – and more especially in certain stocks that will continue to grow despite the recent slowdown in growth expectations. The S&P is currently trading on a PE ratio of 12.3 times for 2010 and 11.3 times for 2011. In Europe, the rapid fall in the value of the euro will provide a massive boost to competitiveness and help offset fiscal tightening while monetary policy will stay loose. For current share valuations to make sense – as illustrated by dividends yielding more than bond yields – one has to anticipate that Europe's sovereign debt will lead to economic collapse. This is far removed from what we believe the underlying reality to be. That is, that the crisis in Europe is now less about its ability to deal with its debts and more to do with political and institutional issues. These issues, while requiring a

higher risk premium in the short term, are already reflected in share prices.

The next sustainable rise in equity prices reconnecting to the economic recovery will likely take time. Seasonal history and a variety of fundamental catalysts suggest that risk aversion could endure for a number of months to come. In the meantime we continue to place our client funds with managers who are alert to the bifurcated market of winners and losers likely to unfold over the coming months and years. The navigation of these markets is best served by detailed, bottom-up stock picking. The opportunities available to companies that are leaders in supply constrained products are truly remarkable in light of rising global GDP and the rapid emergence of the consumer in developing markets. 

The emerging market consumer

by GAVIN JOUBERT

When individuals think or talk about investment opportunities in emerging markets it is most often commodities and commodity companies to which they refer. This is arguably due to many emerging markets, in particular China, having become significant consumers of commodities and are playing a role in driving long-term commodity prices. When investors think of China in an investment context, they therefore tend to think of commodities. Likewise, when individuals think of Brazil in an investment context they most likely think of Petrobras and Vale, the country's two largest companies and amongst the largest oil (Petrobras) and iron ore companies (Vale) in the world.

There are indeed many commodity companies in countries like China and Brazil, and Coronation's global emerging market funds have been, and continue to be, invested in a number of these companies. But the area that is less well documented and which, in many ways, we find more interesting and exciting is that of the emerging market consumer.



GAVIN JOUBERT heads up the Coronation Global Emerging Markets team and has 13 years' investment experience. He has managed a wide range of South African equity and balanced portfolios over the past several years before moving to focus on Global Emerging Markets.

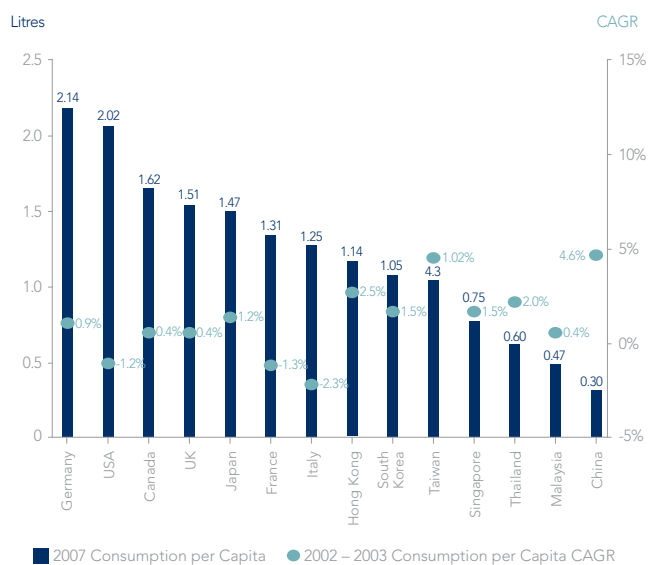
There are 1.3 billion people in China, 1.1 billion in India, 72.5 million in Turkey, over 234 million in Indonesia and just under 200 million in Brazil. That makes almost 3 billion people in just five of the emerging market countries. These five countries are currently enjoying high GDP growth rates, urbanisation and rising disposable incomes. The fact is that the average Chinese consumer earns much more today than he/she did five years ago and will earn much more in five years' time than he/she earns today. In addition to this, consumption of just about anything, whether it be shampoo, toothpaste or beer, is far lower in emerging markets than it is in developed markets.

As emerging market consumers earn more, they spend more. This is a fact supported by the long history of consumer usage and spending patterns in the emerging markets of yesteryear, such as Japan in the 1960s and Korea in the 1980s. Today we are finding a number of very interesting consumer companies in emerging markets – some of which we have invested in as

we believe they are undervalued, and others in which we would love to invest but believe are too expensive – in which instances we will wait patiently until they provide us with an appropriate margin of safety.

We recently invested in a relatively small Chinese company called BaWang. The company produces a range of herbal shampoos for the Chinese market and is the 4th largest shampoo brand in China, with 7.5% market share. The only three brands with higher market share are all Procter & Gamble global brands – Rejoice, Head & Shoulders and Pantene. BaWang has been very successful in building up a brand and resultant consumer loyalty over the past several years, and continues to invest heavily in R&D and marketing.

HAIR-CARE PRODUCTS CONSUMPTION⁽¹⁾ PER CAPITA OF SELECTED COUNTRIES

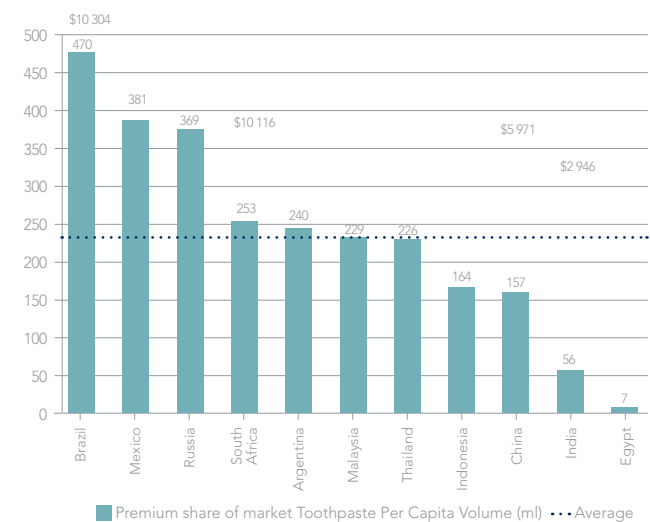


Source: Euromonitor, BaWang International

From the chart one can see that the hair care per capita consumption of the Chinese population is well below that of most countries. Each Chinese consumes 300 ml of hair care products per annum compared to an annual 1 litre for Koreans and 2 litres for every American. As disposable incomes continue to increase, the 300 ml will in our view move closer to the 1 litre mark over time. Thus, the hair care market in China will continue to experience many years of double-digit growth. We believe BaWang is very well positioned to grow its share of this market and compound earnings at a high rate over the next few years.

