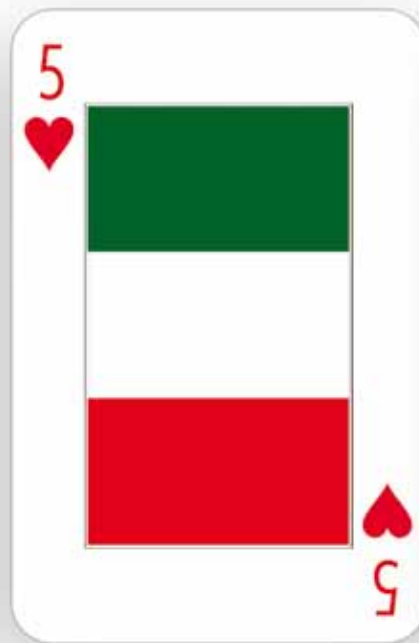


# corospondent

The Coronation Fund Managers Institutional Quarterly



## A faltering global economy

'Reflections' from my inbox	2	International outlook	15
Market data	3	Investing in education	18
Heading for stagflation?	4	Africa	21
Tough choices	6	International portfolio update	22
Bond outlook	9	Antares	27
Equity market update	10	Performance tables	29
Anglo American	12		

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# 'Reflections' 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.*

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On deciding the content for this issue of *Corospondent* we felt that we lacked new ideas. Not because there was no real news flow, but the extreme opposite. So much has happened, yet it feels like the 'Rollercoaster Groundhog Day' we have been experiencing since 2008. For those who don't know, 'Groundhog Day' is a movie in which Bill Murray plays a TV weatherman doomed to live the same day over and over again. Market actions akin to depicting the end of the world seem to be following that very same course.

The quarter started with a massive political battle in the US that took the country to the brink of default, resulting in the loss of its top tier AAA credit rating by Standard & Poor's. This was an unprecedented blow to the world's largest economy and the trigger that started the past few 'whipsaw' months in the markets. Investors were scared and panic ensued. There were just too many unanswered questions around the health of many of the developed market economies. Market volatility moved to levels experienced at the end of 2008. But while it took nine months for volatility to reach these levels in 2008 – in August 2011 it took just six or seven trading days.

The world's focus centred squarely on the solvency of many of the European countries (Greece, Italy, Spain, Portugal, Ireland) and the health of the European banking system. It has to be said that much of the current economic mess has been driven by developed world political regimes. Politicians simply do not have the stomach or will to do what is in the long-term best interest of their citizens – of course not, elections take place every four years! In the following

article, Charles de Kock looks at the factors that have led to the 'mess' and takes us through possible scenarios to avert more crises. In this issue you will see a lot of 'scary' words appear in our articles – stagflation, financial repression, default, risk of contagion. All of these are potential consequences that we may see over the next few years if the current economic crisis is to be well and truly resolved.


Tony Gibson provides a sobering perspective on the global economy and in the Bond outlook, Mark le Roux talks about the difficult task of generating real returns from fixed interest assets over the next five years. With the very real threat of financial repression, South African investors are about to experience a 'very cold shower'. Over the past two decades all asset classes in South Africa have delivered exceptional returns – even sitting in cash provided investors with inflation beating returns. To achieve real returns in the years ahead one will need to exploit all potential return sources and enhancers – an extremely challenging task.

South African markets did not escape the global turmoil. The rand depreciated very quickly, going through the R8 to the US dollar level within days. Inflation threatens and our base case scenario is one of a stagflationary environment. In her article, Chantal Valentine looks at the policy dilemma the country faces and the potential outcome.

But all is not lost. The upside of this wave of investor behaviour has been the drawing of a very clear line – sell or buy. There is no discretion. Many are aiming to 'Europe proof' their portfolios, selling shares irrespective of valuation



or quality. Reactions such as these create opportunity for the valuation-driven, disciplined investor. Of course there is a chance that good value could still get cheaper or better in the short term, but timing the market is a very dangerous game. While there are certainly more questions than answers with no certainty as to how things will unfold, we continue applying our disciplined approach to investing in strong businesses that we view as undervalued.

In closing I feel that I cannot conclude this quarter's issue without paying tribute to Steve Jobs – one of the greatest business leaders and visionaries of the 21st century, who changed the way people consume music and information: iPhone, iPod, iPad. In the words of President Obama 'Steve was the greatest of innovators – brave enough to think differently, bold enough to believe he could change the world, and talented enough to do it.' 

## MARKET DATA

### MARKET MOVEMENTS

Economic group	Qtr 3 2011 %	YTD 2011 %
All Share Index R	(5.8)	(5.4)
All Share Index \$	(21.3)	(22.6)
All Bond R	2.8	5.1
All Bond \$	(14.1)	(14.0)
Cash R	1.4	4.3
Resources Index R	(10.4)	(13.4)
Financial Index R	(3.1)	(1.2)
Industrial Index R	(3.3)	0.0
MSCI World \$	(16.5)	(11.8)
S&P 500 \$	(13.9)	(8.7)
Nasdaq \$	(7.8)	(4.6)
MSCI Pacific \$	(11.6)	(13.4)
Dow Jones EURO Stoxx 50 \$	(28.9)	(19.6)

### KEY ECONOMIC DATA: HISTORY AND FORECAST

	2008a %	2009a %	2010a %	2011f %	2012f %
HCE	2.2	(2.0)	4.4	4.6	3.7
GCE	4.7	4.8	4.6	3.6	4.8
GFCF	14.1	(2.2)	(3.7)	2.7	5.0
GDP	3.6	(1.7)	2.8	3.3	3.6
Current a/c % of GDP	(7.1)	(4.1)	(2.8)	(3.9)	(4.9)
CPI	11.5	7.1	4.3	5.0	5.9
Prime rate (year-end)	15.0	10.5	9.0	9.0	10.5
R/\$ year-end	9.92	7.48	6.81	8.00	8.50
R/EUR year-end	13.44	10.89	9.00	11.12	11.48

# Heading for stagflation?

A look at the global economy

by CHARLES DE KOCK



**CHARLES DE KOCK** is a senior portfolio manager with more than 20 years' investment experience. He plays a leadership role in the asset allocation process and is responsible for the management of a number of client portfolios.

The world is in a proper economic mess. Despite zero interest rates, massive fiscal deficits and unprecedented use of unconventional tools such as quantitative easing, the global economic recovery is faltering. Financial markets have become increasingly volatile as investors react to each and every new data point and failed attempt of policy makers to deal decisively with the sovereign debt crisis in Europe.

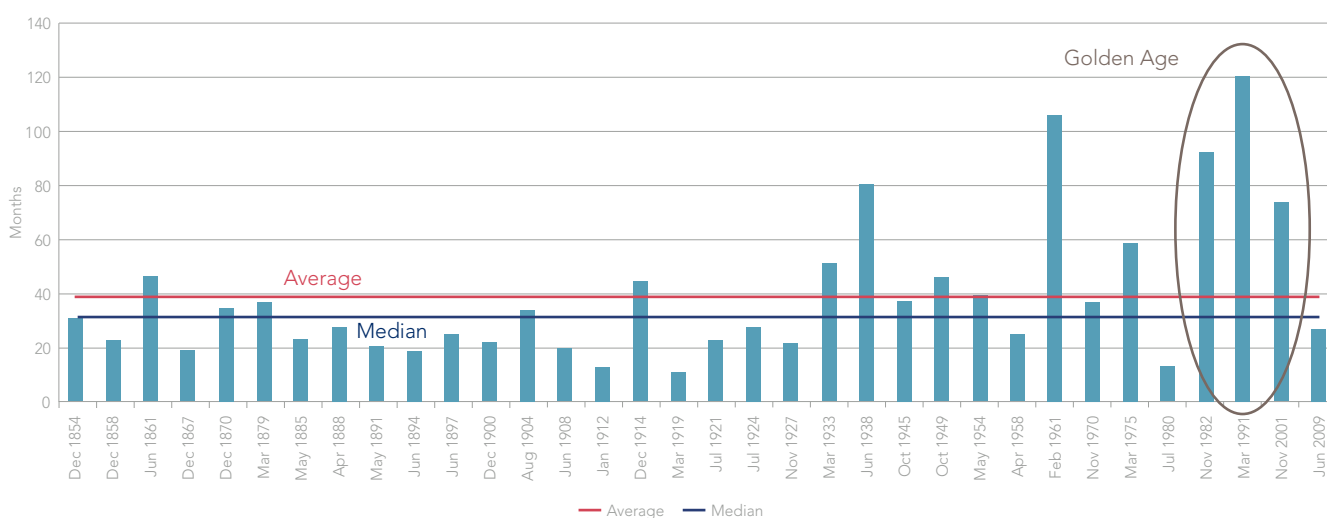
## Historical background

'To know where you are going; it is useful to know where you have been' is a much used expression to convey that a sense of history is necessary to understand the present. One thing that economic history teaches us is that economic cycles are normal; downswings follow upswings – not with perfect predictability of extent or duration, but cycles occur naturally in the economy. The graph below shows the average

expansion measured in months in the US since the mid-1800s. It is clear that the durations of upswings have been extraordinarily long in the recent past. These continuous years of economic expansion led some observers to even speak of the 'end of cycles' and gave the Federal Reserve Board (Fed) credit for managing policy much better than in the years before.

It is our view that the fear of suffering a recession made the Fed keep policy too loose for too long. The availability of almost unlimited amounts of cheap goods from China, and other previously closed parts of the world, ushered in a long period of unbridled consumerism without the normal negative inflationary effects. Central bankers kept interest rates very low in the absence of goods' inflation and bankers happily extended loans to vast numbers of poor credit risk borrowers during these boom times.

US EXPANSION LENGTHS SINCE 1854



Source: Deutsche Bank, NBER

The extended period of individuals living beyond their means was financed by debt. A lot of which went to finance property. And when the property bubble finally burst banks were left with massive amounts of bad debts. The financial crisis of 2008 then followed and it is from this hangover that the world has not yet escaped.

The deep recession led to sharp drops in government revenues, and the resultant massive fiscal deficits have left many governments virtually unable to service their debt.

### **How can governments get out of the fiscal mess they are in?**

#### **1. Grow the economy**

The one way is to grow the economy at all costs. This means keeping interest rates at zero and keeping the fiscal deficit very high. The hope is that by expanding the economy, revenue will naturally rise and only then can a start be made at normalising economic policy. The US certainly tried to go this route, but the shift in the balance of power between the Republicans and Democrats has put paid to this strategy being followed to its full extent. In Europe this 'go for growth' option is not feasible as bond investors have signalled their unwillingness to buy more bonds of the highly indebted nations.

#### **2. Tighten fiscal policy**

The countries that cannot access more debt have no choice but to follow the more painful route of fiscal tightening. This means spending less and taxing more. This is a very unpopular route for politicians but one that has been forced on countries with the worst fiscal balances such as Greece, Portugal, Ireland, Italy and Spain. Tighter fiscal policies in these countries will almost certainly push them right back into recession. Some very tough policy decisions need to be taken in these countries including extending the working age, reducing pension benefits, paying civil servants less and enforcing tax laws fully.

