CORONATION BALANCED PLUS FUND

Quarterly Portfolio Manager Commentary

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

The Fund returned -1.3% for the quarter, resulting in a return of 10.1% over the last year. The Fund's significant exposure to local equity has contributed to performance over the year. The Fund has performed well against its peer group over all meaningful time periods.

Russia's unexpected invasion of Ukraine weighed heavily on markets during the quarter. Commodity prices soared, given Russia's role as a meaningful commodity producer. Expectations for global growth slowed, given rising energy prices, rising interest rates and slowing growth in China.

The MSCI World Index declined -5% for the quarter (dragging 12-month returns down to 10%). The MSCI Emerging Markets [EM] Index declined -7%, with China falling -14%. Given the size of the Chinese economy, a serious slowdown remains a risk to the global economy. China's zero-Covid policy is becoming impossible to sustain, with ongoing lockdowns undermining growth. China's geopolitical ambitions and its association with Russia damaged sentiment further. The MSCI removed Russia from the EM Index, writing its value down to near zero (-100%). South Africa (SA) performed well, with currency strength (ZARUSD +9%) boosting US dollar returns to 16% (as measured by the FTSE/JSE Capped SWIX in US dollars). The Fund has trimmed its overweight position in local equities to buy global equities, reducing a previously underweight position.

Events in Russia further exacerbated the trend of rising inflation, with a dramatic impact on energy costs (brent crude +39% for the quarter and +70% over 12 months) and food expected to put consumer disposable income under pressure. Rising inflation has resulted in a round of interest rate hikes by central banks as seen in the US and UK (and SA) during March. The Fund remains cautious on global bonds given rising inflation, slowing global growth and insufficient yields. The Bloomberg Barclays Global Aggregate Bond Index declined -6% in US dollars.

Higher commodity prices are benefiting the domestic economy as the additional revenues help to stabilise the debt burden. This improvement was reflected in Moody's upgrade in its outlook for SA debt from negative to stable. The Fund has retained its meaningful exposure to local bonds which offer attractive yields, both in absolute terms and relative to alternatives such as cash. The JSE All Bond Index delivered a return of 1.9% for the quarter.

While domestically there are signs of positive policy reform (the completion of the spectrum auction and Transnet inviting private sector bids to operate freight networks), the local economy remains weak. A decade of mismanagement has undermined infrastructure, with power and rail capacity in particular constraining the economy. These challenges, combined with a poor education system (which undermines labour productivity), continue to pose structural headwinds to growth.

However, given the many global headwinds, SA is relatively well positioned given its commodity basket. This, combined with low starting expectations and undemanding valuations, supported strong returns from SA equities for the quarter, with the FTSE/JSE Capped SWIX Index delivering 7% in rands. The Fund benefited from its overweight position in SA equity.

Quarterly performance across the sectors was divergent, with resources (+19%) and financials (+20%) strongly outperforming industrials (-13%).

The resource sector was up strongly as Russia's invasion of Ukraine resulted in a risk/scarcity premium being priced in across almost the entire commodity spectrum. Commodity markets were already tight entering 2022, but Russia's significant role in supplying a number of these markets has created further pressure. Russia is a key producer of palladium (27% of the global total), natural gas (19%), metallurgical coal (17%), crude oil (10%) and thermal coal (9%). Developments in this period will have outsized consequences for energy markets for many years to come.

As would be expected, energy producers benefited sharply during the quarter, with Thungela (+118%), Exxaro (+45%) and Sasol (+37%) all up meaningfully. Holdings in the diversified miners (Glencore +18% for the quarter and Anglo American +22% for the quarter) have contributed strongly to performance over the past few years. While they remain sizeable holdings, position sizes have been cut given the ongoing strength and subsequent reduction in the margin of safety.

The heightened uncertainty during the quarter also buoyed the gold equities and the Fund took the chance to trim these holdings during the period. Goldfields and AngloGold ended the quarter, up 32% and 7% respectively.

The Fund is underweight the platinum group metals miners. While near-term cash flows are expected to be strong, longer-term demand is expected to be undermined
by a shift to electric vehicles. Governments (particularly European) are expected to accelerate battery electric vehicles adoption given recent events as they strive to increase energy independence and reduce reliance on Russian oil and palladium.

The financials index returned 20% for the quarter, driven by a strong performance from the banks (+25%) and life insurers (+17%). The four domestic banks that reported during March all showed a strong recovery in pre-provisioning operating profit to a level matching or exceeding their pre-Covid levels. This was aided by a faster-than-expected recovery in the economy and good cost control. Rising interest rates should support future earnings. Holdings in RMI (+73% over 12 months, +16% for the quarter) and Transaction Capital (TCP) (+10%) have contributed to the Fund over their holding period. RMI continued its journey to simplify its structure, unveiling the value inherent in OUTsurance – a fast growing insurer with the ability to pay out the bulk of its earnings. Despite the RMI share price moves (+73% over 12 months, +15.5% for the quarter), it remains an attractive investment. The core OUTsurance asset trades at a low look-through multiple relative to its high-quality nature and strong growth prospects, particularly in Australia. We expect TCP's WeBuyCars business to continue to gain market share given its convenient and trusted consumer offer.

Industrials declined -13% for the quarter given the decline in its major constituent (Naspers -33% and Prosus -39% for the three-month period). Naspers and Prosus continue to be battered by negative sentiment towards China and the increased intensity of regulatory intervention. Despite the increased risk, we believe the shares are pricing in a conservative outcome. Tencent is a formidable company that generates good free cash flows, has a very engaged user base and is growing businesses across multiple verticals. An investment in Naspers/Prosus offers an extremely discounted entry point to Tencent.

Our portfolio has meaningful exposure to several global businesses listed in SA that we believe offer considerable value. In addition to Naspers/Prosus, examples include British American Tobacco, Bidcorp and Quilter. These counters generally lagged resource/domestic counters during the period as global markets sold off. We used the weakness in its share price to build our holding in Richemont. Richemont has a portfolio of highly desirable luxury brands across the jewellery and watch sector, with branded jewellery expected to continue growing strongly.

In keeping with a trend consistent through 2021, domestic companies continued to report results ahead of our expectations given a more resilient economy and stringent cost-cutting. Our emphasis has been on finding businesses that can prosper even in a low growth economy. For example, a business such as Shoprite has continued to invest behind its franchise and is growing revenues by gaining share in a competitive, low growth economy.

The portfolio has moderate property exposure, preferring to use its risk budget in equities and bonds. While the sector performed strongly during 2021 (+37%) it is still negative (-7% p.a.) over three years. Holdings are predominantly in the A shares, with some exposure to logistics assets. The medium-term outlook remains subdued as a weak economy and a structural shift in demand from increasing digital engagement and work from home trends undermine rental tension.

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

Portfolio managers
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as at 31 March 2022