

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)	220.3%	121.1%	192.6%
Since Inception p.a.	8.8%	5.9%	8.1%
Latest 10 years p.a.	8.0%	6.1%	7.7%
Latest 5 years p.a.	6.8%	5.6%	7.0%
Latest 3 years p.a.	8.3%	5.8%	7.4%
Latest 1 year	4.6%	8.2%	4.2%
Year to date	(1.9)%	2.0%	(1.8)%
Month	(2.1)%	0.7%	(1.9)%

ASSET ALLOCATION

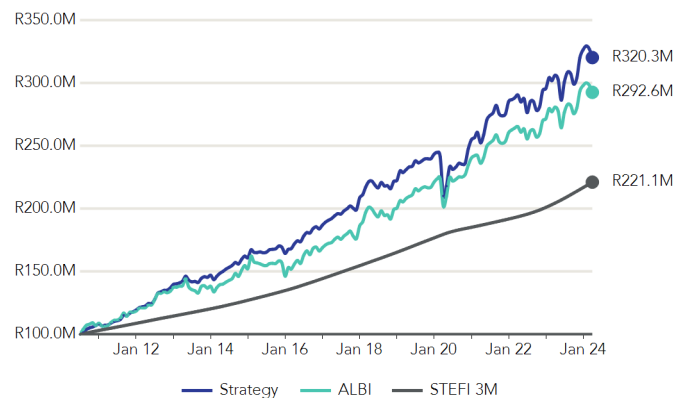
Asset Type	% Strategy
Fixed Rate Government Bonds	84.7%
Government ILBs	3.8%
Property	2.9%
Fixed Rate Other	2.4%
Cash	1.5%
Fixed Rate Corporate Bonds	1.4%
Floating Rate NCDs	1.4%
Floating Rate Corporate Bonds	0.8%
Corporate ILBs	0.6%
Other	0.4%
Preference Shares	0.1%

GENERAL INFORMATION

Inception Date	01 July 2010
Strategy Size †	R6.90 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

†Strategy assets under management as at the most recent quarter end.

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	2.9%
1 to 3 years	1.1%
3 to 7 years	20.9%
7 to 12 years	40.4%
Over 12 years	31.8%

STRATEGY STATISTICS*

Modified Duration (incl. inflation-linked bonds)	6.0
Modified Duration (excl. inflation-linked bonds)	5.8

PORTFOLIO MANAGERS

**Nishan Maharaj** - BSc (Hons), MBA

Nishan is Head of Fixed Interest at Coronation and a portfolio manager across all fixed interest strategies. He joined Coronation in 2012 has 21 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 21 years' investment experience.

**Seamus Vasey** - BCom (Hons), MSc, CFA

Seamus is a portfolio manager and analyst within the Fixed Interest investment unit with more than 20 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.

**Mauro Longano** - BScEng (Hons), CA (SA)

Mauro is a portfolio manager and Head of Fixed Interest research. He co-manages various fixed income strategies for institutional and retail clients. Mauro joined Coronation in 2014 and has 13 years' investment industry experience.

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

REVIEW FOR THE QUARTER

Markets started 2024 intoxicated with the euphoria of the Federal Reserve Board's (Fed) impending monetary policy pivot. Risk assets rode high on the wave of optimism for most of the first quarter.

(Q1-24), with emerging markets doing especially well. Unfortunately, as is generally the case, this optimism faded towards the end of the quarter, with the market's initial pricing of 175 basis points (bps) of rate cuts for 2024 tapering to the Fed's projections of only 75bps. South Africa (SA) has done little to positively differentiate itself from the rest of the emerging market (EM) basket. Uncertainty on the outcome of the local elections, possible coalitions and the policy implications thereof weighed on the performance of the rand and bonds, causing further underperformance relative to EM peers.

