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 2018 brought misery to most investors as the market's focus shifted to growing concerns around global growth prospects. On the one hand, clouds started gathering over the prospects for the US economy as the combination of practically full employment, further interest rate normalisation and the growing risk of significantly higher trade tariffs worldwide resulted in a dramatic shift out of risk assets. These fears were confirmed and further emphasised by the briefly inverted US yield curve, which historically has been a good predictor of recessions in the US. At the same time, and even ahead of the increased antagonism between the US and China, China's growth momentum started to slow visibly. This contributed to investor anxiety about global growth, as fears over the increasing debt build-up in China once again made the headlines. US President Donald Trump's increasingly aggressive stance towards trade tariffs added fuel to this fear-driven fire. In Europe, the rise of populism in some of the larger Western European countries affected confidence in their banking system, while the mass protests in France and ongoing Brexit negotiations further spooked investors.

All these factors and events led to a sharp and dramatic re-appraisal of economic growth and risky assets, with global equities suffering significant price declines in both the months of October and December 2018. December's sell-off was the worst end to a year in the last 45 years. The fourth quarter of 2018 ended up returning negative 12.8% for the MSCI All Country World Index (ACWI), and many markets officially entered bear market territory, with declines of more than 20% from previous highs. Long bond rates declined, given the poorer outlook for global growth, resulting in a marginally positive return quarter for the asset class. Within equities, utilities and real estate (both beneficiaries of lower long-term interest rates) did the best in relative terms. For once, consumer staples lived up to their defensive reputation and outperformed the overall ACWI by about 6%. On the other side of the spectrum, energy was the laggard, given the spectacular drop in the price of oil. The indiscriminate selling of longer duration (higher growth) assets resulted in information technology shares being punished, while other cyclical sectors such as consumer discretionary, industrials and materials also performed poorly. The US equity market slightly underperformed the rest of the world, and surprisingly, emerging markets marginally outperformed the developed world over the quarter.

As mentioned above, long rates in the US declined against this backdrop, with global bonds producing a marginally positive performance. Credit spreads, however, widened given the concerns around global growth, resulting in a negative quarter for credit. Global listed property yielded a negative return of 5.5% over the three-month period, which was better than equities, but still disappointing given the drop in long rates. Within listed property, the US market performed marginally better than the global index. Japan delivered a very strong performance given improving fundamentals for the country's listed property sector. Europe was particularly hard hit, and the UK had a disastrous period given the increased uncertainty around Brexit and a significantly poorer outlook for the sector. Commodities, as expected, had a very tough time given global growth concerns, and gold - for once - lived up to its safe-haven status in a world of increasing uncertainty. The gold price rose by 7.5% over the quarter.

The poor quarter for equities meant that the ACWI returned negative 9.4% for calendar year 2018 - a poor showing after the very strong 2017. For the full year, the US outperformed Europe by almost 10%, with Japan doing slightly better than Europe. Developed markets outperformed emerging markets by about 5% - the first time in the last three years that this has happened. Over the longer term, the developed market outperformance is still marked. Among the emerging markets grouping, Brazil and Russia were the standout performers. Healthcare was the surprising sectoral outperformer in 2018, with financials, industrials, materials, and communication services lagging. The range of sectoral returns was relatively narrow.

Bonds yielded a negative return of just over 1% for the 2018 calendar year, as did property with a negative 4.7% return. Gold was also marginally negative, highlighting the fact that investors really had no place to hide but in US dollar cash.
There were no major moves in the currency markets over the quarter, but over the last 12 months the US dollar strengthened by about 14% against the euro, and by about 4% against the yen.

During these turbulent times, the fund did not perform well. It was down 10.7% over the quarter, underperforming its benchmark by over 3%. Most of the underperformance took place in the month of December. This was particularly disappointing given our defensive asset allocation, but a combination of poor stock picking and a weak property market more than offset our lowish equity allocation. The disappointing fourth quarter resulted in a very poor 2018 in which we lagged the benchmark significantly. We are now slightly behind the benchmark over all periods since inception. This unsatisfactory situation is receiving our full attention, and we are determined to correct it.

