CORONATION EQUITY FUND

Quarterly Portfolio Manager Commentary

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

The fund had a good quarter, returning 10.7%. Over longer periods, the fund has performed well against both its peer group and the quantitative benchmarks.

Our large weighting in global equities has added to fund performance over the quarter and year, respectively. One of the fund's largest international holdings, Airbus, has delivered very strong returns for the portfolio over the past quarter (+36% in rands). This was primarily due to the very strong 2018 full-year results reported in mid-February. Fourth-quarter adjusted earnings before interest and taxes (EBIT) came in 26% ahead of consensus and 2019 full-year guidance of €6.7 billion in adjusted EBIT and €4 billion in free cash flow was well ahead of market expectations. Furthermore, management decided to terminate the highly symbolic but profit-dilutive A380 programme due to a dearth of order activity, signalling that they are increasingly willing to make rational financial decisions even when they are politically unpopular. The once-off shuttering costs for the production line were also well contained. The profitability of the A320neo and A350 continued to improve at a rapid pace and the former programme's teething issues (performance and deliveries of engines) are gradually being resolved. To add fuel to the positive sentiment shift towards the stock, Airbus did not disclose any new inquiries from regulators on past governance transgressions, essentially denying the rumour that the US Department of Justice had opened its own separate corruption probe. This allayed market fears of higher-than-expected future fines. Finally, the recent tragic incidents relating to Boeing's 737 Max aircraft and its subsequent global grounding likely supported the Airbus share price. However, it is our view that Airbus's direct short- and medium-term benefits will likely be limited to somewhat firmer pricing, as the A320neo family's backlog is already full and leaves little flexibility for adding new customers in the coming few years.

Overall, the JSE had a good quarter, with the JSE Capped Shareholder Weighted All Share Index appreciating 3.9%. Resources had another very strong quarter and was up 17.9% - bringing the sector's rolling 12-month total return to a whopping 41.6%. Platinum stocks, in particular, had a very strong quarter on the back of a rising platinum group metal (PGM) basket price.

During the quarter, all mining companies reported their annual or interim results for the period to end-December 2018. These results were characterised by a strong performance from the bulk metals (iron ore, coking coal, thermal coal and manganese). The theme of strong cash flow, deleveraging and capital returns to shareholders continues. Shares reacted positively to results and a strong commodity price environment, driven by tight supply-demand balances and an abatement of US-China trade war fears. Our large exposure to Anglo American (+22%) contributed to performance.

After a long and frustrating wait, PGM shares have finally begun to rally strongly, with our holdings in Northam (+47%), Anglo American Platinum (+38%), Impala Platinum (+66%) and our position in the Palladium ETF (+12% in US dollars) all contributing meaningfully to returns for the quarter. We feel that this is a vindication of our disciplined, long-term approach to investing, where we aim to assess information objectively and dispassionately avoid being swayed by the news and sentiment of the day. Subsequent to 'Dieselgate', negative headlines called for the death of the internal combustion engine and platinum demand along with it. PGM prices dropped below marginal costs of production. At the same time, electric vehicle commodities such as lithium and cobalt were rallying strongly (up three times). Tesla's share price rose seven-fold in the last seven years, and its market capitalisation is comparable to traditional automakers such as General Motors (GM) and Ford, despite the fact that the company has struggled to turn a profit and produces only 3% of the vehicles that GM produces. While we are long-term believers in battery electric vehicles, we expect the process to be evolutionary rather than revolutionary. In the medium term, we also expect PGM demand to surprise positively as a consequence of tightening emissions standards globally. In addition, material underinvestment in mine supply over the last decade means it will take many years before a sufficient supply can respond to current market deficits. We therefore expect structural PGM market deficits to persist for at least the next decade.

After a challenging 2018, it was also particularly encouraging to see that a number of the fund's other high-conviction ideas contributed meaningfully to returns during the quarter. These included Naspers, British American Tobacco and Quilter.

Naspers (+19%) benefited from a strong recovery in the Tencent share price as sentiment towards China shifted positively on the back of a reduction in trade war fears and a resumption in the licensing approval process of online games by the Chinese authorities. Naspers also surprised the market in March by announcing the offshore listing and part unbundling of its offshore internet portfolio (i.e. Tencent, Mail.ru, OLX, Food Delivery, et al.) in an effort to reduce the discount at which it trades relative to its underlying intrinsic value. While this is certainly no 'silver bullet' that will immediately remove the entire discount, we nevertheless view it as a marginally positive step in the evolution of the group into a global consumer internet powerhouse and will allow it access to a wider investor base.

The British American Tobacco share price (+27%) recovered strongly during the quarter on the back of reporting good results which allayed market fears around US volume declines, its debt levels and the outlook for its next-generation products. It also appears that investor fears towards the regulatory headwinds faced by the US business are abating and sentiment is finally starting to turn positive on the stock. Even after this short-term price rally, British American Tobacco is still trading on only 9.5 times one-year forward earnings and a 7% dividend yield. We still believe this to be very attractive for a stock of this quality and it remains the second biggest position in the fund.

Quilter (+28%) performed very well over the period. Its maiden full-year results materially exceeded market expectations. Quilter provided medium term guidance on their profit before tax margin aspirations. At 34%, this too exceeded expectations. The long-term outlook for integrated wealth managers with advice forces at scale remains very attractive. This positive outlook is driven by a decline in advisers following the UK's adoption of the Retail Distribution Review; 'pension freedom' boosting demand for advice and opening up the post-retirement market to wealth managers; and a shift away from defined benefit funds to defined contribution funds.

Stocks exposed to the domestic economy came under significant pressure during the quarter as the realities of operating in a 'no-growth' economic environment filtered through into corporate earnings. The quarter kicked off with a string of profit warnings from the domestic retailers, and the likes of Mr Price (-23%), Massmart (-22%), Truworths (-18.5%) and Dischem (-16%) all ended the period materially lower. Fortunately, the fund had no exposure to any of these stocks. Eskom remained in the headlines as it hit Stage 4 load shedding in the middle of March. Years of mismanagement, corruption and underinvestment are finally coming home to roost. Although, for now we appear to have received a temporary reprieve from the worst of load shedding, it has become clear that we are only starting to understand the true extent of the power utility's problems and that its numerous issues could indeed take years to rectify. Unfortunately, if persistent load shedding becomes the norm over the next few years, the impact on consumer sentiment, business confidence and GDP growth will be devastating. We therefore continue to remain cautious on stocks that are heavily exposed to the domestic economy and our preferred exposures are through high-quality domestic defensive businesses that should weather the challenging environment better than their weaker, economically sensitive peers.

Notwithstanding the uncertainties that abound, our objective remains to build diversified portfolios that can absorb unanticipated shocks. We are happy with the current portfolio positioning and are excited about future return prospects. We will remain focused on valuation and will seek to take advantage of attractive opportunities that the market may present to us and in so doing generate inflation-beating returns for our investors over the long term.

Portfolio managers
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as at 31 March 2019