

The first quarter of 2008 was a challenging one for the manager of any financial sector fund. The index returned -12.8% for the period, the largest quarterly decline in 5 years, and the first time in the 10-year history of the fund that the index has registered four consecutive negative-return quarters. So widespread was the rout that only one share in the universe, Liberty International (a UK listed property stock and a top 5 holding in the fund) delivered a positive return, and this was due solely to rand weakness – in sterling it was down 9%. For the quarter the fund returned -13.5%, over one year -16.1% and over 3 years a compound annual return of 15.4%.

We concluded our previous quarterly commentary with an optimistic outlook; we felt there were sufficient grounds to anticipate better returns in 2008 than the 6% return that the fund achieved in 2007. Clearly with this sort of start to the year, that target becomes somewhat of a challenge. However, the reasoning behind our view remains unchanged – South African financial stocks are inexpensively rated and offer compelling value.

From our point of view, two principal drivers have been behind the de-rating experienced by South African financial shares over the last 12 months. The first is the impact of the slowdown in domestic economic growth - tighter monetary policy has resulted in higher bad debt write-offs by the banks and increases in lapse rates amongst the insurers. The full impact of the slowing will in truth probably only be seen during 2008. It is unlikely that we will see any reduction in domestic interest rates this year, and as a consequence advances growth will come under pressure and credit impairments will continue to rise amongst the banks. Trading profits and private equity realisations will in all likelihood reduce. Some of this should however be balanced by continued strength in corporate businesses for as long as the commodity cycle continues its strength, and the country's infrastructure build continues. Amongst the insurers, new business will be harder to come by and lapses will remain under pressure. However, from what we have seen from the financial results reported during the quarter and our subsequent discussions with company managements, this simply reflects a widely anticipated normalisation in these businesses. There were few surprises in the numbers reported, and there is very little that we have seen that suggests that there is any more to this than the mechanics of a normal cycle at work.

The second driver is largely sentiment driven - the spill over of what has been happening in the banks sector globally, as well as caution amongst foreign investors towards domestic shares following political developments late last year and the Eskom power crisis early this year. The shorter term impact of the sub-prime crisis is a tightening of global credit markets; something that will ease over time as confidence returns to markets. However, the level of profitability enjoyed by many developed market banks is unlikely to be seen again for many years. Regulation is likely to tighten, off-balance sheet vehicles are likely to come back on to the books, economic capital requirements are likely to increase, and as a result returns will decline.

While it would be naïve to assume that the South African financial sector is entirely immune to the impact of global developments, we believe that many of the factors impacting on developed market financial stocks have less relevance domestically. Funding growth will be challenging for our banks in the year ahead (making the capital raising by Standard Bank in the ICBC transaction last year all the more fortuitous) but it is highly improbable that we will experience a meaningful funding squeeze, and nothing like the one that led to Bear Stearns' demise. SA banks are not significantly exposed to sub-prime investments, have very few assets sitting off balance sheet, and are generally well capitalised. The impact of the domestic developments mentioned above may well be a slightly lower medium-term trajectory of economic growth. However, with the exception of earnings derived from mark-to-market equity gains, we do not consider profitability to be abnormally high and still anticipate acceptable medium term earnings growth from the sector as a whole.

Domestic financial stocks are being priced no differently to those of developed markets that are undergoing significant structural issues, have suffered severe write-offs, and where all indications are that profitability was abnormally high. We do not believe these factors to be relevant in any meaningful way to our market. After taking into account a slowing in growth, banks are trading on 12 month forward PEs of 6 to 8 times and dividend yields of 6%. Life companies trade on an average 20% discount to their embedded values, after producing EV returns in the high teens. In many cases small cap financial stocks have been indiscriminately dragged down along with the large caps, and we have added to certain of these during the quarter. While it is impossible to predict how long it will take the financial crisis to fully work its way through the system and for sentiment to recover, we consider these valuations to be compelling, and believe the prospect for superior return generation good.

Neill Young and Godwill Chahwahwa
Portfolio Managers

Fund category
Fund description

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

Launch date

1 July 1998

Portfolio manager/s
Fund size
NAV
Benchmark

Neill Young and Godwill Chahwahwa
R313.7 million
2333.66 cents
FTSE/JSE Africa Financial Index

PORTFOLIO DETAIL

EFFECTIVE ASSET ALLOCATION EXPOSURE

Sector	31 Mar 2008
Domestic Assets	100.00%
Equity	92.32%
Industrials	4.08%
Financials	88.24%
Real Estate	6.59%
Cash	1.09%
International Assets	0.00%

TOP 10 HOLDINGS

As at 31 March 2008	% of Fund
Standard Bank Group Ltd	19.99%
FirstRand Ltd	12.29%
Old Mutual Ltd	11.19%
Liberty International Plc	6.59%
Discovery Holdings Ltd	6.53%
Absa Group Ltd	6.33%
African Bank Investments Ltd	5.68%
Investec Ltd	5.30%
Remgro Ltd	4.08%
Liberty Group Ltd	3.85%
Total	81.83%

INCOME DISTRIBUTIONS

Declaration	Payment	Amount	Dividend	Interest
31/03/2008	01/04/2008	38.10	37.03	1.07
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

MONTHLY PERFORMANCE RETURNS

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Fund 2008	-13.50%	8.09%	-7.43%									
Fund 2007	4.43%	0.27%	4.47%	6.87%	-3.85%	-4.77%	1.00%	-0.47%	-2.73%	12.21%	-5.75%	-4.19%
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%

FEES (excl. VAT)

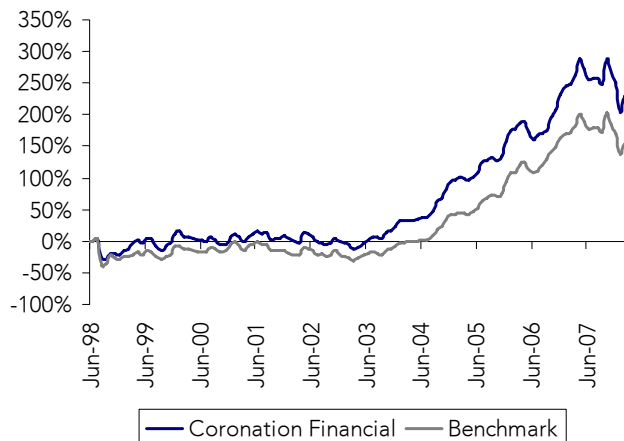
Initial Fee*	Coronation: 0.00% (Direct)
Annual Management Fee**	1.25%
<small>*An initial fee of 0.25% will be charged on all investments placed via administration platforms like Linked Investment Service Providers (LISPs).</small>	
<small>**A portion of Coronation's annual management fee may be paid to administration platforms like LISPs as a payment for administrative and distribution services.</small>	
Total Expense Ratio (TER)²	1.44% 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	-13.45%	-12.84%	-0.61%
Latest 12 months	-16.09%	-16.28%	0.19%
Latest 36 months (annualised)	15.35%	17.59%	-2.24%
Latest 60 months (annualised)	28.47%	27.77%	0.71%
Since inception (annualised)	12.09%	9.03%	3.06%
2007	6.06%	3.03%	3.03%
2006	28.83%	35.83%	-7.00%
2005	32.02%	34.69%	-2.67%
2004	57.09%	52.38%	4.71%

RISK STATISTICS SINCE INCEPTION

	Fund	Benchmark
Annualised deviation	22.06%	24.24%
Sharpe ratio	0.04	-0.08
Maximum gain	53.63%	80.40%
Maximum drawdown	-30.89%	-39.78%
Positive months	59.83%	61.54%