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The Coronation Fund Managers Institutional Quarterly



It's not all doom and gloom

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Notes from my inbox

by **KIRSHNI TOTARAM**



KIRSHNI TOTARAM heads up the institutional business and is a member of the executive committee. She is a qualified actuary and a former manager of the Coronation Property Equity Fund.


The Mayan calendar comes to an end; Nostradamus predicts the end of the world (as we know it); big political battles rage in many of the world's largest economies (most likely worsening many of the globe's financial problems); the eurozone teeters on the edge of disaster; financial terms are now synonymous with phrases drawn from nuclear science – meltdown, chain reaction, toxic, radioactive, fallout, contained, overheating and defused – and let's not forget my 'Twilight Zone' favourites of paranormal, abnormal and subnormal. All are words currently being used to describe how different things are – welcome to 2012.

It should certainly be no surprise that this will be an eventful and volatile year. After all, there was far too much uncertainty as we closed 2011 to expect otherwise. But it is not all doom and gloom – there are some positives to look forward to. London hosts the summer Olympics in July and Facebook will test records as it goes public, stirring excitement about the technology industry in general.

In our first edition for the year we take stock of the happenings of 2011 – nuclear meltdowns, political uprisings in North Africa and the Middle East, downgrade of the world's largest economy and an ever growing euro crisis – and how our portfolios have performed over this period. We also look ahead at portfolio positioning.

With much talk around global emerging market and frontier market allocations, we look at themes, ideas, and more importantly the risks and opportunities that are the reality of investing in these markets.

There is no doubt that this will be another tough year. Governments in most developed markets have gone to extraordinary lengths to support the price of 'risk-free' assets. This reduces the prospect of future returns and we once again touch on the chance that South Africa may well end up in a period of financial repression, where income-producing assets produce negative real returns; this alone represents the greatest challenge for investors over the long run.

For us, it is business as usual. And by usual we mean that the early morning and late night hours have gone up to match the increasing complexity of financial markets and regulation. Our investment philosophy, process and discipline remain unchanged. Our clients continue to have 100% of our attention and efforts to ensure that we give pension fund members a fighting chance of getting positive, real returns to retirement (and into retirement). 

Macro fatigue, anyone?

by **KARL LEINBERGER**



KARL LEINBERGER is CIO and a member of the executive committee. He joined Coronation in 2000 as an equity analyst, was made head of research in 2005 and appointed CIO in May 2008. Karl co-manages the Coronation Houseview portfolios.

The global economic outlook is clearly pretty grim. Most developed economies face the prospect of a prolonged period of stagnation. We also think the risk of inflation is high. If we are right (sometimes in life you pray you are wrong!), then we all face the daunting prospect of allocating capital in a stagflationary environment.

The crisis in Europe is very much an 'after-shock' from the 2008 financial crisis. In 2009 policymakers threw unprecedented fiscal and monetary stimulus at the problem. In so doing they pulled the global economy back from the abyss. But they did not succeed in reducing total leverage in the system. In bailing out an over-indebted private sector, all they succeeded in doing was to buy some time and shift the debt burden from the private sector to the public sector. Today, the governments of most OECD countries are over-indebted. Massive fiscal deficits are keeping economies ticking over, but doing little to kick-start growth. The flaws in the European Union, described by a sage observer in the 1990s as a burning house with the fire exits locked, have been brutally exposed. And finally, as politicians have dithered, the crisis has spread from the embattled periphery to Italy and Spain.

Not uplifting stuff for investors. And this is after four gruelling years in what has been the most volatile period in market history.

We expect the macro-environment to remain challenging and markets to remain volatile.

But it's not all bad news. I see three things to be positive about:

1. *The news is out.* Most of the bad news and challenges we face have been well flagged, are essentially well understood, and feature in the media headlines on a daily basis.
2. *Out of this crisis will come the structural reforms we so desperately need.* As a sceptical investor, I am sorry to say that I have no faith in my fellow man. I believe that it is only in times of crisis, when there are no other alternatives that politicians can be relied upon to enact the deeply-needed structural reforms that are in all of our long-term interests. Smaller and leaner governments, a sounder and more sustainable European Union, more appropriate retirement ages, better capitalised banking systems and more sustainable entitlement programmes will come out of this crisis and be the foundations for the next upcycle.
3. *Bad news usually produces low prices.* As an investor one needs to be ready for when bad news provides an investment opportunity. As Warren Buffet says, in this game you need to be greedy when others are fearful.

The obvious question for the long-term investor then is: to what extent is the bad news discounted in asset prices? In our opinion, there is not a lot of symmetry out there.

Global Equities are attractively priced with many blue chips trading on 12 – 14 PE multiples and 3% – 4% dividend yields. A decade ago the outlook was good, stock prices were high and investors paid heavily for that, enduring a full decade of virtually no return. Today, bad news has produced low prices. This is always fertile ground for the long-term investor.

Global Bonds are overvalued. At 2% – 3% yields, government bonds present an asymmetrical payoff, in our view. Limited upside with the prospect of heavy losses should any of the following scenarios come to pass: higher inflation; any normalisation in short rates from current crisis levels, or finally any kind of a meaningful economic recovery. In general, credit is also keenly priced as a global search for yield has driven down credit spreads. The one exception to this is high quality financial sector credits that have collapsed as the European banking crisis has intensified.

Global Property offers opportunity. Yields are now at mid-to high-single digits throughout Europe, Asia and Australia and this asset class is one of the best priced inflation hedges available today.

Dollar Cash as an asset class is often overlooked. Crisis-level interest rates and attractive valuations elsewhere argue against a high allocation, but we think that a healthy

allocation makes sense nonetheless given the risks in the system. Global equities are up substantially from the financial crisis lows and we think one should keep some powder dry should equity markets again provide an opportunity similar to that of the first quarter 2009.

Local Equities on the other hand, are trading close to fair value. The All Share Index is virtually at its all-time high and many domestic consumer-facing stocks are trading at all-time high ratings. For the biggest building block in a balanced portfolio, this is not a time to be brave.

Local Bonds are overvalued in our opinion. They are anchoring off 30-year low short rates and have been flattered by a desperate global search for yield, sparked by zero cash returns in the world's major cash markets. In addition to this our concerns about inflation are even more marked in South Africa than they are offshore.

In conclusion, we do not expect the world's problems to disappear and we do not expect markets to be any less testing than they have been since the onset of the financial crisis almost four years ago. But we do expect opportunity. Volatility, emotion and newsflow: these are the friends of the long-term investor. 📈

MARKET DATA

MARKET MOVEMENTS

Economic group	Qtr 4 2011 %	2011 %
All Share Index R	8.4	2.6
All Share Index \$	8.7	(15.9)
All Bond R	3.5	8.8
All Bond \$	3.8	(10.7)
Cash R	1.4	5.8
Resources Index R	7.3	(6.5)
Financial Index R	8.7	7.4
Industrial Index R	9.2	9.2
MSCI World \$	7.7	(5.0)
S&P 500 \$	11.8	2.1
Nasdaq \$	6.8	1.9
MSCI Pacific \$	(0.3)	(13.6)
Dow Jones EURO Stoxx 50 \$	3.3	(16.9)

KEY ECONOMIC DATA: HISTORY AND FORECAST

	2008a %	2009a %	2010a %	2011a/e %	2012f %
HCE	2.2	(1.6)	3.7	4.9	3.5
GCE	4.5	4.7	4.9	4.1	4.2
GFCF	13.3	(3.2)	(1.6)	4.3	3.1
GDP	3.6	(1.5)	2.9	3.2	3.0
Current a/c % of GDP	(7.1)	(4.0)	(2.8)	(3.5)	(4.2)
CPI	11.5	7.1	4.3	5.0	6.4
Prime rate (year-end)	15.0	10.5	9.0	9.0	10.0
R/\$ year-end	9.92	7.48	6.81	8.19	8.50
R/EUR year-end	13.44	10.89	9.00	10.76	10.80

The challenges that lie ahead

by **KIRSHNI TOTARAM**



KIRSHNI TOTARAM heads up the institutional business and is a member of the executive committee. She is a qualified actuary and a former manager of the Coronation Property Equity Fund.

After the rollercoaster ride of 2011, investors are in desperate need of some reprieve; but it seems that 2012 will offer little respite.

The protracted indecisiveness of politicians on both sides of the Atlantic has meant that the economies of the Western world continue to flirt with disaster. Europe's social and economic landscape is in crisis and across the world 2012 marks election year for many. France heads to the polls in April and May and already the newswires are gearing up for the US presidential election in November. In addition, voters in Russia, China, Taiwan, Kenya, Venezuela, Mexico and even possibly Egypt will have the opportunity to have their voices heard. With so many of the world's leaders preoccupied with re-election on home soil, there is much cause for concern and uncertainty. Only with global co-operation and brave leadership will we achieve a solution to the world's economic woes.

The year 2012 is destined to be a busy one for boards of trustees as they grapple with volatile global market conditions, intensifying legislation, changing strategy and the reality of trying to provide pensions for their members in a high inflation, low return world.

Some of the key items currently dominating the agenda are:

■ **New Regulation 28**

In July last year the much anticipated changes to Regulation 28 were legislated, with a grace period for funds to comply with the new rules given to 31 December 2011. The changes to investment guidelines, which have been covered in past editions, are as follows:

- Increased international exposure to 25% of fund
- Explicit allowance for hedge funds to 10% of fund
- Allowance for alternatives to 15% of fund
- Allowance for unlisted equities up to 10% of fund
- Allowance for private equity to 10% of fund
- Allowance for exchange-traded commodities up to 10% of fund
- Classification of inward listed as domestic assets (December notice)
- Use of derivative instruments (finalisation currently outstanding)

In addition to the traditional investment guidelines, the new Regulation 28 also explicitly states principles to which funds need to show evidence of adherence: a fund must comply at all times; have an investment policy which is reviewed at least annually; educate the board on investment and governance matters; monitor compliance by all service providers; promote B-BBEE; ensure assets are appropriate for liabilities; perform reasonable due diligence on any service providers and investments prior to appointment; conduct a regular comprehensive risk analysis to take into account changes in the fund and market environment, and consider sustainability issues in the assessment of the long-term value of a security (as detailed within the CRISA guidelines overleaf).

Also incorporated into the legislation are new disclosure requirements aimed at achieving greater transparency through detailed reporting. Among these is the application of the look-through principle on all pooled vehicles. This required several system changes by administrators and asset managers to provide full daily insight into any investment held, including offshore, with a full categorisation across all asset classes and the reasons for all breaches on a portfolio.

With this first hurdle now cleared, the all-important question being asked is: what will trustees do with this new influx of information? While the thinking behind the advent of the new rules remains sound, it is vital that common sense prevails and the information is kept in perspective. Its purpose is to better understand investment strategy and enhance engagement with service providers. It should not be used to further limit the flexibility and robustness required in the setting of investment strategy essential to producing positive real returns in an increasingly tough investment environment.

And this is just the start. There are a lot more legislative changes yet to come. In 2013 we can expect the implementation of the 'Treating Customers Fairly' initiative and we also await the introduction of retirement and social security reform.

