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

The Fund had a reasonable quarter, delivering a return of 1.8% net of fees, with all asset classes, bar South African (SA) property, contributing positively to the quarter's return. The Fund continues to beat inflation over three and five years. However, it is only over the last 10 years that we have managed to beat our benchmark inflation-plus-three.

On the domestic front, the SA economy contracted severely in the second and third quarter of the year as the brunt of Covid-19 lockdowns impacted activity. We expect a tepid recovery as the year progresses and only expect the country to return to 2019 levels of GDP growth by early 2023 in nominal terms. Globally, the virus seems to be staging a second wave and there are many large uncertainties including the outcome of US elections, the Brexit negotiations and geopolitical tensions between China and various countries. In general, however, these economies seem better positioned to recover from Covid-19 due to quicker access to vaccine treatments, better support from government programmes, and more coordinated economic policies.

The Fund has steadily increased its global effective exposure[i] from the beginning of the year from 22% to 27% currently. We have mainly increased our holding of global equities as the other asset classes look expensive (global bonds) or face structural headwinds (global property). While certain equity indices, such as the US S&P 500, look expensive and have rallied hard from the bottom, it has been a narrow market with a few shares delivering the bulk of the performance. There remain many compelling valuation opportunities in the broader market.

We have also increased our equity allocation on the local side. The majority of our exposure is to attractively valued rand hedge shares, such as British American Tobacco and Anheuser Busch InBev. Despite SA's ban on the sale of alcohol and tobacco during the hard lockdown period, these businesses have generally managed to trade their products in many other countries. We think these businesses are defensive and can show real revenue and earnings growth in hard currencies over the medium term. Most importantly, they are strong free cash flow converters and will use their cash to delever their balance sheet and return cash to shareholders. This combination of decent earnings growth and dividend returns is attractive for our portfolios. We have also been adding to domestic businesses that we think have resilient franchises, healthy balance sheets and can deliver earnings growth in a constrained economy. Low expectations are baked into market prices and if we see a better-than-anticipated recovery in earnings bases, we think there will be a robust real performance from our selected basket of equities.

The increase in global and local equities has been funded from our SA fixed income allocation. SA bonds still offer very attractive real yields, especially in the long end of the curve, and the Fund still has a healthy 45% allocation to a mix of government bonds, inflation-linked bonds and corporate credit. We also recognise, however, that a rising government debt burden and widening fiscal deficit will require some serious intervention by the finance ministry. While government acknowledges the seriousness of the economic situation, we think that there is a non-negligible risk that we do not see the decisive policy changes and expenditure reform plans the economy needs to avoid a debt trap.

We remain very cautious on SA property and have not increased our exposure here. Most real estate companies entered the Covid-19 crisis with stretched balance sheets. Pressure on net rental income is likely to intensify and we think a capital restructuring will be necessary for many counters. We had a small allocation to SA property, and we have seen a significant derating of this sector. Despite this, we don't think valuations are compelling enough to increase our allocation.

The Fund has found it difficult to beat its inflation-plus-three benchmark, as very few asset classes have delivered these returns in the last five years. Risk assets, in particular domestic equity and domestic property, have shown sub-inflation to negative returns over this period. Safer assets such as SA cash and SA fixed income have outperformed domestic risk assets on a relative basis. However, rising risks for domestic bonds and cash returning less than 4% mean that these assets have become less appealing. As we sit now, the outlook for risk assets is certainly not rosy, but valuations have more than reflected this and we have thus increased our risk asset exposure. We remain mindful of the Fund's dual mandate and use asset class diversification as well as appropriate put protection to preserve capital. While the outlook remains uncertain, we believe this creates attractive investment opportunities, and a considered increase in risk exposure is justified at this point to enable the Fund to deliver on its mandated inflation-plus-three return hurdle in the future.

Portfolio managers
Charles de Kock and Pallavi Ambekar
as at 30 September 2020

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[i] *Due to currency futures, effective international exposure might differ to asset domicile exposure as used in the formal asset allocation on the fact sheet.*