# CORONATION BOND FUND

Fund Information as at 31 August 2018

CORONATION
TRUST IS EARNED™

## WHAT IS THE FUND'S OBJECTIVE?

The fund seeks to maximise returns from a diverse range of primarily South African bonds. It aims to outperform the All Bond Index.

## WHAT DOES THE FUND INVEST IN?

The Bond Fund can invest in fixed income instruments, issued by governments, parastatals and private companies, as well as cash. Exposure to foreign assets is limited to 10%. The fund is mandated to make use of derivative instruments for efficient portfolio management purposes.

## IMPORTANT PORTFOLIO CHARACTERISTICS AND RISKS

Risk Profile

5/10
Moderate

Maximum growth/
minimum income exposures

Growth Assets: 0%
Income Assets: 100%

The fund is strategically managed to secure an attractive return by investing primarily in a range of government and corporate bonds. It will hold various tactical positions to benefit from the best opportunities as they emerge.

Investments are meticulously researched and subjected to a strict risk management process. Only quality instruments of reputable institutions will be considered. All factors that could affect these investments are carefully monitored, including inflation as well as currency and interest rates.

The risk of losing money over periods of more than a year is low, while it is slightly higher for periods of less than a year. The primary risk exposures are to changes in interest rates and corporate credit events.

## HOW LONG SHOULD INVESTORS REMAIN INVESTED?

The recommended term is 12 months and longer.

## WHO SHOULD CONSIDER INVESTING IN THE FUND?

Investors who seek the benefits of an actively managed bond fund. The fund is particularly suited to those who require exposure to bonds as part of a diversified portfolio.

## WHAT COSTS CAN I EXPECT TO PAY?

An annual fee of 0.75% (excl. VAT) is payable.

Fund expenses that are incurred in the fund include trading, custody and audit charges. All performance information is disclosed after deducting all fees and other portfolio costs.

We do not charge fees to access or withdraw from the fund.

More detail is available on www.coronation.com

## WHO ARE THE FUND MANAGERS?

NISHAN MAHARAJ
BSc (Hons)

STEVE JANSON
BBusSc

SEAMUS VASEY
BCom (Hons), MSc

## GENERAL FUND INFORMATION

| | |
|---|---|
| Launch Date | 1 August 1997 |
| Fund Class | R |
| Benchmark | BEASSA ALBI Index |
| Fund Category | South African – Interest Bearing – Variable Term |
| Regulation 28 | Does not comply |
| Income Distribution | Semi-annually (March & September) |
| Investment minimum | R5 000 or R500/m debit order |
| Bloomberg Code | CORSPBD |
| ISIN Code | ZAE000019790 |
| JSE Code | CNSB |

# CORONATION BOND FUND

CLASS R as at 31 August 2018

CORONATION
TRUST IS EARNED™

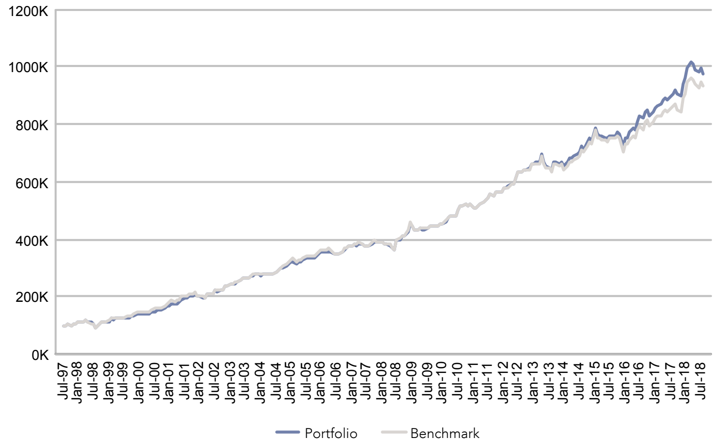
| | |
|---|---|
| Fund category | South African - Interest Bearing - Variable Term |
| Launch date | 01 August 1997 |
| Fund size | R 2.18 billion |
| NAV | 1479.74 cents |
| Benchmark/Performance Fee Hurdle | BEASSA ALBI Index |
| Portfolio manager/s | Nishan Maharaj, Seamus Vasey & Steve Janson |

