CORONATION
TRUST IS EARNED™

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

For the first half of 2021, the Fund has returned 12.4% against the benchmark return of 13.5%. We always strive to manage the Fund with a long-term time horizon in mind. Alpha since inception has been 3.6% per annum, net of fees.

For the quarter, the Fund benefited from being overweight certain SA Inc holdings such as Nedbank and Momentum Metropolitan. At a portfolio level, being underweight SA Inc detracted. Naspers also detracted from performance.

On the domestic front, news flow has (for once!) been meaningfully positive. The political reform agenda is gathering pace. We have seen senior politicians side lined and former president Jacob Zuma found guilty of contempt of court and facing possible jail time.

Tied to the above, meaningful economic reform has been announced that seemed so unlikely only a short time ago, given the ideological barriers being crossed. President Cyril Ramaphosa's announcement lifting the threshold for companies to produce their own electricity without a licence to 100MW has the potential to materially transform power generation in a relatively short space of time and help with crippling loadshedding.

The sale of SAA to a consortium run by the former CEO of Comair, should it conclude, is a positive. This will see a reduced call on the fiscus going forward, with Telkom serving as a good example of a company run well in private hands with limited government interference.

High commodity prices provide a tailwind to revenue collection, which will, in turn, assist with public sector wage austerity and help deal with our high government debt levels.

All of these factors drove up the share prices of SA Inc assets over the quarter. We were net buyers of SA Inc shares over the quarter, increasing our exposure to Sanlam and the banks. Given the strong turnaround in the banking sector operating performances and yet the poor performance in their share prices, we increased our exposure to the sector. Given our meaningful positions in Nedbank and Standard Bank, we chose to increase the exposure through a new position in FirstRand.

We are still not overweight SA as we do see the need to temper some of the SA Inc enthusiasm. The slow pace of our vaccine rollout puts us at a disadvantage compared to other nations, who are seeing returns to normalisation and a more meaningful economic rebound. SA has large tourism, leisure and hospitality sectors, which employ many workers. These sectors remain depressed with a long, drawn-out recovery ahead.

SA also faces numerous structural challenges, many long-term in nature. Failing infrastructure and failing municipalities remain a challenge. High unemployment and dismal schooling outcomes both require high growth rates and a long time frame to fix. While the reform news has been positive, the pace remains slow given the magnitude of the country's challenges.

As always, we seek to build portfolios that can withstand a range of outcomes. Our SA Inc holdings sit alongside great global businesses, growing strongly at attractive valuations; and mining shares, which also have attractive valuations and material free cash flow yields.

On the commodity front, recent news flow has been dominated by the Chinese government's attempts to cool commodity prices. High iron ore, steel and coal prices benefit producers of those minerals but lead to inflation and other imbalances that China is attempting to manage. The two main levers they have used is to a) talk down commodity prices by cracking down on "excessive" financial speculation in commodity markets and b) sell strategic stockpiles of certain metals. Prices of most metals and minerals have corrected over the quarter, suggesting they have had some success. On point a) Our views are that the financial speculation introduces price noise, with prices overshooting and undershooting "the real price", i.e. the one set by underlying supply and demand factors. To this end, demand has remained robust (if slowing a bit off a strong base), and supply discipline remains intact. As such, we expect China's attempts to show only moderate and short-term success. To truly cool prices, China would need to demand fewer metals and minerals. This requires lower growth, with growth being sacrosanct to the Chinese government. On point b) stockpile sales have been small. Ultimately, they would need to be replaced in future, resulting in "excess" demand then.

Despite the fact that we view commodity prices as high, we don't view the share prices as high. The market has taken quite a sceptical approach to this cycle, with share prices lagging commodity prices, resulting in shares trading on undemanding multiples. Put differently, the share prices are discounting commodity prices well below spot (and in many cases below of our base case for where they settle). Supply discipline and generous free cash flow yields add to the appeal of the investment cases.

Our diversified mining positioning remains anchored by Anglo American (good assets in good commodities, good cost position, good volume growth), Exxaro (extremely cheap, limited investment in thermal coal supply should support prices) and Glencore (improving ESG, good commodities exposed to decarbonisation). During the quarter, we rotated some of our Exxaro position into Glencore. We approve of Glencore's stance to manage and responsibly run down its coal assets over time. This is in contrast to Anglo American's stance to spin off their SA coal assets (which we voted against) as more thermal coal will be produced by Thungela than would have been produced had Anglo American elected to retain the assets.

We continued adding to our gold position. We view gold as cheap insurance in a time of heightened risk and find valuations compelling. We had long seen gold equities trade at multiples of NPV. We now see them at discounts using spot prices and see upside risks to the gold price.

Naspers declined more than 15% over the last quarter. This decline followed a strong run in Q1, which left Naspers flat for the first six months of the year. Two factors have been the dominant contributors to this underperformance; the first is the Naspers/Prosus share swap announced in May and the second the Chinese authorities putting in place tighter controls on technology firms when it comes to deemed monopolistic behaviour and data security. There is a concern in the market that the Naspers/Prosus share swap creates added complexity and may orphan the Naspers asset. We believe that it will not be the final iteration and that, down the line, more steps will be taken specifically to unlock the discount at the Naspers level should it persist.

While there has been no direct action by the Chinese regulators on Tencent, some subsidiary companies have been reviewed, and the risk remains that, at some point, Tencent receives similar attention. We do not dismiss this risk but believe that the impact on Tencent's three key business verticals is unlikely to materially reduce the asset's long-term value, especially when bought at a large discount through Naspers/Prosus. In the gaming business, the Chinese government has already tightened regulations, and Tencent are compliant; they also have a strong international component to this business. Stringent consumer data protection within Weixin and the open nature of this platform reduce the likelihood that the advertising business is targeted. We see the risk of regulatory intervention as highest in the fintech business; here, we gain comfort that payments, which carry a lower regulatory risk than other financial products, make up 70% of the business and the non-payments business is in line with new regulation. There is a lot of uncertainty, but our analysis leads us to believe that Tencent is on the right side of the regulatory bodies.

We remain encouraged by the risk-adjusted opportunities we see and the upside potential in the Fund. The current upside remains high relative to history and suggests compelling future returns from the portfolio.

Portfolio managers
Neville Chester and Nicholas Stein
as at 30 June 2021