CORONATION

ACTIVE BOND STRATEGY

INSTITUTIONAL STRATEGY FACT SHEET AS AT 30 JUNE 2020

CORONATION TRUST IS EARNED™

LONG TERM OBJECTIVE

The Coronation Active Bond Strategy represents our best investment view for a specialist bond portfolio. The Strategy is managed in line with Coronation's long-term investment philosophy with asset allocation and bottom-up security selection being actively managed to generate targeted outperformance. 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)	704.7%	601.0%	103.7%
Since Inception p.a.	11.0%	10.2%	0.8%
Latest 20 years p.a.	11.0%	10.2%	0.8%
Latest 15 years p.a.	8.9%	8.0%	0.9%
Latest 10 years p.a.	9.1%	8.3%	0.8%
Latest 5 years p.a.	7.9%	7.5%	0.4%
Latest 3 years p.a.	8.0%	8.1%	(0.1)%
Latest 1 year	1.2%	2.8%	(1.7)%
Year to date	(1.3)%	0.4%	(1.6)%
Month	(1.6)%	(1.2)%	(0.4)%

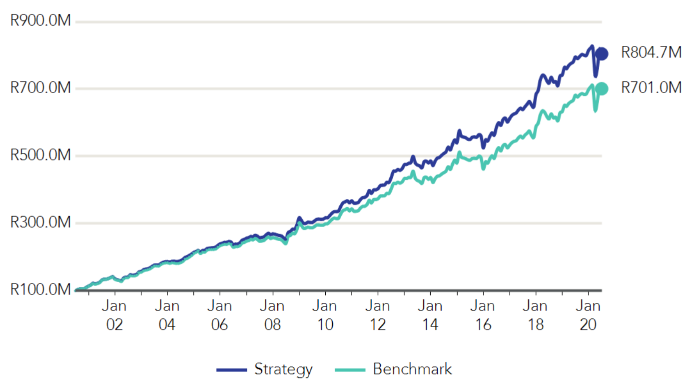
ASSET ALLOCATION

Asset Type	% Strategy
Fixed Rate Government Bonds	84.4%
Fixed Rate Corporate Bonds	4.8%
Corporate ILBs	4.3%
Cash	2.9%
Floating Rate NCDs	2.8%
Fixed Rate Other	1.7%
Floating Rate Corporate Bonds	0.7%
Government ILBs	(1.6)%

GENERAL INFORMATION

Inception Date	01 July 2000
Strategy Size	R6.93 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	4.0%	22.7%
1 to 3 years	1.6%	6.0%
3 to 7 years	6.7%	1.5%
7 to 12 years	28.0%	41.2%
Over 12 years	59.6%	38.8%

STRATEGY STATISTICS

	Strategy	Benchmark
Modified Duration (incl. inflation-linked bonds)	6.8	6.5
Modified Duration (excl. inflation-linked bonds)	6.6	6.5

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 17 years' investment experience.

Steve Janson - BBusSc

Steve is a portfolio manager and analyst within the Fixed Interest investment unit with 13 years' investment experience. Steve's current responsibilities include trading as well as co-managing the Coronation Active Bond Strategy and Coronation Bond unit trust fund.

Seamus Vasey - BCom (Hons), MSc, CFA

Seamus is a portfolio manager and analyst within the Fixed Interest investment unit with 16 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 2015.

DISCLAIMER

REVIEW FOR THE QUARTER

At the beginning of the year, before the novel coronavirus had turned into a fully-fledged pandemic, it was hard to find a pessimist in financial markets. However, the rapid spread of the virus and subsequent nation-wide lockdowns had a devastating effect on the global economy, resulting in a broad-based sell-off across financial markets in the first quarter of this year. The global monetary and fiscal policy response provided an unprecedented financial stimulus into the global economy. Asset prices rebounded in the second quarter (Q2-20) as financial markets reacted to the global stimulus efforts and as economies across the globe started to re-open from their lockdowns. However, markets remain fragile given the uncertain future path of the pandemic and its potential further impact on the global economy.