Colgate Palmolive is one of the largest and most successful consumer product companies in the world. It has operations all over the globe and, in fact today, generates almost 50% of its earnings from emerging markets. One of these markets with the most potential is India.

TOOTHPASTE PER CAPITA VOLUME (ML) – AVERAGE



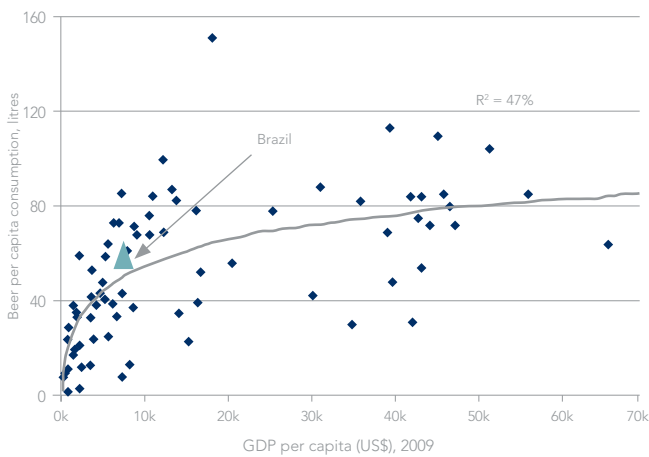
Source: Euromonitor, Morgan Stanley

From the chart one can see that each Brazilian uses 470 ml of toothpaste a year, each South African 253 ml a year and each Indian a mere 56 ml a year. In addition to this, there is a wide discrepancy between how much an Indian living in the urban areas uses versus how much an Indian in the rural area uses, with rural usage (where the bulk of the population live) being far less than 56 ml a year. Once again, we believe that this usage will increase significantly over the next several years. We would also make the point that the level of usage doesn't have to reach that of the the shining white teethed Brazilians – a move from 56 ml to 100 ml a year per capita would result in a doubling of the industry's revenue. Given that Colgate Palmolive has 50% market share in India, the company will be a prime beneficiary of this growth in industry revenue.

Colgate Palmolive India is actually a listed company in India (51% owned by the parent) and as such is investable. Unfortunately, at almost 30 times this year's earnings, we believe that a lot of good news is priced in and that the share is overvalued. We have conducted detailed work on the company, including modelling of earnings going out several years and calculating what we believe the business is worth – we will now wait patiently for the share price to reach the right level before buying.

The chart below shows the correlation between GDP per capita and beer consumption per capita, with each dot representing a country. This chart drives home the point that an increase in GDP results in a rise in disposable incomes and hence per capita consumption increasing. In this particular case we are referring to beer, but the same holds true for most consumer products. The relevance of Brazil is that the Coronation funds have holdings in two of the global beer giants (Anheuser Busch Inbev and Heineken Holdings) that generate approximately half of their earnings from emerging markets, with Brazil being a reasonably large part of the emerging market earnings, particularly in the case of AB Inbev.

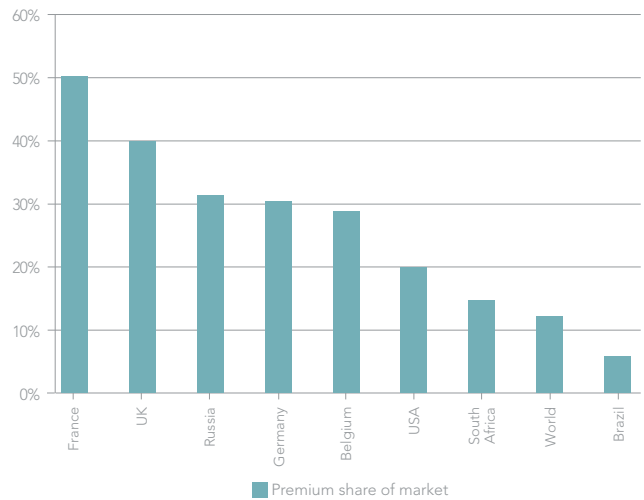
GDP PER CAPITA VERSUS BEER PER CAPITA CONSUMPTION



Source: UBS

Over the next 10 years we expect Brazil's GDP per capita to increase significantly. As a result, beer per capita consumption will increase significantly; this in turn will be a key driver of the revenues of AB Inbev in particular. In addition, the premium beer market in Brazil (and indeed most emerging markets) is still in its infancy when compared to developed markets. As can be seen from the chart below, 50% of beer sales in France are premium beers (40% in the UK and 30% in Germany), whereas in Brazil only 5% of beer sales are of premium beers. Premium beers are, needless to say, priced at a large premium to standard beer and generate both higher revenue and higher margins. As Brazil's premium beer market share as a percentage of the total beer market increases over time (which it will), this too will be another strong driver to AB Inbev's earnings.

