CORONATION
TRUST IS EARNED™

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

The year and final quarter of 2019 turned out to be a decent one for investors who stayed invested in the markets despite very poor news on the economic front. The South African economy, which was already operating at near-stall speed, also had to contend with severe load shedding from crippled electricity supplier Eskom. Yet, equities and bonds performed well and the rand firmed. The market action showed once again how difficult it is to time an unexpected strong performance or a sharp correction. The FTSE/JSE Capped SWIX All Share Index added 5.3% in the quarter and 6.8% for the year. The All Bond Index added 1.7% over the quarter and 10.3% for the year. Only listed property performed poorly, with 0.6% and 1.9% over the quarter and full year respectively. Global equities were also strong, rising 0.4% during the quarter and a very strong 24.5% for the full year, as measured by the MSCI World Index in rand terms.

The fund showed a commendable 9.2% return for the year, which is a real return of 5.2%, thereby exceeding its target of inflation plus 4%. It was, however, not good enough to take the three- and five-year returns to the targeted level. Since inception, the fund has beaten inflation by 5.8% per annum, comfortably ahead of the targeted return. Over the past 10 years, the excess return of 3.2% is slightly behind the target. Major contributors for the year include Northam Platinum, Naspers, British American Tobacco, Anglo American and Altron. Detracting from performance were Sasol, Shoprite, Nedbank, Advtech and Woolworths. The contributors far exceeded the detractors and the fund's equities delivered a return of 10.8% for the year. Domestic bonds delivered a total return of 9.5%, but property investments lost 13% of its value. Foreign assets were the best performing asset class, with a total return of 21.3%.

We increased our exposure to the South African bond market due to the highly attractive real yields on offer. The bond component of our portfolio carries a yield of more than 9%. While we do expect inflation to rise somewhat from the current sub-4% level, it leaves us with a comfortable margin of safety. The high yields in the domestic bond component helped to keep us below the maximum offshore exposure, where yields are extremely low. The high real yield on bonds is also an argument for limiting domestic equity exposure to less than our maximum allowed.

It remains difficult for companies linked to the South African economy to meaningfully grow earnings due to a lack of top line growth in almost every sector. We do acknowledge that the earnings base is low and ratings generally attractive, but without a rise in consumer and business confidence, spending will remain depressed. Our exposure to equities is therefore still skewed towards the global stocks listed on the JSE, such as Naspers, British American Tobacco, Anheuser Busch and others. Exposure to the so-called SA Inc. stocks is held mostly through banks and defensive retailers with very limited exposure to cyclical domestic stocks.

The separate listing of Prosus (the non-South African part of Naspers) has so far not had the desired effect of narrowing the wide discount of Naspers to its underlying assets of Tencent and the other components. We added to Naspers during the quarter, as we believe it still offers exceptional long-term value. It therefore remains the fund's largest single holding.

Looking forward, we are of the view that the targeted return of inflation plus 4% is achievable. The bond component alone has a high enough yield to deliver the required real return and is supported by a good selection of quality domestic and global equities that are reasonably valued. It is, however, crucial that government passes a budget early in the new year that adequately addresses the deteriorating fiscal situation. Some tough decisions need to be taken to curtail spending and stop the bleeding at the SOEs. The placing of South African Airways in business rescue is a signal that government has grasped the seriousness of the situation. More action is needed at other State-run entities. The Reserve Bank, which has cited the dire fiscal situation as a reason for keeping interest rates high, will have room to loosen monetary policy somewhat if the budget addresses some of these crucial fiscal issues adequately. Lower interest rates will help the economy and should also be viewed positively by the markets.

Portfolio managers
Charles de Kock and Pallavi Ambekar
as at 31 December 2019