| | 1 Year | 3 Year |
|---|---|---|
| Total Expense Ratio | 0.87% | 0.87% |
| Fund management fee | 0.73% | 0.74% |
| Fund expenses | 0.03% | 0.03% |
| VAT | 0.10% | 0.10% |
| Transaction costs (inc. VAT) | 0.00% | 0.00% |
| Total Investment Charge | 0.87% | 0.87% |

## PERFORMANCE AND RISK STATISTICS

### GROWTH OF A R100,000 INVESTMENT (AFTER FEES)

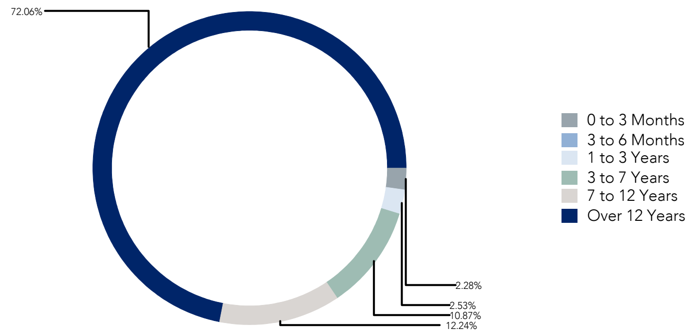
Portfolio R973 371
Benchmark R932 206




## PORTFOLIO DETAIL

### MATURITY PROFILE

As at 31 Aug 2018




### PERFORMANCE FOR VARIOUS PERIODS (AFTER FEES)

| | Fund | Benchmark | Active Return |
|---|---|---|---|
| Since Launch (unannualised) | 873.4% | 832.2% | 41.2% |
| Since Launch (annualised) | 11.4% | 11.2% | 0.2% |
| Latest 20 years (annualised) | 12.4% | 12.3% | 0.1% |
| Latest 15 years (annualised) | 9.1% | 8.8% | 0.3% |
| Latest 10 years (annualised) | 9.3% | 8.8% | 0.6% |
| Latest 5 years (annualised) | 8.6% | 7.9% | 0.7% |
| Latest 3 years (annualised) | 8.6% | 7.5% | 1.0% |
| Latest 1 year | 7.3% | 8.0% | (0.7)% |
| Year to date | 3.5% | 4.5% | (1.0)% |

| | Fund |
|---|---|
| Modified Duration | 7.6 |
| Yield | 10.7% |

### MATURITY PROFILE DETAIL

| Sector | 31 Aug 2018 |
|---|---|
| 0 to 3 Months | 2.3% |
| 3 to 6 Months | 0.0% |
| 1 to 3 Years | 2.5% |
| 3 to 7 Years | 10.9% |
| 7 to 12 Years | 12.2% |
| Over 12 Years | 72.1% |

### RISK STATISTICS SINCE LAUNCH

| | Fund | Benchmark |
|---|---|---|
| Annualised Deviation | 7.5% | 8.5% |
| Sharpe Ratio | 0.28 | 0.22 |
| Maximum Gain | 26.3% | 26.4% |
| Maximum Drawdown | (19.0)% | (22.3)% |
| Positive Months | 70.8% | 70.4% |

| | Fund | Date Range |
|---|---|---|
| Highest annual return | 34.9% | Sep 1998 - Aug 1999 |
| Lowest annual return | (7.0%) | Sep 1997 - Aug 1998 |

### INCOME DISTRIBUTIONS

| Declaration | Payment | Amount | Interest |
|---|---|---|---|
| 29 Mar 2018 | 03 Apr 2018 | 65.25 | 65.25 |
| 29 Sep 2017 | 02 Oct 2017 | 59.78 | 59.78 |
| 31 Mar 2017 | 03 Apr 2017 | 60.37 | 60.37 |
| 30 Sep 2016 | 03 Oct 2016 | 59.02 | 59.02 |