■ CRISA (code for responsible investing in South Africa)

South Africa is only the second country (after the UK) to formally encourage institutional investors to integrate sustainability issues into the long-term investment strategies of retirement funds. The introduction of CRISA, a voluntary code that is expected to be adopted with effect from 1 February 2012, is based on the following five key principles:

1. An institutional investor should incorporate sustainability considerations, including environmental, social and governance (ESG) into its investment analysis and investment activities as part of the delivery of superior risk-adjusted returns to the ultimate beneficiaries.
2. An institutional investor should demonstrate its acceptance of ownership responsibilities in its investment arrangements and investment activities.
3. Where appropriate, institutional investors should consider a collaborative approach to promote acceptance and implementation of the principles of CRISA and other codes and standards applicable to institutional investors.
4. An institutional investor should recognise the circumstances and relationships that hold a potential for conflicts of interest and should proactively manage these when they occur.

5. Institutional investors should be transparent about the content of their policies, how the policies are implemented and how CRISA is applied to enable stakeholders to make informed assessments.

The term 'institutional investor' refers to both boards of trustees and asset managers. Coronation has been a signatory to the United Nations' Principles for Responsible Investment (UNPRI) since 2007 and therefore the adoption and incorporation of CRISA into our policies and processes has been seamless. For boards of trustees, it is important to:

- Explicitly define what is meant by ESG to your service providers.
- Gain regular feedback from service providers as to how ESG factors are being accounted for in the investment process.
- Ensure that service providers vote in accordance with their (or the fund's) proxy voting guidelines.
- Ensure that investment managers show demonstrable evidence of engagement with company management on governance issues.

Coronation's CRISA policy is available for review by all clients on request.

■ Implications for a change in strategy

Investing is shaped by the megatrends that originate in almost every aspect of the world – economics, politics, demographics and technology. Thus traditional investment frameworks struggle to stay relevant if not reviewed frequently. Trends and changes in these elements create great opportunity for the long-term investor but they also mean that investors (asset managers, trustees etc.) need to have the right frameworks in place to adapt their strategy and mindset in the wake of big structural changes.

One of the most talked about themes today is the investment into emerging and frontier markets. It is clear that emerging markets and their trade relationship with one another and the rest of the world is changing. Increasingly it is becoming conventional wisdom that emerging market exposure should form some core element of a



portfolio, and not just included as a tactical move based on price. But identifying the theme has been the easy part – implementation is what appears to be surprisingly challenging.

For most retirement funds, the main reason for poor implementation is the presence of well-established relationships with existing global equity managers (many of which have the flexibility in their mandates to invest in emerging markets). In South Africa this reasoning also holds true, but with one further obstacle – the idea that by having the majority of your fund invested in South Africa (which is an emerging market), any exposure outside of our borders should focus on the developed world. Pleasingly, these perceptions are changing – albeit slowly. The main reasons for this change is that most global funds – despite being permitted to invest in emerging markets – have had historic exposures below 10% of fund – staying mostly in line with the exposures of the MSCI World Index (the benchmark most commonly used for these funds). Even for funds that have changed their benchmark to the MSCI All Country Index (with 12% emerging market exposure), this move alone is not likely to be enough. Furthermore, allowing exposure levels to be determined by benchmarks is a flawed strategy as all benchmarks are constituted using historic market caps rather than being reflective of current economic activity. Thus, an explicit allocation to a specialist manager is warranted.

Frontier markets also offer opportunity, where strong domestic drivers provide great economic diversification to a global portfolio with the potential to significantly enhance much needed returns.

Another important concept that many boards will have to contend with this year (and for many years to come) is the fact that future returns will, in all likelihood, be more muted than they have been historically. South African pension funds have realised incredible real returns over the past 15 years, close to 8% p.a. real, according to the median of the leading consultant surveys. This is reflective of the truly incredible period we have experienced in economic growth and consequently asset class returns over this period. But expectations need to adjust. Over the past year, Coronation has continued to make the point that we expect much more muted returns from all the asset classes as can be seen in the following table.

	Last 10 years* (ZAR)	10-year forecast (ZAR)
Local equity	15.1%	9 – 11%
Global equity	0.1%	13 – 15%
Local property	22.5%	8 – 10%
Local bonds	10.8%	8 – 10%
Global bonds	3.6%	5% – 9%
Cash	8.8%	7 – 9%
Inflation	5.9%	6% +


* To end December 2011

Source: I-Net Bridge, Bloomberg and Coronation

On the fixed interest side we are even more worried as there is a big chance that we could see *negative* real returns from traditional cash and bonds (with inflation currently at 6.1% and cash rates of 5.5%). Incorporating this all into a portfolio context, it means that achieving real rates of return of 6% or even 5% will be a tough challenge.

With future return expectations having fallen and inflation having risen, further research has been conducted on replacement ratios. Historically, funds have typically worked on a 70% replacement ratio to calculate the pensionable amount an individual would need at retirement to maintain his or her lifestyle. This was then used to determine required real rates of return, time periods, and ultimately investment strategy. However, the recent research shows a very high chance that the replacement ratio needed at retirement is closer to 100%. This would take into account greater longevity, a shift in spending (but not necessarily a reduction in spending) and that individuals have tended to save for shorter periods (job turnover has meant that many individuals cash in their retirement funds when changing jobs).

Taking these two elements into consideration it is clear that investment strategies need to be re-examined and that alpha from portfolio management is essential. It also means that member education becomes even more vital, in particular encouraging members to preserve their retirement savings when changing jobs and to avoid poor decisions when electing suitable portfolios on a member choice platform.

There is much to ponder and the new, changing environment will present challenges for all investors. It is thus critical to choose service providers well and to have open and detailed dialogue with all parties to determine the strategy and investment framework that works best for each individual fund and its members. 

Bond outlook

by **MARK LE ROUX**



MARK LE ROUX is responsible for the fixed interest investment process and portfolio management functions for both institutional and retail portfolios. Mark has more than 20 years' experience in managing both traditional and alternative portfolios.

For the local fixed income market, 2011 was characterised by rising inflation, a depreciating currency (the rand lost 22% against the dollar), rocketing food prices and a materially increasing fiscal deficit. Under 'normal' circumstances such a combination would be hugely negative for a bond market, but 2011 was far from normal; concerns over global growth continued, global bond yields plunged (US 10-year now below 2%), worries over the fiscal situation of a number of European countries persisted and the foreign bond investor appetite for yield was heightened by record low domestic short rates. All of which resulted in a decent offset to the fundamental negative backdrop for bonds.

The bond market performed largely in line with its yield to maturity (YTM) for the year. The long dated benchmark government bond (R186 2026 maturity) started at a YTM of 8.30% and ended slightly weaker at 8.47%. The All Bond Index recorded 8.80% for the year, with the star performer being the shorter dated R203 (2017 maturity) at 10.80%, and the ultra long dated R209 (2036 maturity) the worst performer with a return of only 2.70%.

Inflation-linked bonds (ILBs) performed strongly, with the index returning 13% for 2011. The five-year government ILBs produced the top return of 16.5%. For the first time in South African history the very short dated ILBs saw their real yields decline into negative territory (R189 2013 maturity declined to -0.15% real yield). This was driven by the sharp increase in demand for inflation protection as headline inflation breached the upper end of the South African Reserve Bank's (SARB) target range and short rates on money market instruments now in negative real territory.

Themes and expectations for 2012

■ Inflation

We expect inflation to remain elevated and above the 6% upper end of the target range during the course of 2012. The main drivers of this are food prices and the depreciation in the currency. The maize price again made new highs in December 2011, with this very important soft commodity's year-on-year rate of change now running at 99%.

SAFEX WHITE MAIZE PRICE % YEAR-ON-YEAR



Source: I-Net Bridge

■ Short rates

The next move in short rates, we believe, will be upwards. However, given the recent relatively dovish stance of the Monetary Policy Committee, this will most likely only take place in the second half of the year. With a repo rate at 5.50%

and inflation (in our view) averaging above 6%, negative real returns can be expected in money market assets.


■ Yield curve

Government needs to borrow in excess of R150 billion from the bond market to fund the budget deficit in the new fiscal year. This is a sizeable issuance for the market to absorb and is likely to place upward pressure on bond yields during the course of the year, especially at the back end of the curve where most of the issuance is expected to take place. With the SARB trying to keep short rates unchanged for as long as possible, this may result in the yield curve continuing to steepen in the early part of the year. However, as soon as the first rate hike is signalled and believed by the market, the yield curve should flatten quite quickly.

■ Looking forward

Global government bond yields at below 2% are unsustainable. A sell-off in global bonds would be a major risk to our bond market, particularly when combined with the large funding overhang that we face this year. In addition, any delay by the SARB to take action against the rising inflation

trend could have major ramifications for the local bond market – the longer they wait the more entrenched higher inflation expectations become.

Across our bond portfolios, we continue to run lower than benchmark duration positions coupled with a holding in inflation-linked bonds. 

US GOVERNMENT 10-YEAR BOND



Source: I-Net Bridge

Equity market update

Global equities discounting some probability of a global downturn

by **QUINTON IVAN**



QUINTON IVAN joined Coronation in April 2005 as an equity analyst. He currently analyses retail, construction and pharmaceutical stocks. Quinton co-manages the Coronation Equity and Industrial funds as well as the Houseview portfolios.

The past year was characterised by periods of extreme volatility. In the first half financial markets had to digest the implications of the political unrest in North Africa and the Middle East as well as a devastating earthquake and risk of possible nuclear meltdown in Japan. The second half was dominated by continued political wrangling which saw policymakers fail to resolve the ongoing euro crisis. This fuelled uncertainty as global investors reduced exposure to growth assets.

The global economy and financial system remain unbalanced and are being distorted by unprecedented monetary and fiscal stimulus. The precarious state of the global economy has a bearing on market sentiment. In volatile times, emotion often trumps reason resulting in investors mispricing assets. As a valuation-driven, bottom-up stock-picker, Coronation remains resolute in its philosophy of investing for the long term. While this may result in periods of short-term relative underperformance, we believe it will produce superior returns for our clients over the long term.

Given the current global and domestic economic outlook, equities remain our preferred asset class for producing inflation-beating returns. Following the panic that consumed markets in the third quarter of 2011, equity markets recovered in the final quarter, which created the opportunity to reduce exposure to what we consider to be a neutral equity exposure. The All Share Index is currently very near to an all-time high and is certainly not pricing in a sharp correction in the global economy. This coupled with our view that domestic equities are fairly valued does not justify higher exposure. Global equities on the other hand are discounting some probability of a global downturn. Domestic equities have outperformed global equities significantly over the last

decade (15.1% p.a. for the All Share Index versus 0.1% p.a. for global equities in rand terms). We remain of the view that global equities are far more attractively valued than domestic equities. This view was vindicated in 2011 with the MSCI World Index (in rand terms) comfortably outperforming the All Share Index by 13.2% for the year (15.8% for the MSCI World Index versus 2.6% for the All Share Index). Our domestic balanced funds remained close to their 25% offshore limit for the duration of the year.

After a prolonged period of strength, the rand (together with other emerging market currencies) experienced a sharp sell-off towards the end of the third quarter. Given our long-held view that the currency was overvalued, our rand hedge investments such as MTN, SABMiller and British American Tobacco contributed to overall equity performance. We continue to favour global businesses that happen to be listed in South Africa. They remain attractively valued relative to pure domestic businesses and are diversified across numerous geographies and currencies. At the end of 2011, approximately 63% of our equity portfolios were invested in rand hedge counters.

