CORONATION
TRUST IS EARNED™

Please note that the commentary is for the retail class of the fund.

The last quarter of 2018 was a tumultuous one for global markets, with a marked increase in volatility and a number of precipitous falls, which continued until the final day of December. South Africa was no exception to this trend, and, as further pressure mounted on emerging markets, the local markets were also impacted by negative economic indicators, rising political noise as we approach the 2019 elections, and the return of load shedding, together with further evidence of Eskom's financially unsustainable position. The fund delivered a return of -5.3% for the quarter, which unfortunately pushed the full-year return to negative 6.9%.

2018 was one of the worst years for virtually all asset classes. A recent report by Deutsche Bank, which tracks many asset classes, found that 2018 was the worst year on record since 1901, with 63 of the 70 equity and bond markets tracked delivering negative returns for the period. Notably, all 30 of the equity markets surveyed delivered negative returns. What is remarkable is that these negative returns were experienced during a year in which global economic growth was relatively strong. Major economies such as the US and China continued to show healthy growth, and 2018 ended with one of the strongest US labour markets ever seen. While market trends are undoubtedly being skewed by algorithmic trading and increasing investment into 'passive' funds, specific themes are achieving vast media exposure and creating broad uncertainty.

Rising concerns about the trade wars that are being led by President Donald Trump and its effects on both the US and China; the US government shutdown over a deadlock on funding the Mexican border wall; an increasingly disastrous handling of the UK's Brexit plans; and increasing political polarisation in Europe are some of the key headlines worrying investors. Investors appear increasingly nervous to take on any risk in markets where political leaders are behaving in such an unpredictable manner. Companies that fail to deliver, or warn on the future outlook, are immediately punished, with market declines in double digits now the norm.

With the US Federal Reserve still indicating that rates will rise in the US, emerging markets have been under substantial pressure, despite a number of them having favourable economic outlooks. The recent political changes in Brazil potentially bode well for its economy, and the significant decline in the oil price bodes well for all the oil-importing regions of the world - India and Turkey being key markets positively affected by this. The lower oil price will also assist South Africa in providing a boost to consumers who have suffered greatly through 2018's combination of VAT increases, rising oil prices and rising interest rates. More recently, as the increasingly isolated and combative US President frets about the country's falling stock market, he has placed increased pressure on the US Federal Reserve (the Fed) not to hike rates, which has further confused a market that is unused to seeing a sitting president criticise the Fed chairman in such a way.

This volatility and the general market sell-off is undoubtedly providing a fertile environment for future returns but is nevertheless unpleasant to experience. The fund entered 2018 with a relatively low level of exposure to local and global equity markets and we have taken advantage of the sell-off to increase exposure to these risk assets. We have primarily increased local equity exposure, as the South African market is offering levels of upside we have not seen since the financial crisis. Stocks have been priced for a very negative outcome, and, should we see a stable and well-supported election victory for President Cyril Ramaphosa, this will translate into improved consumer confidence and a general pick up in the economy. Overall, equity exposure is now close to 70% in the portfolio. With the recent sell-off in US markets we will also look to add to global equity in the coming months, as we should move through the uncertainty of Brexit and European elections and into a period of relative stability.

As mentioned in previous communications, we have increased our bond weighting by buying domestic bonds. With inflation well controlled and likely to decline further as the rand oil price drops, yields of 9% to 9.5% are very attractive. Globally, bonds remain unattractive given the low levels of real yield available.

Property continues to look attractive to long-term investors on both the domestic and global front. Domestic names have derated to yields of 10% and above, while high-quality US and European retail real estate investment trusts (REITs) have de-rated to high single-digit yields in hard currencies. We have maintained our South African exposure and selectively increased our global property exposure to take advantage of these attractive yields.

This has been a painful year for the fund, with a number of disappointments. What encourages us is the return potential being shown by several markets. We cautioned a few years ago that the easy double-digit returns achieved historically would be difficult to achieve off those high market levels. With markets now significantly off these levels, we believe strong double-digit returns should be achievable in the periods ahead. This will allow us to continue to deliver on our mandate of delivering inflation-beating returns over the medium to long term.

Portfolio managers
Neville Chester and Nicholas Stein
as at 31 December 2018