CORONATION TRUST IS EARNED™

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

It has been a tough year in the mid- and small-cap space, evidenced by the average return across all six Morningstar-rated funds in our peer group of 0.12% for the year. Your fund fared a little better, returning 5.6%, slightly ahead of inflation, which is running at 4.1%. The fund has delivered 1.1% per annum (p.a.) and 2.7% p.a. over 3 and 5 years, remaining the best-performing small cap fund over these periods. These absolute returns are not something to write home about, but merely demonstrate just how tough the environment has been for small- and medium-sized businesses over the last few years.

Drilling deeper into the performance of the fund, the bulk of the fund's positive return came in the fourth quarter, largely driven by our holdings in platinum shares, specifically Northam and Impala Platinum. Their performance, in turn, was driven by the skyrocketing of platinum group metal (PGM) prices. The PGM prices rose 47% in 2019, contributing to the stellar performance of the platinum shares. We have been selling some of these shares into strength, although we continue to hold a sizeable amount. This is predicated on metal deficits continuing for the next few years, driven by an increase in demand as automotive manufacturers face increasingly stringent emissions standards. In addition, supply response has not been forthcoming as a result of underinvestment by the industry.

Cartrack has also been a strong performer over the past year, going up by 70%. Cartrack is a perfect example of the kind of companies we seek to include in the fund. When it listed, it was a little-known company operating in the telematics industry, a space not very well known in the market. However, through our research and previous dealings with some of the companies in the sector, we had a pretty good idea of the long-term prospects of the industry. The management team is impressive, shareholder friendly and has a very clear growth strategy. The company has since compounded earnings at a rate greater than 20% since listing, a feat not many listed companies can claim.

The biggest detractors to fund performance in the last year have been the holdings in Invicta and Advtech.

Invicta has been a dismal share to own in the past few years. Not only has the company been the victim of a brutally tough economy, but was also the recipient of a R750 million fine from the South African Revenue Service for a tax structure that resulted in Invicta paying a very low tax rate for the last seven or eight years. The deluge of bad news has caused the share price to decline significantly and is now priced at approximately half of book value and on about six times price-to-earnings ratio on what we consider to be low earnings. These earnings are unlikely to recover in the current economic environment but should do so in time as things improve.

Advtech has been the darling of this fund and is probably the share we have held the longest. It operates two main divisions: private schools and tertiary. The tertiary division has performed phenomenally, driven by increasing demand from students looking for decent post-matric education that is likely to lead to them finding a job. The demand has been made more acute as the public sector has struggled to keep up with student numbers and affordability. However, the private schooling division has been experiencing a tougher environment. The bulk of Advtech's school portfolio is exposed to the very high-end private schooling sector. The tough economic environment has led to many parents either emigrating or downtrading to lower fee schools as affordability became an issue. This happened in the middle of the division undertaking a massive restructuring of its internal systems. As you can imagine, all of this has led to poor results being achieved. We continue to believe that private schooling is on a structural growth path and that the internal restructuring should result in some cost savings which should mitigate the tough economic cycle. As such, we continue to be holders of Advtech.

Given the poor performance of most shares in the mid- and small-cap space, the valuations have become very attractive, which we believe will be the biggest determinant of future returns. As such, the fund will continue to look for attractively priced shares that will deliver the best risk-adjusted returns.

Portfolio managers
Alistair Lea and Siphamandla Shozi
as at 31 December 2019