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.

The last quarter has probably been the toughest single three-month period the Fund has endured, with it down 31.2% for the period. By now, we are all well versed in the cause of this decline – Covid-19, which I will not discuss in this commentary, but rather refer you to a note written to our clients on the subject by our Chief Investment Officer, Karl Leinberger.

While it is cold comfort, the Fund's one and three-year declines of 26% and 12.2% respectively, make it the second-best performing fund in its category over both these time periods. It is also instructive to point out that in 2008, the year of the Global Financial Crisis, the Fund fell 39%, but delivered 32% and 28% in the following two years. I know you have heard it before, but history has shown that the best times to invest in equities is often the time of maximum pessimism. This feels very much like one of those times. Human ingenuity is such that we will overcome Covid-19, and the world could well look like a very different place in three, six or 12 months' time.

Despite the real problems that Covid-19 brings to many listed companies and to people in general, we are seeing opportunities to invest in some very undervalued shares. Early on in the crisis, we raised a fair amount of cash in the Fund (around 8%), and, as we stand today, have deployed half of that into new investments, with the other half ready to go. We are also weighing up whether to switch out of companies that have been strong performers through this crisis –such as JSE Limited, Spar, Dis-Chem and Pick n Pay – into shares that have taken a beating – such as the apparel retailers.

The largest additions to the Fund in the quarter were the purchase of Truworths, JSE Limited and Mr Price.

Unfortunately, the Truworths purchase was made early on in the quarter before the impact of Covid-19 was known. Since then, the business has had to close its stores during lockdown, which will have a large impact on earnings in the current financial year. In times like these, the most important investment consideration is whether the company has the balance sheet to survive. Truworths, thankfully, has a fortress-like balance sheet with significant net cash, and will certainly be able to ride out the storm. And, perversely, one of its biggest competitors, Edcon, looks very close to failure due to a toxic combination of high debt levels and very weak earnings. There is thus a scenario where Truworths (and all the apparel retailers who survive this crisis) emerge stronger once this crisis is behind us. We also bought Mr Price in the quarter, but the difference here was that we bought it in the few days following the Covid-19-induced sell-off. Mr Price is a high-quality business with an equally strong balance sheet. There is no question that it will survive this crisis.

There are few businesses that will benefit from Covid-19. The JSE is one of them. The huge volatility we have seen in stock markets around the world, including on the JSE, means that the value of trade being conducted on the exchange has increased dramatically in the past month. The JSE earns fees on this increased trade, and as a result, its prospects for the year ahead are better today than they were at the start of the year. The JSE is one of a handful of shares that have appreciated in the month of March.

The three biggest sales during the quarter were Reinet, Oceana and Comair.

The sales of Reinet and Oceana were motivated primarily by the fact that these shares became relatively less attractive compared to many shares which fell materially. Reinet and Oceana have held up very well in this crisis (cigarette and fish consumption supposedly less/not impacted) and were shares we could sell to raise cash for better opportunities.

In the case of Comair, we reacted quickly when it was becoming apparent that Covid-19 would decimate airline shares. The share has now halved from the level at which we sold out. Comair (and many airlines globally) has high levels of debt, raised to Fund the upgrade of its fleet of planes, and can ill afford a sustained period of material earnings pressure. The long-term impact on air travel in South Africa is also hard to comprehend, with more companies likely to cut back on business travel for the next while, driven partly by the crash course we have all had in online/remote communication.

Portfolio managers
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as at 31 March 2020