The All Share Index returned 8.4% for the quarter. Industrials were the best performer with a 9.2% return. Financials returned 8.7% and resources lagged with a 7.3% return. Resource stocks have now underperformed financials and industrials over a three-year period. Having remained underweight resources for most of the year, we moved slightly overweight in our equity and balanced funds during the quarter. Although most commodity prices remain high, we believe that resources currently offer value, with selected resource shares trading at less than 10 times our assessment of normal earnings. The great imponderable




impacting commodity prices and therefore the valuations of resource shares remains demand from China. China has been the single largest consumer of commodities, responsible for, on average, approximately 40% of global demand for most commodities (and even higher in the case of iron ore where China constitutes 60% of global demand). The Chinese economy is extremely unbalanced having been driven by significant investment in infrastructure and very little domestic consumption. The country is also in the process of attempting to cool an overheated property market. Any Chinese hard landing will have dire ramifications for commodity prices and consequently, the pricing of resource shares. It is for this reason that we remain only marginally overweight. Our preferred resource holdings are Sasol, the diversified miners (specifically Anglo American) and Mondi Limited (see the article overleaf). We remain underweight gold shares as we believe they are over-valued based on our assessment of normal earnings. We are also concerned over declining grades and enormous cost pressures faced by these businesses (labour, electricity and water).

Banks returned 7.8% for the quarter, underperforming other financials. Banks have been very poor performers; however, we continue to hold our overweight position on the basis

that valuations are attractive at nine times our assessment of normal earnings and price-to-book ratios of 1.7 times. We believe earnings are low as a result of low net interest margins and high bad debts. This, coupled with a low rating, represent a highly attractive investment proposition.

In contrast, we remain concerned over the earnings base for the average industrial company, especially consumer-facing businesses. These businesses have benefitted from significant tailwinds such as falling inflation, declining interest rates, an emerging middle class and significant social grants. These benefits are in the base, which will make it challenging for these businesses to defend and grow off their current earnings. Consequently, we own very little retailers, other than Woolworths and Mr Price and remain defensively positioned. We continue to find value in selected small caps.

It remains our view that the global economy will face an extremely difficult period in the years ahead. The investment environment is therefore likely to remain volatile and challenging for the foreseeable future. However, global equities discount many of these concerns and we believe offer good value. In an environment fraught with uncertainty, we remain focused on investing for the long term. 

Mondi

A highly attractive investment case

by **DUANE CABLE**



DUANE CABLE joined Coronation in July 2006 as an investment analyst focusing on the resources sector. His current research responsibilities include paper and packaging, gold, steel and various companies within the industrial sector. Duane is the co-manager of the Coronation Resources Fund.

'The best-performing stocks are not in industries that are at the cutting edge of the technological revolution, rather they are often in industries that are stagnant or in decline. These firms are headed by managements that find and pursue efficiencies and develop competitive niches that enable them to reach commanding positions no matter what industry they are in. Firms with these characteristics, which are often undervalued by the market, are the ones that investors should want to buy.' Jeremy Siegel

We have a material position in Mondi across client portfolios and it is one of our highest conviction ideas at present. Mondi is an integrated paper and packaging producer with key operations located in Central Europe, Russia and South Africa. Although the paper and packaging sector is not particularly cutting edge, we believe that Mondi is an asset displaying the characteristics quoted by Jeremy Siegel and presents a great investment opportunity for long-term investors.

History

The roots of Mondi were first planted in South Africa in 1967 when its former owners, Anglo American, built the Merebank Mill. Following more than two decades of growth and consolidation in South Africa, Mondi entered Europe in the early 1990s to pursue expansion through acquisition. Over a long period of time Mondi acquired businesses in Austria, the UK, France, Russia, Slovakia, Poland, Hungary, Denmark, the Netherlands, Bulgaria and Italy.

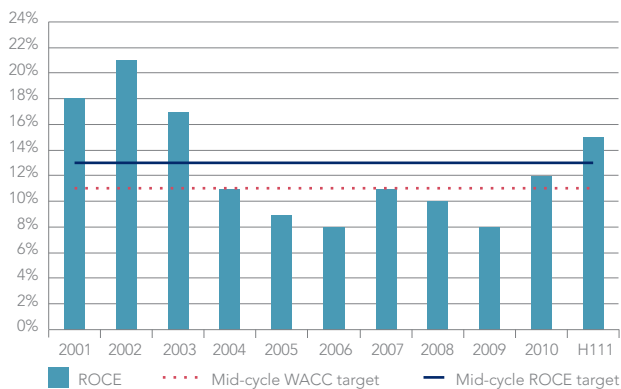
It is interesting to note that Tony Trahar, former Group CEO of Anglo American was in fact CEO of Mondi prior to handing over the reins to current Mondi CEO David Hathorn in

2000. In 2002 Mondi was the biggest division within Anglo American based on contribution to headline earnings, and between 2001 and 2003 was a top three contributor to headline earnings from a total of nine operating divisions within Anglo American. In the period between 2004 and 2006 markets for paper and packaging products were challenging, characterised by production overcapacity and moderate demand growth. For European producers, the situation was exacerbated by the significant weakening of the US dollar against the euro, which reduced euro revenue generated from exports and encouraged competition from importers. In 2007, after a very difficult period for Mondi, Anglo American decided it was no longer a core asset and should be unbundled to shareholders. Given the improved outlook for the business it appeared to be the perfect time for a separate listing; unfortunately the global financial crisis put a premature end to the anticipated recovery in earnings. Mondi listed in July 2007 at R65, peaked at R70 in April 2008, and thereafter pretty much fell in a straight line to bottom at R17.51 by March 2009, trading at 40% of tangible book value.

Mondi is currently trading at R59, only 18% below its peak of R72 reached in July 2011. Why are we still big holders of Mondi going into another period of global economic uncertainty – which many market commentators are comparing to the 2008 global financial crisis? The simple answer is that we believe the intrinsic valuation of Mondi to be materially above the current share price, and short-term macro-economic uncertainty has to some extent already been reflected in the current share price. While it is understandable that many investors are fleeing risky assets in these uncertain times, particularly those with exposure to Europe, we strongly disagree with the view that the risk to

Mondi in the current scenario is comparable to that of 2008. Today, Mondi is stronger from both a financial and asset mix perspective. Going into the crisis the company was at the start of a three-year €850 million investment programme in two growth projects in Poland and Russia. Both these projects are now complete and shareholders will start to reap the benefits of these high-return investments made in the down-cycle. In addition, Mondi permanently closed a material proportion of its high cost capacity during the crisis, which further improved its cost position and industry demand/supply fundamentals. The balance sheet is now significantly stronger and with no major capital expenditure planned, free cash flow generation going forward is likely to be materially above historical levels. Overall, the industry is in better shape with inventory volumes generally lower and permanent capacity closures made during the crisis having improved industry demand/supply fundamentals.

CHART 1: HISTORICAL RETURN ON CAPITAL EMPLOYED (ROCE) COMPARED TO MID-CYCLE ROCE AND WEIGHTED AVERAGE COST OF CAPITAL (WACC) TARGETS



Source: Company reports

Investment case

Some of the highlights which attract us to the Mondi business model are:

- Leading market position across key paper and packaging grades to which it is exposed.
- Generally one of the lowest cost producers in the industry, allowing it to generate superior returns relative to competitors. Mondi has generated return on capital


employed (ROCE) almost double that of its listed peers through the cycle.

- Mondi has also been able to deliver ROCE above its weighted average cost of capital (WACC) through the cycle (refer to Chart 1), which many of its peers have been unable to achieve.
- A highly-rated management team. The culture of the group is one of continuous productivity improvements and a relentless focus on cost control. Their uncompromising focus on generating adequate returns on invested capital through the cycle will ultimately reward long-term shareholders.
- Management is aligned with shareholders and have a material proportion of their own wealth invested in Mondi shares. At current prices, the three executive directors' personal shares are worth almost R100 million, excluding unvested long-term incentive shares. We like it when a management team has skin in the game.
- Mondi is exposed to faster growing emerging markets rather than developed markets like many of its peers.
- The company has a more defensive product mix, i.e. office printing paper and packaging, which is less exposed to the secular shift to electronic media that is impacting graphic paper grades like coated paper.
- Having come to the end of a period of heavy investment in growing the business, ongoing capital expenditure is likely to return to more normal levels. We estimate this to be around 60% to 80% of depreciation, compared to 150% over the last seven years, which allows for significantly increased free cash flow generation.

In our assessment, Mondi is trading at six times our assessment of normalised free cash flow, which we find extremely attractive. At current prices one is buying Mondi at book value. This means that the market assumes Mondi will not deliver returns in excess of their WACC through the cycle, which, as illustrated in Chart 1, has not been the case historically. Looking at consensus earnings for 2012 (already cut 35% over the last six months), Mondi is trading on a nine times PE and a 5.2% dividend yield to December

2012. The combination of a low earnings multiple on low earnings (free cash flow multiple even lower), definitely ticks the right valuation boxes, and as an added bonus you get an attractive forward dividend yield. One of management's priorities for improved free cash flow generation going forward is increased shareholder distributions. The likelihood of either a special dividend or share buybacks over the next two years is therefore extremely high.

The investment case for Mondi is certainly not without risk. However, we believe investors are to some extent cushioned by the large margin of safety to our assessment

of intrinsic value. The two primary concerns in the market currently are the macro-economic uncertainty and risk to near term earnings, and concerns that management might make a value destructive acquisition. The latter, we are less concerned about given management's excellent track record in building the company through value enhancing acquisitions. The clouds on the economic front are certainly dark, but in the words of Warren Buffett: *'the future is never clear, and you pay a very high price in the stock market for a cheery consensus. Uncertainty is the friend of the buyer of long-term values.'* 

International outlook

When will the trendless volatility end?

by **TONY GIBSON**



TONY GIBSON is a founder member of Coronation and a former CIO. He was responsible for establishing Coronation's international business in the mid-1990s, and has managed the Coronation Global Equity Alternative Strategy Fund since launch in 1996.

As 2011 drew to a close it certainly felt as if the trend for the year was a pretty dire bear market; such was the ongoing arrival of negative news – especially out of Europe. In reality, the outcome for 2011 – from an equity index point of view – was fairly benign, with equity markets in aggregate falling by a relatively small amount for the year. Unfortunately, the most noticeable upward trend was that of volatility. Even though US stocks were flat for the last three months of 2011, the average daily move in the S&P 500 Index was 1.6%. A level normally only seen during crises. In the history of the S&P 500, there has never been a day when all 500 names were either positive or negative. However, on just eleven days in its 55-year history have 490+ stocks been either positive or negative. Six of those eleven days occurred since July 2011. This trendless volatility was of course a consequence of the fears in relation to sovereign debts in Europe, and the

resultant risks to the global financial system. It would be easy to dismiss the extreme volatility experienced during 2011 as irrational, but the current liquidity concerns are very real. The recent statements from the governor of the Bank of England indicating that the situation is 'extraordinarily dangerous' should not be dismissed as unnecessary hyperbole. Recent events in Europe have been extraordinary; not just due to the severity of the situation, but also due to the sometimes comical lack of decisiveness from European politicians.

Most commentators – and there is no shortage of them at present – believed that the rescue package agreed in late October looked like a credible solution, which would remove some of the tail risk of a eurozone collapse. However, this was quickly undone by the news that the then Greek Prime Minister planned to call a surprise referendum on whether

or not to accept the newly agreed austerity package; thus calling into question the eurozone/IMF rescue package agreed upon just days before. The markets went into shock and risk aversion returned immediately. The Greek government quickly fell and was soon followed by Silvio Berlusconi in Italy; both countries subsequently appointing technocratic replacement governments with the mandate to cut spending and restore health to public finances. This was in turn followed by a change of government in Spain; with the winning party being elected on an unambiguous ticket of severe austerity measures. The gravity of the situation – as illustrated by a sharp increase in the Italian and Spanish bond rates – has elicited continued dramatic responses from both the leading European politicians and global central banks. In late November a co-ordinated action was taken by central banks to reduce near term bank liquidity concerns, while in early December important steps on the road to fiscal union were announced.