### MONTHLY PERFORMANCE RETURNS (AFTER FEES)

| | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | YTD |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Fund 2018 | 1.87% | 3.93% | 1.79% | (0.31)% | (2.22)% | (0.80)% | 1.92% | (2.54)% | | | | | 3.50% |
| Fund 2017 | 1.52% | 0.57% | 0.89% | 1.33% | 0.88% | (0.32)% | 1.31% | 1.04% | 1.35% | (1.72)% | (0.93)% | 4.99% | 11.30% |
| Fund 2016 | 4.09% | (0.35)% | 2.74% | 1.81% | (0.69)% | 3.66% | 2.24% | (0.69)% | 2.50% | 0.59% | (1.97)% | 1.70% | 16.60% |

*Please note that the commentary is for the retail class of the fund.*

What a difference a few months make. By the end of the first quarter of 2018, the world was in a happy place. Emerging markets were forging ahead, generating bond returns of 4.4% and equity returns of 1.4% (both in US dollar terms), and synchronous global growth was the rising tide that would lift all boats. Fast forward to the end of the second quarter and tears of disappointment are rolling down the faces of most emerging market investors. The sweet nectar that enticed and fuelled an insatiable hunger for yield in developing markets started to sour towards the end of April. Emerging market assets tumbled, spurred on by concerns of an overheating US economy and fears around the escalation of a US/China trade war, in turn fueling a rally in the US dollar. This resulted in emerging market bonds and equities losing between 8% and 10% in the second quarter of 2018, bringing their dollar returns for the year to date to -6.44% and -6.60%, respectively.

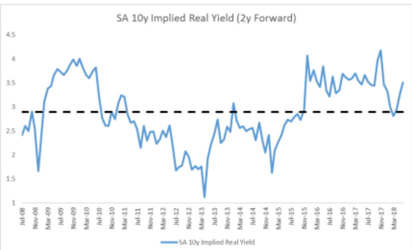
The spirit of 'Ramaphoria' that prevailed during the first quarter of 2018 lost its momentum. In part, this was driven by disappointing growth data and a slowdown in the pace of policy reform implementation. Coupled with the souring global environment for emerging markets, this resulted in the All Bond Index (ALBI) falling 3.8% in the second quarter of 2018, bringing its return year-to-date to 4% (marginally ahead of cash at 3.4), but maintaining a solid double-digit return of 10.2% for the 12-month period. The South African 10-year government bond benchmark yield rose by almost 1% to 8.84% at the end of June (from its first quarter closing level of 7.98%), touching an intra-quarter high of 9.15%. The liquidation of bond holdings by foreigners resulted in a substantial swing in net bond flows, moving from a year-to-date net inflow figure of R17.6 billion (at 31 March 2018) to a net outflow of R35.6 billion (at end-June 2018). This had a significant impact on the exchange rate, with the rand weakening by 13.7% over the quarter.

The local economy has endured an extended period of underperformance relative to global markets and its peers in the emerging market universe. More recently, many of South Africa's self-imposed obstacles have started to show signs of clearing. Inflation remains at a cyclical low and should not exceed the top end of the South African Reserve Bank (SARB) target band (3% to 6%) over the next 12 to 24 months. In fact, current inflation expectations are closer to 5% than 6%, according to the latest Bureau for Economic Research Inflation Expectations Survey. Growth numbers for the first quarter of 2018 surprised materially to the downside (-2.2% quarter on quarter and 0.8% year on year), calling into question the realism of the 'Ramaphoria' effect. This implies that the SARB has room to provide more cyclical support to the local economy by further easing the repo rate; however, considering the recent rout in emerging markets, the worst-case outcome is that the repo rate remains stable for at least the next 6 to 12 months. On the growth front, although most recent data are cause for concern, real consumer income growth will be closer to 2% this year, allowing for an additional recovery in consumer spending, which makes up about 60% of GDP. Long-term growth prospects will rely on an increase in fixed investment into the local economy, which can only be realised in a certain and transparent policy environment. The conditions thereof have been partially met with the new administrative team in government and newly announced policy reforms – although these reforms are likely to be implemented at a much slower pace than suggested at the start of the year. This leaves the South African economy in a very favourable position relative to its peer group, with growth heading higher and inflation being stable (or lower), thereby creating a supportive environment for local bonds.

