CORONATION
STRATEGIC BOND STRATEGY
INSTITUTIONAL STRATEGY FACT SHEET AS AT 30 JUNE 2019

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LONG TERM OBJECTIVE

The Coronation Strategic Bond Strategy is an actively managed fixed interest solution that allocates across all the different fixed income instruments. The Strategy has a flexible mandate with no duration or term restrictions. The Strategy invests in the traditional fixed interest assets, but can also invest in listed property, preference shares and inflation-linked bonds, which are typically excluded in most specialist mandates. This flexibility allows the Strategy to maximise every opportunity in the domestic fixed interest space and produce superior returns for clients. The Strategy aims to consistently outperform the JSE ASSA All Bond Index over the medium to long term.

INVESTMENT APPROACH

Coronation is a long-term, valuation-driven investment house. Our aim is to identify mispriced assets trading at discounts to their fair value through extensive proprietary research. The fixed income portfolios are positioned on a long term strategic market view, but this is balanced by taking advantage of shorter-term tactical opportunities when the market lags or runs ahead of that strategic view. As active managers, we consider investment decisions across the full spectrum of potential return enhancers. These include duration and yield curve positions, inflation-linked assets as well as yield enhancement through credit enhanced assets. We aim to maximise returns by actively combining both a top-down and a bottom-up approach to portfolio construction.

STRATEGY RETURNS GROSS OF FEES

Period	Strategy	Benchmark	Active Return
Since Inception (cumulative)	199.3%	164.0%	35.3%
Since Inception p.a.	10.0%	8.8%	1.2%
Latest 10 years p.a.	10.2%	9.0%	1.2%
Latest 5 years p.a.	9.0%	8.6%	0.4%
Latest 3 years p.a.	10.0%	9.9%	0.1%
Latest 1 year	9.6%	11.5%	(1.9)%
Year to date	6.8%	7.7%	(0.9)%
Month	1.8%	2.3%	(0.5)%

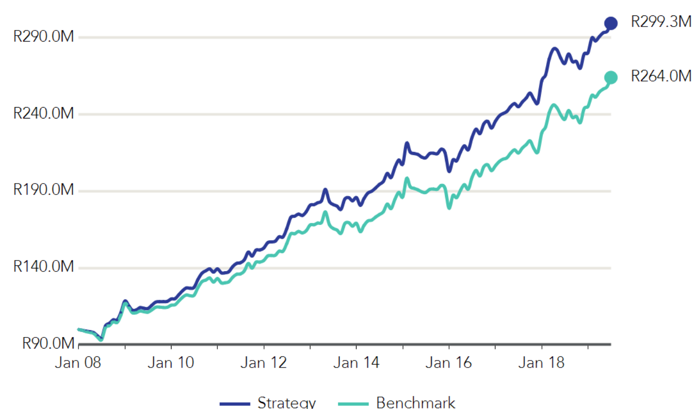
ASSET ALLOCATION

Asset Type	% Strategy
Fixed Rate Government Bonds	58.2%
Fixed Rate Corporate Bonds	17.4%
Cash	9.3%
Property	6.0%
Corporate ILBs	4.9%
Floating Rate Corporate Bonds	1.9%
Fixed Rate Other	1.2%
Floating Rate NCDs	0.9%
Government ILBs	0.2%

GENERAL INFORMATION

Inception Date	01 January 2008
Strategy Size	R5.54 billion
Strategy Status	Open
Mandate Benchmark	JSE ASSA All Bond Index (ALBI)
Dealing Frequency	Daily
Base Currency	ZAR

GROWTH OF R100M INVESTMENT



Benchmark: JSE ASSA All Bond Index (ALBI)

EFFECTIVE MATURITY PROFILE*

Term	% Strategy	% Benchmark
0 to 1 year	1.7%	17.1%
1 to 3 years	2.4%	5.6%
3 to 7 years	12.5%	7.5%
7 to 12 years	10.6%	30.9%
Over 12 years	66.9%	49.0%

STRATEGY STATISTICS*

	Strategy	Benchmark
Modified Duration (incl. inflation-linked bonds)	6.7	7.1
Modified Duration (excl. inflation-linked bonds)	6.4	7.1

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PORTFOLIO MANAGERS

Nishan Maharaj - BSc (Hons), MBA

Nishan is head of Fixed Interest and responsible for the investment unit's process and performance across all strategies. He also manages the majority of fixed interest assets. Nishan has 16 years' investment experience.

Adrian van Pallander - BScEng, HTSdip, CFA, FRM

Adrian joined Coronation in 2002 and is a portfolio manager within Coronation's Fixed Interest investment unit. He is responsible for managing a portion of the fixed interest assets across all strategies as well as analysis, asset allocation modelling and portfolio construction monitoring. He has 17 years' investment experience.

