CORONATION GLOBAL EQUITY SELECT [ZAR] FEEDER FUND

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Quarterly Portfolio Manager Commentary

Please note that the commentary is for the US dollar retail class of the Fund. The feeder Fund is 100% invested in the underlying US dollar Fund. However, given small valuation, trading and translation differences for the two Funds, investors should expect differences in returns in the short term. Over the long term, we aim to achieve the same outcome in US dollar terms for both Funds.

Equity markets posted solid gains in the first quarter, returning 4.6%, and now sit well above pre-Covid levels. While we don't spend any time trying to predict short-term market moves, recent volatility (both up and down) and violent "factor rotations" have whipsawed many investors and provided a real-life stress test of equity portfolios. For a team that strives for continual learning and acknowledges that there is always room for improvement, portfolio results both recently and over more meaningful periods show a strategy that is forging ahead and making solid progress. For the quarter, the Fund gained 6.2% (1.6% ahead of the benchmark); over the last year the Fund gained 56.63% (2.0% ahead); over three years the Fund is 0.4% p.a. ahead and over five years the Fund return of 12.9% p.a., is 1.2% in line with the benchmark.

The Fund has held a position in Porsche for many years, during which time it has performed broadly in line with the market. In January, we re-visited the investment case for Porsche, whose primary asset is a 53% holding in VW common stock. The key conclusions were:

a) VW is not as bad a business as the market would have you think. It was trading on 7 times earnings, which is one-third of the market multiple despite growing its market cap four times in 20 years, earnings by 8% p.a. for over 10 years, and delivering an expected ROCE (return on capital employed) of 10-13%.
b) Porsche did not deserve to be trading at a further 35% discount to the value of its stake in VW.
c) Earnings are reasonable quality, with the business converting 70-90% of earnings into free cash flow (FCF), implying that Porsche, was trading north of a 20% FCF yield on a look-through basis.
d) The transition to EVs (electric vehicles) is more an opportunity than a threat to VW. (It ended 2020 with a BEV (battery electric vehicles) market share of 11% already, which is rapidly growing and on track to exceed its 13-14% share of traditional ICE [internal combustion engine] vehicles.)
e) Any form of sum of the parts analysis, which more accurately valued VW's luxury brands (which include Lamborghini, Bugatti, Bentley and Porsche itself), showed that VW (and therefore Porsche) were massively undervalued.
f) The balance sheet is again solid with year-end net cash coming in at €28 billion.

Our financial forecasts implied the stock was worth double where it was trading and could generate an IRR (internal rate of return) above 20% p.a. Very unusually, we didn't have long to wait for some of this discount to narrow, as Porsche appreciated by circa 60% over the rest of the quarter. It was a top contributor to Fund returns.

Another top contributor for the quarter and last twelve months was Schwab, the largest e-broker in the US with $6.9 trillion in client assets ($4 trillion before the TD Ameritrade Ameritrade acquisition discussed below) in a market of $45 trillion retail assets. It provides brokerage, custodian, advice and asset management services. In 2019, Schwab earned about 60% of revenue from interest on client cash held on its balance sheet in high-quality assets, just under a third from fees on client assets invested in various asset classes and the remainder from commissions.

In late 2019, Schwab cut its trading commissions to zero, and the US e-brokers subsequently sold off given the near-term impact on industry revenues. Soon after, Schwab made an offer to buy its largest competitor, TD Ameritrade.

In the first quarter of 2020, interest rates declined and markets plummeted, causing Schwab to drop over 35%. Our view was that the market was not discounting the propensity for clients to increase their cash balances during a market selloff (which would provide a buffer to the interest rate impact as net interest income is dependent on both the cash balances and the rate), the likelihood of an increase in yields, nor was sufficient value being ascribed to the synergies of the Ameritrade deal ($1.9 billion cost synergies on a base of $5.9 billion in revenue for Ameritrade in 2019, the ability to bring more of Ameritrade's cash onto its balance sheet and the ability to cross-sell more of Schwab's more comprehensive services to Ameritrade clients).

In hindsight, the commission fee cut was a masterstroke from Schwab, allowing it to acquire a competitor, TD Ameritrade at a discounted price.

More recently, interest rates have started to increase and conviction around Schwab's synergy delivery has increased. The stock has doubled from levels seen in April to September last year.

We have written about our cable holdings, Charter Communications (Charter) and Altice USA, in previous commentaries. Both were detractors in the first quarter. However, both are top contributors over more meaningful time periods (three to five years). This is often how it goes for long-term investors: we believe it is highly unusual for stocks to go up in a straight line, periods of underperformance are almost inevitable in the hunt for long-term outperformance, and an investment thesis is likely to be tested many times over a multi-year holding period.

Cable's primary product, the provision of high-speed broadband internet in the United States, took centre stage in 2020 as large parts of the population were forced to work, learn and entertain themselves at home and online virtually overnight. Both companies performed strongly, with Charter growing its internet subscriber base by 9% and Altice by 4% on a year-over-year basis.

Both stocks have since taken a breather due to several factors, none of which we are particularly concerned about. Firstly, we acknowledge that there was likely some pull forward of subscriber growth into 2020 and that these results are unlikely to be repeated in 2021. Secondly, there has been increased noise from mobile operators launching 5G home broadband plans. And lastly, the Biden administration has made announcements relevant to cable. Addressing the first point, we have strong conviction that demand for high-speed internet will continue to increase as data consumption grows rapidly each year. This structural tailwind is supplemented in the nearer term by various stimulus measures that will directly assist lower income households with their monthly broadband bills. And cable continues to be the internet provider of choice. Charter's average broadband subscriber now consumes 700GB of data per month (on a per home basis) and this continues to grow. Capacity-constrained mobile networks, where the average unlimited user consumes 10-15GB per month, are unable to compete in our view. Lastly, Biden's infrastructure plan should provide growth opportunities for cable in previously unserved rural areas, while we view the risk of price regulation as low. Higher corporate US tax rates are factored into our forecasts.

We find the valuations of both our cable holdings extremely attractive in both relative and absolute terms and we continue to expect strong growth in FCF over the coming years based on healthy revenue growth, steadily expanding margins and capex declining to normalised levels. Both also have excellent, shareholder-friendly management teams as evidenced by Altice repurchasing a massive 25% of shares outstanding over the course of 2020.

As we wrote last quarter, we still see ample opportunities for stock pickers and we continue to hold a balanced portfolio of competitively advantaged businesses.

Thank you for your continued support and interest in the Fund.

Portfolio managers
Neil Padoa and Humaira Survé
as at 31 March 2021