Despite the positive local backdrop for South African bonds, the global environment has become unsympathetic as global monetary policy accommodation continues to be wound down. As such, the price one pays for South African government bonds should encapsulate a decent margin of safety to weather short-term market volatility. There are two key measures through which to assess the value in local bond markets; first, by comparing the implied real yields of local government bonds relative to their emerging market counterparts as well as their own history, and secondly, by establishing whether current yields provide a sufficient margin of safety should one of the key underlying drivers (the one that is currently most at risk) experience an abrupt, adverse move.

In the graph and table below we compare the implied real yield of the South African 10-year benchmark to its history and relative to its emerging market peers. We arrive at the implied 10-year real yield by adjusting the nominal 10-year yield for the average actual realised inflation over the two years after the observation point (we use a combination of market and internal forecasts for those periods where this is not available).

As an example, a nominal 10-year yield of 9.04% at 29 June 2018, adjusted by an expected inflation average of 5.1% over the next two years, implies a real yield of 3.46%. Two things are clear from this exercise. First, the current level of real yields in South Africa is attractive relative to history. The graph below shows that real yields are sitting above their 10-year average and are as high as they were during previous times of locally driven economic and political stress. Secondly, relative to our emerging market peer group, South Africa flags as one of the cheapest stable emerging markets, both from a real and nominal yield perspective. We remind readers that both Brazil and Turkey are at very different points in their respective business cycles to South Africa and are going through a period of unsettling economic and political stresses. Therefore the relative valuation of South African government bonds seems relatively cheap.

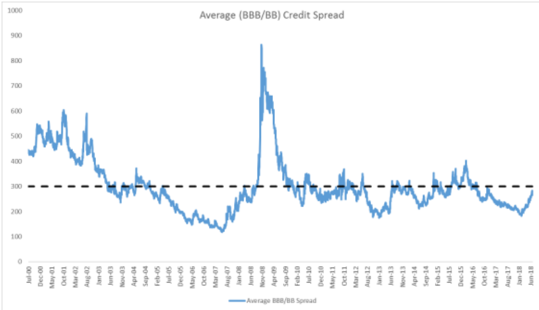



| | Nominal Yield | Implied Real Yield |
|---|---|---|
| Turkey | 16.01 | 5.46 |
| Brazil | 11.68 | 4.37 |
| **South Africa** | **9.04** | **3.46** |
| India | 7.90 | 2.09 |
| Indonesia | 7.74 | 3.19 |
| Russia | 7.68 | 2.13 |
| Mexico | 7.60 | 3.42 |
| Average | 6.45 | 2.20 |
| Chile | 4.59 | 1.52 |
| Malaysia | 4.20 | 1.62 |
| Hungary | 3.62 | 0.87 |
| China | 3.48 | 1.20 |
| Poland | 3.21 | 1.11 |
| Czech Republic | 2.01 | 0.02 |
| Israel | 1.72 | 0.46 |

Source Bloomberg

To arrive at a fair value for South African government bonds, one must take into consideration the following three things: the level of the global risk-free rate; the inflation differential between South Africa and the rest of the world; and a credit spread that quantifies the inherent risk in South Africa as an issuer among emerging markets.