#### **3. Political muddle through**

Politicians of course want to remain popular and get re-elected when their terms in office expire. They will therefore try compromise solutions and sometimes just plain inactivity

hoping for the best. The German voters do not want their taxes to be used to bail out the sick European countries and will not re-elect Ms Merkel if she does. But without German support the euro will fall apart, with dire consequences for all – including Germany. Thus some form of a compromise will have to be made.

Our view is that the euro will hold, but with the more indebted nations ceding some fiscal authority to a central European treasury – probably under the leadership of a German official.

The real basket case of Greece will in all likelihood have to restructure its debt and may even opt out of the euro. If the larger countries such as Italy and Spain also falter, the impact on European banks will be catastrophic. The relevant authorities will have to come up with a plan that ensures the larger nations remain in the euro.

### **Stagflation unfortunately a very real possibility**

Research shows that following a deep financial crisis economies take a long time to recover to the high growth rates experienced in the years leading up to the crisis. We believe that we are in such a period of sluggish economic growth. Households are repairing their balance sheets and will not be tempted back into debt before they feel comfortable in their own financial health. Interest rates are therefore likely to remain very low for a long time as this period of balance sheet repair takes place.

For governments it also means fiscal deficits will remain large as revenue will just not rise until economic growth is more robust. In order not to get runaway deficits government spending will therefore need to be kept in check. Politicians are notoriously impatient and are likely to try and force growth sooner to help their election campaigns. The loose policies followed are in our view still likely to lead to inflation somewhere down the line.

We are consequently of the view that a period of stagnant economic growth combined with some inflation is lying ahead. Economists have dubbed such an outcome 'stagflation'.

## How to invest in a stagflation period?

Income earning investments (cash and bonds) tend to earn very little as interest rates are deliberately kept very low and in all likelihood below the rate of inflation.

On the other hand, growth assets such as property and equities have the headwind of sluggish economic growth to contend with. Earnings growth therefore also struggles during a stagflation era. A period of low returns is therefore to be expected.

But one need not totally despair. There are many very good businesses with strong balance sheets and the ability to pass cost increases on to customers. These businesses should be able to grow their earnings even in tough times. It is our task as fund managers to find these winning companies. The added good news is that, in our view, many quality businesses trade at attractive valuations and have the ability to pay out handsome dividends, in many cases greater than one would earn in cash or bonds. Our balanced portfolios own inflation-linked bonds, high-yielding corporate credit and quality businesses that can pay out good dividends. An appropriate blend of these assets should enable us to weather the current stormy times. 🇬🇧

# Tough choices

## The SARB between a rock and a hard place

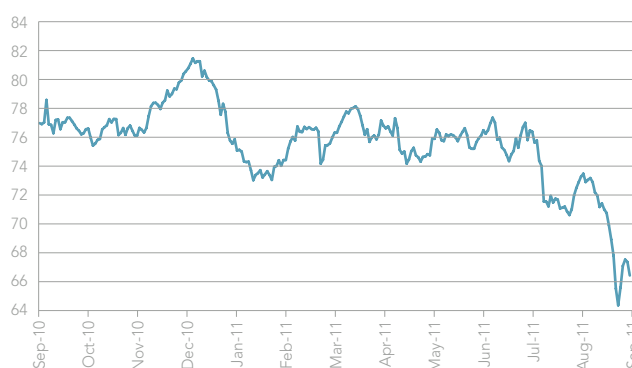
by **CHANTAL VALENTINE**



**CHANTAL VALENTINE** joined Coronation as economic and fixed interest strategist in 2003. With 19 years' experience in analysing local and global markets, she plays a critical role in the investment decision-making process.

We have long argued that a view that the rand would remain strong as long as US (and other developed country) interest rates remained low was too simplistic, viewing this as an unsustainable situation. The thinking behind this conclusion relates to the reasons behind the view of low rates. Rates are not low because this is a 'Goldilocks' world of low inflation and solid growth; they are low because of concerns about the direction of global growth and fears of a double-dip. This kind of growth background is not at all positive for South Africa: it weakens demand for our major exports, and it is likely to lead to a 'risk-off' scenario. Elements of this have started materialising recently, with the rand (and other emerging market currencies) experiencing a sharp sell-off in recent weeks. In the first nine months of the year, the rand was 22% weaker against the US dollar and over 18% weaker on a trade-weighted basis, with almost all of that having taken place in the most recent two-month period.

CHART 1: TRADE-WEIGHTED RAND (INDEX 2000=100)



Source: I-Net Bridge

The implications for inflation are worrying should the rand's weaker tone be sustained. Given the rand's volatile history,

we are loathe to immediately change our official forecast. We have already been of the view that a breach of the target range is likely by the fourth quarter of this year. The recent rand weakness will have some shorter-term impact (almost immediately through petrol and with a slightly longer lag to food), but most of the move should be reflected in next year's inflation data. Should the rand's current levels be sustained, and in the absence of any significant downward move in global commodity prices, the risk of a later and higher peak in CPI is a very real one. Clearly, currency moves are highly volatile and uncertain, but if current currency levels are sustained our CPI forecast would move from the current expectation of a peak just over 6% and a return to target in the first half of 2012, to one where the peak may be around, or over, 7% and there is no return to inside the target range in 2012 at all.

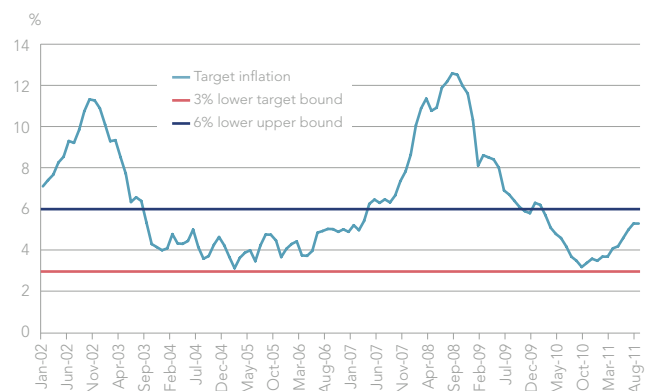
Such an outlook is exacerbated by stubborn cost-push pressures. In particular, lead indicators for food price inflation – which had earlier begun to indicate that a peak in food inflation was in sight – have started turning up again. Maize prices on SAFEX were around all-time highs at the end of September, and are up a startling amount on a year-on-year (y/y) basis (the number that matters for inflation) – white maize was up 69% y/y and yellow maize 53% y/y. These are important for local CPI, both directly in grains and indirectly via animal feed. Given the usual lag SAFEX prices have to food inflation, this implies we will see high food inflation into early next year at least; the recent rand moves may prolong this.

There is an argument that the SARB should ignore food inflation because it is 'cost push'. While we understand the rationale behind this argument (and in general agree that central banks should accommodate first-round relative price changes), we do not really agree with it in the specific instance of South Africa. The main reason for this is that locally, food inflation is demonstrably a leading indicator of overall inflation. This is partly due to its relatively high weight in the CPI basket (14%) but, we think, is also because food price inflation is often used by unions in wage negotiations (particularly when it is higher than headline inflation); in other words, food price inflation leads to second round effects. On a more technical note, we would also argue that even if one accepts the argument against responding to food prices, this is really only valid

as far as fresh food is concerned. Processed food (which in our country accounts for close to half the food basket) has a significant non-food component in its price (wages, electricity and so on all affect the price of processed food products) and is thus already an indicator of second-round effects. We would note in this respect that in the latest CPI number, processed food inflation was 8.5%, compared to 6.3% for fresh food.

Given softer domestic growth (albeit partly due to strike action) against this negative inflation backdrop, the SARB is faced with some tough choices. There is a sense that inflation expectations are not as well-anchored in South Africa as they should be, and that the uptrend in inflation will have a negative effect on expectations going forward (and, in turn, on wage agreements, with the potential for further negative inflation implications, and so on). But inflation targeting does not take place in a vacuum – as is clear from the fact that inflation has been allowed to (significantly) exceed the upper end of the target range in each up-cycle since inflation targeting began (but has not been allowed to breach the lower limit on the downside). And it is pretty much widely accepted that we will breach the upside again this cycle. So shouldn't the SARB cut rates again because growth is weak?

CHART 2: TARGET INFLATION (CPIX/CPI AS RELEVANT)



Source: I-Net Bridge

Here we would caution against a knee-jerk 'growth is weak, cut rates' reaction – and not just because of questions about why growth is quite as weak as it is (i.e. partly due to strikes), or how interest rates could address this. We are unsure about the benefits to South Africa of cutting rates further when it

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would neither address the problems exporters face which are global demand related, while it seems a counter intuitive move for consumers given the SARB's oft-expressed concern that consumer indebtedness is too high. There are already signs that business fixed investment is picking up, but the constraints to investment have not been interest rates.

It is important not to just focus on the nominal level of rates. The repo rate has been at 5.5% since November 2010. At that stage, inflation was around 3.5% and we had a real repo rate of 2%. Currently, the real repo rate is barely above zero, and is expected to go into negative territory imminently. This means interest rate policy is already very accommodative. Furthermore, overall monetary policy is even more accommodative when one takes exchange rate movements into account (a weakening currency is equivalent to policy loosening). Estimates that take both measures (real interest rates and real exchange rates) into account show that overall monetary policy is currently close to its historically loosest levels.

Our feeling, then, is that the SARB should not cut rates any further. However, we cannot rule out a scenario where they feel under pressure to do so – and a scenario where further global weakness materialises in a way that flows through to South Africa might prompt this. We would note, however, that we believe this type of outcome (global weakness combined with an interest rate cut) would lead to more rand weakness and worsen the inflation outlook further. In particular, we are concerned about the precedent set in 2001, when the SARB cut rates in September as a number of global central banks did in the wake of 9/11, but it precipitated a sharp worsening in an already weakening exchange rate and helped lead a sharp rise in inflation the following year. We are concerned that a potential scenario is one where unions continue to demand (and receive) higher wages as inflation rises, but with businesses offsetting this by cutting jobs, resulting in an outcome of both higher inflation and higher unemployment. Whether or not this worse-case outcome materialises, we think South Africa is facing a 'stagflation-lite' episode of some form, where below-trend growth and relatively high inflation will be with us for a while. 

# Bond outlook

## The way forward

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 20 years' experience in managing both traditional and alternative portfolios.*

This quarter I want to steer away from the norm and address two issues that we feel are key for the South African bond market going forward. The first is a phenomenon that we are seeing playing out in a number of the developed-country bond markets, namely the advent of 'financial repression'. And the second is what has taken place in the bond market with respect to foreign holders of South African bonds.

### Ushering in an era of financial repression

*Financial repression:* a term used to describe several measures which governments employ to channel funds to themselves, which in a deregulated market would go elsewhere. (Source: Wikipedia)

It can be in the form of keeping short rates artificially low (negative real short rates), introducing regulation to force banks to hold more government debt (Basel III), or introducing legislation that forces investors to hold certain prescribed assets. Looking back at history, periods of financial repression tend to coincide with negative real returns being generated on fixed income assets (both cash and bonds) and periods of stagflation.

Judging from the statement at the most recent Monetary Policy Committee meeting it appears that certain members are keen to keep short rates at their current historically low levels, and potentially even look for the opportunity to cut rates further. This could be hazardous for the economy as inflation is rising at an alarming rate, heading towards the upper end of the target range of 6% – and with the recent currency depreciation could materially breach it.