PREMIUM BEER MARKET SHARE OF TOTAL BEER MARKET



Source: UBS

We have detailed but three examples of emerging market consumer stocks – of which there are hundreds. Besides the emerging market consumer companies already mentioned, our funds are invested in a number of emerging market telecommunications companies, a handful of emerging market Coke bottlers, three Chinese internet and online gaming companies, a Chinese woman's wear fashion retailer, two Brazilian private education companies and a Brazilian footwear company – all companies that benefit from the emergence of a powerful consumer in emerging markets. We will continue to search for undervalued emerging market consumer companies as we believe this area presents potentially the most attractive opportunity in emerging markets over the next 10 years.

Which is the right route for you?

Externalising your rands with Coronation

by PIETER KOEKEMOER

Over the past 18 months we have spoken a lot about the investment case for increasing exposure to international assets. Simply put, the inclusion of international assets in a total portfolio provides proven diversification benefits and better matches future liabilities. Adding further weight to the argument is that global equities currently offer more attractive valuations than local equities, and the rand is reasonably strong.

If you are looking for a long-term annual return of inflation plus 4% – 5% from your portfolio, you need to invest between 20% and 30% of your total investable assets outside of South Africa. This range is supported by portfolio optimisation studies based on modern portfolio theory, as long as you optimise for long-term investment periods consistent with typical retirement planning horizons. Currently, the average international allocation for South African investors is somewhere between 8% and 15% (depending on how the aggregate portfolio is defined). For as long as the majority of investors' exposure remains only half that of the optimal level, we will continue to highlight the need for further diversification.

Assuming you agree that it makes sense to increase international exposure in your portfolio, let us now turn to the next key decision: How best to implement?

- Should local and international assets be combined in one portfolio or be kept separate?
- If kept separate, should international assets be invested in a multi-asset fund or in a combination of asset class specific funds?
- Should the investment be made via a local, rand-denominated international fund, or by exchanging rands for foreign currency and investing in an offshore domiciled fund?



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.

Combining local and international assets

Many investors prefer to leave the local/international allocation decision to their fund manager, and we offer a number of funds specifically mandated to exercise this discretion on their behalf. However, because there are constraints on the level of international exposure allowed in most multi-asset fund mandates, investors in multi-asset funds should consider additional exposure to an international fund so as to ensure optimal asset allocation.

All Coronation flagship multi-asset funds – Balanced Defensive, Capital Plus, Balanced Plus and Market Plus – have the ability to invest in international assets; an inclusion that we strongly believe improves the long-term risk-adjusted performance of these outcome-oriented funds. The level of foreign exposure in each of these funds depends on a combination of our views on relative valuations, the risk budget of the specific fund and limits imposed by external factors such as regulations.

Let's unpack these constraints in a little more detail. At the moment, all four funds have a limit of 20% exposure to international assets. This limit is set as part of the prudential investment guidelines that govern the portfolio construction for investors in pension funds (this is often referred to as Regulation 28 investment limits, referring to the relevant subordinate legislation to the Pension Funds Act that defines these limits). It is also the generally accepted maximum exposure level for all unit trust funds defined as local funds. Given our current views on global equities, all funds mentioned above have a full 20% international weighting, with the exception of the conservative Balanced Defensive where, to reduce currency-related volatility, we had 14% invested offshore as at the end of June.

Even if you are an investor that normally prefers to leave the full asset allocation decision to the asset manager, the 20% limit means that you should consider investing 5% – 10% of your portfolio into an international fund to ensure that your international allocation is in the optimal 20% – 30% range.



Multi-asset versus asset class specific funds

The basic principles that apply to local multi-asset funds also apply to their international counterparts: they reduce the complexity of making investment decisions and provide instant diversification across asset classes. When investing in a multi-asset fund (with the appropriate investment objectives and risk budget), you can expect your asset manager to make informed asset allocation decisions, focus on reducing the risk of not achieving the desired outcome, and protect you from 'errors of emotion'. Unless you are a sophisticated investor with the desire and infrastructure to construct your own portfolio, multi-asset funds are in all likelihood better suited to your needs. Coronation offers three such international multi-asset funds:

Fund name	Description	Average exposure to equities	Expected equity exposure range	Available in
Optimum Growth	Best long-term investment view across global and local markets	75%	45%-90%	ZAR only
Global Managed	Best long-term investment view across global markets	65%	45%-90%	ZAR & USD
Global Capital Plus (previously Latitude)	Returns in excess of foreign cash while preserving capital over 12 months	35%	20%-50%	ZAR & USD

Externalising rands

Prospective investors in an international fund have the choice of a locally domiciled rand-denominated portfolio or a foreign currency-denominated fund incorporated in a foreign territory. We offer exactly the same international mandates in our local unit trust fund range as we do in our FSB-registered, Irish-based, dollar-denominated fund family.

Note that the 'externalise or not' decision relates more to financial and tax planning than it does to investment considerations. Factors such as the status of the investor (natural person, trust, etc.), the inter-generational needs of a family (kids on different continents or all in South Africa) and the investment horizon and purpose of the portfolio (e.g. planning to draw an income, etc.) will define the outcome rather than whether Asia is a better place to invest than Africa, or whether you should have more exposure to yen and dollars rather than euros and rands. The key attributes of the two approaches are set out in the table on page 20.

Using your individual allowance

South African residents can invest up to R4 million in assets held outside of South Africa. To qualify for this allowance, you need to be a natural person, a taxpayer in good standing and over 18 years of age. This is a lifetime allowance (measured at the time of doing the externalisation transaction/s), although the limit has historically been increased regularly. A family with two children could potentially utilise an allowance of R16 million, adequate for the externalisation needs of virtually all households. The proceeds of the allowance can be used to invest in any foreign assets, including international funds such as the Coronation Global Capital Plus Fund. While owning foreign assets directly comes with additional complexity and cost – you are now transacting across borders after all – it is the only way to fully diversify sovereign risk.