The All Bond Index (ALBI) recouped its losses from the first quarter, increasing by 9.9% in Q2-20 as a result of improved risk appetite in global markets. However, the ALBI remains flat for the year to date and has returned only 2.8% over the last 12 months. The performance of the ALBI was driven by shorter-dated bonds in the zero- to seven-year area of the curve that benefited from an aggressive decline in cash rates on the back of 275 basis points (bps) of repo rate cuts carried out by the South African Reserve Bank (SARB). Longer-dated bonds underperformed due to increasing market concerns about the impact of a further deterioration in government finances and public-sector borrowing requirements. Inflation-linked bonds (ILBs) also underperformed, with the Composite Inflation-Linked Index down 3% over the last 12 months, driven by weakness in longer-dated ILBs. Bond yields were volatile over Q2-20, ending the quarter at levels that were only marginally higher than they were in the aftermath of 'Nenegate' and considerably lower than the levels that were reached during the March sell-off.

Over the past 18 months we actively reduced risk within the strategy, which included lowering our exposure to credit. We were cautious on corporate credit due to a deterioration in the underlying credit fundamentals in the local economy that was not being adequately reflected in credit spreads. The lower allocation to credit has meant a reduced contribution to performance from these yield enhancing instruments.

Credit spreads started to widen over the past quarter, however this has not been consistent across the listed credit market. Many offshore credits, which are issued by local entities are still trading at much cheaper levels than their local market equivalents, suggesting that they have not yet been adequately repriced in the local market. The effects of COVID-19 are still making their way through the economy and we believe that the uncertainty around its effects are not yet fully reflected in credit spreads. While we are invested in selected credit instruments that offer sufficient risk-adjusted returns, our overall allocation to credit remains low due to the generally unattractive pricing within this sector.

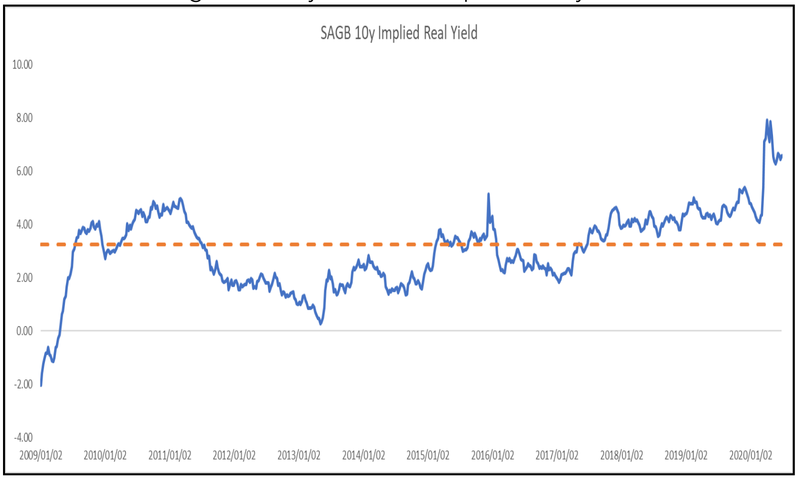
While the portfolio was underweight duration going in to the Covid 19 crisis, we took advantage of the weak price action in bonds during the crisis and went overweight duration. The ensuing volatile period created an opportunity to then reduced duration again as bonds rallied to close to pre-Covid levels. Exposure to the long-end of the yield curve did however detract from recent performance as the yield curve steepened, and bonds in that part of the curve sold-off.

Emerging market debt crises have traditionally occurred in countries that have predominantly foreign-denominated debt; face an accelerated decline in their currency, resulting in an increased debt burden that they are unable to service and an inflationary problem that re-enforces the downward spiral in their currency. South Africa is somewhat different in that inflation will remain modest over the next two to three years, and offshore debt remains relatively low as a proportion of total debt. However, due to an incapacitated State, the poor shape of state-owned enterprises and a lack of structural reform, government finances have deteriorated to such an extent that debt service costs are the fastest rising government expenditure item. In the fiscal year 2020/21, the fiscal deficit will register a whopping -15%, the debt-to-GDP ratio will exceed 80%, tax revenue will be down R300 billion and nominal growth will be down 3.5%. Many countries around the world, both developed and emerging, will face a similar reality as the fiscal taps open to soften the fallout from the Covid-19 pandemic. Unfortunately, due to its poor starting position, glacial pace of reform and reliance on foreign portfolio flows, South Africa is teetering on the edge of a debt trap.

