FLEXIBLE FIXED INCOME STRATEGY

INSTITUTIONAL STRATEGY FACT SHEET AS AT 30 SEPTEMBER 2019

CORONATION
TRUST IS EARNED™

LONG TERM OBJECTIVE

The Coronation Flexible Fixed Income Strategy is an actively managed fixed interest solution that has a flexible mandate with no duration or term restrictions. The Strategy aims to outperform the better of cash or bonds over rolling 3-year periods. The Strategy invests in the traditional fixed interest assets, but can also invest in listed property (max. 15%), preference shares (max. 10%) 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.

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	STEFI 3M	ALBI
Since Inception (cumulative)	139.6%	73.9%	117.4%
Since Inception p.a.	9.9%	6.2%	8.8%
Latest 5 years p.a.	9.0%	6.8%	8.3%
Latest 3 years p.a.	9.2%	7.0%	8.9%
Latest 1 year	9.7%	7.0%	11.4%
Year to date	7.7%	5.2%	8.4%
Month	0.7%	0.5%	0.5%

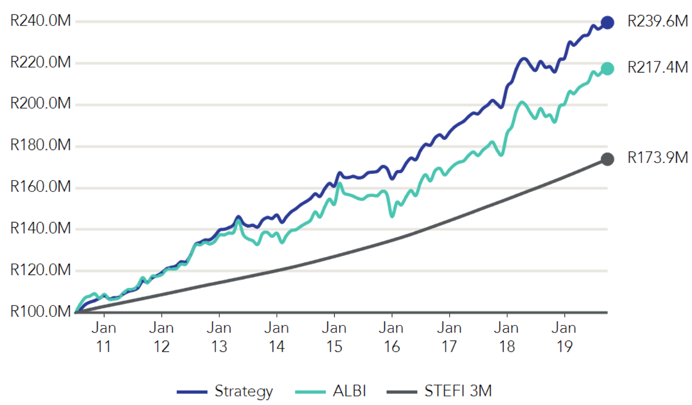
ASSET ALLOCATION

Asset Type	% Strategy
Fixed Rate Government Bonds	47.6%
Fixed Rate Corporate Bonds	25.6%
Corporate ILBs	8.3%
Property	8.2%
Floating Rate Corporate Bonds	3.1%
Fixed Rate NCDs	2.3%
Floating Rate NCDs	2.1%
Government ILBs	1.0%
Fixed Rate Other	0.7%
Other ILBs	0.5%
Preference Shares	0.4%
Cash	0.2%

GENERAL INFORMATION

Inception Date	01 July 2010
Strategy Size	R8.96 billion
Strategy Status	Open
Mandate Benchmark	The higher of cash (Short Term Fixed Interest 3 month Index (STeFI 3m)) or bonds (JSE ASSA All Bond Index (ALBI)) over rolling 3 year periods
Dealing Frequency	Daily
Base Currency	ZAR

GROWTH OF R100M INVESTMENT



Benchmark: The higher of cash (Short Term Fixed Interest 3 month Index (STeFI 3m)) or bonds (JSE ASSA All Bond Index (ALBI)) over rolling 3 year periods

EFFECTIVE MATURITY PROFILE*

Term	% Strategy
0 to 1 year	5.7%
1 to 3 years	3.6%
3 to 7 years	16.1%
7 to 12 years	19.2%
Over 12 years	46.8%

STRATEGY STATISTICS*

Modified Duration (incl. inflation-linked bonds)	6.4
Modified Duration (excl. inflation-linked bonds)	5.9

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 is a portfolio manager and analyst within the Fixed Interest investment unit with 15 years' investment experience. He manages assets within Coronation's specialist bond strategies. He also co-manages the Coronation Global Bond and Granite Hedge funds as well as the Global Strategic USD and Bond unit trust funds. Seamus joined Coronation's Fixed Interest investment unit in August 2015 and is a graduate of the London School of Economics.

DISCLAIMER

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

REVIEW FOR THE QUARTER

Local bond performance was muted in September. The All Bond Total Return Index generated 0.5% for the month and 8.4% year to date. The longer end of the curve (12+ years) delivered the highest return for the month, at 0.7%. Elsewhere, the performance was lacklustre. The 1-3 years returned 0.4%, 3-7 years return was 0.2% and 7-12 years returned 0.2%. Inflation-linked bonds rebounded from August's negative performance and returned 0.4%. Cash returns were unchanged at 0.5%.

Central bank activity captured headlines in September. The European Central Bank (ECB) and the Federal Reserve Board (the Fed) reduced policy rates, while the Bank of England (BOE) and the South African Reserve Bank (SARB) left rates unchanged. Worryingly, the Brexit deadline is looming but there are no signs of a deal being reached anytime soon.