Investing in rand-denominated funds

Current exchange control regulations allow all non-pension fund investors to invest an effectively unlimited amount internationally through a South African unit trust fund. Technically, unit trust managers can invest up to 30% of assets under their management internationally, but because demand for dedicated international exposure has been so low relative to demand for local assets, there is a lot of capacity before this limit is reached. This is the simplest and most cost-efficient route available for investors looking to 'top up' their international exposure. However, assets invested in this way do remain within the South African exchange control net. This option may be the only route to invest in international assets for most family trusts and, in certain circumstances, for natural persons.

Benefiting from international exposure

Our aim at Coronation is to provide an integrated and consistent solution to the international investment needs of all our clients. So, whether you wish us to make the allocation decision on your behalf in one of our multi-asset funds, are looking for a rand-denominated international fund or plan to externalise rands, we can provide the appropriate solution.

	Fund domiciled in South Africa (rand-denominated)	Fund domiciled in Ireland (externalised rands: \$-denominated)
Funds	<i>Full international exposure:</i> Latitude (ZAR) Global Managed (ZAR) World Equity (ZAR) Global Emerging Markets Flexible <i>Combined local and international exposure:</i> Optimum Growth	Global Capital Plus Global Managed Global Opportunities Equity Global Emerging Markets n/a
Accessibility and liquidity	Trades daily. Redemptions settled within 2-3 business days.	Trades daily. Redemptions settled in 4-5 business days.
Cost	Somewhat cheaper – transacting locally	Somewhat more expensive – transacting across borders
Currency exposure	Exactly the same economic exposure – only the reporting currency differs	
Asset class exposure	Exactly the same economic exposure to underlying global assets	
Exchange control risk	Higher: international exposure subject to limits set by SARB and Government	Lower: once assets are externalised, it is difficult for SARB to re-include in excon net
Portability across borders	Lower: Remains a local asset	Higher: Assets already in an offshore domicile
Minimum investment	R5 000 lump sum or debit order from R500 per month	US\$15 000 lump sum

WHERE CAN I FIND MORE INFORMATION ABOUT INVESTING OFFSHORE?

Our International Fund Range brochure, which can be found in Forms Warehouse on our website, has some interesting insights on why one should invest offshore or why one should consider increasing one's offshore exposure.

In order to understand the basic exchange control and tax consequences related to investing in a dollar-denominated international fund, you can refer to our Frequently Asked Questions document (also available in Forms Warehouse on www.coronation.com).

HOW TO INVEST IN A CORONATION DOLLAR-DENOMINATED INTERNATIONAL FUND

STEP 1 Apply for tax clearance

Tax clearance from the South African Revenue Service (SARS) is required prior to investing in one of Coronation's dollar-denominated international funds. To do this simply download and complete a Tax Clearance Certificate (in respect of Foreign Investment Allowance for Individuals). Approval will depend on your specific SARS office and your tax status. Please consult your local SARS office as to the expected time of approval when applying. This Tax Clearance Certificate will be required by your bank and is typically valid for a period of 12 months.

STEP 2 Choosing the right fund

Our revamped website (www.coronation.com) houses a guidance tool to help you match your needs with the right fund. If you require any further details on the various fund options available to you, please contact us on 0800 86 96 42 or speak to your financial advisor.



STEP 3 Visit your bank

Once you've obtained tax clearance, you need to contact your bank to arrange for a transfer of funds. The following documents are required by your bank:

- SARS Tax Clearance Certificate
- A completed Application for Overseas Transfer/OTT/Balance of Payments (BoP) Outward Form available from your banker
- A completed exchange control application form available from www.reservebank.gov.za or from your banker
- A green bar-coded SA ID document (and power of attorney, if applicable)
- Details of the bank account to which you wish the funds to be transferred. Coronation can assist with this process should the transfer be made at any of the following banks:
 - Absa
 - First National Bank
 - Nedbank
 - Standard Bank


Kindly contact us to assess how we could assist in this process.

STEP 4 Complete the Coronation application form

Once you've arranged for a transfer of funds, download the application form on our website, complete and submit to one of our client service consultants.

STEP 5 What we need from you

- Copy of your ID documentation bearing ID number and photograph
- Proof of residential address less than three months old (e.g. utility bill or telephone account)
- Proof of banking details (e.g. bank statement or cancelled cheque less than three months old)
- Proof of SA income tax number if applicable (e.g. SARS-issued document bearing name and tax number)

If your supporting documentation has been provided in full to another primary accountable institution (e.g. your financial advisor) and Client Service has written confirmation of this, you will only need to attach proof of identity and proof of banking details to your application. 

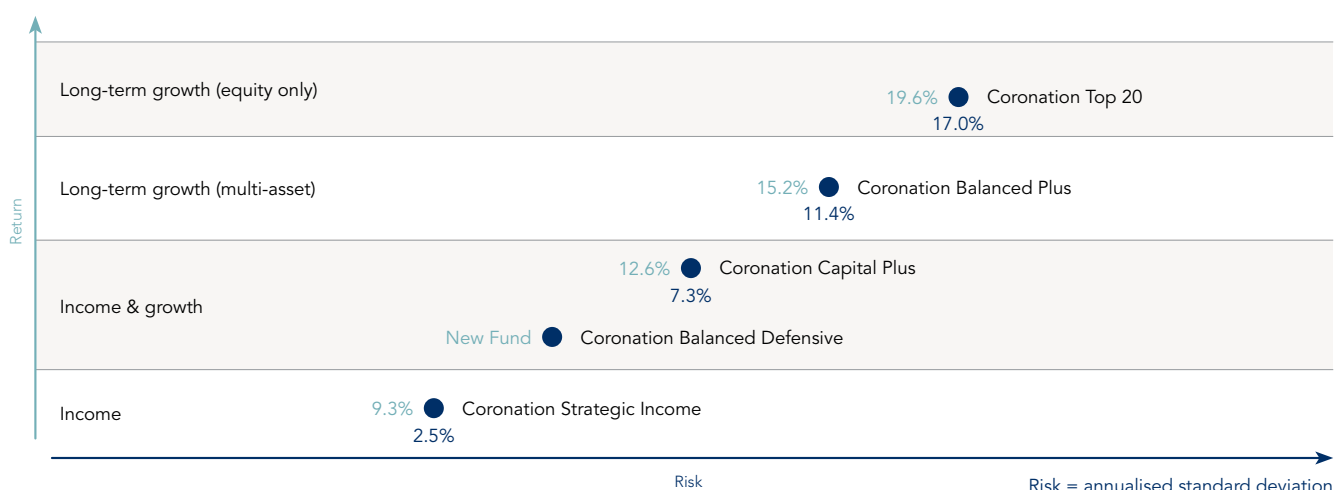
Coronation offers a range of domestic and international funds to cater for the majority of investor needs. These funds share the common Coronation DNA of a disciplined, long-term focused and valuation-based investment philosophy and our commitment to provide investment excellence.

