CORONATION SMALLER COMPANIES FUND

Quarterly Portfolio Manager Commentary

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

In the second quarter of 2020 (Q2-20), the Fund returned 16.8%, regaining some of the lost ground experienced in the first quarter. Despite the recovery, the Fund's one-, three- and five-year returns still show -15.1%, -5.8% and -1.9% per annum (p.a.) respectively. It has been a tough period for small cap shares over the last few years. The Fund remains the top-performing small/mid-cap fund over three- and five-year periods.

Markets all over the world recovered strongly as lockdown restrictions were eased, with some businesses being allowed to operate, albeit under some form of restrictions, resulting in reduced operational capacity. Fears of a liquidity crunch quickly evaporated as central banks intervened and governments initiated historic stimulus to support businesses and employees. All of this has led to markets recovering to pre-Covid-19 levels.

On the domestic economy front, things are not looking as positive. The stimulus announced with much fanfare doesn't seem to be reaching those who need it most. Our fiscal response is limited by our weak public finances. Companies are reporting retrenchments as they seek to offset lost revenues, which will worsen the employment situation and deplete the spending capacity of the consumer.

Given the economic environment we find ourselves in, we have doubled our efforts in understanding the medium- and long-term effects to various industries and businesses. We know that, in these uncertain times, the market creates mispriced assets that can be taken advantage of by the disciplined investor. We have sharpened our pencils on the balance sheets of businesses, stress-testing various scenarios to get a handle on the most vulnerable. Overall, we have not changed our investment process, but have intensified it even further, as we believe opportunities will continue to present themselves.

The largest addition to the Fund over the past quarter was Woolworths (WHL), which came into our universe after dropping out of the Top 40 largest shares. WHL is a well-managed, Southern Hemisphere retail group with operations in both South Africa (SA) and Australia. The SA food operation, which comprises just under half of value, is a high-quality business with strong franchise value, an aspirational brand and significant opportunity for further share gains as it transitions from a niche to a mainstream food retailer. The clothing business combines both SA (15%) and Australian (30%) operations into a scale apparel player, with opportunity to extract synergies as both enjoy common seasonality. The improved buying power should allow for superior negotiating power with suppliers, driving better value for customers. The Australian business has had a couple of false starts due to specific issues we believe are being corrected and should be resolved in time. WHL is attractively valued; trading on 7.1 times our assessment of normal earnings.

We have been reducing our stake in Cartrack. The share has performed very well for us and held up well against most stocks that had come under pressure during the sell-off. We used the proceeds to take advantage of mispriced opportunities.

While things remain as uncertain as ever, we continue to build resilient portfolios that should be able to withstand challenges within our given universe of stocks.

Portfolio managers
Alistair Lea and Siphamandla Shozi
as at 30 June 2020