Local public sector borrowing requirements will push up to almost R800 billion this year due to the drop-off in tax revenue. Over the longer term, more steps are needed to ensure that the underlying growth engine is restarted through targeted, efficient and transparent investment into the local economy by government and the private sector. In the interim, South Africa will have to rely on funding from international finance institutions (IFIs) such as the International Monetary Fund and the World Bank, and capital markets to keep the ship afloat. IFI funding is relatively cheap and has little conditionality, but will still need to be repaid in foreign currency, while local capital market funding will have to be accompanied by a strong commitment to reel in wasteful expenditure, refocus current expenditure and implement key sector reforms (e.g. energy, labour and transport) in order to increase investor confidence and trust. South Africa's inability to deliver key policy reforms has resulted in the current debt crisis and an erosion of investor confidence in the country.

We expect consumer price inflation to average 2.7% over the next year and 3.5% over the next two years. Following the cumulative 275bp rate cuts since the beginning of this year, the SARB has room to reduce rates by another 50bps over the next three to six months and is likely to keep them at similar levels over the next 12 to 18 months to support an economic recovery. The 10-year South African Government Bond (SAGB) currently trades at 9.5%, which implies a real yield (return after inflation) of 6.6%. Figure 1 shows that the implied real yields remain at a very extended level relative to history and to its long-term average. This suggests that, from a local perspective, there is a significant risk premium in place due to the poor fiscal outlook.

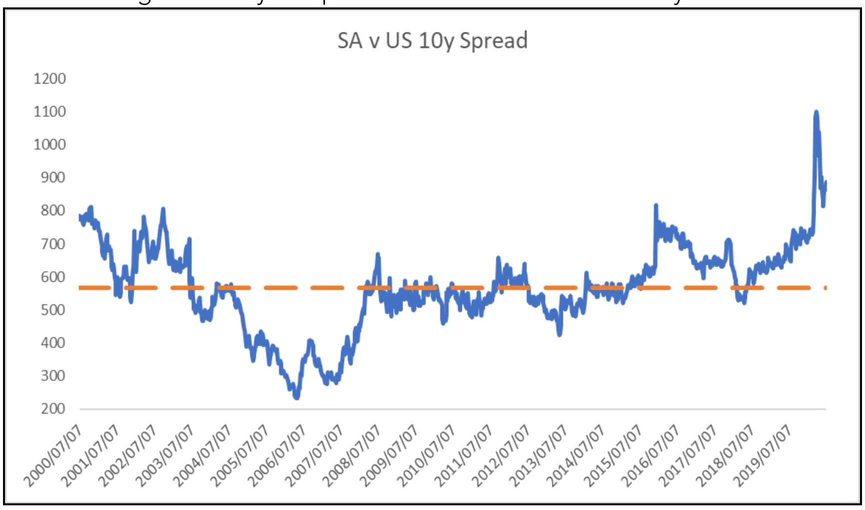
Figure 1: 10-year SAGB implied real yield



Sources: Bloomberg; Coronation

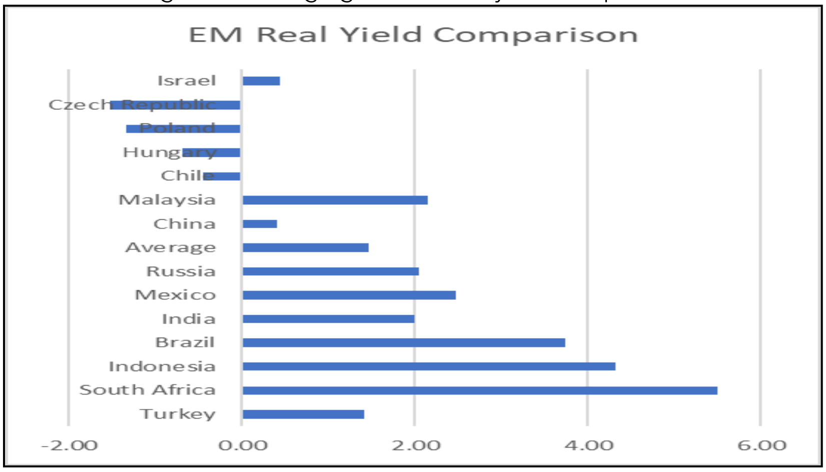
Globally, bond yields and policy rates are testing their zero bounds. US 10-year yields, which are widely accepted as the proxy for global bond yields, are trading at historic lows. The Federal Reserve Board (the Fed) has injected massive amounts of stimulus through its open-ended quantitative easing programme, and policy rates and bond yields are not expected to move materially away from their current levels at any time soon. Even if bond yields do move higher due to structural changes in employment and inflation, our estimate of fair value is not materially more than 1.5% on the US 10-year bond. South African 10-year bonds trade at a spread of 9% above US 10-year bonds, which is considerably above historic levels. If US bonds were to gravitate towards the 1.5% level, unless this is accompanied by a massive inflation shock, the South African spread over US bonds does have a significant cushion to absorb this move, and would still trade at a historically wide spread (Figure 2). Add to this the fact that the 10-year SAGB trades at a significantly wider real yield than its emerging market peer group, and one can see that, even from a global perspective, a significant risk premium remains in place (Figure 3).