The Fed delivered a reduction in its fund's target rate range by 25bps to a range of between 1.7% and 2% by a split vote. Four members voted for the 25bps cut, one for 50bps and two members opted to keep rates on hold. The cut was largely expected by the market, but the split vote casts more doubt over future moves. Furthermore, Fed Chairman Jerome Powell stated that this was not the beginning of a deep rate-cutting cycle and attributed the cut to the weak global economy, uncertainty surrounding trade policy and persistently low target inflation.

In Europe, the ECB reduced the deposit rate by 10bps in September to -0.5%, as expected by the market. The main refinancing and marginal lending rates remained unchanged at 0% and 0.25% respectively. In addition, the ECB announced an asset purchasing program of EUR20bn per month as from November and a tiered deposit rate, which will remunerate bank reserves in excess of the minimum reserve requirement of 0%. ECB President Mario Draghi justified the easing package by citing concerns about weak growth, both realised and expected, as well as weaker inflation outcomes than previously anticipated.

At the end of September, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 7.8% (three year) and 8.2% (five year); largely unchanged over the quarter. 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 South Africa, 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 stable 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 South Africa, headline inflation in August accelerated to 4.3% y/y from 4.0% y/y in July and core inflation printed at 4.3% vs 4.2% y/y in July. The main drivers behind the inflation uptick were an increase in food and alcoholic beverages inflation, housing and utility prices and the August fuel price adjustment. Overall, inflation pressure remains benign, but food prices reflect broad increases and some momentum for a normalisation after a long period of low prices. Producer price inflation continued its downward trend, falling to 4.5% y/y in August vs 4.9% y/y in July. This was a result of falling input costs and a decline in commodity and raw material prices. Given the ongoing low growth and benign inflation prints, the market still sees some room for policy rate easing in the coming months.

The SARB Monetary Policy Committee (MPC) met in September and unanimously voted to leave the repo rate unchanged. The decision to keep the repo rate on hold was largely expected by the market. The committee assessed inflation risks to be broadly balanced, but nonetheless highlighted that some upside risks remain, in particular from energy, water and fuel prices. While global monetary policy is potentially supportive of further easing by the SARB, ongoing fiscal slippage is a major concern for the MPC. The Medium-Term Budget Policy Statement (MTBPS) at the end of October and the Moody's credit review in November remain key event risks the SARB will be monitoring before its next MPC meeting in November.

Apart from weak trading data, confidence remains at recessionary levels. The BER Business Confidence Index fell to 21 points in Q3 2019 vs 28 points in Q2 2019, the weakest reading since Q2 1999. The largest declines in confidence came from the retail and wholesale trade sectors. Data point to continued subdued domestic economic activity in SA and adds to the risk of low growth in 2020.

SA inflation will remain benign and growth subdued, which would, at worse, allow policy rates to remain on hold. However, persistently low growth and the need for further support of state-owned enterprises (SOEs) will weigh heavily on government finances, resulting in wider budget deficits and a significant increase in the debt burden. The global environment remains supportive for EM and SA, especially given the renewed monetary policy easing embarked on by global central banks. However, South African Government Bonds (SAGBs) trade at fair value at best and 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 moderate allocation to SAGBs at current levels.

Given that we expect inflation to average 5% over the next two to three years, only the bonds that have an implied breakeven inflation of close to 5% look interesting. This rules out any ILB with a maturity longer than the year 2029. In addition, ILBs carry a materially longer modified duration (capital at risk) than nominal bonds. The I2046 has a modified duration of 18.2 years, while the R2048 (equivalent nominal bond) has a modified duration of 9.5 years – therefore if both the ILB and nominal curve move 100 basis points (bps) higher, one would lose 8.5% more being invested in the I2046 than the R2048. This means that to be invested in longer end ILBs, the implied breakeven needs to be quite a bit lower than the current 5.9% (closer to 5%) for it to be an attractive investment. Shorter end ILBs, however, at current levels of approximately 3% real return and a more realistic break-even inflation do look much more attractive and do warrant positions in a bond portfolio.

The local listed property sector was up 0.3% over the month but down 4.4% over the quarter, bringing its return for the rolling 12-month period to -2.7%. Listed property has been the largest drag on the strategy's performance, primarily due to generalised equity weakness and idiosyncratic domestic issues relating to the pressure on tenant profitability as a result of lower GDP growth which has had an unfavourable impact on the broader property sector. Despite the underperformance, from a valuation perspective, the sector remains 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 is greater than 10%, 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 2.7% over the last month and quarter, bringing its 12-month return to 19.9%. 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.