

The SA bond market returned 0.9% for the quarter. This lacklustre performance should be seen in the light of more negative surprises on CPIX inflation, two interest rate hikes, an intensification of the credit crunch overseas, and a widening in emerging market spreads. Against that backdrop, the fact that bonds managed a positive return is actually not bad at all! The only really supportive factor was a decline in US bond yields, though that was largely a combination of flight-to-quality bids and fears about US growth, neither of which is particularly healthy for SA. The rand moved largely sideways over the quarter, with a brief spurt of strength in late October/early November proving unsustainable. The all-bond index underperformed both cash and inflation-linked bonds for the quarter and the year.

Bond and Money Market (local currency returns)

Name	December 2007	3 months	6 months	12 months	Year-to-date
All Bond	0.86%	0.9%	4.3%	4.2%	4.2%
GOVI	0.86%	1.0%	4.3%	4.4%	4.4%
OTH1	0.84%	0.2%	4.0%	3.2%	3.2%
Bonds 1-3 Years	1.05%	1.3%	4.1%	7.1%	7.1%
Bonds 3-7 Years	0.77%	0.4%	3.6%	5.2%	5.2%
Bonds 7-12 Years	0.85%	0.9%	4.4%	4.3%	4.3%
Bonds 12+ Years	0.66%	0.4%	4.8%	1.4%	1.4%
Cash	0.90%	2.7%	5.2%	10.1%	10.1%
Barclays BESA Govt Inflation-Linked Bonds	0.80%	5.4%	6.8%	9.2%	9.2%

Source: Deutsche Securities

Each of the three CPIX inflation releases during the final quarter of the year surprised market forecasts on the upside, and the end result was that CPIX had moved up sharply from 6.3% in August to 7.9% in November. This is well above the upper limit of the SA Reserve Bank's (SARB) 3% - 6% target range. The December figure, to be released at the end of January, will almost certainly be well north of 8%. The fact that the driving factors behind the inflation rise remained food and energy added to the SARB's concerns about second-round effects, and the data most probably sealed the decision to raise the repo rate 50 basis points at each of the October and December MPC meetings. The repo rate has now increased by a total of 400 basis points in this cycle.

However, the news was not all bad from an inflation perspective, and indeed from a forward-looking standpoint there are clear signs of improvement. The rand has generally remained stable (not just over the quarter but throughout 2007) and the lagged effect of this will help dampen CPIX beyond the first quarter of 2008. Indeed, the stable rand has already had something of a positive impact on PPI, and unlike CPIX that has tended to surprise on the downside. PPI is a leading indicator of CPIX trends. Meanwhile, the SARB's other stated concern – consumer spending – has shown signs of a sharp slowdown in recent data, and it can only be a matter of time before this is reflected to an acceptable extent in the credit data.

The SARB continues to find itself in a tight spot, with no sign of pressure easing on food and fuel prices, yet all indications are that more than enough pressure has been brought to bear on consumers. There must be a limit to the extent to which exogenous factors (and here we would include Eskom tariff increases) can drive monetary policy in the face of slumping consumer spending. It may be an opportune time to stick our necks out and say that it is likely time that the SARB will pause at the January MPC to see the effects of previous rate hikes – particularly if it is forward-looking.

The international backdrop will continue to be crucial. There are heightened concerns about growth in certain developed markets, particularly in the US. This could keep US bond yields low. However, if the credit crunch continues, risk aversion may stay relatively high and risky assets may stay under pressure. Capital flows into SA have been a key factor supporting the rand in the face of the wide current account deficit, and the rand could become vulnerable if sentiment towards emerging markets in general turns negative. This will remain a key risk this year. A positive side effect may be that concerns about growth should help alleviate some of the pressure recently seen on oil prices.

From a domestic perspective, the outlook is cloudier in the shorter term than the medium term. CPIX is expected to remain elevated in the first quarter, but should begin declining meaningfully from the second quarter and should slip back inside the target range by the third quarter. Coupled with what we expect to be continued evidence of a consumer slowdown, this should provide space for interest rate reductions in the second half of this year. This more positive outlook for bonds is again predicated on the assumption that any depreciation in the currency will be moderate, and is again held hostage to developments in oil and food prices. While the medium term outlook is basically positive, therefore, it remains fraught with risks and the SARB is likely to remain cautious. This fundamentally positive outlook tempered by a number of risks probably argues for keeping duration fairly close to the benchmark at present.

Interest rates in SA have been rising for the last 18 months. In this environment we aim to protect capital as much as possible by reducing exposure to the longer duration assets such as bonds and property and investing the proceeds into cash. When we believe the rising cycle has topped out, we will reverse this action by increasing duration via bonds and property. In June 2007 the portfolio held no government bonds. We took the view that the top of the interest rate cycle had arrived, and that there was sufficient monetary policy tightening in the system by the SA Reserve Bank to curb rising inflation. Thus we bought some bonds and longer dated money market NCDs locking in the much higher yields on offer (9 – 11% pa for 2 – 3 years). Oil and food prices surged in the second half of 2007, prompting the central bank to continue hiking the repo rate by a further 2%.

