# CORONATION BOND FUND
**as at 31 December 2005**

2005 in the fixed income market will be remembered for a relatively stable rand, and an inflation rate (despite a material increase in the petrol price) that surprised on the downside, averaging 3.9% in 2005 versus 4.3% in 2004. The subdued inflation rate allowed the Reserve Bank to reduce the repo rate by a further 50 basis points in April (bringing total rate cuts in the cycle to total 650 basis points so far). The rate cut together with low inflation, robust growth, strong fiscal performance and foreign demand for emerging market investments, resulted in bond yields falling to their lowest levels.

Although local bond yields have reached new record lows and the All Bond Index (ALBI) showed another year of gains, diminishing returns are setting in because of the base. While the ALBI returned 10.8% last year, this was in fact its weakest performance since 1998. Moreover, local bonds far underperformed a stellar equity market return of over 47% in 2005, although they did outperform cash (7.1%). Longer-dated bonds were the best performers in the ALBI: the 12+ years maturity area returned 13.3%, while the 1-3 year area returned 7.7%.

The Coronation Bond Fund produced a return of 4.8%, pretty much in line with the ALBI return of 5.0% over the past quarter. For the year the fund returned 10.9% (net of fees), marginally above the ALBI return of 10.8%. Almost half the fund's return for the year came in the fourth quarter. Inflation-linked bonds, the star bond market performer for the preceding three quarters, finally took a little bit of a breather but still managed to notch a 4.7% return in the quarter. However on a year to date basis, they handsomely outperformed both individual nominal bonds and the ALBI, producing a 17.2% return.

The bull rally in the fourth quarter gained impetus from a stronger rand and two consecutive lower than expected inflation releases. Positive underlying sentiment towards emerging markets, stronger than expected US treasury bonds and a boost from a rising gold price all added to the underlying positive sentiment in November and December. The Emerging Market Bond Index (EMBI) spread reached a new record low in December.

One of the catalysts that caused the bond market to shrug off its lethargy occurred at the beginning of November with the announcement of the take out of VenFin by foreign investor Vodafone. The transaction would result in another material foreign direct investment flow into South Africa (following the Barclays/Absa deal) and continue to provide underlying support for the rand, which we believe would positively influence the country risk premium and the resultant stronger rand will likely keep inflation well and truly in check. Applying this view to our investment strategy, we closed out the fund's underweight duration position relative to the ALBI. The purchases resulted in the fund moving from a modified duration of 3.5 to 4.95 in line with the ALBI's modified duration.

Moving the duration of the fund to neutral has so far proved to be the correct decision as the long-dated area of the market has rallied in excess of 60 basis points since the purchases were made.

Statements from MPC meetings in October and December were worlds apart, with the Governor in October adopting a decidedly hawkish stance and warning of having to raise short rates if second round effects of a rampant oil price fed through to inflation, while in December after CPIX had surprised on the downside for the previous two months, his MPC statement took a much more dovish stance.

The yield curve experienced a fair degree of flattening during the fourth quarter as the shorter-dated area was held in check by static money market rates while demand for long-dated bonds on a benign inflation outlook continued unabated. The spread between the 10-year and three-year bonds narrowed from 53 basis points at the beginning of the quarter to 26 basis points at year end.

During the quarter corporate credit issuance continued at a rapid pace as a number of issuers saw value in locking in funding at the current low levels of rates. Credit spreads continue to trade at tight margins, and we tended to avoid the majority of new issuance as we did not feel that the spread was compensating the investor sufficiently for the risk being taken. The exception was the corporate bond issued by Old Mutual which we felt provided sufficient value and we established a holding in that bond in the fund. Credit exposure continues to run at a reasonably conservative 16% of the fund.

Looking forward, both global and domestic backdrops are likely to remain benign for bonds, but not as good as last year. We would expect an upward drift in bond yields this year. We would also like to emphasise the point made earlier about 'diminishing returns'. We think bond yields could be close to their lows at the moment, but even if they do fall further, this will be off an already low base and bonds will be hard pressed to match the returns seen in preceding years. For a South African investor, it is also unlikely that bond returns would be able to match equity returns, even if those are (as expected) significantly below the heady returns of last year.