We can objectively say that the current level of the South African 10-year bond is 9.04%, the global risk-free rate is 2.86% (US 10-year) and the inflation differential is sitting at 3% (local inflation of 5% and US inflation of 2%). This implies a credit spread of 318 basis points (bps) for South African government bonds. The graph below shows the average credit spread for BBB (investment grade) and BB (first rung of subinvestment grade) borrowers. It must be noted that South Africa has a split credit rating, with Fitch and Standard & Poor's holding a subinvestment grade rating while Moody's holds an investment grade rating for South Africa. The current level of the average credit spread in the graph below is 270 bps, with a long-term average (the black dashed line) of 300 bps. We conclude from these observations that South Africa trades quite cheaply relative to its peer group. Even if credit spreads were to normalise further as global monetary policy conditions tighten to long-term averages, the country's current credit spread provides sufficient room for a cushion against this normalisation, given that it currently trades well above the long-term peer group average.

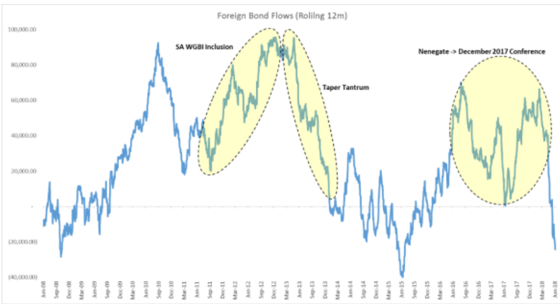



Source Bloomberg

Foreign flows into the local bond market garner a great deal of attention due to their magnitude, but they do not form part of the foundation of our investment case for bonds. We focus on the pricing of risk rather than the psychology surrounding risk. Nonetheless, looking at the trends does provide some insights. The current level of outflows, on a rolling 12-month basis, is equivalent to the level of outflows that the bond market experienced during the period May to June 2013 (the 'taper tantrum') and in the aftermath of 9 December 2015 ('Nenegate'). There are two key observations to be made from the graph below:

Foreign flows in/out of the local bond market are generally driven by momentum (buying as the market becomes more expensive, or selling as it becomes cheaper), making them a bad indicator of future market performance.

Given the degree of selling that has been experienced over the last 12 months (more specifically in the last 3 months), positioning seems a great deal cleaner (that is, not biased to a sell-off or rally in markets). This further suggests that big moves going forward are more likely to be valuation based rather than sentiment/positioning based. This further adds credit to our assertion that from current levels, bond yields are more likely to compress (bond rally) than widen (bond sell-off).




Source Bloomberg

South Africa has made the mistake of looking through rose-tinted glasses for the better part of this year, with asset prices reflecting a much too optimistic outlook for local economic developments. The recent economic disappointments on growth have been a stark reminder of the local economic reality against a global backdrop that has turned more treacherous for emerging markets. South Africa's underlying economy remains in a better place relative to history and to its peer group. Inflation is expected to remain stable and well contained, while growth will continue to move higher. Local bonds have now adjusted to reflect realistic expectations for the local economy and the more unfriendly global environment. South African bonds compare favourably to their emerging market peers relative to their own history, and offer a decent cushion against further global policy normalisation. At current levels, the yields on offer in the local bond market are attractive relative to their underlying fundamentals and warrant a neutral to overweight allocation.

Portfolio managers
Nishan Maharaj, Steve Janson and Seamus Vasey
as at 30 June 2018