Figure 2: 10-year spread: SAGB versus US Treasury Note



Sources: Bloomberg; Coronation

Figure 3: Emerging market real yield comparison



Sources: Bloomberg; Coronation

The shape of the yield curve changed significantly during the first half of the year. South Africa now has the steepest yield curve in the tradeable emerging market universe. The 10-year bond trades at 1.7% above the 6.5-year bond, the 15-year bond trades at 1.5% above the 10-year bond and the 20-year bond trades at 2% above the 10-year bond. The higher yields on offer in the 10-year-plus area of the curve, as well as the inherent breakeven protection in these yields makes this area attractive. Figure 4 shows the breakeven rates for the major government bonds over 1, 2 and 3-year holding periods. These breakeven rates show the extent to which the yield on each bond can increase before the total return delivered by that bond falls below the cash return. It demonstrates that the 15-year area of the curve offers the most protection against a further increase in yields. Combine this with the fact that the 15-year point is steeper than it has ever been relative to the 10-year area (1.5% above), the five-year area (4.4% above) and cash (7.3% above), and the appeal increases.

In addition, at the special adjustment budget in June, Finance Minister Tito Mboweni reinforced the point that National Treasury plans to shorten the duration of its issuance profile to 7 to 10 years, suggesting less supply at the longer end of the curve. This should place downward pressure on longer-dated bond yields relative to the shorter-end of the curve. The objectives set out in the June budget are ambitious, and the fact that the long-end of the yield curve did not flatten suggests market skepticism of the ability of National Treasury to deliver. However, if National Treasury is able to deliver on just half of its objectives, then the yield curve should experience significant flattening. We therefore view it as an attractive relative allocation on the local bond curve.

Figure 4: Average breakeven rates

BOND	MATURITY	YIELD	1Y B/E (CASH @ 4%)	2Y B/E (CASH @ 5.25%)	3Y B/E (CASH @ 6.25%)
R186	21-Dec-26	7.71%	0.92%	1.50%	1.70%
R2030	31-Jan-30	9.41%	0.94%	1.65%	2.15%
R2032	31-Mar-32	10.33%	0.99%	1.77%	2.38%
R2035	28-Feb-35	10.99%	1.01%	1.83%	2.49%
R2040	31-Jan-40	11.44%	1.00%	1.81%	2.47%
R2044	31-Jan-44	11.56%	0.98%	1.78%	2.43%
AVERAGE BREAKEVEN			0.97%	1.72%	2.27%

Sources: Bloomberg; Coronation

The fallout from the Covid-19 pandemic will linger for some time to come. In South Africa, the impact will be felt most in a much dimmer growth outlook, which will have a severe impact on government finances. The effects of the very hard lockdown and poor policy choices will weigh heavily on the economy. As the economy was not well positioned going into the crisis, strong reforms are needed to return the country to a structurally better growth path, although lower short-term interest rates should support the economy through this difficult phase. South Africa is at risk of entering a debt trap and, although promises have been made to restore the country to a more sustainable debt trajectory, the implementation risks are high. The current valuation of SAGBs does provide some compensation for this, implying that local bonds do warrant at least a neutral allocation in portfolios.

From a strategy perspective, we consider the 10-15y SAGBs as the most attractive asset among the FI asset classes and would look to increase duration into weakness, albeit in a measured approach. The 5-10y ILB's are the next most attractive asset class, and we would look to cautiously add to this position at the right price. Corporate bond spreads have widened however this widening has been inconsistent and the spreads available on many counters do not yet fully reflect their inherent risks. We are cautiously adding specific names to our holdings.