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.

Our previous quarterly report highlighted the almost ominously low levels of volatility as evidenced in the length of the bull market (without a technical pull back), the fact that calendar 2017 showed no negative monthly returns (a market first), and the very low levels of implied volatility when buying options. The first quarter of 2018 however shattered this level of complacency. While the year started with a very strong January, a combination of the re-assessment of interest rate levels over the next few years, aggravated by some inflationary pressures, as well as a renewed focus on the privacy debate pertaining to the new technology giants (on the back of some data manipulation claims against Facebook) led the equity market into a new era of volatility. Both February and March produced negative returns, and moving into April the market flirted with the 10% retracement level that would constitute a technical correction. The more recent market jitters have been in response to the increasing probability of a US/China trade war.

The quarterly return for the MSCI All Country World Index (ACWI) was negative 1.0%. Surprisingly, emerging markets outperformed developed markets, producing a return of 1.4%. The rolling 12-month return for the ACWI remains impressive at 14.9%, surpassed by an emerging markets return of 24.9%. The ACWI's five-year annualised return is also reasonable (9.2% p.a.), this time exceeding that of emerging markets (5.0% p.a.). Sectors that outperformed over the last quarter include information technology (ironically, given the recent pressure on Facebook and some of the other industry giants) and consumer discretionary. Materials and energy predictably performed poorly given the change in interest rate outlook, but it also adversely affected consumer staples, which sold off with the increase in longer term bonds (having erroneously been considered as bond proxies during the search for yield a few years ago). The US marginally outperformed the developed markets grouping, but continued currency weakness resulted in US dollar returns being very similar across different markets.

Global bond yields weakened slightly over the quarter, but the weaker US dollar also affected bond market returns worldwide. The Bloomberg Barclays Global Aggregate Bond Index's quarterly return of 1.4% (reported in US dollars) was at least 100 basis points lower in local currency terms. Listed property produced a negative return of 4.3%, affected by both interest rate jitters and a general risk-off trade. The US led the decline in this asset class, and apart from Japan, returns from most other regions were also negative. Again, the weaker US dollar aided the translation to the reporting currency (in USD).

Most commodities sold off against a backdrop of increased concern over the health of the global economy. Gold was essentially flat over the quarter.

The fund had a disappointing start to the year, underperforming its quantitative benchmark by 4.0% for the quarter. Since inception, the strategy return is marginally lagging its benchmark.

Our decision to reduce equity exposure some time ago added to relative performance, but our stock selection underperformed the ACWI benchmark materially over the quarter as well as over the last 12 months. Our instrument selection in property was also poor, as was our overweight position in the asset class. Our credit positions in fixed income performed well, and our gold holding added marginally. Over the last 12 months our biggest detractors were our underweight position in equity, and our stock selection within the equity bucket.

Our biggest positive equity contributors included Amazon (continued rerating on the back of sound execution and speculation about entering other categories), Advance Auto Parts (turnaround strategy gaining early traction after oversold share price), Hammerson (an unexpected bid for the company being rebuffed by its Board), and Airbus (a recent portfolio introduction continuing to execute well). The largest equity detractor was the prior quarter's top performer – L Brands. This after a poor trading statement resulted in its share price retreating to previous lows. Other losers included Altice (cable operator with poor results in its home market, France), Tata Motors (victim of market volatility and poor short-term sales numbers), and Intu Properties (fears that proposed Hammerson deal would fall through). Some of our consumer staple holdings were also marked down in line with the comments above.

We have significantly increased our portfolio exposure to tobacco stocks over the last 12 months. Currently close to 10% of the fund is invested in stocks such British American Tobacco, Philip Morris International, Japan Tobacco and Imperial Brands. While each company potentially offers a slightly different angle in terms of future returns, the overarching investment thesis is that the development of next generation products (while disruptive to the incumbent players in what has been a very stable industry) could prove to present the market with a new growth vector. Heat-not-burn and vapour products have found favour with both existing smokers, as well as ex-smokers, and allow the industry to benefit from premium pricing. The recently announced Food and Drug Administration's review of the industry in America has increased uncertainty in the shorter term, allowing us to pay what we would consider attractive prices for these stocks. In the longer run, we anticipate the larger players to consolidate the new technologies, leading to improving margins compared to the combustible market (assuming no adverse tax developments). Some of these companies are now trading at valuation multiples not far off those levels when they were facing potentially crippling financial legal claims, and we think these positions will serve the fund well over the medium to longer term.

While the fund's short-term performance has been a disappointment, we take encouragement from the fact that the portfolio is showing very attractive potential upside based on our assessment of fair value for our individual holdings in the equity and property buckets. We continue to manage overall portfolio risk, and again over the last quarter we paid around 25 basis points away in the form of portfolio insurance. The cost of protection has now risen materially, and we would in all likelihood not replace the current protection measure when they expire.

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