There seem to be three overlapping schools of thought regarding the best remedy for the eurozone problems. There are those who think that the European Central Bank (ECB) should be the ultimate guarantor of eurozone debt; using the printing press to achieve this if necessary. Essentially, this is quantitative easing as recently practiced by the US Federal Reserve Bank. Secondly, there are those who think that the profligate southern European countries should get a grip on their irresponsible spending. They – Germany being the most significant – argue that no progress can be made on joint debt guarantees by the ECB until this requirement is first fulfilled. Thirdly, there are those who think that the euro is bound for a bust-up. Their belief is that the euro was an ill-conceived project from the outset, and that its demise is both inevitable and desirable.

The Foreign Minister of Poland put the position of the first school of thought in a powerful article in the Financial Times, stating 'We ask Berlin to admit that it is the biggest beneficiary of current arrangements and that it therefore has the biggest obligation to make them sustainable. Germany is not an innocent victim of others' profligacy. The biggest threat to the security and prosperity of Poland is not terrorism, and is certainly not German tanks, not even Russian missiles. It is the collapse of the eurozone.' He added 'I fear German power less than I fear its inactivity.' This view seems to be in the ascendancy, with the likelihood

that Germany, abetted by France, will ultimately allow large scale ECB easing, possibly IMF intervention, in conjunction with austerity packages.

Coronation's view is that thus far all rescue attempts have merely bought more time by dispensing medicine to a sick patient. The inescapable issue is that the rate of unemployment in Spain is 23%, and nearly 50% among 18 to 25 year olds, while in Germany it is 6%. The eurozone's fundamental problem is the 30% gap in competitiveness between the north and south. In the medium term, the only positive outcome is therefore for European policymakers to force the necessary sovereign debt losses to be taken, and for the troubled banking systems to be recapitalised. Only this action, albeit dramatic and painful, will allow the investing world to take Europe off their newspaper headlines.

In the meantime, the good news for investors is that, although there is great disagreement about which is the right scenario, unanimity that the position in Europe is bleak has resulted in this gloom already being reflected in low valuations.

While the investment world remains fixated on the problems in Europe, a more positive trend appears to be emerging on the other side of the Atlantic. The indications are that the US economy is getting back on track. Job prospects are improving, home prices are stabilising, and the US consumers are opening their wallets a bit more freely. More importantly, for the first time during the economic recovery, banks are lending more. After a tentative recovery earlier in 2011, bank credit rose at a 3.9% annual rate in the third quarter and has been accelerating in the fourth quarter. As we know, banks' greater willingness to lend – particularly to job creating small business – is crucial for any improvement in real GDP growth in 2012. Although well short of the high growth levels experienced five years ago, consensus forecasts are for real US GDP growth to accelerate (from 1.7% in 2011) to 2% and 2.6% in 2012 and 2013 respectively.

While fundamentals in the US look solid, the question is whether continued strain in Europe will hamper US corporate profits. Broker forecasts for 2012 are suggesting earnings growth by US companies – based on US fundamentals alone – of around 10%. However, due to anticipated weakness


in Europe, these forecasts have been pared back to low single digit increases. It is our opinion that the risks to these forecasts lie to the upside. One reason for this could be if the most dire forecasts for Europe do not materialise. However, an upward revision is more likely to occur due to a positive surprise from the level of economic activity in the US, as domestic growth continues to recover. If so, earnings would come in significantly stronger than expected. In addition, if the outlook for earnings improves or there is more certainty regarding economic outcomes, we would expect valuations to receive a significant lift as improved prospects for 2013 are factored in.

Taking a line through the Coronation Global Equity Fund of Funds' performance in 2011, it is clear that this has not been an easy environment for our managers to add alpha. Collectively in fact they have generated negative alpha. We believe that, in time, the present volatility will settle back to historical levels, and investors will intimately assess the value of equities based upon fundamentals – not momentum or the perceived crisis of the hour. We remain optimistic regarding the potential returns from the equities in our portfolios and believe that the value of these companies will eventually be reflected in their stock prices, and accordingly returns will be more consistent with our historical performance.

While we are of the opinion that the current environment presents buying opportunities for the patient investor, we remind ourselves that careful stock selection is needed to identify attractive investment opportunities. Investors cannot ignore the fact that profit margins for companies in the S&P 500 are at or near their historical peaks. Similarly, the business models of many businesses are now under threat – either from technological innovation or new international competition. As a result, the profit margins currently achieved by many leading companies are unsustainable, leading us to conclude that those companies that **do** have robust business models will materially outperform the market average.

It would seem that now, more than ever, extraneous factors are driving short-term market performance. This is often referred to as 'noise' in financial jargon and can include comments from a politician in a European nation, or a rumour regarding the exposure levels of a global financial institution. Fundamental investors attempt to avoid such 'noise' and focus on individual companies within the

context of the global economy. Of course, ignoring such short-term manias can result in underperformance over short periods of time. However, attempting to react to and trade based on such events will almost assure long-term underperformance simply due to the trading costs involved. Equity markets are currently rife with shares that are broadly misunderstood by the investment community, and it would appear that the widespread adoption of ETFs is only acting to increase these pricing anomalies. As investors have slowly returned to equity markets after the markets recovered from the crisis of 2008, they have increasingly been utilising ETFs as the preferred vehicle to gain market exposure. The large majority of ETFs are passively managed indexation strategies that attempt to capture broad market returns. Such indices often exclude the best performing shares because of size and/or liquidity constraints. Additionally, there are increasingly focused ETFs that invest in a specific sector or country. For example, an investor can own an ETF of a certain index excluding financials if one were disinclined to own financial companies.

We prefer to invest via active managers, who base their investment decisions on sound, long-term, and proven investment fundamental analysis. 



Global emerging markets

by **PIETER HUNDERSMARCK** and **GAVIN JOUBERT**

China represents the single largest country exposure in the Coronation Global Emerging Markets (GEM) Fund and makes up 32% of the portfolio. We are frequently asked if we are worried about China – specifically about the sustainability of the Chinese economy and whether there is a property bubble. The answer is that both issues do worry us. On the first point we don't believe that the current consumption of commodities by China is sustainable, and as a result we believe that current commodity prices are in many cases unsustainable at current levels (iron ore and copper in particular). This consumption of course, through infrastructure spend, makes up a large part of the Chinese economy and we would therefore naturally expect China's infrastructure spending to moderate. In terms of a property bubble, we do believe that there is a property bubble in certain of the larger cities (Shanghai in particular), but we don't believe that it is a nationwide issue. Partly because of these concerns we don't own any Chinese commodity companies, banks or property companies.

We certainly don't believe that the Chinese economy will continue to grow at 10% p.a., as it has over the past 30 years. However, even an average annual growth rate of 5% to 6% over the next five years would make it one of the healthiest economies in the world, and would provide a nice tailwind for consumer businesses in China. At the same time, we believe that the mix of the Chinese economy over time will shift, with infrastructure and exports becoming smaller and consumption becoming bigger. We also hold the view that in 5 and 10 years' time the average Chinese individual will spend a lot more on cars, clothes and food than he or she does now. Today, China already contributes 40% of the group revenue of KFC (owned by YUM! Brands); more cars are sold in China than in the US (China is Rolls Royce's single largest market); Apple already generates 12% of its



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***GAVIN JOUBERT** is head of the Coronation Global Emerging Markets team and has 14 years' investment experience. He has managed a wide range of South African equity and balanced portfolios and currently co-manages Coronation's range of Global Emerging Market funds.*

revenue from the country and yet only 1% of Chinese mobile subscribers have an Apple iPhone, and the list goes on. The key point is that already the Chinese consumer is a significant force, and it is the Chinese consumer that attracts us. We spend a large amount of time researching Chinese consumer stocks, valuing these businesses and investing in those that are trading well below what we think they are worth.

So while we do have concerns about China, we believe the prospects for many Chinese consumer companies over the next several years are extremely promising. Importantly, we also believe the valuations of a number of Chinese consumer companies are very attractive. Our entire 32% exposure is invested in Chinese consumer companies across a range of very different industries, with the common thread that they all sell goods to consumers in China. We are invested in the second largest local supermarket retailer; a high-end clothing retailer; two car manufacturers (including the only BMW China joint venture); the second largest beer company; three consumer-focused internet companies; a department store; two Macau casino operators; a branded food and beverage company, and a ladies footwear retailer named Daphne.

Daphne

The ability to invest with a long-term time horizon, beyond the noise of the short term where the majority of market participants spend their time, is one of the anchors to our investment philosophy. Because we look out over long time periods we aim to identify and invest in businesses that can survive the test of time – ideally ones that have a leading position in a promising business space, a growing business value, have enduring competitive advantages, a clear strategic focus, a robust balance sheet, and above all an attractive valuation.

Many of these attractive qualities can be found in Daphne. Established in 1987 as a family owned shoe manufacturing company, today it is the market leader in affordable branded ladies fashion shoes in China, with 4 000 outlets under its *Daphne* brand and 1 300 outlets under its *Shoebox* brand. Unlike other Chinese-listed companies that focus on mid- to high-end footwear, Daphne competes in the mass-market segment with its *Daphne* brand (72% of sales and 84% of operating profit (EBIT)) and the low-end family segment with its *Shoebox* brand (21% of sales and 18% of EBIT). Today the company is still controlled by the original founding family.

The size of the business opportunity facing Daphne is significant. In 2010, Daphne sold about 26 million pairs of shoes. Assuming no repeat purchases by the same customers, Daphne is presently only serving 26 million customers, or about 8% of the total addressable urban Chinese female population (of about 300 million). More importantly, it is highly likely that its target market (young, middle class working women) will buy more than one pair of shoes a year. As such, Daphne is still only scratching the surface of arguably the largest shoe market in the world.

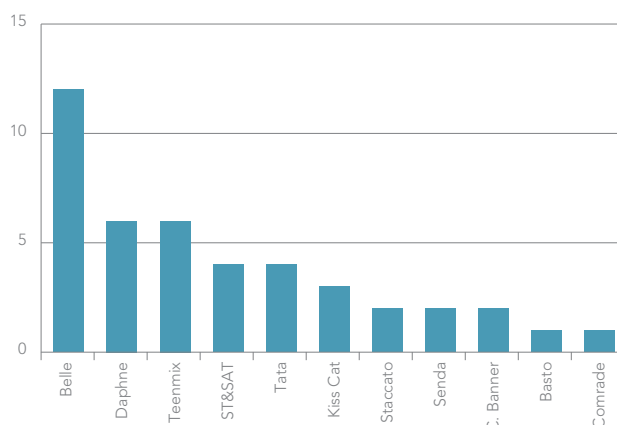
Daphne's competitive position within the shoe market is strong. It owns two powerful brands – the *Daphne* brand is ranked no. 2 by market share and *Shoebox* is no. 1 in the lower income category. Daphne's competitive arena is highly fragmented, and consists mainly of unbranded and/or unlisted regional players with presence in either mid- or high-tier cities. Daphne has extensive nationwide coverage of cities from tier 1 all the way through to tier 6 cities. By casting its net wide, Daphne has gained first move advan-

tage into the lowest-tier cities where there are few mass market aspirational brands.

