

Last year was an excellent year for the Coronation Income Fund which took top honours at the 2006 Raging Bull Awards for the best risk-adjusted return over three years, and was ranked Best in Sector at the Standard & Poor's Awards for the year to end December 2005.

The Coronation Income Fund has had a good start to the year with the fund returning 1.7% for the first quarter.

In a relatively rare turn of events, the SA bond market produced a negative return in March. The All Bond Index (ALBI) fell by 0.23% over the month, although shorter-dated bonds did produce small positive returns. Over the first quarter, bonds still produced a positive return of 1.5%. Again, the shorter area was the place to be: the 1 - 3 and 3 - 7 year areas each returned 1.8%, but longer bonds produced less.

The ALBI was the worst performer in both March and in the first quarter, being beaten even by cash (+1.7%) and, as has become commonplace, by inflation-linked bonds (+2.7%).

It certainly was not as though any great problem beset South Africa in particular; on the contrary, the bond market took heart from a continued relatively strong rand and contained inflation. Rather, we saw bonds weaken as a spillover from jitters in global markets – something that we have been highlighting as a potential risk for a while.

It seems that March marks the lower turning point in global bond yields too. Indeed, since then, bond yields in developed countries have generally risen to levels that are around two-year highs (though in absolute, historical terms they remain relatively low). To some extent this represented the Federal Reserve pulling US bonds kicking and screaming upwards, as it continued a steady upward move in the Fed funds rate (now at 4.75%, well above what consensus had expected a year ago).

In Europe official interest rates are on the rise – with more expected to come over the course of this year. But most interesting has probably been the confirmation of a structural change in Japan: the “end of deflation” has been proclaimed; the Bank of Japan has started to withdraw “quantitative easing” and is expected to actually raise rates sometime during the second half of the year.

Despite all this, emerging markets continued to perform well. The current line of thinking seems to be that despite the gradual withdrawal of liquidity, global growth remains robust and so emerging markets – most of which export commodities or are otherwise geared to the global growth cycle – will continue to perform well.

While accepting that this is a valid argument, we also remain somewhat cautious. South Africa will continue to do well as long as the general emerging market universe is in favour, but we note that some jitters have set in with some emerging markets (Iceland, Hungary) and some developed commodity exporters (New Zealand) finding their currencies under pressure. The rand did not escape a bout of the jitters, though at the time of writing it has retraced its losses. We remain concerned that falling global risk appetite will see currency weakening of countries that are running large current account deficits and in turn potentially place upward pressure on inflation and interest rates; South Africa would fall into this grouping.

Of course, local developments are also important in determining a final value for bond yields: while global bond market movements are likely to be a primary determinant of trend, local issues will affect South African bond spreads versus other countries. Inflation, while expected to drift up further from its trough, is not expected to provide any major scares (unless there is a sharp move downwards in the rand). However, other local developments support at best an unchanged repo rate, with risks that the next move is up – a point of view now publicly espoused by Governor Mboweni. The main concern from a monetary policy perspective at present is the booming domestic economy; while higher growth is good, the extent of what we are seeing appears to be stretching the economy's capacity. Such imbalances show up in the ever-widening current account deficit; if left unchecked to grow indefinitely, this will eventually become unsustainable with a potentially messy rand (and inflation) outcome as a result.

We would expect the upward drift in bond yields to continue this year. During the quarter we trimmed down the government bond position, mostly via the R194 and the R198, and increased our holding to a selection of corporate bonds. The inflation-linked bonds remain a core holding in the fund (6.5%) acting as an inflation hedge and portfolio diversifier. They contributed positively to the quarter's performance, with real yields having rallied again on the back of very aggressive demand.

Tania Miglietta
Portfolio Manager

Fund category	Domestic Fixed Interest Income
Launch date	3 April 2000
Portfolio manager	Tania Miglietta
Fund size	R120.6 million
NAV	1121.84 cents
Annual management fee	0.75% (ex VAT)

Benchmark	BEASSA ALBI (1 – 3 year) TR Index
Fund description	Aims to provide a high level of current income with moderate levels of capital growth. Stability of capital invested is of prime focus.

ASSET ALLOCATION

Maturity Band	31 Mar 2006
0 – 12 months	60.09%
1 – 3 years	27.36%
3 – 7 years	6.18%
7 – 12 years	3.01%
12+ years	3.36%

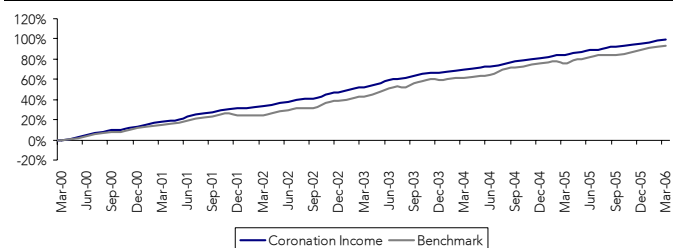
PERFORMANCE AND RISK STATISTICS

	Fund	Benchmark
Latest 12 months	8.28%	9.41%
Latest 36 months (annualised)	9.44%	10.51%
Latest 60 months (annualised)	11.07%	10.97%
Since inception (annualised)	12.18%	11.56%
Annual deviation since inception	1.91%	2.72%
Sharpe ratio	1.09	0.54
Maximum gain	99.26%	26.14%
Maximum drawdown	0.00%	-1.54%
Positive months	98.61%	88.89%

ANNUAL RETURNS SINCE INCEPTION

	Fund	Benchmark	Active Return
2005	8.16%	7.70%	0.46%
2004	8.52%	10.17%	-1.64%
2003	13.64%	15.02%	-1.38%
2002	12.16%	11.50%	0.66%
2001	15.75%	11.56%	4.19%
2000	13.14%	11.54%	1.60%

CUMULATIVE PERFORMANCE SINCE INCEPTION



INCOME DISTRIBUTIONS

Declaration	Payment	Amount	Interest
31/03/2006	01/04/2006	17.85	17.85
31/12/2005	01/01/2006	24.61	24.61
30/09/2005	01/10/2005	22.16	22.16
30/06/2005	01/07/2005	33.05	33.05

PERFORMANCE RETURNS

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	YTD
Fund 2006	0.56%	0.60%	0.53%										1.70%
B'mark 2006	0.74%	0.74%	0.35%										1.84%
Fund 2005	0.64%	0.67%	0.27%	0.93%	0.68%	0.90%	0.49%	0.57%	0.59%	0.52%	0.91%	0.70%	8.16%
B'mark 2005	0.34%	0.96%	-1.05%	1.69%	0.41%	1.25%	0.75%	0.31%	0.18%	0.24%	1.40%	0.99%	7.70%