DOMESTIC FLAGSHIP

FUND	FUND DESCRIPTION	FUND HIGHLIGHTS
INVESTOR NEED: CAPITAL GROWTH		
Top 20	A concentrated portfolio of our top stock picks on the JSE.	Produced 1.5x the equity market's return at only 0.9x the equity market's risk since launch.
Balanced Plus	Best investment view across all asset classes. Ideal for retirement savers.	R100 000 invested at inception in 1996 is worth R837 862 today, compared to R592 933 achieved by its average competitor.
INVESTOR NEED: INCOME & GROWTH		
Capital Plus	Focused on providing a growing regular income. Ideal for investors in retirement.	Outperformed inflation by 8.5% p.a. since launch in 2001.
Balanced Defensive	A lower risk alternative to Capital Plus for investors requiring a growing regular income.	Top-decile performer over 2 years, 3 years and since launch in the Asset Allocation – Prudential Low Equity Category.
INVESTOR NEED: INCOME ONLY		
Strategic Income	Asset allocation across the yielding asset classes. Ideal for investment periods between 6 months and 2-3 years.	Outperformed cash by on average 2.3% per year since launch in 2001.

EXPECTED RISK VS. RETURN

Return = annualised returns



5-year performance and risk quoted from Morningstar as at 30 June 2010. Figures quoted in ZAR after all income reinvested and all costs deducted.



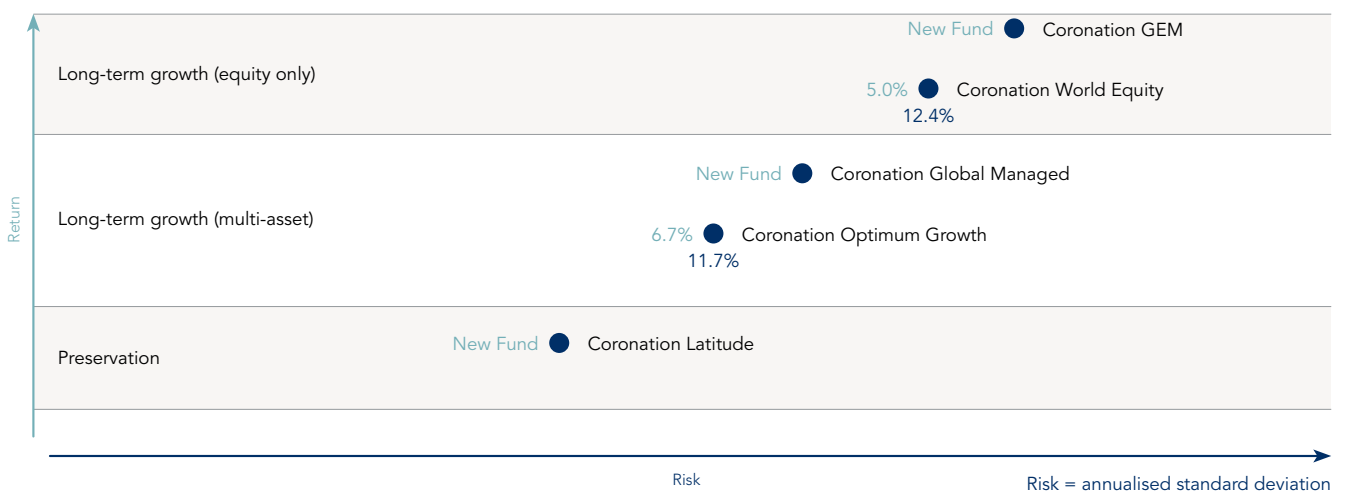
INTERNATIONAL

FUND ¹	FUND DESCRIPTION	FUND HIGHLIGHTS ²
INVESTOR NEED: CAPITAL GROWTH		
Global Emerging Markets Flexible Global Emerging Markets	Best investment view across emerging markets	Outperformed the MSCI EM Index (measured in US\$) by 5% p.a. since launch. The only dedicated emerging markets fund in SA.
World Equity [ZAR] Fund of Funds Global Opportunities Equity	A focused portfolio of the best developed market equity managers	Outperformed the MSCI World Index (measured in US\$) by 2.8% p.a. since launch in 1997.
Global Managed [ZAR] Global Managed	Best global investment view for US dollar investors	A new fund positioned to benefit from our belief that foreign assets will provide the best returns over the long term.
Optimum Growth	Best rand risk-adjusted returns from a global multi-asset portfolio	4th best performer out of 70 funds in the foreign and worldwide equity and flexible categories in 2009.
INVESTOR NEED: CAPITAL PRESERVATION		
Latitude [ZAR] Fund Global Capital Plus	Returns in excess of foreign cash while preserving capital in US dollars over any 12 months	Produced a US\$ return of 11% p.a. since inception in 2008, comprehensively beating its cash benchmark. The name of this fund will change to Global Capital Plus [ZAR] subject to regulatory approval.