The FTSE/JSE All Bond Index (ALBI) was down -1.8% over the quarter, driven by its poor performance in February and March, as bond yields rose by close to 100bps, inching closer to the highs last seen during the Covid crisis. Most of this poor performance was driven by the performance of the long end of the yield curve (>12 years). Inflation-linked bonds (ILBs) performed slightly better, returning -0.37%, as elevated real yields and stubborn inflation continued to help the asset class. However, over the last 12 months, both the ALBI's (4.19%) performance and that of ILBs (5.74%) remain significantly behind cash (8.15%). Given that the rand was also down c.4.69% versus the US dollar over the last 12 months, SA bond performance translated to dollars would have fared only marginally better than global bond performance over the same period (FTSE World Government Bond Index [WGBI] was down -0.84% in US dollars).

In emerging markets, China's headline inflation increased to 0.7% year on year (y/y) from a deflation of 0.8% y/y in January. The inflation uptick was driven by holiday-related demand associated with Lunar New Year celebrations. Food price deflation slowed, and travel costs increased by 23.1% y/y in February from 1.8% y/y in January. The Producer Price Index, which tends to be less impacted by Lunar New Year celebrations, fell 2.7% y/y in February from a contraction of 2.5% y/y in January.

In SA, the economy expanded by 0.1% quarter on quarter (q/q) in the fourth quarter of 2023 from a contraction of 0.2% q/q in the third quarter of 2023. From the production side, mining and manufacturing production increased while agriculture, construction and domestic trade declined. On the expenditure side, household consumption and inventory accumulation increased, but this was offset by weak net trade, reduced government expenditure, and a decline in gross fixed capital formation. Overall, the economy grew by 0.6% in 2023 from a growth figure of 1.2% in 2022.

The South African Reserve Bank (SARB) unanimously voted to leave the repo rate unchanged at 8.25% at the March MPC meeting. The MPC cited sticky inflation and elevated inflation expectations as the main reasons for keeping the repo rate unchanged. Food inflation has been on a decline, but there is concern that prices could rebound following reports of damage to the summer crops due to dry and hot weather conditions. The SARB slightly updated headline inflation to 5.1% from 5.0% for 2024 and left its projections unchanged for 2025 and 2026 at 4.6% and 4.5%, respectively.

Headline inflation increased to 5.6% y/y in February from 5.3% y/y in January while core inflation ticked up to 5.0% y/y from 4.6% y/y. The increase in inflation was driven by higher medical aid insurance tariffs, and an uptick in service inflation. Food inflation slowed down due to base effects, while transport costs increased on the back of high fuel prices. Elsewhere, prices were generally soft with modest gains in apparel, household services, restaurants, and hotels.

As at the end of December 2023, the market was pricing that the SARB's Monetary Policy Committee would cut the repo rate by 75bps by the end of 2024, but recent pricing suggests that the repo rate will remain unchanged until the end of 2025. Market expectations for inflation are for it to average 4.5% in 2025, which implies a real repo rate of c.3.5% for most of the forecast period. We expect inflation to remain stickier and average 5.4% in 2025. Our stickier inflation forecasts are all supply-side based due to higher food prices driven by the effects of El-Niño, a weaker rand translating into higher imported inflation and the higher cost of doing business in SA as a consequence of inadequate network infrastructure. However, as we have previously argued, with real growth struggling to break above 1.5%, policy settings could be regarded as excessively restrictive and as such, we would view a reduction in the policy rate of 0.5%-0.75% starting in November 2024. This would still maintain a real policy rate of 2.0% based on our inflation forecasts.

At the end of March, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 9.17% (three-year) and 9.82% (five-year), higher compared to the end of the previous month. Our inflation expectations suggest that the current pricing of these instruments remains attractive due to their lower modified duration and, hence, high breakeven relative to cash. In addition, NCDs have the added benefit of being liquid, thus aligning the Strategy's liquidity with the needs of its investors. The Strategy continues to hold decent exposure to these instruments (fewer floating than fixed), but we will remain cautious and selective when increasing exposure.

