CORONATION
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The fund had a good quarter and returned 7.9%. Since inception, it has averaged an annualised return of 16.7% relative to its benchmark return of 14.1%, while it has moderately underperformed its benchmark over the past five- and 10-year periods.

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 quarter materially lower. Fortunately, the fund had no exposure to any of these stocks during the quarter. 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 now starting to understand the true extent of the problems that the power utility faces 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 stocks that should weather the challenging environment better than their weaker economically-sensitive peers. Against this challenging economic backdrop, the South African Reserve Bank left rates unchanged at its 28 March meeting and cut its 2019 GDP forecast from 1.9% to 1.3%, while the much-anticipated ratings review by Moody's was deferred and South Africa maintained its investment-grade rating.

Performance attributions over the past three years have been boosted by our holdings in Pick n Pay, Netcare, Mondi and Spar. During the quarter, low weightings in domestic stocks such as Vodacom, Mr Price, Truworths and Bidvest contributed to outperformance.

After a challenging 2018, a number of the fund's high-conviction ideas contributed meaningfully to returns during the first quarter. Firstly, Naspers 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 at 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 very positive step in the evolution of the group into a global consumer internet powerhouse and will allow it access to a wider investor base. While Naspers remains one of the fund's highest-conviction ideas, its continued outperformance over time has led to it occupying a disproportionate size in the fund's benchmark, currently circa 40%. In order to manage single-stock risk in the overall portfolio, the fund now finds itself significantly underweight Naspers. Therefore, perversely, if Naspers continues to do well (which we certainly hope and believe it will), there is a high probability that the fund will underperform its benchmark. While we continue to strive to find great investment ideas, we remain mindful of our commitment to construct diversified anti-fragile portfolios – the performance of which is not dependent on the outcome of a single investment idea. In this way, we aim to deliver high-quality risk-adjusted returns.

As previously communicated, Naspers completed the listing and unbundling of Multichoice (its video entertainment business) during the quarter. We believe Multichoice is a good-quality business and although the South African operations are fairly mature, it should still grow earnings strongly as management turns around the loss-making 'rest-of-Africa' operations. We also believe that given several structural differences (lack of broadband, high cost of data, demand for local content, best-in-class sports offering, etc.) versus many developed markets, the competitive threat from the global over-the-top competitors (the likes of Netflix, Amazon Prime, et al.) is overblown. Multichoice is currently trading on circa 7 times our assessment of normal earnings. We used the period of heightened share-price volatility post the unbundling to add to our position.

During the quarter we received an offer from a consortium of investors (led by Israel's Central Bottling Company (CBC)) for our stake in Clover (+30% for the quarter). The offer price was close to our assessment of Clover's intrinsic value and we decided to support the offer. The British American Tobacco (BTI) share price (+27% for the quarter) recovered strongly during the quarter on the back of 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 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, BTI 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.

Aspen reported interim results in March that were below market expectations, and the share sold off aggressively as the market became concerned about its high debt levels and the risk of a covenant breach, should it not be successful in concluding the sale of its infant milk business. The poor organic growth performance and working capital management added to investor concerns. The Aspen business is currently in a transitory phase as management repositions the portfolio to capitalise on future growth opportunities, and we continue to believe that the debt load is manageable. Aspen is currently trading on 6 times our assessment of normal earnings and we have added to our position on the back of the weakness in the share price.

Notwithstanding the economic challenges that South Africa faces, markets have had a positive start to the year. The National Elections are scheduled in early May 2019 and we expect little improvement in the economy before then. Decisive policy action will, however, be required post the election to ensure the economic challenges are effectively addressed. We continue to believe that the portfolio is filled with stocks that remain very attractively priced, and we are optimistic about future return opportunities.

Portfolio managers
Sarah-Jane Alexander and Adrian Zetler
as at 31 March 2019