1. Rand- and dollar-denominated fund names are included for reference.
2. Fund highlights refer to rand-denominated funds only.

EXPECTED RISK VS. RETURN

Return = annualised returns



5-year performance and risk quoted from Morningstar as at 30 June 2010.
Figures quoted in USD after all income reinvested and all costs deducted.

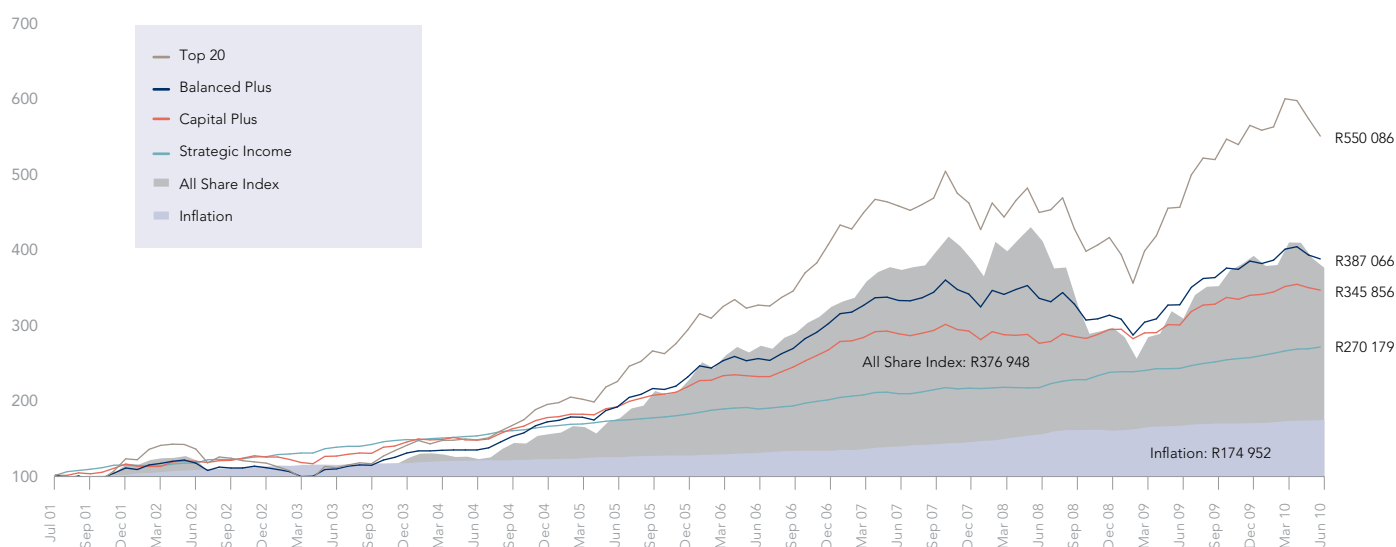
FUND	LAUNCH DATE	ANN RETURN SINCE LAUNCH ¹ (ZAR)	QUARTILE RANK SINCE LAUNCH	5 YEARS (ZAR)	5-YEAR QUARTILE RANK	3 YEARS (ZAR)
DOMESTIC FLAGSHIP						
INVESTOR NEED: CAPITAL GROWTH						
Top 20 FTSE/JSE Top 40 Index (ZAR)	1-Oct-00	22.54%	1st	19.63%	1st	6.38% (0.51%)
Equity FTSE/JSE Shareholder Weighted All Share Index (ZAR)	15-Apr-96	17.34%	1st	16.59%	1st	3.70% 1.12%
Balanced Plus Composite Benchmark ² (ZAR)	15-Apr-96	16.19%	1st	15.21%	1st	5.28% 3.57%
INVESTOR NEED: INCOME & GROWTH						
Capital Plus CPI + 4% per annum (ZAR)	2-Jul-01	14.78%	1st	12.62%	1st	6.34% 11.70%
Balanced Defensive CPI + 2.5% per annum (ZAR)	1-Mar-07	8.72%	1st	-	-	8.76% 10.20%
INVESTOR NEED: INCOME ONLY						
Strategic Income 110% of Short Term Fixed Interest 3-month Index + 3%	2-Jul-01	11.68%	1st	9.34%	1st	9.08% 10.59%

1. ANN RETURN SINCE LAUNCH = Annualised returns since launch.
2. Benchmark for the Balanced Plus Fund comprises: 63% Equity (Capped All Share Index), 22% Bonds (All Bond Index), 10% Foreign (60% MSCI Equity gross, 25% JP Morgan Global Bond Index, 15% JP Morgan USD 3-month Treasury Bill) and 5% Cash

Figures are quoted from Morningstar as at 30 June 2010 for a lump sum investment and are calculated on a NAV – NAV basis with income distributions reinvested.

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 30 June 2010. All income reinvested for funds; FTSE/JSE All Share Index is on a total return basis. Balanced Defensive is excluded as it does not have a meaningful track record.



Sources: Morningstar and I-Net Bridge



FUND	LAUNCH DATE	ANN RETURN SINCE LAUNCH ¹ (US\$)	QUARTILE RANK SINCE LAUNCH	5 YEARS (US\$)	5 YEAR QUARTILE RANK	1 YEAR (US\$)
INTERNATIONAL						
INVESTOR NEED: CAPITAL GROWTH						
Global Emerging Markets Flexible MSCI Emerging Markets (US\$)	1-Oct-00	(4.04%) (9.11%)	1st	- -	- -	16.09% 23.48%
World Equity [ZAR] FoF MSCI World Index (US\$)	15-Apr-96	5.39% 2.59%	1st	2.07% 0.61%	1st	10.08% 10.77%
Optimum Growth CPI+5% per annum (US\$)	15-Apr-96	10.71% 9.57%	1st	3.70% 8.72%	3rd	14.32% 10.09%
Global Managed ³ Composite Benchmark (US\$)	31-Oct-09	(2.35%) (3.40%)	2nd	- -	- -	- -
INVESTOR NEED: CAPITAL PRESERVATION						
Latitude (ZAR) 50% Libor + 50% Euribor (US\$) +1.5%	22-Sep-08	11.00% 1.67%	1st	- -	- -	5.86% (4.51%)

3. Benchmark for the Coronation Global Managed Fund comprises: 63% MSCI World (total return) Index, and 40% Citigroup World Government Bond Index.