We continue to believe that there is sufficient tightening in the cycle to bring inflation back into the target range by the end of this year, thus allowing the MPC to begin the process of reducing interest rates towards the end of 2008. The portfolio is currently positioned for the top of the interest rate cycle via the large holding in high yielding NCDs and longer maturity bonds. This barbell positioning enables us to achieve a longer modified duration (currently 1.69) without losing out on yield. The portfolio is now yielding 10.3%.

The fund's preference share and property exposures remain unchanged. The fund continues to be managed in a conservative manner, with the main focus on achieving a high yield for investors, taking cognisance of the volatility inherent in the market at the moment and the speed with which the interest rate cycle can turn.

Mark le Roux and Tania Miglietta
Portfolio Managers

Fund category
Fund description

Domestic Fixed Interest Varied Specialist
A widely diversified, actively managed fund that aims to provide a higher level of income than a pure income fund.

Launch date

2 July 2001

Portfolio manager/s

Fund size

NAV

Benchmark/performance fee hurdle

Mark le Roux and Tania Miglietta
R5.5 billion
1308.46 cents
BEASSA ALBI (1 - 3 year) TR Index

PORTFOLIO DETAIL

EFFECTIVE ASSET ALLOCATION EXPOSURE

Sector	31 Dec 2007
Domestic Assets	100.0%
Cash/Money Market	52.2%
Bonds	30.2%
Listed Property	9.3%
Preference Shares	7.7%
Other investments	0.6%
International Assets	0.0%

INCOME DISTRIBUTIONS

Declaration	Payment	Amount	Dividend	Interest
31/12/2007	01/01/2008	24.14	1.11	23.03
30/09/2007	01/10/2007	25.33	2.82	22.51
30/06/2007	01/07/2007	23.45	1.10	22.35
31/03/2007	01/04/2007	21.66	0.30	21.36

MONTHLY PERFORMANCE RETURNS

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Fund 2007	1.69%	0.79%	0.67%	1.70%	0.18%	-1.06%	0.02%	1.21%	1.24%	1.34%	-0.76%	0.49%
Fund 2006	1.17%	1.61%	0.87%	0.66%	0.42%	-1.05%	0.73%	0.78%	0.70%	1.78%	1.33%	0.96%
Fund 2005	0.70%	0.92%	0.26%	0.88%	1.16%	0.76%	0.48%	0.73%	0.68%	0.65%	0.87%	1.35%

FEES (excl. VAT)

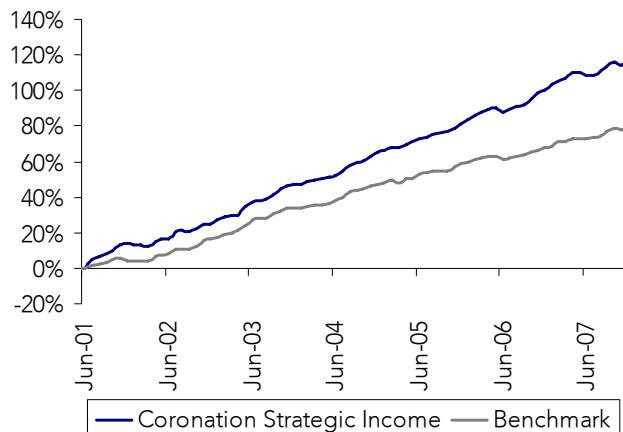
Initial Fee	Coronation: 0.00%
Annual Management Fee*	1.00%
* A portion of Coronation's annual management fee may be paid to administration platforms like LISP's as a payment for administrative and distribution services.	
Total Expense Ratio (TER) ²	1.12% per annum

Advice Costs (excluding VAT)

- Initial and ongoing advice fees may be facilitated on agreement between the Client and Financial Advisor.
- An initial advice fee may be negotiated to a maximum of 3% and is applied to each contribution and deducted before investment is made.
- Ongoing advice fees may be negotiated to a maximum of 1% per annum (if initial advice fee greater than 1.5% is selected, then the maximum annual advice fee is 0.5%), charged by way of unit reduction and paid to the Financial Advisor monthly in arrears. This annual advice fee is not part of the normal annual management fee as disclosed above.
- Where commission and incentives are paid, these are included in the overall costs.

PERFORMANCE AND RISK STATISTICS¹

CUMULATIVE PERFORMANCE SINCE INCEPTION



PERFORMANCE FOR VARIOUS PERIODS

	Fund	Benchmark	Out-performance
Year to date	7.73%	7.07%	0.66%
Latest 12 months (annualised)	7.73%	7.07%	0.66%
Latest 36 months (annualised)	9.32%	6.80%	2.52%
Latest 60 months (annualised)	11.54%	9.07%	2.47%
Since inception (annualised)	12.55%	9.42%	3.12%
2006	10.40%	5.65%	4.75%
2005	9.85%	7.70%	2.16%
2004	11.88%	10.17%	1.71%
2003	18.09%	15.02%	3.07%

RISK STATISTICS SINCE INCEPTION

	Fund	Benchmark
Annualised deviation	3.52%	2.72%
Sharpe ratio	0.80	-0.10
Maximum gain	29.19%	15.89%
Maximum drawdown	-1.29%	-1.85%
Positive months	91.03%	85.90%