If we are heading into a version of this scenario, we favour holding positive real yielding assets such as inflation-linked bonds (ILBs), where one is at least guaranteed a positive real return if held to maturity. It is of interest to note that

in a number of the developed countries ILBs are trading at 0% real rates, or even negative real rates.


### Burning under the African sun

Foreign interest in buying South African bonds (similar to certain times last year) reached fever pitch towards the end of August. The primary driver of this 'en masse' purchase was the decline in yields on long-dated bonds in the developed world, making our high-yielding SA local currency bonds very attractive.

For the year ending August, foreign investors had bought close to R50 billion of our bonds. Yes, the 'carry' pickup of between 5% and 6% was highly attractive, but as with anything in the market, it doesn't come for free. The risk they appear to have ignored was the expectation that the rand would remain stable (and overvalued) into perpetuity. In September the rand sold off 15% at its lowest point, effectively wiping out the carry yield pickup for foreign investors in South African bonds and a fair deal more. In short, all the South African bonds bought in rands by foreign investors this year are now at a book loss. In response, R14 billion were sold in the latter part of September.

### Outlook

In summary, we believe real returns from cash and bonds are likely to be relatively poor over the longer term, both from a South African perspective and a global perspective. Short rates are likely to remain lower for longer and inflation will become problematic.

In our view, the way forward is to run shorter duration positions relative to benchmarks, combined with a liberal inflation-linked bond holding. 

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# Equity market update

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.*

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*'Uncertainty is the friend of the buyer of long-term values'*  
Warren Buffet

Global news is continually dominated by the sovereign debt crisis in the eurozone. The lack of decisive action by the European Central Bank (ECB) and the European Union in resolving the Greek crisis allowed contagion to spread from the periphery to Spain and Italy. This resulted in the bond market bidding up the yields of these countries to levels where they would be unable to finance their deficits. Unlike Greece, Spain and Italy are too big to fail and given the entwined nature of the European banking system, any default would have dire consequences for the global economy.

Investor uncertainty was also fuelled by political wrangling in the US that resulted in a last minute decision by congress to raise the debt ceiling to combat a weakening economy. This culminated in ratings agency, Standard & Poor's, downgrading US debt – the first time in the country's history. This led to widespread panic as investors fled to safe-haven assets, resulting in a significant appreciation in the gold price and sharp compression in the yields of US treasuries notwithstanding the credit downgrade. Developed and emerging equity markets sold-off aggressively with massive intra-day volatility. This culminated in the Fed committing to maintain interest rates at levels close to zero until at least mid-2013. Even the ECB has softened its stance on inflation given the precarious state of the global economy.

The combination of accommodative global monetary and fiscal policy together with rising food and oil prices is likely to lead to higher inflation. In this scenario, equities remain our preferred asset class for producing inflation-beating

returns. We increased our equity exposure during the quarter on the back of the market panic and hold close to what we consider to be an overweight position. We continue to favour global over domestic equities – multinational blue-chip companies are the cheapest they have been in three decades with attractive dividend yields (especially when compared to cash) and pristine balance sheets. We remain at the maximum allowed offshore exposure.

The All Share Index returned -5.8% for the quarter. Financials were once again the best performer with a -3.1% return. Industrials returned -3.3% and resources were the worst performer, with a -10% return. Resource stocks have been poor performers in response to disappointing global economic growth and renewed fears that the world may slip back into recession. We used this opportunity to add to the diversified miners (specifically Anglo American), Sasol and the paper stocks. While most commodity prices remain high, we believe that resources offer value, with selected resource shares trading at less than 10 times our assessment of normal earnings and have moved slightly overweight. However, we remain underweight gold and platinum producers given our concerns over declining grades and enormous cost pressures faced by these businesses (labour, electricity and water).


Banks returned -3.3% for the quarter, underperforming other financials. Banks are currently unloved by the market and this is reflected in their significant underperformance relative to the market. We believe earnings are low (low net interest margins and high bad debts) and this, coupled with a low rating, presents an attractive investment proposition. We remain overweight banks given attractive valuations



at 9 times our assessment of normal earnings and price-to-book ratios of 1.7 times.

The earnings of the average industrial company are up four times since the start of the decade and even more so for consumer-facing businesses. We believe it will be a challenge to defend and grow off this base. Consequently, we own very few retailers, other than Woolworths and Mr Price and remain defensively positioned. We continue to find value in selected small caps.

We continue to believe the rand is overvalued and are invested in rand hedges such as MTN, SABMiller, Naspers and Bidvest.

In conclusion, there is no shortage of uncertainties in the global economy. As a result, markets are likely to remain volatile and challenging for some time to come. As a long-term investor, this is not bad news as times of uncertainty often create opportunities when emotion trumps reason. We look forward to capitalising on these opportunities. 

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# Anglo American

94 years in the making

by **HENK GROENEWALD**



**HENK GROENEWALD** joined Coronation in January 2005. Prior to this, he spent two years as a trainee equity analyst with Allan Gray and three years as an electrical engineer at Sasol. Henk co-manages the Coronation Resources Fund and the Absolute range of funds.

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*'Of all those expensive and uncertain projects, however, which bring bankruptcy upon the greater part of the people who engage in them, there is none perhaps so perfectly ruinous than the search after new... mines. It is, perhaps, the most disadvantageous lottery in the world, or the one in which the gain of those who draw the prizes bears the least proportion to the loss of those who draw the blanks; for though the prizes are few, and the blanks many, the common price of a ticket is the whole fortune of a very rich man. Projects of mining, instead of replacing the capital employed in them... commonly absorb both capital and profit.'*

Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*

*'When your efforts run in the face of conventional wisdom and accepted mastery, persistence can look like madness. If you succeed in the end, this extreme originality reformulates into a new level of mastery, sometimes even genius; if you fail in the end, you remain a madman in the eyes of others, and maybe even yourself. When you are in the midst of the journey... there's really no way of knowing which one you are.'*

Hilary Austen, *Artistry Unleashed: A Guide to Pursuing Great Performance in Work and Life*

In his book *Outliers*, Malcolm Gladwell challenges our conventional ideas around the origins of success. He sets out to prove, rather eloquently, that success is not borne out of innate genius but can in a large part be attributed to when and where you were born, the opportunities you are presented with, and the amount of practice you are willing to put in.

What then determines the success of a company in an industry where most fail? Mining is a risky business. Adam Smith understood this when he wrote *The Wealth of Nations* in 1776, and history has not proved him wrong. In the 'disadvantageous lottery' of mining, there have been many abject failures and few successes.

The most crucial factor determining success of a mining operation is the quality and location of its assets. The assets that a company own are dependent on its history and the opportunities afforded to build or acquire great mines. Like humans then, one of the key ingredients to a company's success is the time and location of its birth.

## History of Anglo American

Anglo American was formed in 1917, by German-born Sir Ernest Oppenheimer. South Africa is a country blessed with natural resources, but back in the early 1900s it was still in the early stages of developing into the mining powerhouse we know today.

It was a fortuitous time to be a mining entrepreneur in South Africa. Diamonds were discovered in Kimberley in 1869 (the reason for Oppenheimer coming to South Africa in the first place), gold was discovered in the Wits basin in 1886 and in 1924 a geologist named Hans Merensky discovered platinum in the Bushveld.

In the early years Anglo American invested in gold, diamonds, platinum, copper and coal. It became the major shareholder in De Beers in 1927. Cash flows from mainly gold and diamonds were used to expand the company



aggressively and consolidate its position. In 1951 Time magazine named Sir Ernest 'The world's king of diamonds and prime minister of gold!'

From its base in mining, Anglo American acquired other interests and became a major force in the South African economy. In 1987 it controlled about 60% of the total market capitalisation of the JSE through 80 different listed companies.

A period of unbundling and simplification culminated in 1999 with a London listing, combining its South African and offshore operations previously held by Minorco. At listing the market capitalisation of Anglo American was \$21 billion.

### Recent errors

Over the last decade, China's rapid industrialisation led to a surge in demand for most commodities. Commodity prices increased at a rapid rate as mining companies battled to keep up with the demand. The result was the creation of one of the greatest booms in mining that we have ever seen, and ultimately the spectacular crash of mid-2008.

Anglo American was the darling of the market in the run-up to 2008. Its share price reached an all-time high of \$70, and at the peak it boasted a market capitalisation of almost \$90 billion.

Regrettably, like other mining companies, management and the board were imbued with false optimism from the record high commodity prices and, at the top of the market, went on an acquisition spree. The worst example of this was undoubtedly the acquisition of Minas Rio from MMX for a total consideration of \$6 billion. While this made the sellers very rich, it was a poor deal for shareholders, and placed the balance sheet under immense pressure just as commodity prices started to unwind.

From the darling of the market in 2007, Anglo American quickly became an easy share to dislike as commodity prices faltered. The company suffered under high debt levels due to recent acquisitions. Cash flows from their major divisions disappointed. Anglo American Platinum (Amplats) was exposed as a high cost producer and De Beers needed to

be recapitalised. Anglo American had to cut their dividend and narrowly avoided a rights issue in the aftermath of the crisis. The share price bottomed at \$13 in March 2009.

### The future

Despite the strategic errors, Anglo American's rich history lays the foundations for its future success. The current suite of assets has gone through many siftings, with the best being kept and developed further, and the worst sold. As one of the foremost mining companies for a great number of years, it also benefited from the many opportunities to acquire large, quality assets that were out of reach for most.

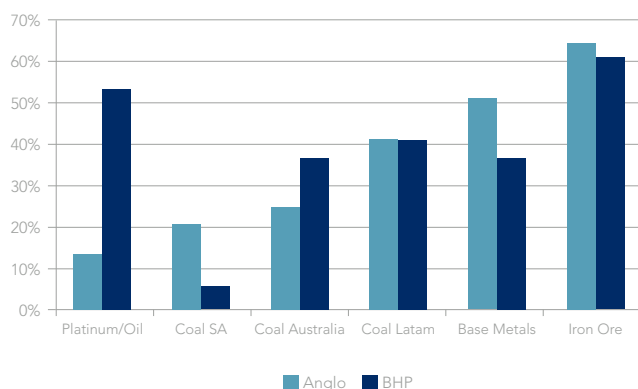
Both platinum and diamonds are unique assets which were acquired by Sir Ernest Oppenheimer in the very early part of the company's lifecycle. The last gold assets were sold in 2009, but the substantial historic cash flows from gold (yes, there was a time when gold mines generated cash!) was used to expand the group.

Some of the 'newer' acquired assets are also of very high quality. Anglo American bought Disputada, a Chilean copper producer, in 2002 for \$1.3 billion. In 2006, the same mines generated an operating profit of \$1.5 billion. In 2003, 65% of Kumba was acquired for R40 a share before the split between Kumba Iron Ore and Exxaro. Kumba Iron Ore is still one of the best long-life, low-cost iron ore assets in the world.

We do not subscribe to the view that reserves of any commodity will run out soon. However, in most cases the easiest and most accessible reserves were extracted first and what is left is more difficult and expensive to mine. Therefore, high-quality, low-cost mining assets with significant remaining lives are becoming more scarce and valuable. These types of assets are in general concentrated in the hands of the largest diversified mining companies, including Anglo American.

Today, BHP Billiton is the largest and generally accepted as the best mining company in the world. They also have a long and proud South African history which contributed to their success. As illustrated in chart 1, Anglo American's assets are in most cases comparable in quality to that of BHP, the 10th largest global company.