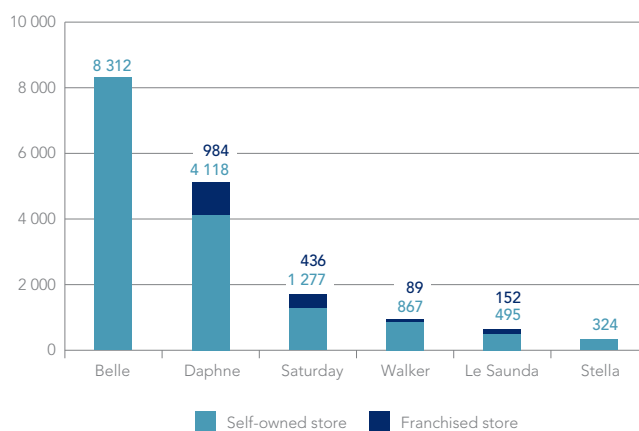
Daphne produces the vast majority of products at its own manufacturing facilities, from where they are shipped to its retail distribution network. This sales network allows Daphne the leverage against suppliers for bulk buying and better rental contracts than peers. The low cost production model and management pedigree of building and maintaining market leading brands makes Daphne a powerful force in the retail shoe market.

Daphne market share and network size

DAHPNE RANKS NUMBER 2 BY BRAND MARKET SHARE IN CHINA, 2009



SECOND LARGEST FOOTWEAR SALES NETWORK



Source: BAML



Despite their high market share in the formal retail market, both the *Daphne* and *Shoebox* brands are underpenetrated in China, with *Shoebox* (1 300 stores) the least penetrated of the two. The company is well funded, with over 15% of its market capitalisation in cash and zero debt, and is poised to expand its network strongly in the coming years. Each year, for the next five years, Daphne plans to roll out approximately 500 *Daphne* stores, 300 *Shoebox* stores and 150 of its newly acquired mid-tier brands. This store rollout will allow the *Daphne* brand to deliver nearly 20% revenue growth in our view, from a combination of 14.5% space growth and same-store-sales-growth (SSSG) of 6% on a normalised basis, while the *Shoebox* brand will expand space by 30% and will see 9% SSSG, leading to just under 40% revenue growth.

With 19% and 13.5% operating margins for the *Daphne* and *Shoebox* brands respectively, Daphne enjoys the second

highest profitability among listed ladies footwear companies in China. The company earns these margins on the lowest average selling prices in the peer group, which further speaks to its low-cost business model. We believe these margins have room to expand as the business matures, selling prices increase ahead of inflation, and scale advantages are further defined.

In summary, Daphne offers us an attractive opportunity to invest in a well-run, growing, branded Chinese consumer company that will benefit from the consumption shift taking place in the Chinese economy over the next decade. We believe the business is worth in excess of HK\$13, versus a share price of just over HK\$8 today. At a 10.4x rolling forward price earnings multiple (and 9x forward when accounting for the cash), we believe the opportunity is very attractive. Daphne is a 2.5% position in Coronation's GEM funds. 

Africa

Nationalisation – cheap politics and costly mistakes

by **PETER TOWNSHEND**



PETER TOWNSHEND joined the Africa team in July 2008. He currently co-manages the Coronation Africa and Africa Frontiers Funds. Prior to joining Coronation, he worked as an analyst with an African hedge fund.

Mining is in many ways a unique business. For a start, miners exploit finite resources. Once a mineral deposit has been exhausted, it is gone forever. This immediately puts miners in the firing line as what they exploit today is taking from future generations. Mining is also messy. While the actual area affected is often insignificant in relative terms and mines are typically in very remote locations where few will ever see or feel their impact, there is something about a big, untidy hole in the ground that can fire up opposition, even in another continent. Miners can also experience periods of what seems to be obscene profitability. Coca-Cola cannot increase the price of its fizzy drinks by 1 000% over a period of a few short years but this is precisely what has happened to iron ore miners, and their current margins are eye watering. But most of all, mining is possibly unique in terms of the scale of investment required and the time horizon that mining firms must consider.

From initial exploration to discovery, then through construction and to full production is typically measured in decades. And large mining projects can cost tens of billions of dollars. Commodity cycles can be a lot shorter than the mining investment cycle, so mining companies are never sure as to what sort of markets they will be bringing on new projects. And when you have committed billions of dollars to a project with no certainty that your product will sell for \$100 or for \$10, making big investment decisions is a leap of faith. The last thing a mining executive then wants to worry about is security of tenure or tax and royalty regimes. But, this is exactly what is happening around the world currently.

And Africa is no exception. In many African countries, commodities constitute a significant portion of GDP and dominate export earnings. In addition, the companies that

exploit them are often among the only foreign investors of any size. So, whether it is oil in Nigeria and Angola, copper in the Congo and Zambia, gold in Tanzania and Ghana or diamonds in Namibia and Botswana, mining is a high profile business on the continent. Having committed enormous amounts of capital in establishing mines or oil fields and being reliant on the state for mineral rights, mining companies are soft targets for politicians of all stripes. In South Africa, Zambia, Zimbabwe and Tanzania we have seen populist politicians find an eager audience when they start bashing the miners and calling for a bigger slice of the pie – or for outright nationalisation.

Nationalisation does not work. Africa is littered with the corpses of state mining companies that in a few short decades destroyed what were once vibrant private sector-led mining industries. But memories are short. Barely a decade has passed since Zambia privatised its bankrupt state mining firm. In that time, copper output has exploded and recently surpassed the previous peak output levels. But a new (populist) government is now looking to renegotiate the mining tax regime for the second time in less than five years. And a little further south in Zimbabwe, the country's leaders are trying to force mining companies to give up 50% of their assets. Closer to home, calls for the nationalisation of the mining sector in South Africa are growing louder ahead of what is likely to be a bitterly fought leadership race within the ruling party in 2012.


All of this is particularly galling given that the solution is in fact relatively simple – write a fair mining code the first time and then stick to it through thick and thin. Ideally the state should own mineral rights and should retain a carried stake in all mining projects (perhaps between 10% and 20%). Royalties



based on revenue also make sense for the state as they are simple and the effective tax take is significant (somewhere between 1% and 3% feels about right). Another possibility is a variable tax rate such as that under which the gold mining industry in South Africa has traditionally operated, where the tax rate moves according to profitability. This gives the miners some relief in tough times and allows governments a bigger slice of the pie in boom times. For the miners, some tax exemption in the early years allows faster recovery of the huge capital invested, as does the ability to write capital off against early profits. The precise levels of taxation need to be debated in each country, but once settled they need to be cast in stone. Certainty has real value and we would argue that for mining companies the absolute numbers are less important than a degree of certainty. Evaluating an investment with a 50% effective tax rate is easily done. Evaluating an investment where you are not certain whether the tax rate will be 50% or 75%, is far more difficult.

The Republic of Mali in West Africa illustrates this point. It comprehensively rewrote its mining laws in the early 1990s, and to the best of our knowledge has not meaningfully tampered with them since. In the decades since, it has come from nowhere to be the third largest gold producer in Africa, is among the top 15 gold producers in the world, and one of the most favoured gold investment destinations on the continent. Unfortunately, common sense seldom

dominates political discourse so the current uncertainties are unlikely to be the last that we see. This is just one of the tragedies of Africa and it does very real damage to the industry and has a very real impact on development. The mining industries in the Congo and Zimbabwe, for example, remain a shadow of what they could (and should) be and the mineral wealth of dozens of other African countries remains underutilised.

Despite this rather gloomy picture, Africa does still provide enormous opportunity for commodity companies as it hosts some of the last of the world's great, undeveloped orebodies. In our opinion, markets are not always very good at pricing uncertainty, yet when it strikes it can provide attractive opportunities for the long-term investor. We have significant investments in mining companies that operate in Tanzania, Egypt and Zimbabwe. In all three countries there is significant uncertainty around either politics (Egypt), taxes (Tanzania) or ownership (Zimbabwe). And in all three instances, if we allow for even our most negative potential outcome, there is still a large gap between our fair value and the current market price. There will undoubtedly be further surprises and more negative headlines. But, looking through the noise, we think our investors will be amply rewarded for taking a longer-term view and then showing that rarest of investment skills – patience. 

International portfolio update

■ Coronation Global Equity Fund of Funds

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Jul 00	(7.92%)	14.18%	(0.26%)	2.50%
Benchmark		(5.02%)	11.75%	(1.82%)	0.65%

Annualised, quoted in USD

The fund returned 5.6% for the quarter, bringing the rolling 12-month performance to -7.9% against the -5.0% of the MSCI World Index.

The quarter was again dominated by the ongoing European sovereign debt crisis. The new governments of Greece, Spain and Italy provided impetus to fiscal austerity in those countries, but an attempt to create greater fiscal unity within Europe was struck down by a British veto, and an agreement between the other 26 nations appears increasingly uncertain. Globally the crisis weighed heavily on sentiment and markets. However, economic data from the US is moving in the right direction and is expected to improve in 2012, an election year.

In terms of regional equity performance, North America was the best performing region, rising a strong 11.1%, while Japan was the worst, falling 3.9%. Asia ex-Japan rose 6.0%, while Europe rose by 5.5%. The fund's regional positioning had a significant negative impact over the quarter.

Overall, our managers also had a significantly negative impact on performance over the quarter. This was largely a result of volatile markets and increased uncertainty which led to increased exposure to cash, and less exposure to what was ultimately a strong equity market performance. This was especially evident among our European managers who all underperformed, in particular Lansdowne Europe and Adelphi Select funds.

Lansdowne Global and Cantillon Global also lagged over the period, while Contrarius Global generated good alpha and Viking Global also finished marginally ahead of the index this quarter.

After a period of underperformance we redeemed Royal Capital and introduced Sands Capital Growth Fund and Vontobel Emerging Market Fund.

Sands is a concentrated, valuation-driven growth fund run by Sunil Thakor and David Levanson. The firm manages approximately US\$18 billion across all strategies and the portfolio managers are supported by a team of 25 analysts and research associates. Since inception, they have generated annualised alpha of 6.3%.

Vontobel has a large team of analysts looking at stocks for their regional and global strategies. The Emerging Market Fund is run by Rajiv Jain, the firm's head of portfolio management who has run the fund for more than 10 years. Although also growth orientated, the firm has a strong valuation process coupled with a long-term investment horizon and low turnover. The fund has generated 4.2% annual alpha over the past 10 years.

2011 was a tough year for active, valuation-driven managers such as those with whom we place capital. With market volatility at extreme levels and short-term momentum dominating stock prices, our managers were unable to generate their historical levels of return. However, equity markets remain attractively priced and we are confident that our managers will provide good returns once some semblance of normality returns. This may not happen in the short to medium term as Europe continues to find ways to resolve its crisis, but there are some signs that conditions are improving, particularly in the US.

■ Coronation Global Capital Plus

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Sep 09	(1.60%)	–	–	5.62%
Benchmark		0.89%	–	–	0.24%

Annualised, quoted in USD

To claim that 2011 was an eventful year would probably be an understatement. In March, global financial markets were initially jolted by the earthquake and tsunami in Japan, but



recovered reasonably quickly when it became apparent that the doomsday scenario with regard to a nuclear disaster would not materialise. The dysfunctional political process in the US regarding the lifting of the debt ceiling then tested investors' resolve, leading to the first downgrade of US debt in history. Counter intuitively this downgrade was followed by a sharp rally in US bonds and an equally sharp decline in global equities. At the same time, the European sovereign debt crisis reignited fears of a global recession. The political landscape in North America and the Middle East was permanently changed by the events following the events of the Arab Spring.

