CORONATION MARKET PLUS FUND

Quarterly Portfolio Manager Commentary

CORONATION

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

Capital markets responded dramatically to the unprecedented levels of stimulus that most developed markets unleashed in response to the Covid-19 lockdowns. After record-breaking declines in major equity markets, we saw unprecedented rises and further tightening in bond yields, with the benchmark US ten-year government bond yield dropping well below 1%.

The Fund was positioned to benefit from the majority of these rising asset prices, delivering a return for the second quarter of 2020 (Q2-20) of 17.3% against the benchmark return of 16.7%. As markets fell, we cut our put protection and raised our global equity weighting. This was specifically due to the view that the significant business support being offered by developed markets would allow their businesses to survive the lockdown, in stark contrast to South Africa (SA), where there has been precious little support for the corporate sector, implying any bounce back in SA will be marginal at best. Unfortunately for SA businesses, we have seen this situation play out. The S&P 500 has recovered to close to its all-time high levels, within 2% of where it started the year and 6% below where it peaked. The JSE All Share, while being only down 3% since the start of the year, is flattered by a number of very large global companies, not least of which is Naspers/Prosus. If you exclude the global companies listed on the JSE, the index is down closer to 20%, reflecting the brutal reality of what the hard lockdown and lack of support has cost our economy.

While we were adding to global equities in March and April, we once again find ourselves now cutting this exposure. There is a warring struggle between vast amounts of liquidity being provided by global central banks trying to find investment destinations and the reality of tougher economic outlook with the ultimate question of how all this additional liquidity will be paid for. For the time being, the liquidity is winning, as ultra-low interest rates force investors from the sidelines into equities. Ultimately, however, the gravitational pull of delivered earnings will see reality reassert itself and we expect some normalisation of ratings on equities.

Counter to this, now that a lot of the bad news is discounted in the price, we are having a long hard look at the unloved SA equities. Foreign investors have been exiting SA, both from equities and bonds, and a number of good-quality defensive businesses are now trading at far more attractive levels. Given the continued prevalence of a lockdown, albeit in a more accommodating stance, it is still difficult to forecast what the revenue trajectory for some of these businesses will look like, making near-term earnings forecast difficult. But, if our assessment of the quality of the franchise and balance sheet strength is correct, we can still identify those that will be able to resume delivering robust earnings once the economic situation normalises. This is where we have focused our attention in the SA equity component. We now own meaningful positions in the food retailers, hospitals, and some of the more defensive retailers. Overall, our SA equity component still has a bias to global companies, but this has reduced from the previous quarter.

A sector we have added exposure to has been the insurance and specialised finance sector. With markets having rebounded very rapidly, asset bases are close to where they were at the start of the year, while many of these companies are still trading well below their intrinsic value. Companies such as Quilter, the UK-based wealth manager, as well as the recently-listed Ninety One have increased in our portfolio holdings. We have also added to the life insurance sector, buying Sanlam and Liberty, as well as adding to our existing position in Momentum. While all will face a much tougher economic environment, the nature of their operations is such that they can operate under lockdown conditions with greater ease than many other industries.

From a fixed income perspective, we have continued adding exposure to our position in SA government bonds (SAGBs). Here is also a challenging market, with two very strong counteracting forces. The parlous state of SA's fiscal position is top of mind for global investors who have significantly reduced their holdings of SAGBs. Against this, real yields are now at previously never seen levels, as rising nominal yields (due to increased supply of bonds) and falling inflation combine to offer a compelling real yield opportunity. At the longer end of the curve, real yields are well in excess of 6% under all but the most extreme inflation scenarios. While the short end of the curve is being anchored by the exceptionally low repo rate, the long end of the curve reflects the lack of appetite to take on long-dated SA government risk.

Given that SA has managed its existing portfolio of debt well, and is not very exposed to dollar liabilities, we think the possibility of default in one's own currency is unlikely. Therefore, as a hold to maturity investor, the only downside we can see would be the risk of inflation reaching double digits for a meaningful time over the coming decade. In our opinion, with the current South African Reserve Bank board in place, this is a fairly low probability risk.

On the global bond side, we remain very underweight government bonds. Currently 90% of the world's developed market bonds by value are trading with yields below 1%, a truly staggering statistic. Should any inflation return to the system (always a risk given the unprecedented money printing we have seen), there will be significant losses in this asset class.

Listed property has been the 'ground zero' of the economic impact of the global lockdowns. Impacting retail centres and office blocks as shelter-in-place instructions have seen massively changed behaviour. While it is too soon to be able to call how quickly life returns to normal ,and to what extent work-from-home and online purchasing becomes the new normal, one has been able to identify some of the winners and losers from these levels. Companies with sufficiently strong balance sheets or defensively-positioned assets with defendable levels of rental will survive. We have made some small investments in the sector to profit from these opportunities, but very much on a case-by-case basis. This is a sector in which many more opportunities will present themselves over time as stressed balance sheets result in distressed selling of quality assets.

We have reached the halfway mark of the year with the Fund down around 3.5% year to date, which we would not have seen as a win at the beginning of the year, but is undoubtedly better than where we would have expected to be at the end of the last quarter. On a forward-looking basis, the low levels of many of the assets we are invested in now indicate we should be in for a sustained period of strong returns in the years ahead. Ultimately, the return you achieve is strongly influenced by the price you invested at. We are very confident about the ability of the Fund to achieve solid returns from these levels.

Portfolio managers
Neville Chester and Nicholas Stein
as at 30 June 2020