**CHART 1: THE QUALITY OF ANGLO AMERICAN'S ASSETS RELATIVE TO BHP BILLITON**



Source: Company reports, Coronation research – Operating margins before interest and tax used as an illustrative measure of quality

### Valuation

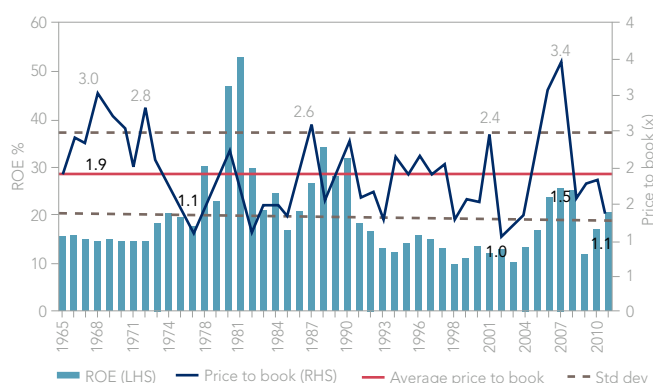
In valuing a company we focus on the fundamentals of the business, realising that its value is not always accurately reflected in the share price. To determine the value of a business we try to ignore the short-term noise and focus on long-term, through the cycle earnings. While this is hard even for relatively predictable companies, it is even more difficult for cyclical companies where we constantly have to fight to not be overly influenced by recent history. While never a precise estimate, our assessment of value is backed up by extensive research and scenario analyses.

We recognise the fact that commodity prices are high, and Anglo American's short-term performance will be determined by short-term commodity price gyrations. The long-term performance of an investment in Anglo American will be determined by the difference between what is implied by the current share price and the actual outcomes.

At the peak in 2008, Anglo American traded at \$70 per share. Today you can buy the same company for almost half that amount. At current prices, it trades at below 10 times our assessment of long-term earnings, and only 1.1 times net asset value. The market thus assumes that Anglo American will not deliver returns much in excess of their cost of capital. Chart 2 shows the company's price to net asset value over time.

The current share price implies a long-term return of below 10%. This compares to an average return on equity over the last 94 years of 15.6%, and 18% over the last 45 years. We believe it is improbable that Anglo American's return will be below what the market is pricing in and that there is a high likelihood of returns materially above this.


**CHART 2: ANGLO AMERICAN PRICE TO BOOK MULTIPLE AND RETURN ON EQUITY**



Source: Citigroup Research. Last data point 30 September 2011

### Conclusion

Given the current weak global outlook, conventional wisdom would indicate that investors steer clear of the more cyclical sectors of the market. While weak economic conditions are clearly negative for commodity prices and thus short-term cash flows of our resource companies, we see some value in the sector and especially in Anglo American.

We try to ignore conventional wisdom as it is rarely synonymous with intelligent investing. Anglo American has been built up over 94 years with genius and sometimes a touch of madness. The result is a portfolio of quality assets that hold the key to future success as it has in the past. This is being offered to investors at a discount. Anglo American is a top 10 holding across our portfolios. 

# International outlook

The (financial) world is not about to end – it is merely dealing with reality for the first time in a number of decades.

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.*

In recent weeks there has been no shortage of doom and gloom headlines in the press, covering the ongoing problems of, among others: the sovereign debt crisis in Europe; the budget debate in the US, and the increasingly anaemic economic indicators from the developed economies. These factors, coupled with extreme market volatility in August and September, elicited immediate comparisons in the financial media to the volatility experienced during the financial crisis of 2008. Increasingly it is believed that we are experiencing a return to the financial crisis of late 2008. In fact, current equity risk premiums appear to be reflecting equal or greater risk than in December 2008. This phenomenon can be seen by examining the Chicago Board Options Exchange's Volatility Index (VIX), a measure of market expectations of near-term volatility as expressed by S&P stock index option prices. Some interesting comparisons that emerge are as follows:

Date	Event	VIX Level
15 Sep 2008	Lehman Brothers chapter 11 filing	31.7
16 Sep 2008	AIG bailed out by US government	30.3
8 Aug 2011	Day following S&P downgrade of US credit	48.0
30 Sep 2011		43.0

In 2008, it took nine months for the level of volatility to reach these elevated numbers – whereas in August 2011 it took just six or seven trading days. Investors, still fearful from events in 2008, sold first and asked questions later. The implication is that investment risks are currently the same as, or greater than, those during the disruptive events of 2008. However, we believe that comparisons with October 2008 are overdone. Current European sovereign risks aside, the fundamentals are somewhat different today for a number of reasons:

- Corporate profits and balance sheets are materially stronger than they were in 2008.
- The Federal Reserve has kept borrowing rates at historic lows, and has made clear that they will maintain low Fed Fund rates for the foreseeable future.
- The US banking system has significant reserves (more than \$1 trillion in aggregate reserves) with aggressive write down imbedded in current assets.

While the S&P downgrade of the US government debt may have been the final trigger for the August sell-off, the solvency of the US government does not appear to be the primary concern of markets, as evidenced by the fall in yields on 10-year Treasuries following the rating change. Many factors contributed to the tumultuous markets experienced in the third quarter. These included questions regarding the sustainability of corporate profit levels, high unemployment levels, and uncertainty regarding the solvency of certain European countries and the potential for contagion to spread to other economies. With regard to corporate profit margins, we believe that concerns regarding sustainability are warranted; given that the net profit margins of major US corporations are at, or near, all-time highs. The profit margin expansion witnessed over the past decade and longer has been aided by factors including decreased corporate tax rates and rising government expenditures. The most recent increases in profit margins are largely on the back of cost controls rather than revenue increases, and may even reflect underinvestment by certain businesses. For companies whose margins have expanded as a result of underinvestment, margin levels may well not be sustainable.

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However, many better managed companies in developed markets have also focused on long-term returns on capital as opposed to near-term performance. These companies continue producing strong operating results and often repurchase their shares too. We view this as an opportunity to invest at attractive valuations, and over the medium term believe that attractive returns on assets will be realised irrespective of periodic volatility.

That said, in the short term fear in investment markets remains acute, with most potential investors staying well away from risk assets such as equities. After all, it is difficult to have conviction when we are bombarded on a daily basis with news of the imminent collapse of the euro, the US dollar, and the overall banking system. In order to gain some perspective of the current turmoil, it may be helpful to contemplate, hypothetically, what an economics lecturer may tell his class in **2021**, regarding the years immediately following the 2008 credit crisis. The points highlighted by the lecturer would, in all likelihood, track the following sequence:

- Sometime during the last two decades of the 20th century, core economic growth from the developed world economies began to slow. This, coupled with a rapid ageing of their populations would, all things being equal, have resulted in the gradual decline of living standards of these countries' citizens. This would not just be in terms of current lifestyle, but also future benefits such as healthcare and pensions.
- However, the governments and citizens of the developed countries were very reluctant to accept this outcome. Increasingly the citizens turned to the easily available credit as a means of supplementing their lifestyles. The accumulation of these increased borrowings by the citizens was predicated on the belief that historic economic growth patterns (and salary increases) would soon resume. Likewise, their countries' governments also relied increasingly on debt markets to cover their spending over-runs.
- In 2000, a massive speculative bubble in the technology sector burst, causing a major loss of investment wealth by the citizens of the developed world. This in turn led to a loss of investment confidence by investors, and inevitably, economic growth fell.
- Governments in the developed world should have let the free market work through this economic cycle. Unfortunately, however, the response of the developed world central banks was to cut interest rates to unprecedented levels so as to avert recession. Additionally, interest rates were held at these low levels for a number of years – far longer than was justified by economic necessity.
- The result was that consumers, already having been attracted to the world of easy and cheap credit, now became fully confirmed 'debt-addicts'. Debt began to be taken at an alarming rate, particularly when it came to home ownership by increasingly uncreditworthy new buyers.
- More so than ever, the undeniable decrease in economic growth was remedied by more and more debt. Their governments followed suit – supplementing falling tax receipts with increased borrowings. All developed governments were guilty – but Greece, Spain and Portugal were most definitely the worst offenders. The UK and the US were of course also on this debt accumulation wave. This is well illustrated by the fact that, in the prior decade, the volume of lending in the United States grew five times as fast as the real economy.
- Persistent and inappropriately low interest rates led to a housing bubble with all its exotic new debt and derivative instruments. This bubble eventually burst in late 2008, effectively bankrupting the developed markets' banking system. This chapter has been well documented and need no explanation at this point.
- Following 2008, the citizens of the developed economies largely realised that their credit addiction had to end. This was essentially forced upon them due to their banks dramatically tightening lending standards. However, individuals also came to the realisation that the long-held notion that 'things will soon get better' was delusional.
- But the developed world governments did nothing of the sort. They were not honest enough to tell their citizens that a severe bout of belt-tightening by their governments was essential. Neither did they tell them that social benefits had to be cut, and taxes raised in order to stem the continued burgeoning


levels of national debt that their governments were accumulating. Nor, of course, were their electorates willing to hear this message should they have accurately communicated such.

- In 2011 the developed world was, on balance, characterised by weak and ineffective leadership. Leaders who essentially hoped that they would see out their terms of office before their bad and unsustainable policies caught up with them.
- Fortunately that same year, investment markets communicated their unwillingness to tolerate the situation any longer. In the period starting 2011, investors, specifically bond market investors, forced leaders to make changes. This they did by refusing to continue funding their deficits; delivering the very clear message – ‘change your ways or be put out of business’.
- Changes, that dithering politicians would otherwise never have made, were rapidly implemented in the years that followed. This was particularly true in Europe where the rules were changed; thereby allowing a remodelled Europe to move forward on a more disciplined and united basis.
- Similarly, the US financial system was also modified, with the objective of achieving sustainable growth. But with the one big difference – this time growth would be achieved within the confines of the new, lower

growth, reality. This was of course forced upon these administrations by the dual fears of a drying-up of bond finance from emerging markets and credit rating downgrades by the rating agencies.

### **The conclusion that he will give to his class**

Following the credit bubble that burst in 2008, the five-year deleveraging from 2008 to 2013, was an extremely difficult one for the global economies. It took a number of years before the financial system stabilised. The changes that occurred during this post-bubble period were ultimately forced upon governments; but not because the elected leaders had the will or desire to make them. It was rather due to the fact that investment markets had had enough of weak and duplicitous political leadership. Importantly, these changes were essential to restore confidence to the world's financial system.

In the period following 2012, sustained economic growth from the developed world economies resumed. While growth rates were lower than those enjoyed in the early 2000s, this new level of growth has proven to be at a more sustainable level. The most favourable consequence of the recalibration of developed economy growth expectations is that the prospect of another financial meltdown is much reduced. Importantly, the growth that is currently being experienced is neither based on the excessive build-up of debt nor unrealistic expectation of future economic growth rates. 

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# Investing in education

## In Brazil and India

by **MARK BUTLER**



*MARK BUTLER has 13 years' experience investing in emerging markets. Prior to joining Coronation's emerging markets unit in 2008, he was based in London with Aberdeen Asset Management and Baring Asset Management.*

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Education is a key ingredient to the growth of an individual and a nation. The benefit for a country to invest in education is most apparent when one looks at a country which is still classified as emerging, yet outshines developed markets. The country I'm referring to is South Korea, which since the 1950s has improved access to education to such an extent that it has moved from 21st place in the OECD ranking tables, to first. Without this investment in education, the country would not be where it is today and Samsung and Hyundai would not be global household names.