The bulk of the disappointing performance in 2018 was due to poor equity selection, which we discuss in more detail below. Our property holdings (particularly those in the UK) also performed very poorly, led by Intu where the second bid for the company in 18 months failed given Brexit jitters. The fixed interest portion within the portfolio performed reasonably well, but the allocation was not large enough to offset the other detractors. Our lowish equity allocation did cushion the fund somewhat.

When assessing our equity mistakes in 2018, it is worth noting that while our hit ratio (number of winners vs number of losers) was reasonable (slightly below one), the impact of our losers on overall performance dwarfed the positive impact of the winners.

In the previous quarterly report, we highlighted Advance Auto Parts - the fund's biggest positive contributor over 2018. We have subsequently exited this position in favour of shares where we anticipate greater upside from current levels, on a risk-adjusted basis. Other notable positive contributors over the last year included long-time holdings such as Amazon, Alphabet and Blackstone. After a period of underperformance, Pershing Holdings also contributed positively. However, as mentioned above, these positive positions were more than cancelled out by the underperformers. We spoke before about our position in the tobacco stocks. These holdings were the biggest detractors, costing the fund about 2% in relative performance. British American Tobacco was by far the biggest culprit. Limited Brands also detracted materially during a year in which its profits continued to disappoint as the group had to focus on discounting their products to entice customers to spend. Tata Motors, Aspen, JD.com and Comcast were other detractors. Upon analysis, it is clear that apart from the tobacco sector being hit by regulatory changes in the US and slowing demand for e-cigarettes in Japan, most of the other disappointments (bar Aspen and L Brands where profits have disappointed) happened as a result of specific circumstances that did not feature in our initial analysis of the companies. Tata's woes were exacerbated by the Brexit saga, JD's founder was implicated in a sexual scandal in the US, and Comcast disappointed the market with poor asset allocation decisions. We have exited Tata given the increasingly murky outlook for auto sales in China and we have sold out of Comcast given the concerns around future capital allocation decision-making. All our other big losers remain in the portfolio, with our assessment of upside in many of these cases being very appealing.

Spotify is a relatively new position in the fund. It listed only recently in the US without raising capital, an unusual event in itself. Spotify is the leading global music streaming platform, with almost 100 million paying subscribers, which is double that of its nearest competitor, and a similar number of ad-supported/free users who have historically shown a strong tendency to migrate to the paid tier. We expect to see continued strong growth in Spotify's user base, as people increasingly embrace streaming, and anticipate that levels of churn (a key focus of the market, driven recently by the shift to family/student plans) will continue to decrease.

We therefore believe that Spotify is well placed in a recovering music market that only returned to growth in 2015 (driven solely by streaming), after almost two decades of decline. Spotify is headed by its highly-rated and pioneering founder, Daniel Ek, who is building out a two-sided marketplace in his quest to "democratise" music and make it easier for artists to become discovered and earn a living; over time we expect these artists tools to provide significant monetisation potential and see further potential as terrestrial radio inevitably moves online.

Although currently loss-making, Spotify is cash generative and has a growing cash balance of around US$2 billion (9% of market cap) along with a valuable stake in China's dominant music platform, Tencent Music Entertainment (8% of market cap). We believe Spotify has multi-year growth potential (management target 25-35% p.a.) and a roadmap to sustained profitability as the dominant player in a changing, but growing, global music market.

When assessing the prospects of our holdings in the fund, we are excited about their potential. The equity holdings are managed by capable executive management teams, and most of them have strong value propositions for their customers. While it is difficult to assess where we are in the equity market cycle, we see more opportunities following the recent sell-off and we have added to some of the longer-duration stories such as Spotify and Facebook. We have also increased the equity allocation somewhat to the fund's highest level in more than six months. We continue to be positive about the prospects for our property holdings, and we are starting to find selective value in the credit market. We are clearly not satisfied with the fund's more recent performance, but have not changed our process or philosophy, and remain confident that those factors that have yielded success over the longer term, will continue to serve us and our clients well in future.

Portfolio managers
Louis Stassen and Neil Padoa
as at 31 December 2018