The significant reduction in rate cut expectations over the last quarter has tainted the enthusiasm for risk assets. However, the monetary policy pivot remains in play and, as such, emerging markets should continue seeing supportive flows into their markets. Idiosyncratic SA factors have led to further underperformance of SA assets relative to the peer group. Low growth, sticky inflation and burgeoning deficits will continue to weigh on SA's longer-term outlook unless reform implementation is accelerated through increased private

sector participation. SA's bond yields remain elevated but still provide an attractive alternative to cash, given their high embedded risk premium. We would advocate slightly overweight positions in bond portfolios, focused on maturities of less than 12 years, together with decent allocation to sub-10-year maturity ILBs and very little allocation to local credit.

ILBs are securities designed to help protect investors against inflation. They are indexed to inflation so that the principal amount invested and, hence, the interest payments rise and fall with the inflation rate. ILBs have offered protection to investors over the last quarter. However, current breakeven inflation across the ILB curve averages between 5.5% and 6.0%, which is well above even our own expectations for inflation over the medium term. It is only the shorter-dated ILBs (I2029, six years to maturity and I2033, 9 years to maturity) that flag as cheap from a valuation perspective. Risks on the inflation front remain elevated, and these shorter-dated ILBs warrant a decent allocation within portfolios due to their inherent inflation protection.

The local listed property sector was down 1.02% over the month, bringing its 12-month return to 20.47%. Operational performance will remain in the spotlight as an indicator of the pace and depth of the sector's recovery. The current poor growth outlook, combined with an increase in cost base due to higher administered prices and second-round effects on loadshedding, will weigh on the sector's earnings in the coming year. We believe that one must remain cautious due to the high levels of uncertainty around the strength and durability of the local recovery.

Corporate credit is an incredibly effective tool that can be used to enhance the yield and longer-term performance of fixed income portfolios. However, it is important to understand that yield is earned over a multiyear investment horizon, and a long-term focus is essential when analysing and investing in the asset class. Managing credit risk is broader than just focusing on the specifics of an individual lender. Instead, we must consider the incremental risk that a corporate credit adds to a portfolio in relation to its overall risk profile and the effect on portfolio liquidity and then ensure that positions are sized correctly.

Low levels of issuance and tightening spreads have created a guise of safety when it comes to investing in the local credit markets. SA credit remains an illiquid market that necessitates detailed scrutiny of underlying fundamentals and relative attractiveness, especially within a deteriorating macroeconomic environment like SA.

We believe that allocating significant amounts of capital to the local credit market is unwise and would represent a substantial opportunity cost in the face of attractive valuations in other, more liquid asset classes. The current level of credit spreads on offer are at historically compressed levels, despite SA being in its weakest economic position. Corporate profitability and creditworthiness are inevitably tied to economic outcomes, with significant polarisation in performance. SA is a sub-investment grade economy; thus, local credit should trade at high yield spreads. However, SA trades as an investment-grade issuer. The only spreads that trade at the high yield equivalent are riskier issuances coming from taxi financing, subordinated tranches of securitisations and bank debt.

The use of structured products, such as credit-linked notes (CLNs), has become ubiquitous within the local market. This sector of the market has grown exponentially over the last five years and has reached a market size of over R100 billion, but only a third of this market reprices, creating an inaccurate representation of asset volatility and pricing. CLNs mask the underlying/look-through credit risk as the issuing entity (predominantly local banks) is seen as the primary credit risk. The increased usage of CLNs has not expanded the pool of borrowers; instead, it has only served to concentrate it. This is due to the ability to limit the volatility of these instruments as valuations are not regularly adjusted based on the underlying asset price movements. This is why CLN repacks of SA government bonds have become so popular over the last five years. The combination of attractive yields and no volatility is an opportunity that not many would pass up unless, of course, pricing transparency is important to the underlying investor. As a result, there can be significant unseen risks within fixed income strategy. Investors need to remain prudently focused on finding assets of which the valuations are correctly aligned to fundamentals and efficient market pricing.

We remain vigilant of the risks from the dislocations between stretched valuations and the local economy's underlying fundamentals. 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.