Coronation's Emerging Markets funds hold two education companies, totalling around 8% of the portfolio, namely Brazil's Anhangera and India's Educomp. Education increases the earnings impact of an individual, and this is most apparent in Brazil where an individual with a tertiary qualification earns two and a half times that of a person with just a high school diploma.

Tertiary education participation by Brazilians between 18 and 24 years old is low, with only 20% enrolled at a university or college. In contrast, the participation rate in Argentina and Chile is three times higher.

Even though Brazil's education spend is 5% of GDP, the quality of state school education is poor and does not equip scholars for university. There are limited places available within the state university system – less than 10% of total students – which tends to be taken up by those educated at elite private schools. The remainder are catered for by the private sector, of which a quarter are in religious and philanthropic institutions which cannot cater for increased

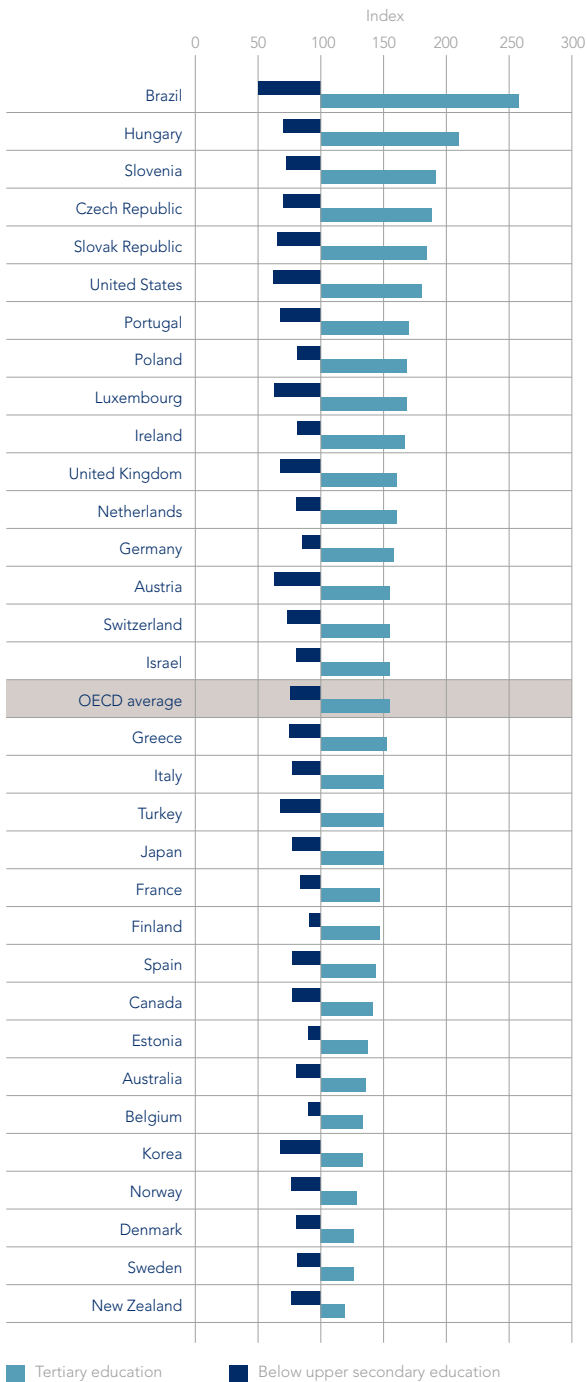
demand. Hence, an opportunity was created for 'for-profit' private sector universities. These are mainly in the form of small, family-run independent institutions operating from a single location. They lack scale, operational efficiency, and some are in financial distress and struggle to attract and retain quality academic staff. An additional concern by prospective students is that these 'brands' are not well recognised and while their earning capability will increase, it will not be the two and a half times increase in salary they had hoped for.

The education sector is being consolidated which is where the company in which we have invested, Anhangera, comes in. The product is aimed at working adults and is a strong brand in Brazil's fragmented education market. Anhangera is embarking on a process to consolidate the market and create a national number one. Campuses use the same content per subject and share central administration which dilutes fixed costs, increasing earnings as additional campuses are added to the network and existing campuses mature. Mature campuses operate with gross margins of 50%, while acquired campuses operate on gross margins as low as 20% because small operators lack scale. On average, the existing 60 campuses in the portfolio are operating at less than 70% of capacity. The number of students has increased to 200 000 from less than 50 000 five years ago, and when fully matured, Anhangera expect to cater for 300 000 students. The company benefits from an exemption on income tax on undergraduate education provided they grant a specified number of bursaries to students from underprivileged backgrounds.



RELATIVE EARNINGS FROM EMPLOYMENT BY LEVEL OF EDUCATIONAL ATTAINMENT FOR 25 – 64-YEAR-OLDS (2009 OR LATEST AVAILABLE YEAR)

Upper secondary and post-secondary non-tertiary education = 100



Source: OECD

The Anhangera share price has halved since late 2010 on the back of concerns over Brazilian customer defaults. Those who default do not return at the end of a semester and are typically replaced at the next intake. We have met with management on numerous occasions during the last year, have performed detailed analyses on the company and believe that it is significantly undervalued. It is trading on 11 times next year's earnings, which we believe is substantially below what the company can earn once the campuses mature.

Our second education company is Educomp in India which has four segments: smartclass™ technology-based teaching aid (William Smith/Star Schools but for all subjects and all years), K-12 (primary and secondary) physical schools, higher education and an on-line platform. The principal products are smartclass™ and the K-12 rollout.

The quality of state-run education is extremely poor and education is a high priority among Indian families. The middle class in India has expanded in the last two decades as the nation has become wealthier, driving the demand for quality private education higher. In India, tuition fees vary dramatically from US\$20 per month to over US\$1 000 per month.


The lack of well-qualified teachers in the country is where smartclass™ provides a world class solution, and having personally sat through a demonstration I can attest to the 'wow' factor. smartclass™ consists of a hardware platform which allows the teacher to retrieve and display all course material from a content library through projector or LCD screen. Subscribers have access to more than 16 000 modules which cover the entire primary and secondary school syllabus in India. The modules were developed over a period of 10 years and are seven to eight times larger than the next competitor. Independent research indicates that Educomp has close to 90% market share, which together with the lead time to create curriculum material, makes it extremely difficult for a competitor to compete on anything other than price. So with the cost per student at around US\$2 per month there is little incentive for schools to skimp on quality and offer an alternative product. Around 7 000 schools subscribe to smartclass™ with the product

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reaching about 50 000 classrooms. However, this represents just 9% of private schools and 3% of individual classrooms. Management's target is to increase the number of classrooms covered to 350 000. Historically, the cash-generating capability of this division has been poor due to Educomp incurring large upfront expenses from supplying hardware to the school, with the school only paying in monthly instalments. This has now been outsourced to a third party in return for a portion of the profits. Educomp now receives their cash within a period of two years and incurs no capital outlay for each new school added.

The operation of physical K-12 schools is the second key business segment. It is estimated that there is a shortage of 200 000 private schools in India. The building of a new school is capital intensive and Indian bureaucracy draws out the process substantially, limiting schools to only admitting students into the first few grades in their first year of operation (even though there is sufficient demand to fill Grade 1 through to Grade 12 on their first day of operation). Under current regulations, it takes four years of operation before all classrooms are filled. Educomp has 59 schools in operation today with another 30 planned, but because of the

drawn-out enrolment process, only four are operating at full capacity, with the other schools in various stages of maturity. Therefore, it will take around four years before these schools mature and as they do revenue will increase by more than 400%. Given the fixed-cost structure, profits will increase by a multiple of this amount.

Educomp's share price had, at one stage, fallen by almost 80% from its high in the final quarter of 2009. This was primarily over concerns that the company was not generating enough cash to meet its financial obligations. We believe that the steps management have taken to slow the growth of the business and improve cash generation will start to come through in the next two years, and the company will comfortably meet its obligations. It currently trades on less than eight times earnings for the year ahead and these earnings are very depressed for the reasons outlined above. This makes Educomp one of the cheapest stocks in our entire coverage universe – which is very rare for an Indian company. While there are certainly execution risks involved, our assessment of its business strengths coupled with the extremely cheap valuation suggest there is substantial risk adjusted upside in Educomp. 

# Africa

## Is Zimbabwe the true survivor?

by **PETER LEGER**



***PETER LEGER** joined Coronation in April 2005 as a portfolio manager. He has 13 years' experience in the financial markets in Africa as both a portfolio manager and research analyst. Peter currently heads up the Africa ex-SA unit for Coronation, which includes the Coronation Africa and Coronation Africa Frontier Funds.*

Many of you will be familiar with the TV reality show 'Survivor' – a competition where contestants are stranded in a remote location with little more than the clothes on their backs. The competitors need to survive as a tribe, but in truth it is everyone for themselves. Alliances are forged and symbiotic compromises made in the interest of survival. One by one, team members fall as only the resilient remain. As the series by-line goes: Outwit. Outplay. Outlast. It makes for entertaining viewing and reveals the lengths and depths of human cunning, versatility and resourcefulness.

The economic and business equivalent of this TV series has to be the role of chief executive officer in the average Zimbabwean business. The resourcefulness displayed by these individuals overshadows anything you might see on Survivor. We have written in the past about Zimbabwe, but it's worth reflecting a little more deeply on just how remarkable the story of survival has been.

Can you imagine a world where prices change constantly; where a beer bought at the beginning of a meal costs less than one bought at the end, and where the bus fare changes as the journey progresses? It is a world where regulated prices make a mockery of service charges, such as the cost of a mobile call which results in users not hanging up and keeping a line 'live' for hours. Inflation has made the cost of a call negligible and network congestion makes it impossible to get through once you've hung up. Now multiply these challenges tenfold and you will find yourself in the shoes of a chief executive officer trying to keep his business afloat in Zimbabwe.

The first casualties of hyperinflation are financial services businesses. The mortgage book is inflated away, pricing risk

correctly is extremely difficult, insurance businesses need price stability to price product and so forth. Once Zimbabwe dollarised, the banks were left shadows of their former selves, insurance businesses had their books devastated and on the positive side, the economy had virtually zero debt.

Now add price controls to this for consumer products. This wipes out your industrial companies as the profit incentive to produce is eliminated, and sales become an exercise in destocking and putting manufacturing capacity on care and maintenance in the hope that one day sanity and normality will return.

At this stage, all businesses find themselves with staff who cannot access food, energy or healthcare, and the wages they receive have no purchasing value. The system freezes up and survival becomes incredibly difficult. But many Zimbabwean companies have survived, and a few even thrived. The likes of Econet (mobile operator) stared fixedly down the tunnel in the hope of some light. They struck deals with Chinese equipment makers to finance capital expenditure, enabling them to keep rolling out capacity, convinced that one day the madness would stop. And today a great deal of the madness has stopped. Econet is an extremely successful business in a virtually unassailable competitive position.

