CORONATION

FLEXIBLE FIXED INCOME STRATEGY

INSTITUTIONAL STRATEGY FACT SHEET AS AT 30 JUNE 2020

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)	131.3%	82.0%	122.0%
Since Inception p.a.	8.7%	6.2%	8.3%
Latest 10 years p.a.	8.7%	6.2%	8.3%
Latest 5 years p.a.	6.9%	6.8%	7.5%
Latest 3 years p.a.	5.7%	6.8%	8.1%
Latest 1 year	(2.8)%	6.4%	2.8%
Year to date	(5.0)%	2.9%	0.4%
Month	(0.8)%	0.4%	(1.2)%

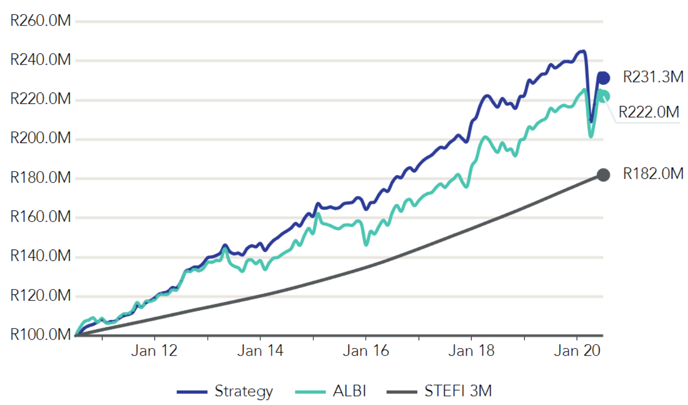
ASSET ALLOCATION

Asset Type	% Strategy
Fixed Rate Government Bonds	60.3%
Fixed Rate Corporate Bonds	26.0%
Corporate ILBs	6.6%
Property	5.6%
Floating Rate Corporate Bonds	1.9%
Fixed Rate Other	1.5%
Floating Rate NCDs	1.0%
Floating Rate Other	0.6%
Other ILBs	0.5%
Preference Shares	0.3%
Cash	0.2%
Government ILBs	(4.5)%

GENERAL INFORMATION

Inception Date	01 July 2010
Strategy Size	R8.76 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	3.2%
1 to 3 years	2.8%
3 to 7 years	19.3%
7 to 12 years	27.6%
Over 12 years	41.2%

STRATEGY STATISTICS*

Modified Duration (incl. inflation-linked bonds)	6.5
Modified Duration (excl. inflation-linked bonds)	6.4

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.

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 18 years' investment experience.

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

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

REVIEW FOR THE QUARTER

The local economic backdrop is concerning, but valuations were considerably cheaper by the end of first quarter. South Africa's asset price recovery was buoyed by better risk sentiment in global markets. The All Bond Index (ALBI) was up 9.9% in the second quarter of 2020 (Q2-20), but its returns remain flat year to date and a paltry 2.8% over the last 12 months. ALBI performance continues to be the driven by bonds in the zero- to seven-year area of the curve, as cash rates have pulled down aggressively on the back of 275 basis points (bps) of repo rate cuts carried out by the South African Reserve Bank (SARB). The 12-year-plus area of the curve has continued to underperform due to the deterioration in government finances and increased public sector borrowing requirements. Inflation-linked bond (ILB) performance has been dismal, with the Composite Inflation Linked Index down 3% over the last 12 months, led again by ILBs in the seven-year-plus area. Despite poor index performance, ILBs out to seven years have still generated a higher return than cash (2.9%) year to date.

We are already six months into 2020, a year that truly defies description, with a landscape that still presents as volatile and treacherous. At the beginning of the year, before the novel coronavirus turned into a fully-fledged pandemic, it was hard to find a pessimist in financial markets. The subsequent global lockdown sent both global and local economies into severe recession. Global monetary and fiscal policy then unleashed a flood of money into the economy, the likes of which has never been seen before, spurring expectations for a quick recovery. Asset prices started to recover in Q2-20, as economies across the globe started to open up from 'hard lockdowns.' However, concerns about a second wave of infections in developed markets and escalating infection rates in emerging markets (EMs) threaten to derail the recovery.

The rand was stronger, as it gained 2.9% (QTD) against the US dollar, ending June at US$1/R17.40. The easing of lockdown measures globally and initial indications that the expected contraction would not be as severe as initially thought, served to buoy risk sentiment and EM currencies. However, the local fundamental backdrop remains quite poor.

EM debt crises have traditionally occurred in countries that predominantly have 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 portion of total debt. However, due to an incapacitated State, the poor condition of state-owned enterprises, a lack of targeted structural reform, and a dearth of political direction, 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 EMs, 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 implementation and reliance on foreign portfolio flows, South Africa is teetering on the edge of 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, as well as 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, transport), to increase investor confidence and trust. South Africa has a long history of not delivering on key policies and reforms, which has resulted in the current debt nexus and erosion of investor confidence in the country. Consumer price inflation will average 2.7% over the next year and 3.5% over the next two years. Following the cumulative 275bps 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 the economic recovery.

At the end of June, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 5.06% (three-year) and 6.32% (five-year), much lower than the previous month. Shorter-dated NCDs have pulled lower due to the significant interest rate cuts, recovery in bond yields and tightening of credit spreads. Short-dated 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. In addition, NCDs have the added benefit of being liquid, thus aligning the liquidity of the strategy with the needs of its investors. The strategy continues to hold decent exposure to these instruments (less floating than fixed), but we will remain cautious and selective when increasing exposure.

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 going forward. 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 interest rates will lend support to the economy through this difficult phase. SAGBs do embed a decent risk premium, although this premium has reduced slightly post the recovery in Q2-20. As mentioned, South Africa is on the brink of a debt trap and, although promises have been made to restore the country to a more sustainable debt trajectory, the implementation risks remain elevated. The valuation of SAGBs does provide some offset to this, implying that local bonds do warrant at least a neutral allocation in portfolios.

The local listed property sector was up 12.9% over June, bringing its return for over the quarter to 18.7% and -38.4% over the rolling 12-month period. Listed property has been the largest drag on the strategy's performance. This has resulted in a general rise in balance-sheet risk across the sector. The current crisis will reduce rental income, put pressure on asset values, increase the cost of borrowing for lower-quality businesses, and test inexperienced management teams. It is entirely possible that most of the companies will require additional capital and that dividends are suspended to preserve capital. One must be cautious not to take these at face value and understand how the key issues mentioned above affect that yield. We believe there are a few select large-cap counters that satisfy our stringent conditionality.

The FTSE/JSE Preference Share Index was up 2.8% over June bringing its return over the quarter to 17.6% and -13.4% over the 12-month period. Preference shares offer a steady dividend yield linked to the prime rate and, depending on the risk profile of the issuer, currently yield between 8% and 10% (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 consider the 10-15y SAGBs as the most attractive asset among the fixed income 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. Listed property looks relatively attractive, but allocations need to be made on a stock specific basis with careful consideration paid to evolving issues. Corporate bond spreads have widened however this widening has been inconsistent. In addition, the relative stability in risk markets combined with the net redemptions in the listed credit market, has once again slowed the normalization in credit spreads back to levels consistent with international counterparts and underlying fundamentals. We are cautiously adding specific names to our holdings.

We remain vigilant of the 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.