CORONATION GLOBAL MANAGED [ZAR] FEEDER FUND

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Quarterly Portfolio Manager Commentary

Please note that the commentary is for the US dollar retail class of the fund. The feeder fund is 100% invested in the underlying US dollar fund. However, given small valuation, trading and translation differences for the two funds, investors should expect differences in returns in the short term. Over the long term, we aim to achieve the same outcome in US dollar terms for both funds.

The last quarter of 2017 continued to bring good news and strong returns to equity investors around the world. A combination of surprisingly strong economic data points (especially in regions like Europe and China), and a relatively benign outlook on interest rate normalisation in the US fueled equity markets to new highs. Investor euphoria grew even stronger when the US legislative forums agreed to a radical reform of the country's tax system, one of the cornerstones of the Trump administration's efforts to kick start growth in the economy. The headline corporate federal tax rate is proposed to drop from 35% to 21%, in return for introducing a territorial tax system. This will result in US-based multinational companies paying slightly more tax on their non-US earnings in return for a drastic reduction in domestic tax rates. At the time of writing this report, much of the detail remains unclear, but it does not take away from the fact that this is a significant event that, in the short term, will lead to a jump in earnings for the S&P 500 companies of around 7-10%, and in the longer term could propel the US economy onto a higher growth path.

Global equity markets returned 5.7% for the quarter, and a very strong 24.0% over calendar 2017. The S&P 500 ended the year with a positive return delivered in every month – a historic first. In addition to the abovementioned factors, inflationary pressures around the world continued to surprise on the downside and global central bank liquidity remained at close to peak levels throughout the year. This Goldilocks scenario culminated in very low volatility levels, with the cost of protection on equity markets continuing to reach new lows at the time of writing.

Emerging markets had a blowout year, producing 37.3%, with China registering the strongest performance (+54.3%). Within developed markets, performances were closely bunched together, with Europe and Japan marginally outperforming the US. This was primarily as a result of the weaker US dollar as the country performed better than most other markets in local currency terms. The US dollar weakened by 14% against the euro over 2017. Over the longer term, the US equity market has however performed significantly better than any of the other developed equity markets.

While there wasn't much divergence amongst the performances of the various sectors over the quarter, healthcare continued to lag, as did utilities and telecommunication services. Energy stocks benefited surprisingly little from a strong rebound in the oil price. As a result, energy (+6.9%) was the worst performing subsector in the MSCI All Country World Index (ACWI) in 2017. Energy is probably the one sector (outside of real estate) that stand to benefit the least from the tax reform. Information technology was the standout winning sector with an annual return of 41.8%. Other notable laggards were telecommunication (+8.1%) and utilities (+14.1%).

Global fixed interest markets, on the other hand, had a very uneventful final quarter of 2017, returning 1.1%, with returns from Europe being boosted by the weaker US dollar. For calendar 2017, these markets, however, returned a more respectable 7.4%, again benefiting from the much weaker dollar over the period. Credit spreads continued to contract, partially fueled by the expected benefits from the tax reforms.

Listed property had a strong quarter, returning 3.8% and yielding a total return of 11.4% for the year. Again, these numbers were flattered by US dollar weakness, but even in local currency terms the performances in the various geographies were quite diverse. Hong Kong returned 45.8%, Europe 15.8%, while Japan returned a negative 8.9% in yen. The US was a laggard with retail portfolios continuing to underperform the logistics subsector.

The gold price performed well over the last year, returning just more than 13.5%. Other commodities were also strong, although soft commodities lagged other categories materially.

The fund performed well against this backdrop. Its return of 16.1% for 2017 was very strong in absolute terms, albeit slightly behind the benchmark return of 17.1%. Since inception of the fund almost 8 years ago, this performance is in line with that of the benchmark.

It is gratifying to note that the strategy's equity carve out beat the ACWI benchmark comfortably over both one and three years, and marginally over the five-year period. The property carve out was particularly strong over one year, yielding a return of 23%. This subsector of the fund added a lot of value relative to the global bond index, which is being considered the alternative. Our credit positions underperformed the global bond index over the last year as expected, given our conservative positioning in this bucket. The merger arbitrage bucket detracted, after the fund's Rite Aid position was negatively impacted by the renegotiated terms of the Walgreens deal. Our direct gold position contributed positively.

Probably the biggest detractor to performance was our decision just over a year ago to reduce the strategy's equity exposure to below the benchmark weight of 60%. We ended the year with an exposure of around 55%, and given how strong equity markets performed, this opportunity cost to the fund was material. We continue to manage the risk profile of potential returns, and hence felt that it was the appropriate thing to do. We remain underweight equities in our positioning, as we believe that the current trading levels are discounting a lot of good news.

Within equities, our biggest positive stock contributor this quarter was L Brands, a position that we have previously discussed in detail. It bounced back spectacularly from very oversold levels, but subsequent to the quarter end sold off after poorer than expected Christmas trading numbers. Other strong contributors over the quarter included Fox (on the back of a proposed take-over by Disney), Amazon, Spirit Airlines (a low-cost US airline introduced into the portfolio a few quarters ago), Naspers, and Intu (after announcing a merger with Hammerson).

By far the biggest detractor was Altice NV, a new position in the fund that was severely punished by the market for producing poor trading numbers (especially in its French operation). This led to market concerns about Altice's ability to service its reasonably high debt levels. Other disappointments included Allergan (loss of patents and adverse court outcome), Newell Brands (poor trading update), and CVS Caremark and Walgreens (both punished due to fears that Amazon will enter the retail pharmacy market).

Over the last year Fortress remained our biggest positive contributor after its takeover by Softbank. Estácio and JD.com added significantly, as did most of our other alternative asset managers (Apollo, KKR and Carlyle). Internet positions like Amazon, Naspers and Facebook benefited from the strong uplift in the sector. The biggest detractors over 2017 were Altice NV (discussed above), Allergan and the retail pharmacy stocks Walgreens, CVS Caremark and Rite Aid on the back of the Amazon fears. Put options to protect the fund from a significant drawdown in the equity market cost the fund 43 basis points. We will continue to use index options to help manage the risk profile of the fund.

The tax reform signed into law in the US is a game-changing event, and investors should expect the portfolio to change once the details of the programme have been fleshed out. During the last quarter our decision to increase the fund's exposure to US cable stocks like Comcast, Charter and even Altice NV was partially influenced by the fact that this sector will be a prime beneficiary of the proposed tax changes. The sector is almost exclusively focused on the US domestic market, provides for tax at the maximum rate, and is a significant investor in capital equipment, which will receive preferential tax deductions in terms of the current proposals. While the outcome of the tax reform initiative remained uncertain until just before Christmas, some of these stocks have reacted strongly before and after the bill has been passed. We will continue to assess investment opportunities with an open mind, but are also conscious of the fact that in a competitive environment like the US there is a chance that at least some of the benefits of the tax reform will be competed away.

With regards to the other asset classes, we remain concerned about the level of long-term interest rates, and as such remain negative about the outlook for global bonds. We also think credit markets are discounting a benign outcome in terms of corporate defaults, and have very low exposure to this asset class. Listed property still looks appealing in some of the geographies, and we will continue to selectively add to this sector over time.

Portfolio managers
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as at 31 December 2017