Mark le Roux
Portfolio Manager

# CORONATION BOND FUND
**as at 31 December 2005**

CORONATION FUND MANAGERS

| | |
|---|---|
| Fund category | Domestic Fixed Interest Bond |
| Launch date | 1 August 1997 |
| Portfolio manager | Mark le Roux |
| Fund size | R186.7 million |
| NAV | 1347.91 cents |
| Annual management fee | 0.75% (ex VAT) |

| | |
|---|---|
| Benchmark | BEASSA ALBI Index |
| Fund description | Seeks to provide investors with a well-diversified exposure to the SA bond market. |

## ASSET ALLOCATION

| Maturity Band | 31 Dec 2005 | 30 Sep 2005 |
|---|---|---|
| 0 – 1 year | 7.90% | 14.65% |
| 1 – 3 years | 14.87% | 10.07% |
| 3 – 7 years | 20.50% | 50.22% |
| 7 – 12 years | 29.54% | 14.31% |
| 12+ years | 27.19% | 10.75% |

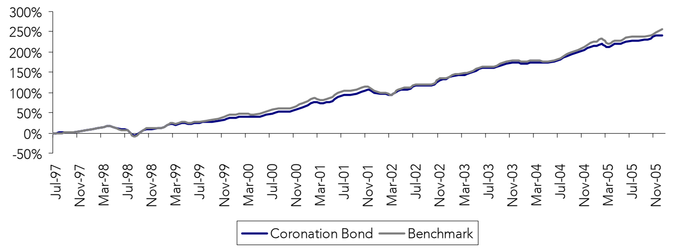
## PERFORMANCE & RISK STATISTICS

| | Fund | Benchmark |
|---|---|---|
| Latest 12 months | 10.96% | 10.80% |
| Latest 36 months (annualised) | 14.09% | 14.67% |
| Latest 60 months (annualised) | 16.15% | 15.55% |
| Since inception (annualised) | 15.89% | 16.30% |
| Annual deviation since inception | 8.32% | 9.99% |
| Sharpe ratio | 0.51 | 0.48 |
| Maximum gain | 26.21% | 26.36% |
| Maximum drawdown | -19.02% | -22.26% |
| Positive months | 79.21% | 77.23% |

## ANNUAL RETURNS SINCE INCEPTION

| | Fund | Benchmark | Active Return |
|---|---|---|---|
| 2005 | 10.96% | 10.80% | 0.16% |
| 2004 | 13.94% | 15.25% | -1.31% |
| 2003 | 17.47% | 18.07% | -0.60% |
| 2002 | 16.32% | 15.96% | 0.36% |
| 2001 | 22.36% | 17.84% | 4.52% |
| 2000 | 19.43% | 19.44% | -0.01% |
| 1999 | 23.05% | 28.73% | -5.68% |
| 1998 | 5.00% | 5.04% | -0.04% |
| 1997 | 6.08% | 7.12% | -1.04% |

## CUMULATIVE PERFORMANCE SINCE INCEPTION




## INCOME DISTRIBUTIONS

| Declaration | Payment | Amount | Interest |
|---|---|---|---|
| 30/09/2005 | 01/10/2005 | 49.05 | 49.05 |
| 31/03/2005 | 01/04/2005 | 59.42 | 59.42 |
| 30/09/2004 | 01/10/2004 | 83.29 | 83.29 |
| 31/03/2004 | 01/04/2004 | 66.02 | 66.02 |

## PERFORMANCE RETURNS

| | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sept | Oct | Nov | Dec | YTD |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Fund 2005 | 1.04% | 1.38% | -2.11% | 2.01% | 0.35% | 2.02% | 0.62% | 0.16% | 0.32% | 0.70% | 2.12% | 1.91% | 10.96% |
| B'mark 2005 | 1.45% | 1.99% | -3.67% | 2.06% | -0.12% | 2.69% | 1.00% | 0.02% | 0.08% | 0.63% | 2.37% | 1.97% | 10.80% |
| Fund 2004 | -0.59% | 0.88% | 0.19% | -0.67% | 0.20% | 0.95% | 1.75% | 3.29% | 1.19% | 1.86% | 1.86% | 2.29% | 13.94% |
| B'mark 2004 | -1.03% | 0.96% | -0.23% | -0.81% | 0.14% | 1.12% | 1.98% | 3.51% | 1.28% | 2.17% | 2.25% | 3.06% | 15.25% |

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