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

Performance

The Fund returned 0.7% for the quarter, bringing the year-to-date return to 5.1%. This compares to a benchmark return of 8.7%. Since inception, the Fund has generated an annualised return of 10.5%, 1% ahead of the benchmark.

The performance of global investment markets in the past quarter has been dominated by the growing realisation that the US Federal Reserve Board intends to leave policy rates higher for longer. While the US economy continued to exhibit resilience and inflation moderated, expectations of a soft landing began to build. Stubbornly high rates may threaten this. This, along with concerns about weak growth in China and fragility in its property sector in particular, has been reflected in asset prices. Some of the strong gains achieved in the first half of the year have been returned, but despite this, the MSCI World Index has generated an 11.1% USD return in the first nine months of the year.

In contrast, domestic assets have been dismal. Year to date, the FTSE/JSE Capped SWIX Index is essentially flat, listed property is down -4.5%, the FTSE/JSE All Bond Index has delivered a meagre 1.5%, and the rand has weakened 10% against the dollar. These returns are, in part, a reflection of the attractive yields on offer in developed markets. But equally, they are all a reflection of increasingly evident inhibitors to growth in the South African economy, the weakening commodity cycle and the fiscal pressure that results. National Treasury has communicated the need for budgetary restraint but appears increasingly isolated. The likelihood of any meaningful belt-tightening actually coming to pass seems low – particularly in an election year when policies such as the introduction of National Health Insurance and an extension of the Social Relief of Distress grant are likely to be central to an ANC campaign.

In the third quarter, the financial index returned 2.2%. Short-term insurers were the principal contributor, returning 20.1%, with life insurers up 3.9% and banks (by far the largest constituent in the index) up 1.6%. Contributions to quarterly performance relative to the benchmark came from overweight positions in OUTsurance, Standard Bank and Sanlam, and underweight positions in Old Mutual and Remgro. The largest detractors from performance came from overweight positions in St James' Place, Nedbank and FirstRand, and underweight positions in Capitec and Absa. Over one and three years, Transaction Capital remains the largest detractor from Fund performance. At its peak, it made up 2.4% of the Fund. Given the collapse in the share price, it currently makes up 0.4% of the Fund. We see significant value in the share but are cognisant that the path to realising this comes with greater than the average variability of potential outcomes.

Portfolio actions and positioning

During the quarter, we increased the Fund's holdings in Reinet, FirstRand, Investec, OUTsurance and St James' Place and made small reductions to holdings in Capitec and Quilter.

Both banks and insurers reported financial results to end-June. The endowment benefit of higher interest rates was evident in the banks' net interest margins which, combined with trading gains from those with operations in the rest of Africa, resulted in strong revenue growth. Some of this benefit was offset by an increase in credit losses as rising pressure on consumer disposable income began to bite. The second half of the year should see some continued endowment benefit but a stabilisation of the credit performance.

Life insurers reported improved investment returns and a strong recovery in operational earnings as mortality claims normalised following the elevated levels experienced during the Covid pandemic. However, the challenging economic environment is evident in high lapsation levels, particularly in the mass market. In addition, new business volumes are increasingly under pressure in the affluent market placing pressure on new business margins. We expect the industry to continue to face volume challenges as banks target the funeral and simple life cover markets.

FirstRand is the Fund's largest holding and one of the largest overweight positions relative to the benchmark. The company has recently announced significant changes in its leadership structure, with the chairman, group CEO and CFO, and the CEO of the retail and commercial bank (FNB) all vacating their roles. Usually, an announcement like this would be a cause for concern. In the case of FirstRand, we take a different view. While the timing of the changes is slightly earlier than we may have expected, this is evidence of regular, thought-out succession planning and showcases the bench strength within the business. The COO will move to the CEO role, and no executive skills will be lost to the group, except the group CEO (who is retiring). The incoming chair is a highly rated previous CEO of the group, available to support the incoming CEO should this be necessary. Importantly, the CEO of FNB will be redeployed internally to head up the group's fintech strategy. FirstRand is already an established leader in digital strategies in the domestic banking sector. We would view a dedicated focus on this part of the business by an individual of this calibre in a positive light, given the changing nature of retail banking globally and the growth challenges faced by domestic-facing businesses in a low-growth economy.

Outlook

South Africa faces the challenges of a weakening commodity cycle and increasingly evident infrastructural constraints (power, rail, roads, water), which are likely to place even greater pressure on economic growth and social stability. We are of the view that it is the higher quality domestic businesses that will be able to navigate a low-growth economy successfully by taking market share from peers. These businesses may not be the cheapest in their respective sectors, but nonetheless trade at relatively undemanding multiples and feature strongly in the portfolio. They are supplemented by companies that have exposure to markets with stronger fundamentals where we see attractive growth opportunities.

Portfolio managers
Neill Young and Godwill Chahwahwa
as at 30 September 2023