The last quarter of the calendar year proved to be a rewarding one for investors in risky assets across the globe, but specifically in the US. The MSCI World Index rose by 7.7% over the quarter, bring the total return for the year to -5.0%. Interestingly, emerging equity markets continued to underperform their developed counterparts, with the annual number -18.2% (4.5% for the quarter). Over the year the range of returns, even among developed equity markets, was huge with the US showing slight positive numbers (around 2%) and European bourses performing the worst with numbers around -17% for the major markets. A few percentage points of this underperformance was due to the weakness of the euro, although remarkably the currency only weakened by about 2.5% against the US dollar over the year.

While fixed interest markets were uninspiring over the quarter, the sector still returned more than 6% for the year, despite the severe sell-off in some of the European sovereign instruments during the period. Listed property was flat for the year, with a sharp rebound in the US-listed market in the quarter.

The fund had a good last quarter, returning 3.6%. This was significantly ahead of the benchmark, which was negatively affected by the weakness in the euro over the period. However, the 12-month return of -1.6% is a disappointment, even with the benchmark also in slightly negative territory. Since inception the fund has continued to exceed its outperformance target.

While the fund's high exposure to equities hurt performance in the earlier part of the year, it contributed strongly over the past quarter. In addition, stock picking has been good, with significant alpha added over the period. Over the year, alpha generation was also satisfactory. Notable stock contributors included Great Wall Motors, Safeway, Google, Interpublic

and Pernod Ricard. Toward the end of the year we started to reduce our equity exposure by buying protection. We believe this to be prudent given the fund's lower risk appetite. We do continue, however, to believe that equities, in the medium term, will deliver the best returns from all the available asset classes.

The fund's fixed-interest exposure also contributed positively over the quarter; erasing losses from earlier in the year. Most of our holdings rebounded as risk appetite increased, and we expect good returns from these instruments.

Listed property disappointed over the quarter and the full year, with negative returns generated over the calendar year. This has been as a result of both deeply discounted capital raisings by our Japanese stocks and a severe sell-off in Singaporean property stocks over concerns about global growth. We have added to some of these holdings, and continue to expect good returns into the future.

Our gold position was almost flat over the quarter, but still up for the year. We added slightly to the position into the weakness experienced in December. Natural gas continued to be a major disappointment, both over the shorter term and since initiating the position. There is no doubt that the fundamentals for the commodity have weakened since the initial trade, but we still believe that the current price is discounting all of the bad news, without any possibility of an improvement in the supply/demand fundamentals being priced in.

The past year has been a trying one in financial markets, especially for risk averse investors. The fund did not escape the volatility and we are determined to make 2012 a better year for our investors. However, early indications are that we should continue to expect significant swings in investor sentiment given the fragility of the global economic situation.

■ Coronation Global Equity Alternative Strategy Fund of Funds

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Aug 96	(4.92%)	8.57%	1.82%	8.25%
Benchmark		(4.05%)	5.41%	0.29%	4.21%

Annualised, quoted in USD

The fund produced a return of 2.9% for the quarter, against the MSCI World Index return of 7.7%.

Three of the fund's European managers were the worst performers in 2011, despite outperforming the index. Over the four years in which the fund has invested in these managers all have strongly outperformed the market, with the worst annualising at 4.1% (in euros) compared to the MSCI Europe Index annualising at -9.6%. The worst performing manager was redeemed in November.

The two global managers continued to outperform strongly, returning 7.6% and 1.4% for the year, compared to the MSCI World Index return of -5%. Over the quarter the strongest performer benefited from their short book, while the other was hurt by their gold exposure.

The US managers produced diverse performances in 2011 and solid performances over the quarter. The top performer returned 9.3% in 2011 and over three years has recorded an annualised return of 13.2%. The two managers who underperformed the index in 2011, while having outperformed over five years, are to be redeemed by March 2012.

The two new investments made at the start of 2012 are a US manager with a strong stock-picking track record and consistent performance, and an emerging markets manager with an eight-year track record of annualising close to 13%, while consistently managing the portfolio at a very low net exposure. At the start of 2012 the fund is invested in 13 managers.

■ Coronation Global Emerging Markets

	Launch date	1 year	3 years	5 years	Since inception
Fund	14 Jul 08	(13.15%)	23.94%	-	5.32%
Benchmark		(18.17%)	20.42%	-	(1.09%)

Annualised, quoted in USD

The MSCI Emerging Markets Index closed the year down 18.2%. The fund performed marginally better, declining by 13.2% and in so doing outperformed the index by 5% for the year. Since the fund launched 3.5 years ago it has outperformed the market by 6.4% per annum.

The recent sharp market declines have led us back to a number of shares that we owned in 2008/2009, but sold out of by 2010 due to very strong share price performance and resultant unattractive valuations. Coca-Cola Hellenic (CCH) is one such example. The past year's market turmoil resulted

in a 40% decline in CCH's share price which gave us the opportunity to buy this business again at very attractive levels. CCH is the world's second largest independent Coke bottler, only marginally behind the largest, Coca-Cola FEMSA, with both generating around \$9 billion in annual revenue. Coca-Cola FEMSA bottle Coke in most of Latin America, while CCH bottle Coke for most of Eastern Europe. Although the company is listed in Greece it really is an emerging markets business. Only 7% of group volumes come from Greece, while around 2/3rd of revenue is generated in emerging markets. The bulk of this comes from Eastern Europe, where Russia and Poland are key markets. Nigeria is also a very important non-European market for the company.

CCH has a number of very positive drivers which, taken together, will lead to double-digit earnings growth for a number of years, in our view. Firstly, per capita consumption (pcc: the number of small cans of Coke consumed by each individual annually in any given country) of Coke in many of the company's key markets is very low. Italy (a mature market), for example, has pcc of 245, Poland 174, Russia 75 and Nigeria a negligible 23! We believe the pcc of Poland, Russia and Nigeria (in particular the latter two) will increase substantially over the years, and these three markets make up 35% of CCH's group volumes. Secondly, margins are below normal in our view, with CCH's EBITDA margins of 14% being well below the 16% to 22% range of other listed Coke bottlers in Eastern Europe and Latin America. A number of factors will drive margins higher over time, with a key one being the move from off-premise/multiple servings (2 litre Coke plastic bottles bought from a supermarket) to on-premise/single servings that naturally happens as markets develop (Coke cans consumed in restaurants/bars and at home). A continued shift towards higher margin non-CSD products (bottled water, energy drinks, etc.) over the next several years will also enhance margins. CCH trades on a high single-digit free cash flow multiple on our estimate of more normal earnings (taking into account the factors mentioned above), which we think is a very attractive entry point for a business of this quality.

Over the past few months we also added to the fund's exposure to the Macau gaming operators. In total, 4% of the fund is now invested in these stocks, compared to only 1.5% at the start of the year. The current exposure at the portfolio level is made up of positions in Melco Crown Entertainment (2.5% of fund), Las Vegas Sands (1.5% of fund) and MGM China (1% of fund). Melco Crown Entertainment (MCE) and MGM China (MGM) have all of their operations in Macau,



whereas Las Vegas Sands (LVS) generate about 45% of their profits from Macau, with the balance coming from Singapore (45%) and Las Vegas (10%). It is astonishing to think that LVS generates 90% of its profit from Asia today, whereas five years ago 100% of profits came from Las Vegas.

What has kept us largely away from the Macau operators in the past has been our view that despite the very positive long-term drivers, the risks are also higher than average, and the valuations have not been sufficiently attractive. The key longer-term risk in our view would be additional regulation in some form or another, including the opening of an alternative gambling destination in China. The key shorter-term risk would be a significant drop in VIP gambling due to tough economic conditions or another credit crunch. The second (shorter-term) risk worries us less: we think about businesses in terms of the next five years and beyond, and the prospects for Macau are very attractive over the longer term, in our view. While we believe the probability of extreme regulation is low, it remains a risk, and the way that we deal with this is to incorporate it into the discount rate that we require in valuing these businesses.

Given the market's current concerns about China, the Macau gaming companies have experienced sharp share price declines over the past several months, and as a result the valuations have become quite attractive, in our view. Both MCE and MGM are trading on high single-digit historic (2011) free cash flow multiples, while LVS is trading on a high single-digit free cash flow multiple two years from today. It is necessary to look out a few years as LVS is currently adding significant new capacity. Given the long-term prospects for Macau, we believe that current valuations are very attractive and that one is being compensated for the risks.

In summary, over 25 million people now visit Macau every year (55% of these from Mainland China) and the gaming revenue in Macau is already six times larger than that of Las Vegas. What is interesting however, is that gaming revenue accounts for 90% of Macau's revenue, whereas in the case of Las Vegas (and other equivalent gaming centres), gaming revenue makes up only 40% of total revenue, with the other 60% coming from hotel accommodation, entertainment, food and beverage, and retail. Macau today is largely a destination for VIP high-rollers. The mass market is still in its infancy and this is what creates the long-term opportunity, in our view. Approximately 10% of Chinese who can visit Macau (based on income levels) currently do so.

Today there is significant new resort development happening that will result in more mass market activities (entertainment and retail) being available on Macau. The transport links to Macau are also undergoing significant improvements which will enable far more Chinese to visit, and quicker, than what is currently the case. Mass market visitors have the additional benefit that they generate higher margins than VIP visitors. Both MCE and LVS (the fund's two largest positions) have operations that are largely concentrated in the part of Macau that is being developed as the mass market area. We believe that Macau, driven by the mass market, has many years of growth ahead and one pays a very attractive price today for these long-term prospects.

■ Coronation Global Bond

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Oct 09	8.15%	–	–	5.47%
Benchmark		6.35%	–	–	4.20%

Annualised, quoted in USD

The fund returned 3.2% against the Citigroup World Government Bond Index return of -0.1% for the quarter.

After falling sharply in the third quarter, the global benchmark US 10-year Treasury oscillated in a relatively narrow range around 2% and delivered 0.8% for the quarter. Within the US government bond market, breakeven rates of inflation rose by around 0.2% across the maturity spectrum as real yields fell slightly. Reflecting, a combination of a slight improvement in risk appetite and further comments from the Federal Reserve that rates would remain lower for longer.

On the opposite side of the Atlantic, markets were less settled with continued turmoil in Europe. The contagion within the eurozone saw sentiment towards Italy continue to deteriorate, contributing to the exit of Prime Minister Berlusconi. During the final quarter of 2011, Italian bond prices fell 3% and Portugal 3.7%, while Spain regained some poise to match the 1.8% return of German bonds. Greek bond prices meanwhile continued to reflect the flight of Icarus, plunging another 30% in value as 10-year yields soared to above 30%. The previous deal involving the private sector and debt restructuring involving writedowns of 50% now looks to be off, with rumours of new discussions focusing on haircuts of closer to 75%.

The end of Jean-Claude Trichet's tenure at the European Central Bank (ECB) provided the opportunity for a change of emphasis by his successor, Mario Draghi, who cut the central bank rate by 0.25% during November and December, reversing the hikes of April and July. The ECB was also forced to intervene through its Securities Market Programme (SMP) once again, but perhaps most significant is its extension of its Long-Term Refinancing Operations (LTRO) to cover a three-year term and the relaxation of collateral requirements. At the first LTRO the ECB made available €489 billion to 523 banks; the authorities would probably like to see some of this reinvested in peripheral bond auctions (a carry trade of sorts), although a large amount is likely to be used to alleviate stresses associated with significant bank bond maturities.

