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

Quarter 2 saw a retracement in the gains made by banks and life insurers in Q1. Despite outperforming, the fund returned a negative return of -4.4% against the benchmark return of -6.0%. Over more meaningful periods of five and 10 years, the fund has generated compound annual returns of 11.2% and 15.5% respectively, which should be seen in the context of index returns of 11.7% and 14.8%. At the end of June, the fund celebrated a 20-year track record. Since inception, the fund has delivered a compound annual return of 13.0%, which compares favourably to both peers and the benchmark.

The quarter under review was a challenging one for the sector, the South African market and emerging markets in general. As the spectre of global protectionism and the threat of a trade war rises, emerging markets are caught in the crossfire. A move towards normalisation of interest rates in developed markets has also had a negative impact on emerging markets. Following a brief honeymoon period, the reality of the challenges faced by the Ramaphosa administration are becoming increasingly apparent. Uncertainty over land redistribution policy and a still-contested revised mining charter are just two examples of this. The rand ended the quarter at 13.73 to the US dollar, the same level it was at just a week before the ANC elective conference in December. The decline in share prices of banks and insurers that started in March continued into the second quarter, with banks down 7.8% and life companies down 11.0%. A more resilient performance from property and general financials cushioned the blow slightly.

Contributors to fund performance for the quarter included overweight positions in Investec, PSG Konsult and Hammerson, as well as an underweight position in Sanlam and a zero holding in Barclays Group Africa. Detractors from performance were overweight positions in MMI, Nedbank and Afrocentric and a recovery in the share prices of Resilient and Capitec, neither of which the fund holds.

At the end of June, Old Mutual completed the first step of its managed separation process - the listing and unbundling of its shareholding in the UK wealth management business, Quilter plc. The second step will come towards the end of the year when it distributes 35% of its 55% shareholding in Nedbank. In the lead up to this event, the fund held a significant position in Old Mutual (c.12%) as we felt that the market was undervaluing the sum of its parts. Quilter is an attractive asset operating in a market under-pinned by strong structural growth drivers. Reforms in the UK savings industry in recent years have resulted in two supporting pieces of regulation: RDR has had the effect of reducing the supply of independent financial advice; while pensions freedom has increased demand for the same advice by placing greater responsibility on the individual to plan and save for his or her retirement.

Quilter, previously known as Old Mutual Wealth, has been built in large part by acquisition off the base of the UK business inherited when Old Mutual bought Skandia in 2006. Some misadventures have taken place along the way, but today the business is an intelligently constructed operation spanning virtually the entire savings value chain. It consists of a financial advice force of c.1 600 restricted financial planners, a platform providing administrative/reporting capabilities and tax wrappers, and an investment component providing multi-manager solutions as well as a more traditional private wealth offering. At c. £100m of AUA, Quilter is a sizable player in the market, comparable to peers St James Place and Hargreaves Lansdown. Underpinned by the changes in the UK savings market, net flows to the business have exceeded 6% of opening AUA for the last three years. Advised assets placed on a platform tend to be relatively sticky, and we expect the market to continue to grow strongly for some time. As a meaningful participant, we expect Quilter to benefit from this growth.

As is often the case, the investment case is not without risk. Revenue margins have declined for each of the last three years as competition in the space has increased. Some additional fee pressure is likely to be felt, although this should be more than offset by asset growth. Most importantly, the business will transition to a new IT platform towards the end of the current year / early next, and the risk of lasting brand damage exists if not done seamlessly. Having discussed this in some detail with company management, we believe that the steps put in place to mitigate this risk are as comprehensive as one could expect.

As part of the listing process, Old Mutual sold 10% of its shareholding in Quilter at a price that we felt meaningfully undervalued the business, in advance of unbundling the remaining holding. The fund participated in this placement, and in addition to the shares received on the unbundling, holds 4% of Quilter. In addition to the acquisition of Quilter, which was funded by the sale of Old Mutual, we increased exposure to FirstRand, Discovery and Intu during the quarter, and reduced exposure to Investec, HCI and Nedbank. In addition, we exited the fund's positions in Afrocentric and Brait.

As a general comment, following the selloff in Q2, financial share valuations now look more reasonable but we expect share prices to remain under pressure in the near term. Pre-close updates from the banks towards the end of the quarter reaffirmed our view that economic activity remains subdued, and that translating the improvement in consumer and business confidence into loan growth / new policy sales will take time. We are hopeful that this will start to manifest more clearly in 2019, but the risks to sustaining this confidence are increasingly evident.

Portfolio managers
Neill Young and Godwill Chahwahwa
as at 30 June 2018