

Coronation Global Managed Fund

An update from the manager

By Gavin Joubert, Senior Portfolio Manager
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The Coronation Global Managed Fund was launched in October 2009 and is now approaching its two-year track record. Since inception the fund has generated an annualised return of 11.7% in US dollars. This places it among the five top performing global balanced funds in the Foreign Asset Allocation Flexible unit trust category. In addition the fund has outperformed its composite benchmark (60% MSCI World Index and 40% Citigroup World Government Bond Index) by 1% p.a. since inception. Investors can choose to invest in either the rand or dollar-denominated vehicles. Both funds are managed on exactly the same basis and should over time deliver very similar US dollar returns.

We launched the fund just under two years ago as a result of the following views:

- *Global assets (in particular global equities) are far more attractively valued than South African assets.* Many South African investors have most or all of their assets invested locally and have very little global exposure. This is concerning given our view that the valuations on South African equities are not that attractive, and that we expect more muted returns from this asset class over the next 10 years. In addition, South Africa makes up less than 1% of the world's economy and stock market value; has an overvalued currency; a challenging political landscape, and is becoming less competitive by the day.
 - *There was significant opportunity for a global balanced fund that makes extensive use of the full range of asset classes (equities, listed property, commodities, government bonds, corporate bonds and cash).* With most South African investors having too little invested offshore a global balanced fund (that makes both individual instrument selection and asset allocation decisions) is the ideal investment vehicle for investors who want to diversify offshore by means of a multi-asset portfolio.
 - *One does not need to be based in London or New York to manage a global fund - more important than location is investment philosophy and process.* We have demonstrated our ability to manage global funds and deliver world-class returns. An example of this is the Coronation Global Emerging Markets [USD] Fund, which has outperformed 98% of its peers (largely based in London and New York) since the fund launched three years ago. Global Managed's track record to-date is also encouraging. Based in Cape Town, Coronation's offshore investment team is staffed by some of our most senior fund managers and supported by a full research team of eight individuals who analyse global and emerging market stocks. We are also in the process of further increasing our resources in this team. An additional benefit of being based in South Africa is that the fund manager is accessible to local clients, which is not always the case with offshore funds.
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Our view that global equities are by far the most attractive asset class is reflected in the fund's equity exposure of around 73%. As reference points, we would expect the average equity exposure over a five-year cycle to be around 65% and the maximum equity exposure to be 75%. Given that global share prices showed no growth over the past 10 years (at a time when earnings have grown significantly), valuations have contracted and today one can buy high quality US or global businesses on very attractive ratings. The list of opportunities is long, but a sample of the fund's current top 10 holdings provides some flavour in this regard.

- **HEINEKEN** is the world's third largest brewer (after Anheuser Bush Inbev and SABMiller). It is the global leader within the high margin premium sector and fast-growing emerging markets contribute 50% of its revenue. In addition to a revenue line that we believe will show decent growth over the next few years, the company (in our opinion) has not been managed efficiently from a cost point of view and this is beginning to change. We therefore expect operating margins to improve substantially over the next few years. Despite these positive fundamentals, Heineken trades on a mere 12.5 times the free cashflow we believe it will generate over the next one-year period.
- **SAFEWAY** is the third largest supermarket retailer in the US (after Walmart and Kroger). Between 2004 and 2008 the company invested heavily in store improvement which is now complete. Consequently, the business is generating significant amounts of free cashflow. Operating margins are at 20-year lows and the company should benefit from rising inflation in the US. Safeway also continues to buy back large amounts of its own (undervalued) shares. Despite this, its share currently trades on less than 10 times free cashflow.
- **VODAFONE** is one of the largest mobile telecommunications companies in the world. While mobile penetration is very high in most of the countries they operate in, we are very positive about the prospects for mobile data which we believe should result in some revenue acceleration. In addition, Vodafone currently receives no dividends from its US business (Verizon Wireless), although it is just a matter of time in our opinion before this changes. As a result, large sums of additional cashflows are likely to be heading Vodafone's way and a substantial part of this could be returned to shareholders in the form of increased dividends or share buybacks. Vodafone today trades on less than 10 times free cashflow and on a dividend yield of around 5.5% which we regard as very attractive given the factors mentioned above.

Many investors bemoan the fact that they have achieved no returns over the past 10 years from their offshore investments and therefore question why they should be invested offshore at all. Our response is that this is exactly why one should be investing offshore today. As referred to earlier in this article, due to flat share prices (and increasing earnings), valuations have contracted substantially over the past 10 years, making global equities far more attractive today than what they were a decade ago. We would also point out that the primary reason for these poor returns was their starting point, which was very high. In other words, 10 years ago we were still in the final stages of the TMT bubble, which meant that valuations were 'silly'. For example, Vodafone, (which today trades on less than 10 times free cashflow), was valued on over 50 times free cashflow in 2001. It is no wonder that an investment made in Vodafone 10 years ago has been a poor investment. The same holds true for a number of global equities.

Besides global equities, we also feel that a number of listed property stocks are attractive and have around 5.5% of the fund invested in property. The focus of the fund's investment is in Asia (Singapore in particular and to a lesser extent Japan) and Australia with the average yield

of the fund's holdings north of 6%. Most of the holdings are trading at, or below, net asset value.

We believe that government bonds around the world have benefited from a flight to safety and as such are overvalued. This ranges from US to German to UK government bonds. Consequently the fund has zero exposure to government bonds as we feel these bonds present a high probability of capital loss. A small portion of the fund (4%) is invested in selected corporate bonds where we feel the yield compensates one for the risk of de-rating.

Overall we are very optimistic on the outlook for the fund's returns and believe that given current valuation levels, a 10% to 11% p.a. return in dollars over the next few years is well within reach.
