CORONATION SA EQUITY FUND

Quarterly Portfolio Manager Commentary

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

2019 was a positive year with the fund delivering 12.4%, ahead of the benchmark return of +10.5%. For the fourth quarter, the fund delivered 6.6% ahead of the benchmark return of +4.9%. This is a relatively new fund without a meaningful long-term track record.

South African investor confidence remains weak as impatience has set in with the slow pace of much needed reform. SOEs are fragile with SAA entering business rescue in the fourth quarter and PRASA placed under administration. The rebuilding of critical institutions is underway with strengthened teams in place at SARS and the NPA and most recently the appointment of a new CEO at Eskom. The plight of Eskom remains concerning, as years of poor maintenance leave an unstable power utility. Unplanned outages are very disruptive given the lack of spare capacity and pose a major threat to economic growth prospects. The severe load shedding experienced in December is expected to have taken a toll on retailers' fourth quarter earnings. Growth continued to disappoint with a contraction in both the first and third quarter. Low domestic growth and low inflation (3.7% CPI for 2019) should give rise to rate cuts. However, the SARB has been reluctant to cut rates, believing that dovish monetary policy will have a limited impact given the high structural impediments to growth. As a result, real yields of South African bonds are at very attractive levels and local bonds therefore have a meaningful role to play in the portfolio. We are more cautious on domestic property, where we expect companies to struggle to show distribution growth over the medium term as rentals that have benefited from high escalations for many years come up for renewal and are rebased to market.

The JSE All Share Index returned 12% for the year and 4.6% for the quarter. While this was a better year for South African equities, longer term returns for domestic growth asset classes remain low (JSE All Share Index 6% p.a. over 5 years/ JSE Listed Property 1.2% p.a. over 5 years). We continue to see value in South African listed equities. The JSE returns were boosted by the South African resource sector which performed strongly; overcoming fluctuating sentiment on global growth to finish the year up 28.5%. Industrials and Financials were considerably weaker delivering 8.9% and 0.6% respectively with the higher domestic exposure of the financial sector weighing on performance.

Within the index, it was pleasing to see names that had detracted from performance in 2018 contribute strongly. Most notable among these were the Platinum Group Metals (PGM) with the fund's holdings in Northam (+186% for the year and 49% for the quarter) and Impala (+291% for the year and +51% for the quarter) up particularly strongly. Other notable performers for the year include our global holdings with Quilter (+38%), British American Tobaccos (+36%), Naspers (+22%) and ABI (23%) also doing well. The fund's underweight position in domestic businesses contributed positively, as the challenges of a lacklustre consumer environment and persistent structural cost inflation eroded earnings.

While our equity and balanced portfolios remain significantly exposed to offshore stocks, we have added to selected domestic holdings where we see value. Any near-term recovery in domestic stocks is likely to be a shift in sentiment rather than a dramatic improvement in earnings.

On the resources front, our large exposure to the PGM sector contributed meaningfully to fund performance for both the quarter and the full year. Platinum-group companies benefited from rising prices given growing demand (as emissions regulation requires higher vehicle PGM loadings) and a limited supply response. While we have cut our holdings into price strength, we still have meaningful exposure. The years of underinvestment in PGM mines mean supply is unable to respond timeously. Significant capex with long lead times is required to change this. Northam's strength also reflected an easing of investor concerns on the overhang of the BEE deal funding, which becomes less dilutive at a higher share price. Another meaningful contribution came from the fund's large position in Anglo American which benefited from its ownership of Amplats (+149%) and Kumba Iron Ore (+65%). Both assets benefited from commodity price strength (PGMS and iron ore) due to tight markets with an inability for supply response in the short term. We anticipate that the PGM deficit will be more enduring.

Sasol suffered a tumultuous year collapsing on the back of further cost overruns relating to the Lake Charles Chemicals Project and a delay in its financial results. The board used this time to conduct a thorough review of internal controls and governance structures. Our underweight position during the year contributed to performance and we took the opportunity to add to the position at a time when investors had lost faith in the company. The previous joint CEOs have now left the business, a new internal appointment has been made and the ethane cracker achieved optimal run rate by year end. The share has rebounded c20% off its recent lows. Risks in the company remain high and we continue to manage the position size carefully.

Within the financial sector, Quilter (+38%) performed strongly in its second year of listing as the market bought into management's vision of building a focused, integrated UK wealth manager. The reduced uncertainty in the UK political backdrop also helped.

Naspers (+22%) had a busy year with the unbundling of Multichoice, the establishment of Prosus - an Amsterdam listed entity that houses its international assets, unbundling of a portion of Prosus (26%) to shareholders and a bid for JustEat, a multinational food delivery player. Unfortunately, the restructuring had little impact on the discount at which Naspers (and now Prosus) trade to their underlying holdings. Given the capital allocation track record of management, we think the market is taking an overly pessimistic view on the discount. Given the attractiveness of the underlying assets and the holding company discount, Naspers and Prosus constitute a significant holding in the fund. Their major asset, Tencent, is growing rapidly in online payments and financial services; a market segment many times larger than the gaming market they currently dominate. While strong incumbents and the regulated nature of financial markets do increase the risk profile, financial services has the potential to be a very large and profitable business.

British American Tobacco, a share which detracted from performance in 2018, was up strongly (+36%) during 2019. It continued to deliver on its strategy; growing revenues (despite falling volumes in traditional combustible tobacco), widening margins (helped by cost reduction) and strong cash conversion. This, despite a changing regulatory environment. US regulators are becoming increasingly concerned on youth recruitment and potential harm of alternative tobacco delivery methods like vaping. The magnitude of the threat posed by this category to its traditional business now looks reduced.

While it was pleasing to see market recognition of the value inherent in some of the fund's larger positions during 2019, we continue to see attractive opportunities for disciplined, long-term investors that should generate inflation-beating returns overtime.

Portfolio managers
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as at 31 December 2019