Within foreign exchange markets, Europe's problems and the ECB actions led the trade weighted euro to its lowest levels since the beginning of 2006. Meanwhile, the US dollar recovered some ground as economic data surprised on the upside. Emerging market and commodity-based currencies performed better during the quarter as risk appetite improved.

Credit markets remain split along financial and non-financial lines, with true corporates continuing to do relatively well. Within financials the tone has been better, reflecting the improvement in risk sentiment and the abundance of liability management exercises – where banks have sought to buyback debt at below par (100) but above current trading levels for capital management purposes ahead of new regulations. Financial credits remain volatile on systemic fears brought about by the weak price action of European government bonds and large impending debt refinancing.

During the quarter the fund maintained a short duration position, the bulk of which comes from an underweight in Japanese bonds. Within the US we now hold the majority of exposure through inflation-linked bonds. We also increased exposure to German inflation-linked bonds where breakevens fell as low as 0.8% in five years during November. Within Europe we took a position in Finland, one of the best quality issuers in Europe, after large swings in European government bonds left markets dislocated. We reduced exposure to Australian and UK bonds, two of the best performing markets during the quarter. The US dollar remains our currency exposure, with other significant exposures in the Norwegian krone and Swedish krona. We remain underweight yen and euros.

■ Coronation Africa Frontiers

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Oct 08	(14.63%)	12.35%	–	11.33%
Benchmark		5.34%	5.46%	–	5.61%


Annualised, quoted in USD

The fund regained some ground in the quarter and was up 3.6%. However, for the year 2011 it ended 14.6% lower before fees. This is clearly not the sort of return we hope to deliver to our investors and also does not reflect the opportunity we see in Africa. It was a year in which none of our major markets were spared, and in which currencies also moved negatively against us. For the year, Nigeria has fallen 21.6% in dollar terms, Egypt has plummeted 44.7%, Kenya is down 31.5% and Ghana ended 12.2% lower. Our investors have done better than the markets, but given our oft stated goal of delivering absolute returns rather than beating markets, this will be of little comfort. So what went wrong? Against a highly uncertain global economic backdrop it was a difficult year for markets around the world and particularly so for emerging markets. The markets in which we invest are not always closely correlated to global moves, but this year a variety of country-specific problems combined with globally negative sentiment to drive African markets lower. We briefly discuss two of the markets in more detail below.

Nigeria's stock exchange is dominated by banks, which generally suffered another dreadful year. Despite a massive government led bailout of the sector, investors have continued to shun banking shares and most are now trading lower than in the depths of the Nigerian banking crisis. The irony is that the banks are much healthier now than at any time in the last five years, and yet the investors in Nigeria that were clamouring to buy bank shares in heavily oversubscribed equity issues in 2007 (when the banks were rotten to the core) are now avoiding them and have largely fled to the perceived safety of government bonds. Needless to say, this is not a trade that we would agree with. The bank shares we hold in Nigeria also fell during the year, but were among the best performing in the sector. The large investments we hold in brewers in Nigeria again delivered decent returns and remain high conviction positions.

Egypt is slowly moving through the transition from dictatorship to democracy. Much remains uncertain and protest still rocks

the country. With negative headlines dominating, it is only for the brave investor – and brave investors seem to be in short supply. We continue to believe that Egypt hosts some of the finest companies in our investment universe and that these can now be bought on ratings that adequately compensate for the uncertainty. Consequently, Egypt makes up a large portion of our funds.

We have no particular insight as to how global or African markets may perform through 2012. What we know is that we hold a portfolio of high quality companies on more than reasonable ratings. With value on our side, we certainly hope 2012 will deliver a better result than 2011. 

Note: All returns quoted in USD unless otherwise stated.

Guest contributor

In this issue Gene Salamon, Three Bridges Europe fund manager, gives us his view on the ongoing crisis in Europe. Gene is an experienced hedge fund manager operating out of New York. He gained experience as a European analyst with Clay Finlay before moving into the hedge fund world, working for the legendary Leon Cooperman of Omega Capital prior to launching his own fund with Indus. Deep fundamental research and active portfolio management results in a moderately concentrated portfolio of typically 60 positions in the Three Bridges Europe Fund. Gene has demonstrated his ability in generating solid returns in all market conditions and especially in the protection of capital during bear markets. We particularly like the fact that Gene is based in New York where he is somewhat removed from the European market noise. This enables him to focus on thorough research and take longer-term positions which we believe is the best way to manage your capital. Our fund of hedge fund products have US\$12 million invested in the fund.

Three Bridges Europe Fund Indus Capital Partners, LLC

While still far from genuine resolution, progress on addressing the European sovereign debt crisis continued apace in November. There is an increasing sense of urgency among European leaders, perhaps related to recent evidence that



GENE SALAMON, fund manager of Indus Europe

the crisis is beginning to weigh on Germany's and France's own economic growth outlook.

While there appears a greater sense of urgency within the European Union (EU) regarding the sovereign debt crisis, the question still remains as to what the European leaders are willing and able to agree on despite their renewed vigour. The European Central Bank (ECB) has positioned itself as ready to provide support to the sovereign debt markets as fiscal reform commitments and progress are made, but it remains unclear how far they are willing to go. Through the early days of December, the ECB has again cut interest rates (despite a higher inflation outlook) and expanded its funding support of the banking system to help reduce the pace of deleveraging pressures on the real economy, but it continues to show restraint on sovereign bond purchases and remains opposed to outright quantitative easing (QE). QE seems almost unavoidable at some point if the economic and monetary union is to be maintained given the severe

austerity required of the peripheral countries. Regaining economic competitiveness is a daunting task even with the tailwinds of low interest rates and a weaker currency to boost exports, let alone with 5% to 10%+ borrowing costs and the €/£ at current levels. The evidence that austerity alone is not a viable solution appears to be growing. The circular nature of how tax hikes and cost cuts drag down GDP is clear in Greece where GDP revisions have been consistently negative. Ireland is being forced to find further cost cuts to stay on track with deficit reduction targets as GDP expectations decline. A similar pattern can be seen in Portugal where 2012 GDP is now expected to be -3% and deeper cuts are consequently required. We remain optimistic that these patterns are not lost on the ECB or European leaders. As similar reforms are implemented in the much larger countries of Italy, Spain, and elsewhere, we would expect QE to become an increasingly palatable option for both the ECB and Germany as they see proposed reforms actually being implemented.

November's political leadership developments in Italy, Greece and Spain are positive as these new parties appear to be coming in with much stronger mandates to implement fiscal and structural reforms than the old guard. Italy's recently announced €30 billion fiscal reform package appears to be a good first step, but still leaves much to be desired in terms of labour reform and competitiveness.

Despite the lack of a formal fiscal reform package, it is clear that Spain will face an additional growth headwind in 2012 from austerity measures. Greece convincingly passed its 2012 budget recently, targeting a 5.4% deficit vs. -9% in 2011 through a mix of cost cuts and tax hikes. The weight of more countries undertaking austerity measures at the same time creates a clear headwind to economic growth across all of Europe, but a distinct gap between growth in northern Europe and southern Europe is likely to persist. As fundamental bottom-up investors, we hope to capitalise on a stock-by-stock basis, long and short, from these divergences in performance by company, sector and country. Identifying and capitalising on different operating environments and the positive or negative impact on individual companies is a key element of our research process. Although we are not macro investors, we do seek to understand the dynamics of the different countries to better appreciate the operating backdrop for companies. We often find companies priced

irrationally partly because of where they are based despite bottom-up analysis showing their key drivers are not determined by their home country economics. Examples include global retailers we have owned that are based in peripheral Europe, but sell primarily outside the periphery, as well as core Europe-based banks with heavy Central and Eastern Europe (CEE) exposure where we have been short at times for fundamental reasons. Parallels can also be found intra-sector. For example, our in-depth understanding of the auto sector has led to investment positioning to take advantage of strong high-end auto demand while avoiding the negative implications of weaker mass market supply-demand dynamics.

We expect the likely economic weakness ahead will further separate best in class businesses from weaker peers. We feel our fundamentally driven investment process positions us well to take advantage of this on the long and short side of the portfolio. We used the volatility during the month of November to selectively add to, replace and initiate a few new longs and shorts, while keeping overall exposures roughly unchanged.

Despite the challenging markets, we are excited about the opportunity being created for our fundamentally driven, bottom-up stock selection process and continue to make a significant investment in the expansion of the team. 



INSTITUTIONAL FUND PERFORMANCE

PORTFOLIOS ^Δ	FEES [°]	LAUNCH DATE	1 YEAR	3 YEARS	5 YEARS	CUM SINCE LAUNCH [†]	ANN SINCE LAUNCH [†]
GLOBAL BALANCED							
Houseview	G	01-Oct-93	8.21%	16.84%	10.75%	1 667.27%	17.04%
Peer Median*			8.55%	14.70%	8.32%	1 321.34%	15.65%
Managed	G	01-Apr-96	9.04%	17.91%	11.80%	1 142.64%	17.35%
Peer Median*			8.55%	14.70%	8.32%	684.79%	13.98%
DOMESTIC BALANCED							
Domestic Houseview	G	01-Jan-98	6.48%	18.39%	11.77%	845.38%	17.40%
Peer Median*			6.48%	16.79%	9.94%	711.71%	16.13%
SPECIALIST EQUITY							
Core Equity	G	01-Mar-04	5.57%	20.64%	12.62%	382.77%	22.26%
FTSE/JSE Shareholder Weighted Index			4.26%	17.86%	8.65%	292.61%	19.08%
Houseview Equity	G	01-May-00	3.51%	20.72%	11.58%	686.99%	19.34%
FTSE/JSE Shareholder Weighted Index ¹			4.26%	17.86%	8.83%	453.16%	15.79%
Aggressive Equity	G	01-Jan-04	5.05%	22.48%	12.80%	400.65%	22.30%
FTSE/JSE Shareholder Weighted Index			4.26%	17.86%	8.65%	308.70%	19.24%
SPECIALIST FIXED INTEREST							
Institutional Cash	G	01-Sep-06	6.97%	8.08%	9.26%	59.87%	9.20%
Short Term Fixed Interest 3-month Index			5.48%	6.89%	8.34%	53.26%	8.34%
Active Bond	G	01-Jul-00	9.85%	8.37%	9.51%	303.82%	12.90%
BEASSA All Bond Index			8.82%	7.39%	8.59%	274.07%	12.16%
Strategic Bond	G	01-Jan-08	9.70%	8.88%	–	53.00%	11.22%
BEASSA All Bond Index			8.82%	7.39%	–	44.89%	9.71%
INFLATION-LINKED BENCHMARK							
Global Absolute	G	01-Aug-99	7.73%	14.99%	11.22%	662.49%	17.77%
CPI + 6% p.a.			12.11%	11.30%	12.94%	326.57%	12.39%
Domestic Absolute	G	01-Apr-02	5.00%	16.20%	12.06%	436.36%	18.80%
CPI + 5% p.a.			11.11%	10.30%	11.94%	177.36%	11.03%
Inflation Plus	G	01-Oct-09	10.32%	–	–	31.98%	13.12%
CPI + 3.5% p.a.			9.61%	–	–	18.58%	7.87%
Medical Aid Absolute	G	01-Apr-04	6.55%	13.26%	11.42%	215.25%	15.97%
CPI + 3% p.a.			9.11%	8.30%	9.94%	93.34%	8.88%
HEDGE FUNDS							
Presidio	N	01-Oct-05	12.48%	22.55%	14.92%	160.68%	16.57%
Cash + 7% p.a.			12.36%	13.66%	15.29%	141.13%	15.12%
Multi-Strategy Arbitrage	N	01-Jul-03	11.05%	13.82%	13.23%	214.95%	14.45%
Cash + 5% p.a.			10.36%	11.66%	13.29%	183.92%	13.06%
Granite Fixed Income	N	01-Oct-02	9.62%	10.95%	10.85%	172.47%	11.45%
Cash + 3% p.a.			8.36%	9.66%	11.29%	172.20%	11.43%
OFFSHORE FUNDS²							
Global Equity FoF (US\$)	N	01-Jul-00	(7.92%)	14.18%	(0.26%)	32.77%	2.50%
MSCI World Index (US\$)			(5.02%)	11.75%	(1.82%)	7.79%	0.65%
Global Equity Alternative Strategy FoF (US\$) ³	N	01-Aug-96	(4.92%)	8.57%	1.82%	239.49%	8.25%
50% MSCI World Index + 50% USD Cash (US\$)			(4.05%)	5.41%	0.29%	88.79%	4.21%
Global Managed (US\$)	G	01-Mar-10	0.75%	–	–	9.54%	5.09%
60% MSCI World Index + 40% Citigroup World Government Bond Index (US\$)			(0.31%)	–	–	11.14%	5.93%
Global Capital Plus (US\$) ⁴	G	01-Sep-09	(1.60%)	–	–	13.62%	5.62%
50% 3-month USD Libor + 50% 3-month Euro Libor (US\$) + 1.5%			0.89%	–	–	0.56%	0.24%
Global Bond (US\$)	G	01-Oct-09	8.15%	–	–	12.73%	5.47%
Citigroup World Government Bond Index (US\$)			6.35%	–	–	9.69%	4.20%
Global Emerging Markets (US\$)	G	14-Jul-08	(13.15%)	23.94%	–	19.70%	5.32%
MSCI Emerging Markets Index (US\$)			(18.17%)	20.42%	–	(3.74%)	(1.09%)
Africa (US\$)	G	01-Aug-08	(16.05%)	19.85%	–	36.58%	9.55%
3-month USD Libor + 4%			4.34%	4.46%	–	17.18%	4.75%
Africa Frontiers (US\$)	G	01-Oct-08	(14.63%)	12.35%	–	41.72%	11.33%
3-month USD Libor + 5%			5.34%	5.46%	–	19.41%	5.61%