The environment in Zimbabwe today is greatly improved, yet still tough. The government of national unity is a disaster and Zanu-PF doggedly does what it can to undermine any economic upliftment – holding the misguided view that a downtrodden proletariat can be subjugated. Despite this, companies are producing solid results and some are producing sterling results. The brewer, Delta, is running close to historical peak capacities. Zimplats, in the face of

lunatic indigenisation demands, continues to see its parent, Implats, invest heavily in growing mining and processing capacity. As an investor, the political noise emanating from Zimbabwe has, on the whole, been horrible this year. Yet it has been one of the better performing markets in Africa this year. This is because despite a tough environment, resilient management teams are doing a great job steering their businesses.

Equity prices and attitudes to the region reflect the political noise and remote perspective of Zimbabwe. We don't make light of the risks of investing in Zimbabwe. But what attracts us is the overly aggressive discounting that investors price into Zimbabwean assets. If one prices in the reality, valuations are extremely attractive. To a foreign investor, the word 'indigenisation' is synonymous with confiscation. We often

wonder, would the media be less critical if the word 'taxation' had been used instead? Higher taxation has become all the vogue globally: the UK has seen every form of tax dramatically increased; Australia has targeted commodity companies aggressively for higher taxes, and the US is in deep debate as to how taxes can be increased. Yet the additional risk that has been priced into these markets has not been particularly taxing!

We have material exposure to Zimbabwe. We don't expect it to be a comfortable ride. However, we do think, in time, the aversely cautious perspective of Zimbabwe will drift towards the reality, and investors will be handsomely rewarded for backing proven survivors. Those that have outwitted, outplayed and outlasted. 🍷

*Zimbabwean exposure accounts for 12% of the Coronation Africa Frontiers Fund.*

# International portfolio update

## ■ Coronation Global Equity Fund of Funds

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Jul 00	(5.85%)	5.12%	0.59%	2.06%
Benchmark		(3.84%)	0.5%	(1.68%)	0.01%

*Annualised, quoted in USD*

The fund declined 17.1% for the quarter, bringing the rolling 12-month performance to -5.9% against the -3.8% of the MSCI World Index.

The quarter was characterised by some of the most extreme market volatility ever experienced. The European sovereign

credit crisis was again at the forefront of market concerns as a Greek default was widely anticipated and the contagion effect spread to other European states, especially Italy. Another seismic event was the downgrade of US government debt after a protracted negotiation over the extension of the US debt ceiling and this was the trigger for a mid-August sell-off. A slowing of economic activity in Europe, the US and even China exacerbated an already nervous market. Sharp sell-offs were followed by large rebounds as markets were whipsawed by changing investor sentiment and daily news flow. However, the overriding trend was downwards and equities and commodities sold-off in a flight to safety for US dollars and Japanese yen.

In terms of regional equity performance, Japan was the best performing region, falling only 6.4%. Europe performed the worst falling 22.9%, closely followed by Asia ex-Japan with a decline of 21.5%. North America fell 14.3%. The fund's regional positioning had a significant negative impact over the quarter.

With the exception of the US funds, the managers generally delivered good performance. Morant Wright Japan delivered 4% alpha for the quarter and Indus Asia 5.5%.



In Europe, results were a little mixed, but excellent performance from Adelphi Europe and Egerton Europe significantly outweighed the weaker returns from Memnon Fund and Lansdowne Europe.

The global managers also had a good quarter, in particular Cantillon Global Equity which closed the period 7% ahead of the MSCI World Index. Lansdowne Global, Abdiel Capital and Contrarius also generated index-beating returns for the quarter.

The US managers all suffered sharp sell-offs in certain of their top holdings rather than a general decline in their portfolios. They remain confident in their positions and that the stocks will rebound.

During the quarter we added a small position in Abdiel Capital, a small and mid-capitalisation oriented value manager. Run by Colin Moran and Geoff Gentile, Abdiel has an outstanding track record achieved through a combination of disciplined, concentrated stock picking and judicious use of cash.

While fear continues to pervade the markets, it is likely that risk assets will remain out of favour in the short term. Europe is moving closer to a solution for Greece and other member states in financial trouble. The Fed and other central banks are committed to taking any steps necessary to provide market support and a further round of quantitative easing is possible. President Obama has announced a new job creation policy which is hoped to stimulate the economy and return it to a sustainable growth level. Despite all the negative news flow, the fact remains that there are many high-quality companies that will continue to grow and emerge from the crisis in an even stronger position than before, regardless of the short-term volatility in share price. These are the companies that we seek to invest in, and we view these levels as an attractive investment opportunity that will deliver attractive returns over the medium term.

## ■ Coronation Global Capital Plus

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Sep 09	(2.81%)	–	–	4.52%
Benchmark		1.58%	–	–	0.73%

*Annualised, quoted in USD*

The events that unfolded during the third quarter of 2011 once again, like in 2008, threatened to destabilise financial markets around the world. Global equity markets lost 16.5% of their value over the quarter, with emerging markets leading with a 22.5% loss. Some developed market bond indices showed spectacular returns of more than 10% as the cocktail of a flight to safety, the completion of QE2, and the announcement of further government intervention at the long end of the US yield curve drove yields to new record lows. Currencies became victims of large capital flows, and units such as the Brazilian real lost 16% of its value against the US dollar over the quarter. Even the Australian dollar was down 9.2% over the period. Commodities also fell foul of this aggressive move to reduce risk in all portfolios, with copper down over 23%, platinum close to 12% and oil more than 5%. Predictably the gold price rose by over 8% over the quarter.

The fund performed poorly against this incredibly negative backdrop, producing -9.6% for the quarter, and -2.8% on a rolling 12-month basis. Since inception the fund is still outperforming its target and the volatility, downside deviation and other measures of risk confirm its low risk constraints.

In hindsight we moved to our maximum risk allocation too early in the sell-off, closing off the opportunity to increase exposure as the crisis deepened and prices fell further. Listed property also correlated closely with equities as risky assets repriced, so despite slightly outperforming our benchmark in this sector, the portfolio effect could not be dampened.

Our physical gold position, despite having been reduced into the price strength, continued to help the portfolio. Our equity selections outperformed the general equity market by some margin, but the magnitude of the price declines still negatively impacted overall performance. Even our fixed interest positions, inherently higher beta (than the conventional bond market) given the nature of these instruments, hurt overall performance. Natural gas prices

continued their decline, despite large corporates starting to position themselves for when this market turns. However, the small size of this position limited the impact at portfolio level. The fund's currency positions added to overall performance slightly, given that we were not exposed to any of the peripheral currencies.

Looking ahead we remain excited about the opportunities offered by the market uncertainty.

### ■ Coronation Global Equity Alternative Strategy Fund of Funds

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Aug 96	(2.97%)	4.39%	2.22%	8.19%
Benchmark		(3.16%)	0.42%	0.8%	4.06%

*Annualised, quoted in USD*

The fund produced a return of -9.9% for the quarter, compared to the MSCI World Index return of -16.5%.

Relative to the market all the managers performed well over the quarter, with an attribution of -6.4%, while -2.6% can be attributed to currency exposure and cash. The fund's euro currency exposure negatively impacted performance in September. As we enter the final quarter of 2011, the fund has a total of 12 managers. One global manager was redeemed in August and two new US managers added in September.

Our global managers detracted the least from performance, with the top-performing manager returning -0.1% for the quarter and 1.8% year-to-date (compared to the MSCI World Index return of -11.8%). Performance was driven by strong stock picking in a diversified portfolio with a low net exposure (average of less than 30%) and some gold exposure. The manager's five-year annualised return is 11.5% compared to the MSCI World Index of -1.7%.

The US and European managers produced a similar attribution over the period. The top performance from the US managers came from the manager we added in the second quarter of this year, returning -5.5% for the quarter against the S&P500's -14.3%. This manager keeps net exposure within a steady range of between 20% and 50% and seeks to outperform through stock selection. There have been few changes to the top holdings; however, the outperformance was largely generated by good equity short

positions. The manager continues to build on a strong long-term track record with a three-year annualised return of 9% compared to the S&P500's -1%.

The two new US managers added in September follow a very fundamental stock picking philosophy and were previously portfolio managers at highly regarded equity long/short funds. Their September performances were -1.1% and -3.2%, compared to the S&P500's -7.2%. Both managers have strong long-term track records, with one producing a one-year return of 13.3% against the S&P500's -0.9%, and the other recording a three-year annualised return of 2.9% when the S&P500 recorded -1%.

The top-performing European manager returned -5.4% for the quarter against the -16.8% (in euro terms) of the MSCI Europe. This manager continued running a concentrated portfolio but reduced the concentration towards the end of the quarter, running a net exposure of around 30% through the quarter. A small number of the top holdings performed well relative to the market, but the outperformance was mostly generated on the short side. The manager continues to be one of the top-performing European managers relative to his peers, with a five-year annualised return of 10.2% compared to MSCI Europe of -8.1%.

### ■ Coronation Global Emerging Markets

	Launch date	1 year	3 years	5 years	Since inception
Fund	14 Jul 08	(11.94%)	10.39%	–	4.31%
Benchmark		(15.89%)	6.59%	–	(2.51%)

*Annualised, quoted in USD*

The turmoil in global markets accelerated in August and September and as is typically the case in times of crisis, emerging markets declined significantly more than developed markets; even though one could very rationally argue that the fundamentals of emerging markets are far better than those of the developed world. It was not only the equity markets that declined, but also the currencies and during September the Turkish lira, Russian rouble, Mexican peso, Hungarian forint, Brazilian real, South African rand and Polish zloty all lost between 12% and 16% of their value against the US dollar. Year-to-date the MSCI Emerging Markets Index is now -21.7% and the fund is somewhat better at -16.9%. Since inception just over three years ago, the fund has outperformed the index by 6.8% p.a.



This sell-off has ultimately been driven by panic and fear and stock movements are significant, with double-digit daily declines in single stocks being frequent. These are not normal conditions and although we very much consider ourselves to be long-term investors, we have found ourselves being more active in the portfolio than would ordinarily be the case. We build the portfolio on a risk-adjusted expected return basis, with position sizes being determined by the upside to our fair values (expected return) as well as consideration of the risk to the earnings streams embedded in these values.

In our view, it is times like these (with forced selling resulting in irrational price moves) that one typically gets the opportunity to upgrade the quality of the portfolio, and this is what we have been doing: buying high-quality businesses that we sold out of two years ago due to valuation, which have now become very attractive again. Lianhua Supermarkets (China), X5 Retail (Russia) and Anhanguera (Brazil) would all fall into this camp. These shares have as much upside to fair value as the shares we sold, but the businesses are higher quality in our view. Our conviction in the five-year earning streams of these businesses is also higher than that of the shares we sold, meaning that the risk-adjusted expected returns are more attractive.

We continue to search for opportunities and members of the team are scheduled to go to Asia for a two week trip in November to meet with a range of companies, both current portfolio holdings and potential new ideas. Other members of the team will be travelling to both Brazil and China in January.

## ■ Coronation Global Bond

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Oct 09	2.96%	-	-	4.50%
Benchmark		4.61%	-	-	4.80%

*Annualised, quoted in USD*

The fund returned -2.02% against the Citigroup World Government Bond Index return of 2.38%.

Bond markets were exceptionally volatile over the past quarter. Signs of a renewed slowdown in global growth and a subsequent rise in risk aversion led the global benchmark, the US 10-year treasury, to fall from 3.2% at the end of June to below 2% in September. Many developed market bond yields followed suit, falling around 1% during the quarter.