Returns are in US\$. For rand returns, refer to fund fact sheet in the personal investments section of coronation.com.

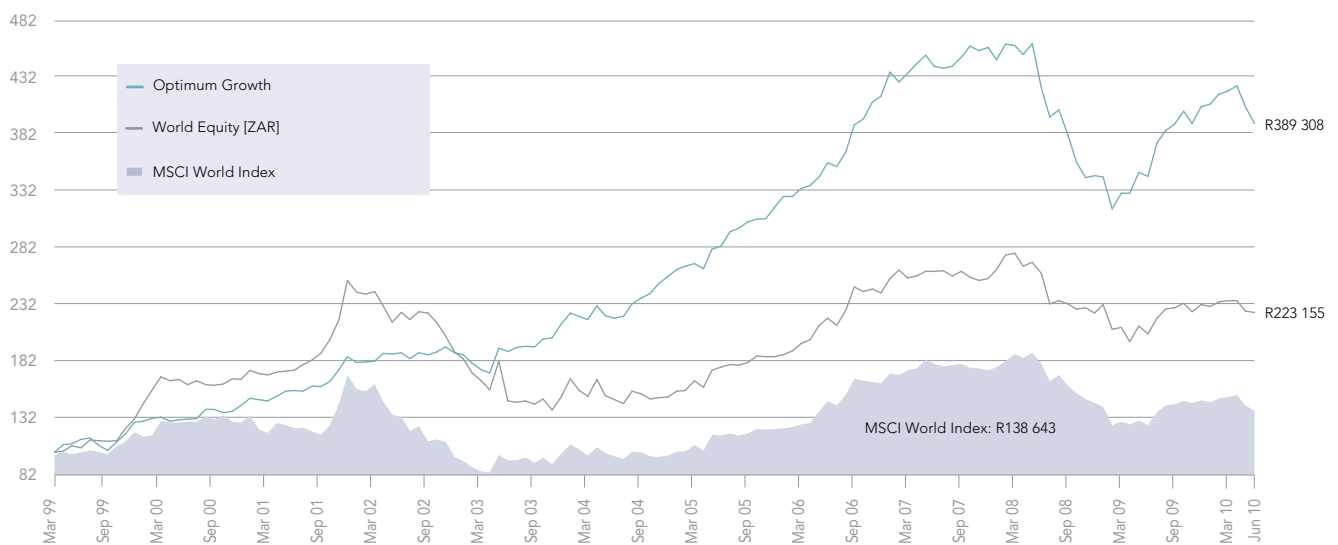
4. The name of this fund will change to Global Capital Plus subject to regulatory approval.

Unit trusts should be considered a medium- to long-term investment. The value of units may go down as well as up. Past performance is not necessarily an indication of future performance. Unit trusts 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. Commission and incentives may be paid and, if so, are included in the overall costs. Forward pricing is used. A member of the Association of Collective Investments, South Africa.

Full fund fact sheets including fee information available on our website www.coronation.com.

Growth of R100 000 invested in our international funds on 15 March 1999

Value of R100 000 invested in Coronation's rand-denominated international funds since inception of the Coronation Optimum Growth Fund on 15 March 1999 as at 30 June 2010. All income reinvested for funds; MSCI World Index is on a total return basis. Latitude, Global Emerging Markets Flexible and Global Managed are excluded as they do not have meaningful track records.

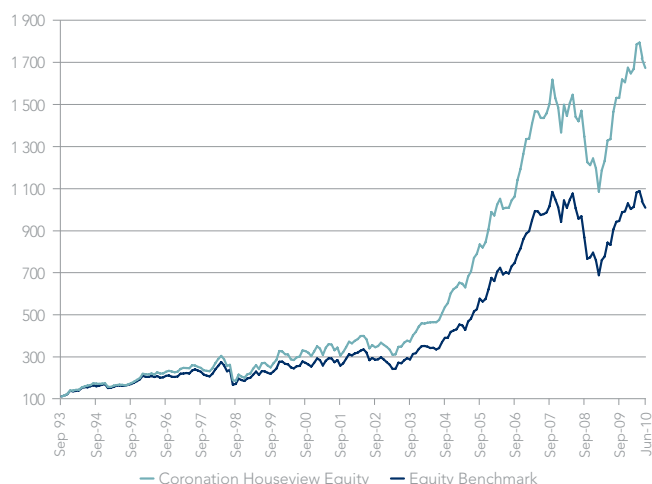


Sources: Morningstar and I-Net Bridge

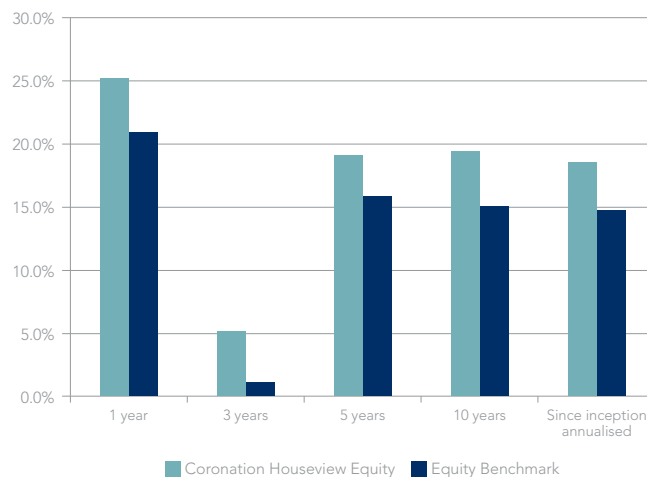
CORONATION HOUSEVIEW EQUITY* RETURNS VS. EQUITY BENCHMARK