^Δ Figures are quoted from the Independent Retirement Fund Survey as at 31 December 2011.

¹ Benchmark for Houseview Equity changed from FTSE/JSE Capped All Share to the Shareholder Weighted All Share Index on 1 July 2007.

² Figures quoted in US\$ as at 31 December 2011.

³ This fund is available to institutional investors only.

⁴ Formerly known as Global Latitude.

[°] G = Gross, N = Nett

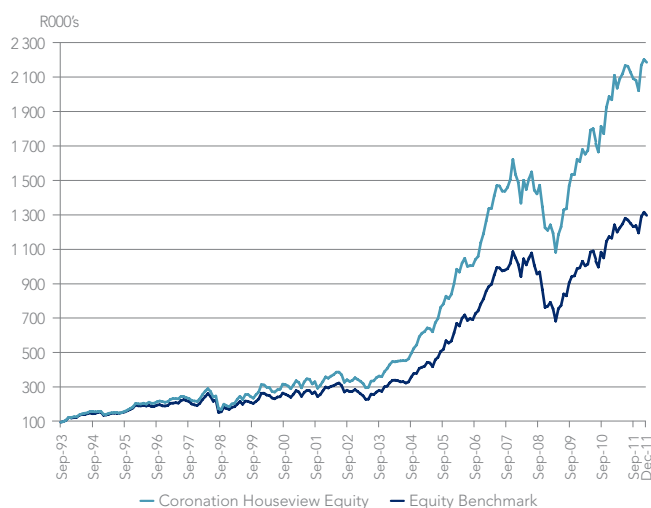
[†] CUM SINCE LAUNCH = Cumulative returns since launch, ANN SINCE LAUNCH = Annualised returns since launch. Figures of one year and less indicate percentage change.

* Peer Median is the median of the fully-discretionary retirement fund portfolios of the largest managers as published in performance surveys and calculated by Coronation Fund Managers.

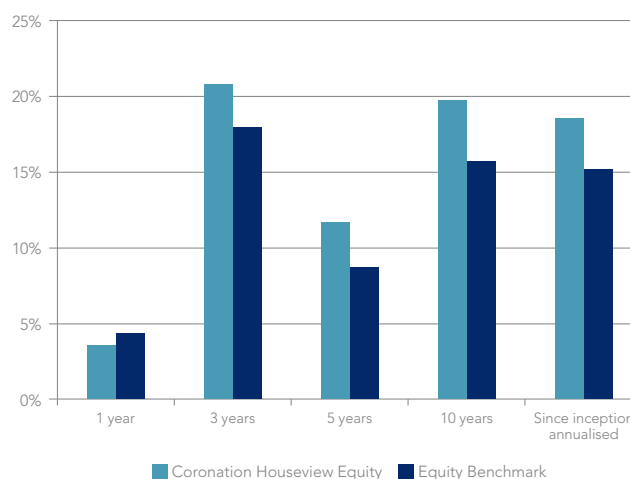
CORONATION HOUSEVIEW EQUITY RETURNS VS EQUITY BENCHMARK

5-YEAR ANNUALISED RETURNS	CORONATION HOUSEVIEW EQUITY	EQUITY BENCHMARK	ALPHA
1998	8.15%	6.49%	1.66%
1999	14.23%	10.91%	3.33%
2000	10.93%	7.52%	3.41%
2001	10.95%	9.38%	1.57%
2002	9.46%	7.14%	2.32%
2003	18.02%	13.49%	4.53%
2004	14.12%	9.35%	4.78%
2005	23.35%	18.63%	4.72%
2006	28.38%	23.07%	5.31%
2007	33.79%	29.52%	4.28%
2008	23.36%	19.28%	4.09%
2009	22.23%	19.77%	2.45%
2010	18.55%	15.12%	3.42%
2011	11.58%	8.65%	2.93%
ANNUALISED TO 31 DECEMBER 2011			
1 year	3.5%	4.3%	(0.8%)
3 years	20.7%	17.9%	2.9%
5 years	11.6%	8.6%	2.9%
10 years	19.7%	15.6%	4.0%
Since inception in October 1993 annualised	18.4%	15.1%	3.4%
Average outperformance per 5-year return			3.48%
Number of 5-year periods outperformed			14.00
Number of 5-year periods underperformed			-

CUMULATIVE PERFORMANCE



ANNUALISED RETURNS SINCE INCEPTION



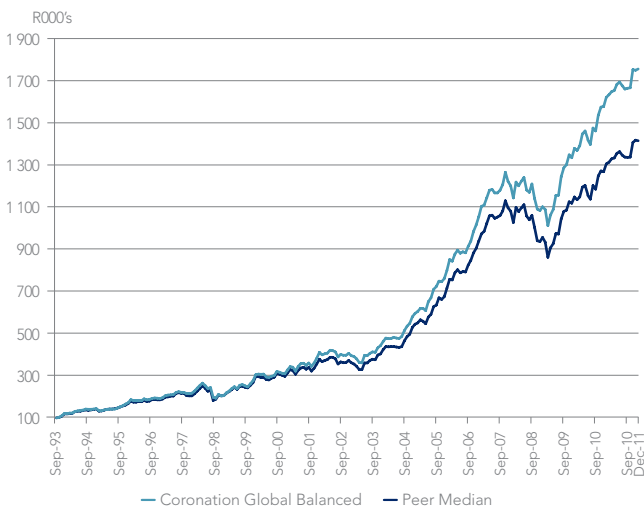
An investment of R100 000 in Coronation Houseview Equity on 1 October 1993 would have grown to **R2 186 401** by 31 December 2011. By comparison, the returns generated by the Equity Benchmark over the same period would have grown a similar investment to **R1 294 440**.



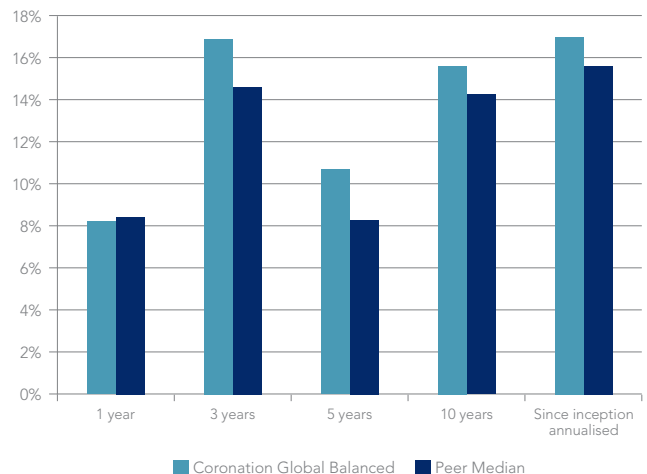
CORONATION GLOBAL BALANCED RETURNS VS PEER MEDIAN*

5-YEAR ANNUALISED RETURNS	CORONATION GLOBAL BALANCED	PEER MEDIAN	ALPHA
1998	11.21%	11.26%	(0.04%)
1999	16.36%	15.54%	0.82%
2000	13.82%	13.17%	0.65%
2001	16.54%	15.02%	1.52%
2002	12.74%	12.05%	0.69%
2003	17.67%	15.96%	1.71%
2004	14.35%	13.30%	1.05%
2005	19.58%	18.16%	1.42%
2006	20.74%	19.53%	1.22%
2007	24.93%	24.82%	0.10%
2008	18.96%	17.52%	1.44%
2009	18.28%	15.19%	3.09%
2010	15.23%	12.02%	3.21%
2011	10.75%	8.32%	2.43%
ANNUALISED TO 31 OCTOBER 2011			
1 year	8.2%	8.5%	(0.3%)
3 years	16.8%	14.7%	2.1%
5 years	10.8%	8.3%	2.4%
10 years	15.6%	14.3%	1.3%
Since inception in October 1993 annualised	17.0%	15.7%	1.4%
Average outperformance per 5-year return			1.38%
Number of 5-year periods outperformed			13
Number of 5-year periods underperformed			1

CUMULATIVE PERFORMANCE



ANNUALISED RETURNS SINCE INCEPTION



An investment of R100 000 in Coronation Global Balanced on 1 October 1993 would have grown to **R1 767 274** by 31 December 2011. By comparison, the median return of peers over the same period would have grown a similar investment to **R1 422 805**.

* Peer Median is the median of the fully-discretionary retirement fund portfolios of the largest managers as published in performance surveys and calculated by Coronation Fund Managers.

Coronation Asset Management (Pty) Ltd is an authorised financial services provider. Coronation Top 20 is 1st over 5 years and Coronation Balanced Plus is 1st over 5 years and since inception in their respective ASISA fund categories to 31 December 2011. Source: Morningstar. Unit trusts are generally medium to long-term investments. The value of units may go up as well as down. Past performance is not necessarily an indication of the future. Unit trusts are traded at ruling prices and can engage in borrowing and scrip lending. Fluctuations or movements in exchange rates may cause the value of underlying international investments to go up or down. Fund valuations take place at approximately 15H00 each business day and forward pricing is used. Performance is measured on NAV prices with income distribution reinvested. Performance figures are quoted after deduction of all costs incurred within the fund. Coronation is a full member of the Association of Savings & Investment SA.



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HE SAYS, "YOU CERTAINLY
DID YOUR HOMEWORK."**

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Over 5 years

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