However, there were notable exceptions led by Greece, where 10-year spreads widened another 6% to stand at 23% with the market down 25% in value. The wild price swings were highlighted by the returns of Italy and Portugal, whose markets fell by 4.3% and 1% respectively, contrasting starkly with Ireland's return of 27.7%, which was three times greater than the next best performer, the UK at 9%.

Economic activity in developed markets began to stagnate at the end of March and money markets began scaling back expectations of further rate rises by central banks. As the evidence of a slowdown in activity mounted, bond markets began to rally. This rally accelerated in August as risk appetite deteriorated, equity markets started to break down and credit markets began to widen. Subsequently, commodities and then emerging market currencies followed suit. The fund's short duration position detracted from performance but we remain of the view that yields are too low in the medium term.

Political risks moved from North Africa in early 2011 to Washington and Brussels. The US debt ceiling debacle resulted in a fudged outcome as political parties failed to produce a credible deficit reduction plan. Standard & Poor's downgraded its rating on US debt from AAA which had been in place since 1941 to AA+. With US growth now slowing and controversial hardcoded spending cuts likely to be enacted, the US debt debate is likely to re-emerge during the next six months. Meanwhile the debt crisis in Europe and specifically Greece has taken centre stage.

Within Europe, Greece remains on death row but a stay of execution has been granted for now. Disbursement of the sixth tranche of the IMF/EU programme is pending the approval of the Troika (IMF/EU/ECB) which is contingent on Greece having measures in place to meet its fiscal commitments. This payment looks like it will be delayed until mid-November as the authorities seek to reassess the extent of private sector involvement in a planned €109 billion second Greek rescue package. With a deteriorating fiscus from a greater than expected slowdown in growth and slippage on debt reduction measures, a Greek default moves ever closer. Greece's next bond repayment is due on 19 December; whether it can last that long is doubtful.

The politicians in Europe have failed to establish convincing fire breaks to stop the contagion from a Greek default spreading to other sovereign states. Perhaps the most concerning development was the deterioration in sentiment

towards Spain and Italy. Ten-year yields rose over 1% to above 6% in July and only moderated on the back of large open market operations by the ECB. This may have tamed the markets for now but with Italy requiring funding of approximately €250 billion in 2012 it is clear that the authorities cannot afford a buyers' strike. At the beginning of the debt crisis the EFSF (European Financial Stability Fund) was established. This fund was to issue bonds and use the proceeds to help bailout the periphery. As developments have unfolded it has become clear that the newly enlarged €440 billion fund is still insufficient. Talk of leveraging the EFSF capabilities or expanding it to a rumoured €2 trillion is fraught with problems. Central to the problems faced by the eurozone is one of identity; are nations willing to cede more control in a move towards greater fiscal union, and is the core willing to transfer material financial resources to weaker states for the common good? Talk of a common Eurobond has not gone away but seems a step too far at the moment. Voters who have lived within their means are becoming increasingly reluctant to bail out those who have not. The question is – can the banks who have financed the excessive spending recoup enough of their money in order to avoid a systemic banking crisis? What appears increasingly clear is that higher capital requirements for banks and a need to deleverage their balance sheets means the availability and cost of finance to business is to change significantly, putting further restraints on growth.

The likelihood of slower growth and the recent correction in commodity prices has led inflation expectations to fall. In April 10-year US break-even rates of inflation peaked at 2.6% and at the end of June fell from 2.4% to as low as 1.7% in September. Long-term inflation expectations in the US are now well below what has historically been realised. Real yields have fallen sharply in many markets with the US 10-year real yield trading at zero, implying investors are happy just to be compensated for inflation in this uncertain environment. The fund increased its exposure to inflation-linked assets at the expense of fixed rate bonds to just over 25%, adding US, Canada and Sweden to its existing exposure to Australia and Japan.

Credit markets which had begun to look too optimistically priced in the early part of 2011 have sold off sharply, particularly within the financial sector. Europe has seen the weakest markets with the spread on many corporate indices doubling. Financial spreads have been the hardest hit on concerns over sovereign-related losses and fears over the


prospects for refinancing which are particularly demanding during 2012 and 2013. We reduced our exposure to Supervalu and Deutsche Bank ahead of this weakness, and maintained the likes of Old Mutual, Standard Bank and added some exposure through Investec. These holdings proved a drag on performance during September but we remain confident in their long-term attractiveness.

In the currency markets the yen remains the best performer of the majors, reaching new highs on a trade-weighted measure. The US dollar has seen some reprieve as risk appetite has deteriorated and carry-related trades have been unwound. It remains to be seen how the banking crisis in the developed world will filter through to emerging markets but this could have a material effect on bonds and currency rates. We increased our exposure to the US dollar by reducing our currency exposure to Europe and Australia.

### ■ Coronation Africa Frontiers

	Launch date	1 year	3 years	5 years	Since inception
Fund	1 Oct 08	(11.45%)	11.00%	–	11.00%
Benchmark		5.29%	5.62%	–	5.62%

*Annualised, quoted in USD*

The fund had a difficult quarter, losing 16.1%, taking losses for the year-to-date to 17.6%. Few markets were spared the pain and the larger markets in our universe were all weak. Egypt continues to drift lower against the backdrop of its messy transition to a democratically elected government (hopefully complete by mid-2012). The Kenyan market has come off sharply, inflation has run away from the central bank and the currency has sold-off heavily. And in a thinly traded Nigerian market, the banking shares continue to sell-off, with some now lower than during the depths of the banking crisis in 2008/9. The Zimbabwean market, in contrast, has performed surprisingly well this year. But, with elections looking increasingly likely next year, these investments may also come under pressure as the negative noise and news builds up ahead of voting. Our valuation-based approach to investing and long-term view allows us to hold (or increase) positions in the face of short-term negatives. We never do this lightly and watching the market disagree with one's views is extremely discomfiting. But, as detailed on page 21, we are reasonably confident that over the longer term our clients will be amply rewarded for holding on in Zimbabwe. 

# Guest contributor

Peter Testa is co-manager of the Antares European Fund, a fund he started with fellow manager, Luca Orsini, in December 1998. Based in Lugano, Switzerland, Antares manages approximately \$500 million. The company has a strong investment track record in European mid-caps achieved through fundamental, bottom-up research and a tried and tested portfolio construction methodology. Since inception, the fund has annualised at 11.4% compared to the MSCI European Index return of -1.4% per annum. The Coronation Global Equity Alternative Strategy Fund of Funds has \$17 million invested in the Antares European Fund.



**PETER TESTA**, co-manager of Antares European Fund

## Antares

By late August, the market had entered a 'phony war' phase. Punctual corporate news flow remains healthy, but deeper problems are on their way. An age of austerity where European and US governments shift from stimulus spending to withdrawing significant funds from the economy as deleveraging begins will transform a low growth environment into recession.

The impact of governmental withdrawal will be magnified as waning corporate confidence saps resources further. Most companies we have met with so far in our post-summer road shows, for example, have reigned in expansion initiatives in preparation. Lower gross new hiring (and capital expenditure) will lead to worse net employment figures. The negative event cycle will continue from there.

The measures recently implemented to promote US employment and support housing as well as the Fed's funding measures to help mortgage interest rates may soften the recessionary forces in the US. However, nothing of the sort will arrive to help Europe. The latest move in Germany to gain parliamentary support for the European Financial Stability Facility measures announced on 21 July will now require a vote in the Bundestag to approve every

new step proposed, down to the exact amount of funding. Market forces will run circles around this lead-footed process. The European lack of understanding of the financial markets remains astounding. For those out there wishing for recessionary forces to be allowed to run their course unrestricted, their wish is about to be granted in Europe.

The silver lining comes from the fact that many key industries will be unable to repeat the plunge of the 08/09 recession. For example, the 08/09 recession saw annual US new housing starts decline from 2 million to 600 000. Mathematically, the same absolute decline cannot happen again. Corporate balance sheets in large companies are in much better shape entering this crisis, hence the 'lights turning off' factor should be less dramatic. Also, investors have a fresh example of how a recessionary and financial crisis conspires to smash corporate earnings. The earnings downgrade cycle should rapidly run its course with the rate of expected profits decline perhaps even running ahead of the actual deterioration of corporate performance.

In any case, the risks we were seeking to avoid have not disappeared even if they have been more priced in. Even a downgrade cycle amounting to half that of 08/09 implies an impending 25% fall in the median 2012 earnings forecast, while the prospective market earnings multiple on current forecasts remains 10% above that reached in March 2009. Our deleveraging process continued through August but in an illiquid market made even worse by the fact that August is always a month of little liquidity. We have sought to use every rally to further sell down our exposure with a goal of reaching a 120% gross and below 10% net exposure level at this stage.

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Inside the long portfolio, we have been reorienting the positions into two main camps. We have retained positions in companies with low cyclical risk and where a repeat of the 08/09 downgrade cycle would still leave the stock on a single digit multiple. One example would be Meggitt, where the civil aerospace aftermarket business constitutes most of its profits. In 08/09, aftermarket revenues underperformed mileage flown by 15% during the downturn without any over recovery during the upturn. Hence, a rerun of the same downgrade cycle is also unlikely. The other camp of longs are where the nature of the company's business plus phase of development mean that profit downgrades are likely to be minimal or non-existent, yet the shares have been beaten up in August. We have focused on the large cap universe for such new ideas. An example would be German software giant SAP where the stable growth from the maintenance revenues drives the profit and loss, while the current strong product cycle is supporting the license growth at the fastest pace for many years. We bought SAP after a 20% fall in the shares during August. Consequent to this refocusing

exercise and the deleveraging, to date we have turned over 50% of our long portfolio by value in the past six weeks.

With our short portfolio we have been reluctant to chase down the cyclical end of the market post upwards of 35% share price declines over a month in many names. While significant downside remains in several of these shares, the risk of a rapid bounce is also possible before the phase of negative hard corporate news flow arrives. Hence, our focus for new shorts is in those companies which are incorrectly perceived as cyclical and are still priced as such. We will build a more fully researched list of potential cyclical shorts with large earnings downside for when the negative corporate specific news flow begins to arrive in peer companies.

