CORONATION EQUITY FUND

Quarterly Portfolio Manager Commentary

CORONATION

TRUST IS EARNED™

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

The Fund returned 7.2% for the quarter, resulting in a return of 22.1% over the last year. The Fund has performed well against its peer group over all meaningful time periods.

It was another strong year for global markets as the MSCI All Country World Index ended the year up 19% in USD. Markets shrugged off the rise in infections caused by the Omicron variant to deliver a 7% rise in the fourth quarter (Q4-21), including 4% in December.

Emerging markets performed poorly, with the MSCI Emerging markets (EM) Index declining -3% in USD. This was materially impacted by China, where government regulation of the economy has become increasingly intrusive and capricious. While the risks are high, Chinese technology stocks trade at extremely attractive valuations. The Fund is exposed to China through both its global equity allocation as well as its domestic equity allocation where it holds Naspers/Prosus and commodity stocks.

The Fund's allocation to global equities has bolstered both returns and risk management over the longer term. However, performance was disappointing in this calendar year as a consequence of the Fund's holding in selected Chinese stocks and its holding in several high-quality, growth companies that sold off late in the year as part of a market rotation from growth into value. We view these holdings as very cheap and believe they offer an attractive risk-reward profile.

The largest Chinese investment among the global holdings is JD.com, which we believe to be an extremely well-positioned company. JD.com has responsible social practices and has consistently invested in distribution to widen services into Tier 2 and 3 cities. It also is a meaningful beneficiary of industry regulation that will prohibit many of the anti-competitive practises pursued by Alibaba over the years. We expect the business to grow strongly, with expanding margins and strong free cash flow generation. We spoke earlier in 2021 about the Fund's investment in Auto 1. Like many long duration growth stocks that retreated during last year in the face of rising global interest rates, Auto 1's share price performance thus far has been disappointing. However, we continue to believe in the intrinsics of the business model. Auto 1 has a cost-efficient direct-from-consumer sourcing model, superior transactional pricing data, and a growing retail business. We expect this to deliver sustained market share gains for many years from a fragmented used car retail industry. We added to the position during the quarter.

The South African (SA) economy is recovering after the deep recession of 2020. The economy is forecast to return to its pre-Covid levels in 2022, a year earlier than previously expected. This better economic performance, combined with improved governance and a commitment to fiscal sustainability, should be sufficient for SA to navigate its fiscal challenges for the next few years. The improved fiscal situation was reflected in the upgrade by Fitch Ratings of SA's credit rating outlook from negative to stable. Longer term, economic growth remains critical to avoid a debt trap. Challenges include unstable power supply, structurally high unemployment, a poor education system, declining productivity, and slow policy reform. High levels of social inequality and unemployment came to the fore in Q3-21 with the outbreak of looting across KwaZulu-Natal. The rand declined -8.5% against the USD for the year (-5.8% for Q4-21).

Like global markets, local markets ended the year strongly, with the JSE Capped SWIX Index delivering 9% in rands in Q4-21 to end the year up 27%. We believe SA equities are cheap, given the breadth of value across sectors, including resources, global stocks that are locally listed and domestic shares. There was broad strength, with the resource sector delivering 32% for the year (22% for the quarter), financials 30% (3% for the quarter) and industrials 26% (16% for the quarter) despite the pressure on major constituent Naspers (-18% for the year and -1% for the quarter).

Within the resources sector, holdings in the diversified miners (Glencore +80% for the year and Anglo American +46% for the year) have contributed strongly to performance over the past few years. Strong demand, driven by recovering economies and decarbonisation, along with disciplined capital expenditure have supported tight markets. The diversified miners continue to offer good value with low multiples and solid free cash flow generation. During the year, proceeds from the PGM shares were recycled into gold equities (AngloGold and Goldfields) which offer upside and reasonably priced protection against stretched sovereign balance sheets and the risk of structurally higher inflation. Both have improved their production profiles and geographic diversification. We anticipate a period of increased returns to shareholders under their new leadership teams.

The Fund has meaningful exposure to several global businesses that are listed in SA. These include Naspers (-18% for the year, -1% for the quarter)/Prosus (-18% for the year, +9% for the quarter), British American Tobacco (+16% for the year, +13% for the quarter), Bidcorp (+26% for the year, +2% for the quarter), Quilter (+6% for the year, +9% for the quarter), Textainer (+103% for the year, +8% for the quarter) and Aspen (+81% for the year, -17% for the quarter). Aspen is negotiating a potentially accretive disposal of its API business and a vaccine licensing deal from J&J to supply the African Union. The weaker fourth quarter return from Aspen reflects high expectations at the onset.

The Fund has a considerable holding in Naspers/Prosus that we believe to be materially undervalued. This is because of the low value being attributed directly to Tencent and the discounts which exist at the holding company level. The investment risk has increased with China's regulatory interventions and the threat to foreign capital. Thus far, regulations affecting technology companies are broadly consistent with what we see elsewhere, covering fintech, Antitrust law, data security, and gig employee labour protection. Tencent is a formidable company that generates good free cash flows, has a very engaged user base and is growing businesses across multiple verticals. None of the restrictions thus far are expected to meaningfully change Tencent's prospects. An investment in Naspers/Prosus offers a cheap entry point to Tencent and provides access to an attractive investment portfolio.

Disappointingly, the Fund sold down its investment in MTN (+184% for the year, +21% for the quarter) too early. Whilst we were believers in the operational turnaround, we were very concerned about the outlook for the Nigerian economy and the regulatory risk within Nigerian Telecoms. Improved stakeholder relations and the likely conclusion of a mobile money licence in Nigeria support future earnings growth, and we have re-established a holding in the company.

Domestic companies continued to report results ahead of our expectations throughout 2021 due to more resilient economic activity and stringent cost control. We believe attractive stock picking opportunities exist either from businesses with specific opportunities like Dis-Chem (+71% for the year, +20% for the quarter), RMI (+43% for the year, +21% for the quarter) or Transaction Capital (+83% for the year) or even in more mature industries like banking or food retail where those with strong franchises that have continued to invest should benefit from share gain. Shoprite (+54% for the year, +17% for the quarter) demonstrated this during the fourth quarter by surprising the market with the strength of their sales growth. This is a management team that has invested behind their business, building distribution centre capacity, updating systems and embracing digitisation. Their progress in building out a data-driven business built around the consumer is impressive.

RMI has been restructuring to create a focused property and casualty insurance company. The restructuring initially announced should unlock shareholder value as the unbundling of holdings in MMI and Discovery reduces the conglomerate discount and improves investor focus on the underlying assets (specifically OUTsurance). OUTsurance is a quality business that we expect to deliver double-digit earnings growth while generating high returns. The attractiveness of the restructuring proposal was increased during the quarter when RMI received a generous offer for their stake in Hastings. The resultant cash inflow and associated degearing will enable RMI to avoid the rights issue required to achieve the initial unbundling and improve the dividend flowthrough from the very cash generative OUTsurance business. Despite the share price moves during the quarter, this remains an attractive investment with the core OUTsurance asset trading at a low look-through multiple relative to its high-quality nature and strong growth prospects, particularly in Australia.

Whilst headwinds exist in both global markets and the domestic economy, we believe domestic assets are well priced for the risks and should offer attractive returns off these low starting prices.

Portfolio managers
Karl Leinberger and Sarah-Jane Alexander
as at 31 December 2021