

In another challenging quarter for financial shares, the fund returned -2.2%, against the index return of -1.6%. The consistent decline in share prices in the sector over the past five months has reduced the one year return on the fund to 25.9% and a compound per annum return over three years to 28.7%.

This was a quarter in which newsflow was probably the most negative for banks, with a further 50 basis point increase in domestic interest rates, the effects of the National Credit Act starting to become apparent, and the sub-prime crisis and its impact across a number of developed economies making headlines. Share prices have been volatile, but despite this the banks outperformed the life insurance sector for the period, effectively staying level while the life stocks retreated by 4.3%. This is probably a function of two things:

- As pointed out in our previous commentary, valuations were very attractive going in to the period – it would appear that much of the impact of domestic drivers had already been discounted into bank share prices
- SA banks have very little if any direct exposure to the sub-prime market, with only FirstRand and Investec carrying immaterial balance sheet positions (\$2 million and £22 million respectively.) The crisis has however put pressure on the ability of banks around the world to access inexpensive short term funding, and local banks will be no exception.

The turmoil in the credit markets serves as a useful reminder of why banks continue to be rated globally as discount businesses. Northern Rock, a UK mortgage lender, was probably the most publicised casualty of the sub-prime crisis – it constituted the first run on a bank in that country in over a century. The irony is that its near-demise was not caused by lending to poor quality borrowers, but rather due to a number of banks on the other side of the Atlantic doing just this, which had the effect of extreme tightening in the short-term funding market on which the Northern Rock business model was so dependent. (US banks would repackage or securitise the high risk loans into units and sell these units off to investors. As the US sub-prime borrowers unsurprisingly defaulted on their mortgages, the market for all types of securitised paper simply dried up.)

Times of volatility often provide opportunity, and this was no exception. The Investec share price has been under severe pressure since concerns about the sub-prime market first began to surface. At about the same time, Investec spent £220 million buying Kensington, a UK lender into what is termed the non-conforming market – i.e. borrowers whose basic incomes may not qualify for large mortgages, but whose variable incomes (for example in the form of bonuses or commissions) would support a higher level of indebtedness.

As the Northern Rock crisis unfolded in the UK, it dragged down with it other banks that had exposure to the mortgage lending market, Investec included. The quality of this book is probably poorer than initially thought, and while the timing of the acquisition was clearly not optimal the nature of the investment is typical of the company's opportunistic style; one which has in the majority of cases created value for shareholders over the longer term. Kensington will contribute in the region of 5% to earnings, and the market appears to have overstated its significance to the group. Investec's market value has declined by over 30% (£1.5 billion) from its peak, and we consider this an attractive opportunity to build a position in an asset that includes businesses with high quality annuity earnings (private banking and asset management) where the high level of the more volatile earnings streams is now appropriately discounted in the share price.

Banks and insurers released their results to June during the period, all reporting strong earnings growth with the exception of Old Mutual and Mutual and Federal. As expected the growth in retail earnings in the banks slowed as the impact of 300 basis points of interest rate increases takes effect, and bad debts start to normalise. This was to a large extent compensated for good by growth in corporate and commercial banking, and we expect this trend to continue. The market is currently placing a 60% probability of a further 50 basis point rate hike, and we are increasingly concerned about the potential impact on the consumer and hence retail banking (and particularly vehicle and asset finance) if this were to happen.

The domestic life insurers reported solid embedded value returns in excess of 20% on an annualised basis, supported by higher equity markets and good growth in the value of new business. Encouragingly, new business flows were strong, aided by a recovery in retirement annuity sales and continued growth in risk products.

Notwithstanding our comments on the impact of another interest rate increase above, we continue to see the banks as being inexpensively priced given their attractive long-term earnings prospects and diversified earnings streams. Within the life insurance sector, we believe certain stocks continue to offer compelling value, and the fund is positioned accordingly.

Neill Young
Portfolio Manager

Fund category
Fund descriptionDomestic Equity Financial
Invests in a broad range of financial shares, including banks, insurance and investment companies.

