CORONATION TRUST IS EARNED™

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

Following the aggressive sell-off in the first quarter, stocks rebounded strongly during the second quarter of the year (Q2-20). The Fund returned 13.9% for the quarter compared to the 12.9% index return for the same period. Over three, five and 10 years, the fund returned -8.9%, -6.6% and 7.2% compared to -8.5%, -5.3% and 7.9% index returns respectively.

Following the record decline in equity markets during the first quarter of 2020 (Q1-20), Q2-20 saw a rapid recovery. The MSCI All Country World Index recovered 19.2% in US dollars during the quarter, reflecting the huge amounts of fiscal and monetary stimulus being injected into the global economy. In addition, following stringent Covid-19 shutdowns, many markets started relaxing lockdown regulations and resuming economic activity in a measured fashion. Along with its global counterparts, the JSE Capped Shareholder Weighted Index experienced a significant rebound during the quarter (+21.6%), but remains down (-10.7%) for the year to date. This reflects the damage the Covid-19 economic shock has wrought on an already weak economy. South Africa's (SA's) weak fiscal position constrains its ability to provide financial support to businesses and households.

In SA, resources (+41%) outperformed industrials (+16.6%), financials (+12.9%) and property (18.7%). Within financials, banks (+7.4%) continued to lag life insurance (+19.0%) and property. The banking sector has been very active in providing support to both consumers and corporates during the lockdown. This support has been varied and includes loan restructures, instalment deferrals, covenant waivers and extending liquidity facilities. The economy is shedding jobs and many companies, particularly among small, medium and micro-enterprises, are likely to fail. One therefore expects the banks to book rising impairments over this period, and this, coupled with declining economic activity, should drive bank profits lower over the near term. The big banks came into this crisis well capitalised and with well-provided books, therefore, post Covid-19, we expect the bank franchises to prove resilient and for profitability to be restored.

FirstRand is now the largest of the bank exposures in the Fund. We took opportunity to increase the Fund holdings following relative underperformance during the quarter. This is a business that has delivered high return on equity over the past decade. FirstRand's attractive customer proposition has brought strong asset growth, resulting in dominant main bank market share in the middle/upper income market. FirstRand have leveraged their position of strength; diversifying their sources of non-interest revenue, reinvesting in their digital offering and driving down their cost-to-income ratio. These actions stand them in good stead to continue gaining market share, even in a tough economy. Conservative past lending practices and healthy capital adequacy levels mean the balance sheet should be resilient. FirstRand trades on 7.7 times our assessment of normal earnings.

The property sector rebounded surprisingly strongly as the economy started re-opening after the hard lockdown and more tenants, other than just essential services, started trading. Rent collections have started to improve across all property sectors, particularly the non-essential retail segment, which had been hardest hit due to the inability to trade during the lockdown. Concerns around balance sheet vulnerabilities eased, with the banks engaging constructively, granting covenant waivers and extending liquidity to allow the sector to weather the Covid-19 closures. The impacts of job losses and company failures will take some time to work through the property sector as both retailers and businesses downscale their space needs, and, despite securing covenant relief now, the sector will still need to bring capital structures to more sustainable levels of gearing over the long term. We therefore remain cautious on the sector and underweight in the Fund.

Contributors to Fund performance for the quarter included overweight positions in RMI, Discovery, Nedbank and Quilter, as well as the underweight in Capitec Bank. Holdings that detracted from quarterly returns included EPE Capital Partners and an underweight position in Sanlam, as well as the fact that we did not hold Transaction Capital stocks nor Redefine and Resilient Reit LTD property stocks. We took the opportunity to add to holdings in FirstRand, Sanlam, Nedbank and Standard Bank, and funded these purchases from Old Mutual, Hammerson and Discovery. Sanlam has become a significant holding in the fund, a business we believe to have the highest-quality life franchise in the SA market. The business has continuously delivered sector-beating growth and quality of earnings, but, in the past, often traded at a significant premium to embedded value. In the current market, one can access this great franchise in line with their conservatively stated embedded value - a very attractive opportunity in our view.

Markets continue to surprise us. The market correction began at a point when investors were still being bombarded daily with negative news flow. The rebound in the SA market has come despite the high and rising levels of government debt and rising unemployment. We retain our commitment to look through the short-term noise and invest where we believe the market is mispricing the long-term fundamentals.

Portfolio managers
Neill Young and Godwill Chahwahwa
as at 30 June 2020