Seamus Vasey - BCom (Hons), MSc

Seamus co-manages the Coronation Global Bond Strategy and has 15 years' experience in financial markets. Seamus joined Coronation's Fixed Interest investment unit in August 2015 and is a graduate of the London School of Economics.

DISCLAIMER

The content of this document and any information provided may be of a general nature and is not based on any analysis of the investment objectives, financial situation or particular needs of any potential investor. As a result, there may be limitations as to the appropriateness of any information given. It is therefore recommended that any potential investor first obtain the appropriate legal, tax, investment or other professional advice and formulate an appropriate investment strategy that would suit the risk profile of the potential investor prior to acting upon such information and to consider whether any recommendation is appropriate considering the potential investor's own objectives and particular needs. Neither Coronation Fund Managers Limited nor any subsidiary of Coronation Fund Managers Limited (collectively "Coronation") is acting, purporting to act and nor is it authorised to act in any way as an advisor. Any opinions, statements or information contained herein may change and are expressed in good faith. Coronation does not undertake to advise any person if such opinions, statements or information should change or become inaccurate. This document is for information purposes only and does not constitute or form part of any offer to the public to issue or sell, or any solicitation of any offer to subscribe for or purchase an investment, nor shall it or the fact of its distribution form the basis of, or be relied upon in connection with any contract for investment. The value of the investments may go down as well as up and past performance is not necessarily a guide to future performance. Coronation Fund Managers Limited is a full member of the Association for Savings and Investment SA (ASISA). Coronation Asset Management (Pty) Ltd (FSP 548), Coronation Investment Management International (Pty) Ltd (FSP 45646) and Coronation Alternative Investment Managers (Pty) Ltd (FSP 49893) are authorised financial services providers.

* For SA Fixed Income investments only. Excludes international investments, equities, property and preference shares.

REVIEW FOR THE QUARTER

The All Bond Index (ALBI) was up 3.7% over the quarter, bringing its return to 11.5% over the last 12 months. This performance is well ahead of cash (quarter-to-date [qtd]: 1.7%; rolling 12 months: 6.9%) and inflation-linked bonds (ILBs) (qtd: 2.9%; rolling 12 months: 4.0%). The outperformance of the ALBI was driven by the 7- to 12-year area where bonds rallied 30 basis points (bps) to 50bps versus bonds longer than 12 years, which only rallied 8bps to 10bps. Prospects of rate cuts in South Africa (SA) buoyed the seven to 12-year area, while further fiscal deterioration due to lower growth and larger state-owned enterprise (SOE) bailouts weighed heavily on longer-dated SA government bonds (SAGB). The strong performance of the ALBI over the last quarter combined with the appreciation of the rand (2.3% versus the US dollar), put SAGB performance at 6.6% in US dollars, above global emerging market (EM) bond performance of 5.7% in US dollars (JP Morgan GBI-EM Global Diversified Composite).

The rand was up 2.9% over the month, ending at 14.08 to the US dollar. Increasing concerns of lower growth due to the intensification of the US-China trade war, combined with benign inflation expectations, led to more dovishness from the US Federal Reserve (Fed) and European Central Bank, which fuelled the global bond market rally. By the end of June, the US 10-year bond had rallied to 2% (down from 2.7% at the beginning of 2019), while approximately US$13 trillion worth of global government bonds slipped into negative yielding territory. This spurred a rally in nearly all emerging markets' currencies and bonds, as the carry trade came back into vogue.

On the local front, fortunately inflation should average 5% until the end of 2021 due to the poor demand environment and subdued services prices. Unfortunately, growth will average less than 1.5% over the same horizon, given the constraints on consumer spending and corporate investment. This benign growth and inflation environment should allow the SA Reserve Bank (SARB) to reduce interest rates by around 0.5% over the next six to nine months, which is supportive for local bonds. However, given the slow nominal growth environment (a combination of slow real GDP growth and low inflation) and the need for more extensive support for SOEs (e.g. Eskom), government finances are set to deteriorate even further. Using current economic assumptions, the budget deficit is likely to be well below -5.5% over the next three years and debt-to-GDP above 60% by 2021. Frontloading further support for Eskom will worsen these numbers meaning the budget deficit and the debt-to-GDP ratio will move to approximately -6% and 60%, respectively, a lot earlier (this does not include a debt transfer from Eskom's balance sheet to the sovereign's). The net effect will be a further deterioration in creditworthiness of SA, a downgrade to sub-investment grade by Moody's and an exit from the Citi World Government Bond Index (WGBI) by March 2020, if not sooner.