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	23.33%	18.63%	4.70%
2006	28.36%	23.07%	5.29%
2007	33.77%	29.52%	4.26%
2008	23.35%	19.28%	4.07%
2009	22.21%	19.77%	2.44%
5 years to date	14.74%	11.56%	3.19%
ANNUALISED TO 30 JUNE 2010			
1 year	25.4%	21.3%	4.1%
3 years	5.2%	1.1%	4.1%
5 years	19.0%	16.2%	2.8%
10 years	19.3%	15.1%	4.1%
Since inception in October 1993 annualised	18.3%	14.8%	3.6%
Average outperformance per 5-year return			3.50%
Number of 5-year periods outperformed			13.00
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 **R1 673 916** by 30 June 2010. By comparison, the returns generated by the Equity Benchmark over the same period would have grown a similar investment to **R1 004 264**.

* 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.



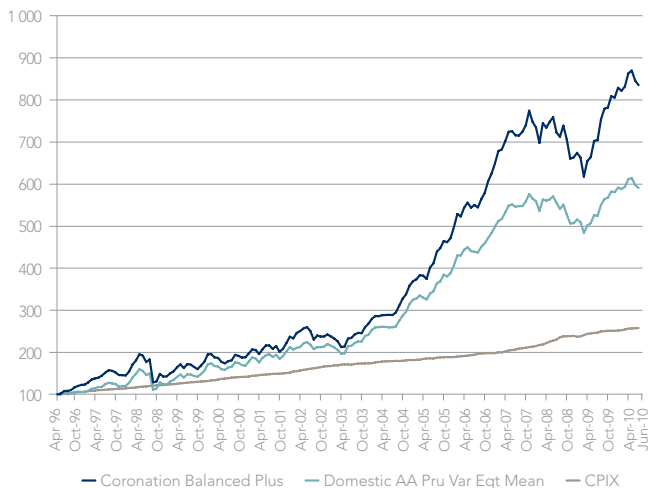
CORONATION BALANCED PLUS FUND VS INFLATION AND AVERAGE COMPETITOR†

5-YEAR ANNUALISED RETURNS	CORONATION BALANCED PLUS	INFLATION	REAL RETURN
56 months to 31 December 2000	15.69%	7.90%	7.79%
2001	14.05%	7.41%	6.65%
2002	10.43%	8.04%	2.39%
2003	14.43%	7.33%	7.10%
2004	13.64%	6.68%	6.95%
2005	20.39%	5.85%	14.54%
2006	22.36%	5.54%	16.82%
2007	25.35%	5.17%	20.18%
2008	19.28%	6.41%	12.87%
2009	17.60%	6.82%	10.77%
5 years to date	12.95%	7.65%	5.30%

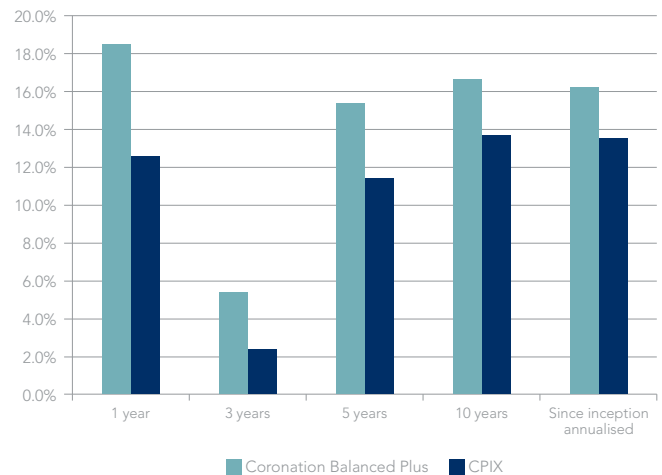
ANNUALISED TO 30 JUNE 2010	CORONATION BALANCED PLUS	AVERAGE COMPETITOR	ALPHA
1 year	18.6%	12.7%	5.9%
3 years	5.3%	2.7%	2.6%
5 years	15.2%	11.4%	3.9%
10 years	16.7%	13.7%	3.0%
Since inception in April 1996 annualised	16.2%	13.4%	2.8%

Average 5-year real return	10.12%
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%	1

CUMULATIVE PERFORMANCE



ANNUALISED RETURNS SINCE INCEPTION



An investment of R100 000 in Coronation Balanced Plus on 30 April 1996 would have grown to **R837 862** by 30 June 2010. 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 **R592 933**.

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



**MEET THE FUTURE YOU.
HE SAYS, "WISE MOVE FOR INVESTING
OFFSHORE WITH CORONATION."**

What you see is what you get. Through the low-risk Coronation Global Capital Plus Fund we've replicated our success in managing absolute funds. By investing in selected opportunities across international markets, Global Capital Plus delivers solid returns and preserves capital all at the same time. You can invest in rands or dollars by contacting your financial advisor or calling us on 0800 22 11 77.

CORONATION 
FUND MANAGERS



Coronation Asset Management (Pty) Ltd is an authorised financial services provider. Unit trusts are generally medium to long-term investments. The value of units may go up as well as down. Past performance is not necessarily an indication of the future. Unit trusts are traded at ruling prices and can engage in borrowing and scrip lending. Fluctuations or movements in exchange rates may cause the value of underlying international investments to go up or down. Fund valuations take place at approximately 15H00 each business day and forward pricing is used. Performance is measured on NAV prices with income distribution reinvested. Performance figures are quoted after deduction of all costs incurred within the fund. Coronation is a full member of the Association of Savings & Investment SA.