Launch date

1 July 1998

Portfolio manager

Fund size

NAV

Benchmark/performance fee hurdle

Neill Young

R995.6 million

2671.52 cents

FTSE/JSE Africa Financial Index

PORTFOLIO DETAIL

EFFECTIVE ASSET ALLOCATION EXPOSURE

Sector	30 Sep 2007
Domestic Assets	100.00%
Equity	96.29%
Industrials	3.31%
Financials	92.98%
Real Estate	3.09%
Cash	0.62%
International Assets	0.00%

TOP 10 HOLDINGS

As at 30 September 2007	% of Fund
Standard Bank Group Ltd	20.67%
FirstRand Ltd	20.47%
Old Mutual Ltd	11.42%
Discovery Holdings Ltd	7.43%
Liberty Group Ltd	7.06%
Absa Group Ltd	6.28%
African Bank Ltd	4.07%
Investec	4.01%
Remgro Ltd	3.32%
JSE Ltd	3.28%
Total	88.01%

INCOME DISTRIBUTIONS

Declaration	Payment	Amount	Dividend	Interest
30/09/2007	01/10/2007	10.40	9.58	0.82
31/03/2007	01/04/2007	48.55	47.47	1.08
30/09/2006	01/10/2006	46.90	45.39	1.51
31/03/2006	01/04/2006	13.80	12.45	1.35

MONTHLY PERFORMANCE RETURNS

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Fund 2007	4.43%	0.27%	4.47%	6.87%	-3.85%	-4.77%	1.00%	-0.47%	-2.73%			
Fund 2006	7.01%	0.60%	3.69%	0.43%	-5.96%	-4.35%	2.94%	1.45%	1.68%	7.56%	3.63%	7.94%
Fund 2005	0.30%	3.52%	-2.03%	-0.91%	2.54%	3.02%	8.57%	0.52%	2.04%	-1.46%	3.14%	9.55%

FEES (excl. VAT)

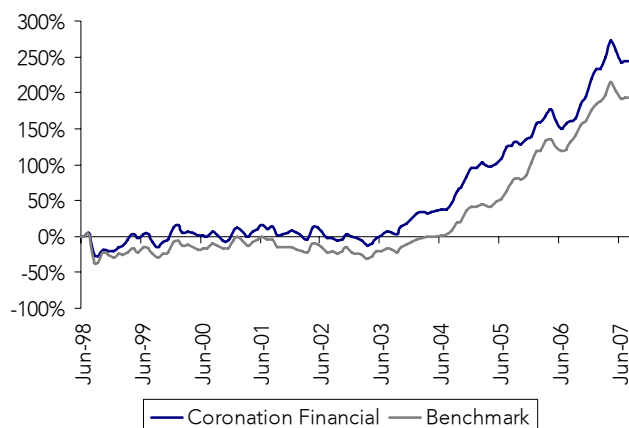
Initial Fee*	Coronation: 0.00% (Direct)
Annual Management Fee**	1.25%
*An initial fee of 0.25% will be charged on all investments placed via administration platforms like Linked Investment Service Providers (LISP's).	
**A portion of Coronation's annual management fee may be paid to administration platforms like LISP's as a payment for administrative and distribution services.	
Total Expense Ratio (TER)²	1.43% 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	4.67%	3.78%	0.89%
Latest 12 months (annualised)	25.94%	19.17%	6.76%
Latest 36 months (annualised)	28.61%	31.41%	-2.80%
Latest 60 months (annualised)	29.80%	28.73%	1.08%
Since inception (annualised)	14.40%	11.27%	3.13%
2006	28.83%	35.83%	-7.00%
2005	32.02%	34.69%	-2.67%
2004	57.09%	52.38%	4.71%
2003	25.19%	17.92%	7.28%

RISK STATISTICS SINCE INCEPTION

	Fund	Benchmark
Annualised deviation	21.31%	23.83%
Sharpe ratio	0.16	0.01
Maximum gain	53.63%	80.40%
Maximum drawdown	-30.89%	-39.78%
Positive months	61.26%	63.06%