CORONATION TOP 20 FUND

Quarterly Portfolio Manager Commentary

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

The first quarter of 2020 will be remembered for a number of records; none of which we would ever want to repeat. Globally this will go down as the worst first quarter in stock markets in recorded history. In the US, the S&P 500 Index recorded the fastest bear market (defined as a 20% fall in markets) in history, falling over 20% in 20 days, compared to 1929 when it took 36 days. This was followed shortly thereafter by the highest ever print in unemployment claims in the US. The main driver behind this is the developing Covid-19 pandemic. The details of this are explained in our CIO's commentary accessible on our website.

For the Fund, this has meant a torrid quarter in terms of absolute performance, with the Fund declining by 20.5% since the beginning of the year. It is cold comfort to us that we have managed to outperform the market and the Fund's benchmark, which fell by 22.9% this year. With stock markets melting down all around the world, there have been precious few places to hide. Perversely enough, one of the best performing counters has been our large overweight position in Naspers/Prosus. Despite being domiciled in China, where the original virus outbreak occurred, this company has benefited from the early exit of China from lockdown, but mainly due to the fact that its main source of revenue is virtual products (gaming, video, music, on-line content etc.) all of which was uninterrupted and, in fact, generally boosted by a move to self-isolation.

Naspers has appreciated by around 11% so far this year, benefiting from the much weaker rand as much as from its holding in Tencent. It has also proved fortuitous that their attempt to buy out Just Eat for a cash purchase price of $8 billion fell through, so that they were not saddled with a new food delivery business in the midst of a lockdown. They now have that cash war-chest to pick up potential casualties from the global rout in markets.

Given that Tencent has actually increased by around 23% in rand terms so far this year (and, by implication, Naspers has underperformed this move) and the Naspers group is in such a solid position with a very strong balance sheet, we remain holders despite the very strong relative outperformance in the Fund. By our calculations, Naspers trades in excess of a 50% discount to its underlying assets.

The second-best performer for the quarter was the Fund's large holding in British American Tobacco (BAT). After having been a major underperformer in 2018, we built BAT up to a top three position in the Fund. A global staple, trading on a single-digit earnings multiple seemed to be a very attractive proposition. It has proven to be a very defensive stock to own through this period of global volatility. With a lot of concerns already discounted in the price, the stock is likely to benefit from continued demand, as well as the drop-off in oil prices resulting in its customers having more disposable income for tobacco purchases. With a globally diversified footprint and strong cash generation, BAT remains one of our top three holdings.

Finally, the third best performer in our portfolio was our holding in Shoprite, which managed to eke out a small gain for the quarter. This position was built up last year, as the market turned sceptical on the growth prospects for the African retailing giant after a couple of quarters of poor performance. Our analysis indicated that most of these tough results were from one-off factors, and that the core underlying franchise remained exceptionally strong. While its African business will always remain susceptible to economic cycles on the continent, it is a compelling retail footprint that you were not paying for in the share price. Since the self-isolation and then lockdown was promulgated, FMCG retailers have benefited from a huge burst in panic buying and 'pantry stocking'. They are also continuing to trade to ensure that South Africans have access to food during the lockdown period. While ultimately this is just a case of future purchases being brought forward and will impact sales later on, the FMCG retailers should be one of the few businesses that will emerge from this period relatively unscathed. Our other FMCG retail holding, Spar, was our fifth best performing share in the period.

The greatest disappointment during the quarter was the performance of our platinum shares. While the rand platinum group metal (PGM) basket was up in excess of 50% for the quarter, the share prices of our holdings of Northam and Impala have fallen around 44% and 46% respectively. A starker divergence between the economic fundamentals and the actual share prices would be hard to find. There are many factors at play, both for and against the outlook of these companies, yet the share prices appear to be only pricing the most negative of outcomes. Based on our assessment of normal PGM prices (much lower than today's levels), the platinum shares are all trading on very low single-digit earnings multiples. While production has largely been shuttered under the lockdown, any return to normal production will see a significant return to profitability. And any hiatus in demand from the shutdown in global auto manufacturers is offset by this lack of supply from South Africa (SA). Given this favourable outlook for the sector, we have added to our holdings in the month of March.

The sector that hurt the Fund the most has been the banking sector. As the lockdowns came into place, the banks sold off dramatically, with further negative moves post the Moody's downgrade. We think the Moody's downgrade is a non-event for the banks. SA's yields and credit spreads were already pricing this in, and this should have very little real impact on the bank results. The real damage to the banking system will come from the lockdown. Any stress in a regional economy always ends up in the banking sector. It is the primary mechanism for extending credit into an economy and any contraction in that economy will be felt in the banks' credit losses. With every small business now under threat of going out of business, and plenty of mid-size and large ones as well, the risks are very real of a major spike in credit losses. While in the developed world, massive government stimulus and support plans have been introduced, SA has failed to implement equivalent plans along with its lockdown. This is primarily a result of a lack of fiscal space to do this given where our government finances are currently.

Having said that, the banking system is extremely well capitalised. While the SA banks never suffered direct fallout in the Global Financial Crisis (GFC), they were required to implement all the new capitalisation standards that were approved post the GFC. This means that banks have very significant capital buffers and can handle a substantial deterioration in credit losses. The SARB has also started to relax capital buffers to allow banks to cope with the influx of Covid-19-related bad debts, without having to resort to raising new capital. All of this means that the banks should easily be able to handle the stress, if the lockdown is lifted as planned. Should it continue in this extreme form for longer, then the stresses will magnify and the banks could end up in a loss-making position, which, while not threatening their existence, will take a number of years from which to recover. Given the above, we have continued

to hold our positions in the bank shares but have not added to them.

Lockdowns are occurring around the world, and the lockdown in the UK has meant that any plans of turning around the fortunes of INTU (the UK based shopping centre portfolio) have been impaired. Prior to the crisis, the company was already struggling with significant debt levels and tough trading conditions, but they had a plan to largely resolve this. The impact of Covid-19 will see further retailer insolvencies in the UK and further declines in centre valuations. We have therefore decided to sell out the remaining holding in INTU, which had largely been completed by the quarter end.

As the portfolio stood at the beginning of April, our models show the stocks we own in the portfolio have a total upside of 68% to our analysts' fair values. This is the highest potential total return the portfolio has offered in a decade. Obviously, there are assumptions in these valuations, but we have moved quickly as a team to ensure we have priced in the effects of the pandemic and the lockdown on our fair values. While the moves have been extreme and brutal so far, we think the worst has been priced into equity valuations and from here onwards expect a rebound. The portfolio quality has continued to improve and we have used the selloff to buy high quality businesses on low ratings, which will stand the Fund in good stead over the long term.

Portfolio managers
Neville Chester and Nicholas Stein
as at 31 March 2020