## IMPORTANT INFORMATION THAT SHOULD BE CONSIDERED BEFORE INVESTING IN THE CORONATION BOND FUND

Unit trusts should be considered medium- to long-term investments. The value of units may go down as well as up, and therefore Coronation does not make any guarantees with respect to the protection of capital or returns. Past performance is not necessarily an indication of future performance. The fund is mandated to invest up to 10% of its portfolio into foreign securities and may as a result be exposed to macroeconomic, settlement, political, tax, reporting or illiquidity risk factors that may be different to similar investments in the South African markets. Fluctuations or movements in exchange rates may cause the value of underlying investments to go up or down. Coronation Management Company (RF) (Pty) Ltd is a Collective Investment Schemes Manager approved by the Financial Sector Conduct Authority in terms of the Collective Investment Schemes Control Act. Portfolio managed by Coronation Asset Management (Pty) (FSP 548) Ltd, an authorised financial services provider. The Management Company reserves the right to close the fund to new investors if we deem it necessary to limit further inflows in order for it to be managed in accordance with its mandate. Unit trusts are allowed to engage in scrip lending and borrowing. Standard Chartered has been appointed as trustees for the fund (www.sc.com/za; 011-2176600). Coronation is a full member of the Association for Savings & Investment SA (ASISA).

## HOW ARE UNITS PRICED AND AT WHICH PRICE WILL MY TRANSACTION BE EXECUTED?

Unit trusts are traded at ruling prices set on every trading day. Fund valuations take place at approximately 15h00 each business day, except at month end when the valuation is performed at approximately 17h00 (JSE market close) and forward pricing is used. Instructions must reach the Management Company before 14h00 (12h00 for the Money Market Fund) to ensure same day value. The payment of withdrawals may be delayed in extraordinary circumstances, when the manager with the consent of the fund trustees deem this to be in the interest of all fund investors. These circumstances may include periods when significant underlying markets suspend trading which will prevent accurate valuation of the instruments held in the fund. When the suspension of trading relates to only certain assets held by the fund, these assets may be side-pocketed. This process allows normal liquidity on the assets that can be valued, but will delay liquidity on the affected portion of the fund. If the fund is faced with excessive withdrawals, the affected withdrawals may be ring-fenced, which is the separation and delayed sale of the assets reflecting the interest of the liquidity seeking investors. It ensures that the sale of a large number of units will not force Coronation to sell the underlying investments in a manner that may have a negative impact on remaining investors of the fund.

## HOW WAS THE PERFORMANCE INFORMATION INCLUDED IN THIS FACT SHEET CALCULATED?

Performance is calculated by Coronation as at the last day of the month for a lump sum investment using Class R NAV prices with income distributions reinvested. All underlying price and distribution data is sourced from Morningstar. Performance figures are quoted after the deduction of all costs (including manager fees and trading costs) incurred within the fund. Note that individual investor performance may differ as a result of the actual investment date, the date of reinvestment of distributions and dividend withholding tax, where applicable. Annualised performance figures represent the geometric average return earned by the fund over the given time period. Unannualised performance represents the total return earned by the fund over the given time period, expressed as a percentage.

## WHAT IS THE TOTAL EXPENSE RATIO (TER) AND TRANSACTION COSTS (TC)?

TER is calculated as a percentage of the average net asset value of the portfolio incurred as charges, levies and fees in the management of the portfolio. The TER charged by any underlying fund held as part of a fund's portfolio is included in the fund expenses portion of the TER, but trading and implementation costs incurred in managing the fund are excluded. A higher TER does not necessarily imply a poor return, nor does a low TER imply a good return. The current TER may not necessarily be an accurate indication of future TER's. The 1 year TER is for the 12 months to end of September 2017 (updated annually). The 3 year TER is for a rolling 36-month period to the last quarter end (December, March, June and September).

Transaction costs are a necessary cost in managing a fund and impacts the fund's return. They should not be considered in isolation as returns may be impacted by many other factors over time including market returns, the type of fund, the investment decisions of the investment manager and the TER.

The Total Investment Charge is the sum of the Total Expense Ratio (TER) and transaction costs.

## ADVICE AND PLATFORM COSTS

Coronation does not provide financial advice. If you appoint an adviser, advice fees are contracted directly between you and the adviser. For more information please contact the relevant platform (Linked Investment Service Provider or Life Assurance Provider).

## WHERE CAN I FIND ADDITIONAL INFORMATION?

Additional information such as daily fund prices, brochures, application forms and a schedule of fund fees and charges is available on our website, www.coronation.com

## IMPORTANT INFORMATION REGARDING TERMS OF USE

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