At the end of June, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 7.8% (three year) and 8.3% (five year); down significantly over the month. The spreads of floating-rate NCDs have dulled in appeal over the last few quarters due to a compression in credit spreads. There has been a reduced need for funding from banks in SA, given the low-growth environment. Fixed-rate NCDs continue to hold appeal due to the inherent protection offered by their yields and relative to our expectations for a lower repo rate. However, credit spreads remain in expensive territory (less than 100bps in the three-year area and 110bps in the five-year area). The strategy continues to hold decent exposure to these instruments (less floating than fixed), but we will remain cautious and selective when increasing exposure. NCDs have the added benefit of being liquid, thus aligning the liquidity of the strategy with the needs of its investors.

In last quarter, as evidenced by the performance of the various sectors of the ALBI, longer-end SAGBs (20- to-30-year area) materially underperformed 10-year SAGBs. In the last year, the spread that the 20-year SAGB trades above the 10-year SAGB has moved from 0.5%, to more than 1% above. The total return analysis we conducted makes the case for allocating capital to the long end of the SAGB curve very compelling.

ILBs have underperformed nominal bonds for over 10 years now, with the underperformance being most pronounced in the last two years (ALBI 10.8%; Composite Inflation-Linked Index [CILI] 3.1%). This underperformance has been driven by a rally in nominal bonds and a selloff in ILBs. Real yields have moved higher by approximately 150bps to 200bps over the last five years, depending on which area of the curve one is looking at. Most of the ILB yield curve trades close to, if not above, a real yield of 3%. This absolute level of real yield does seem attractive, relative to history. We conducted a total return analysis for nominal SAGBs and ILBs for parallel shifts in the yield curve (+50bps, +25bps and -25bps) and two inflation scenarios (average inflation over the next two years of 5% and 6.3%). Shorter-dated ILBs outperform their nominal counterparts under all scenarios. Shorter-dated ILBs therefore warrant a more favourable allocation in a portfolio relative to shorter-dated nominal bonds.

Cyclical economic factors are supportive of bond yields. Inflation will remain benign and growth subdued, which would allow an easing in policy rates. However, persistently low growth and the need for further support of SOEs will weigh heavily on government finances, resulting in wider budget deficits and a significant increase in the debt burden. SAGBs are most likely to exit the Citi WGBI in the next 12 months, as pressure mounts on Moody's to move SA into sub-investment territory. The global environment has turned more supportive for EM and SA; however, SAGBs have a very limited margin of safety against a turn in global sentiment or a worsening in local economic conditions. Therefore, it is prudent to maintain a neutral to slightly underweight allocation to SAGBs at current levels. Any exposure to SA bonds should be taken in longer-dated SAGBs and shorter-dated ILBs.

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The local listed property sector was up 1.5% over the month, bringing its return for the rolling 12-month period to -5.1%. Listed property has been the largest drag on the strategy, primarily due to generalised equity weakness and idiosyncratic domestic issues relating to the possible closure of Edcon, its impact on the broader property sector and lower real GDP growth. However, from an income perspective, distribution growth and expectations about future distribution growth remain sound. Despite the underperformance, from a valuation perspective, the sector is still very attractive. The changes in the property sector over the last decade (including the increased ability to hedge borrowings and large offshore exposures) should make listed property more resilient going forward. If one excludes the offshore exposure, the property sector's yield rises to approximately 10.7%, which compares very favourably to the benchmark bond. The strategy maintains holdings in counters that offer strong distribution and income growth, with upside to their net asset value. In the event of a moderation in listed property valuations (which may be triggered by further risk-asset or bond-market weakness), we will look to increase the strategy's exposure to this sector at more attractive levels.

The preference share index was up 2.0% over the month, bringing its 12-month return to 19.7%. Preference shares offer a steady dividend yield linked to the prime rate and, depending on the risk profile of the issuer, currently yield between 9% and 11% (subject to a 20% dividends tax, depending on the investor entity). The change in capital structure requirements mandated by Basel III will discourage banks from issuing preference shares. This will limit availability. In addition, most of the bank-related preference shares trade at a discount, which enhances their attractiveness for holders from a total return perspective and increases the likelihood of bank buybacks. Despite attractive valuations, this asset class will continue to dissipate, given the lack of new issuance and because it risks being classified as eligible loss-absorbing capital (only senior to equity). The strategy maintains select exposure to certain high-quality corporate preference shares but will not actively look to increase its holdings.

We remain vigilant of risks emanating from the dislocations between stretched valuations and the underlying fundamentals of the local economy. However, we believe that the strategy's current positioning correctly reflects appropriate levels of caution. The strategy's yield remains attractive relative to its duration risk. We continue to believe that this yield is an adequate proxy for expected strategy performance over the next 12 months.

As is evident, we remain cautious in our management of the strategy. We continue to invest only in assets and instruments that we believe have the correct risk and term premium to limit investor downside and enhance yield.