Our goal is to build a portfolio in structure and content that will generate positive returns month by month with low volatility even in the troubled market that we expect to persist. 📊



INSTITUTIONAL FUND PERFORMANCE

PORTFOLIOS <sup>A</sup>	FEES <sup>o</sup>	LAUNCH DATE	1 YEAR	3 YEARS	5 YEARS	CUM SINCE LAUNCH <sup>†</sup>	ANN SINCE LAUNCH <sup>†</sup>
<b>GLOBAL BALANCED</b>							
Houseview	G	01-Oct-93	8.39%	13.53%	12.20%	1578.44%	16.96%
Peer Median*			6.68%	11.08%	9.18%	1228.86%	15.46%
Managed	G	01-Apr-96	8.73%	14.33%	13.10%	1071.27%	17.20%
Peer Median*			6.68%	11.08%	9.18%	646.10%	13.84%
<b>DOMESTIC BALANCED</b>							
Domestic Houseview	G	01-Jan-98	6.83%	14.26%	13.70%	789.16%	17.22%
Peer Median*			6.28%	12.34%	11.16%	664.90%	15.95%
<b>SPECIALIST EQUITY</b>							
Core Equity	G	01-Mar-04	6.37%	15.30%	14.63%	345.79%	21.79%
FTSE/JSE Shareholder Weighted Index			4.14%	11.43%	10.01%	262.67%	18.52%
Houseview Equity	G	01-May-00	4.92%	14.50%	13.82%	628.65%	19.00%
FTSE/JSE Shareholder Weighted Index <sup>1</sup>			4.14%	11.43%	9.63%	410.98%	15.36%
Aggressive Equity	G	01-Jan-04	6.57%	16.68%	14.96%	363.03%	21.87%
FTSE/JSE Shareholder Weighted Index			4.14%	11.43%	10.04%	277.53%	18.70%
<b>SPECIALIST FIXED INTEREST</b>							
Institutional Cash	G	01-Sep-06	7.06%	8.65%	9.33%	57.16%	9.30%
Short Term Fixed Interest 3-month Index			5.61%	7.44%	8.49%	51.22%	8.48%
Active Bond	G	01-Jul-00	6.95%	11.24%	9.95%	289.95%	12.86%
BEASSA All Bond Index			5.92%	10.04%	9.02%	261.39%	12.10%
Strategic Bond	G	01-Jan-08	6.96%	11.61%	–	47.80%	10.98%
BEASSA All Bond Index			5.92%	10.04%	–	39.98%	9.38%
<b>INFLATION-LINKED BENCHMARK</b>							
Global Absolute	G	01-Aug-99	7.77%	14.22%	12.62%	632.25%	17.78%
CPI + 6% p.a.			11.69%	10.79%	12.77%	316.76%	12.45%
Domestic Absolute	G	01-Apr-02	5.62%	14.90%	13.74%	413.01%	18.78%
CPI + 5% p.a.			10.69%	9.79%	11.77%	171.60%	11.09%
Inflation Plus	G	01-Oct-09	9.04%	–	–	26.99%	12.69%
CPI + 3.5% p.a.			9.19%	–	–	16.52%	7.95%
Medical Aid Absolute	G	01-Apr-04	6.85%	12.94%	12.46%	203.86%	15.97%
CPI + 3% p.a.			8.69%	7.79%	9.77%	90.20%	8.95%
<b>HEDGE FUNDS</b>							
Presidio	N	01-Oct-05	12.36%	20.88%	16.62%	145.61%	16.16%
Cash + 7% p.a.			12.42%	14.22%	15.45%	134.20%	15.24%
Multi-Strategy Arbitrage	N	01-Jul-03	10.61%	12.83%	14.13%	206.78%	14.55%
Cash + 5% p.a.			10.42%	12.22%	13.45%	177.00%	13.14%
Granite Fixed Income	N	01-Oct-02	9.64%	11.64%	11.16%	168.08%	11.58%
Cash + 3% p.a.			8.42%	10.22%	11.45%	166.79%	11.52%
<b>OFFSHORE FUNDS<sup>2</sup></b>							
Global Equity FoF (US\$)	N	01-Jul-00	(5.85%)	5.12%	0.59%	25.77%	2.06%
MSCI World Index (US\$)			(3.84%)	0.50%	(1.68%)	0.06%	0.01%
Global Equity Alternative Strategy FoF (US\$) <sup>3</sup>	N	01-Aug-96	(2.97%)	4.39%	2.22%	229.99%	8.19%
50% MSCI World Index + 50% USD Cash (US\$)			(3.16%)	0.42%	0.80%	82.96%	4.06%
Global Managed (US\$)	G	01-Mar-10	(5.02%)	–	–	0.28%	0.18%
60% MSCI World Index + 40% Citigroup World Government Bond Index (US\$)			(0.28%)	–	–	6.22%	3.89%
Global Capital Plus (US\$) <sup>4</sup>	G	01-Sep-09	(2.81%)	–	–	9.65%	4.52%
50% 3-month USD Libor + 50% 3-month Euro Libor (US\$) + 1.5%			1.58%	–	–	1.52%	0.73%
Global Bond (US\$)	G	01-Oct-09	2.96%	–	–	9.21%	4.50%
Citigroup World Government Bond Index (US\$)			4.61%	–	–	9.82%	4.80%
Global Emerging Markets (US\$)	G	14-Jul-08	(11.94%)	10.39%	–	14.54%	4.31%
MSCI Emerging Markets Index (US\$)			(15.89%)	6.59%	–	(7.84%)	(2.51%)
Africa (US\$)	G	01-Aug-08	(9.75%)	13.59%	–	31.38%	9.00%
3-month USD Libor + 4%			4.29%	4.62%	–	15.89%	4.77%
Africa Frontiers (US\$)	G	01-Oct-08	(11.45%)	11.00%	–	36.76%	11.00%
3-month USD Libor + 5%			5.29%	5.62%	–	17.82%	5.62%

<sup>A</sup> Figures are quoted from the Independent Retirement Fund Survey as at 30 September 2011.  
<sup>1</sup> Benchmark for Houseview Equity changed from FTSE/JSE Capped All Share to the Shareholder Weighted All Share Index on 1 July 2007.  
<sup>2</sup> Figures quoted in US\$ as at 30 September 2011.  
<sup>3</sup> This fund is available to institutional investors only.  
<sup>4</sup> Formerly known as Global Latitude.

<sup>o</sup> G = Gross, N = Nett

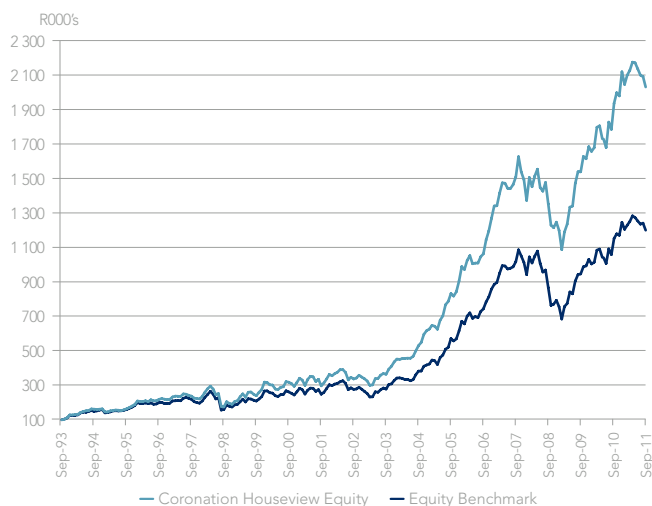
<sup>†</sup> CUM SINCE LAUNCH = Cumulative returns since launch, ANN SINCE LAUNCH = Annualised returns since launch. Figures of one year and less indicate percentage change.

\* 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.

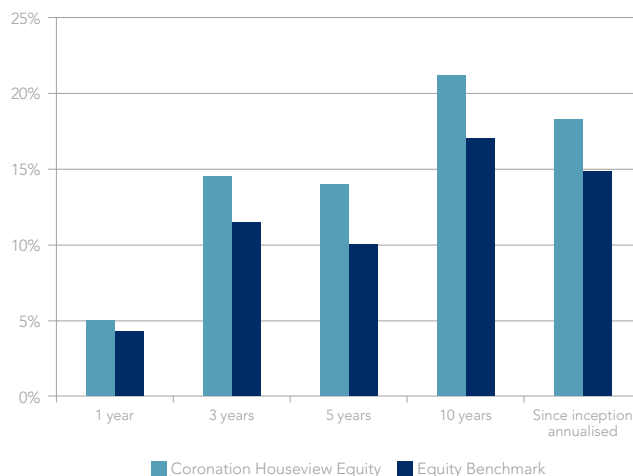
CORONATION HOUSEVIEW EQUITY RETURNS VS EQUITY BENCHMARK

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%
4 years 9 months to September 2011	10.42%	7.32%	3.10%
<b>ANNUALISED TO 30 SEPTEMBER 2011</b>			
1 year	4.9%	4.1%	0.8%
3 years	14.5%	11.4%	3.1%
5 years	13.8%	10.0%	3.8%
10 years	21.2%	17.0%	4.1%
Since inception in October 1993 annualised	18.2%	14.8%	3.4%
Average outperformance per 5-year return			3.50%
Number of 5-year periods outperformed			14.00
Number of 5-year periods underperformed			-

CUMULATIVE PERFORMANCE



ANNUALISED RETURNS SINCE INCEPTION



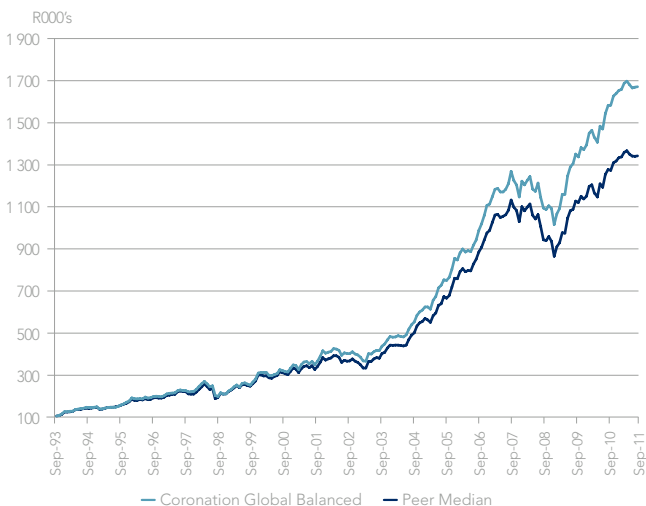
An investment of R100 000 in Coronation Houseview Equity on 1 October 1993 would have grown to **R2 024 333** by 30 September 2011. By comparison, the returns generated by the Equity Benchmark over the same period would have grown a similar investment to **R1 195 722**.



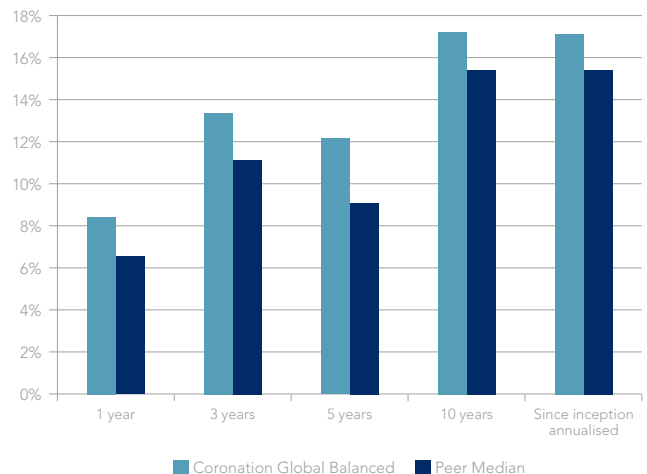
## CORONATION GLOBAL BALANCED RETURNS VS PEER MEDIAN\*\*

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%
4 years 9 months to September 2011	10.15%	7.28%	2.86%
<b>ANNUALISED TO 30 SEPTEMBER 2011</b>			
1 year	8.4%	6.7%	1.7%
3 years	13.5%	11.1%	2.4%
5 years	12.2%	9.2%	3.0%
10 years	17.1%	15.5%	1.6%
Since inception in October 1993 annualised	17.0%	15.5%	1.5%
Average outperformance per 5-year return			1.41%
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 678 442** by 30 September 2011. By comparison, the median return of peers over the same period would have grown a similar investment to **R1 346 940**.

\*\* 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.



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FUND MANAGERS

