



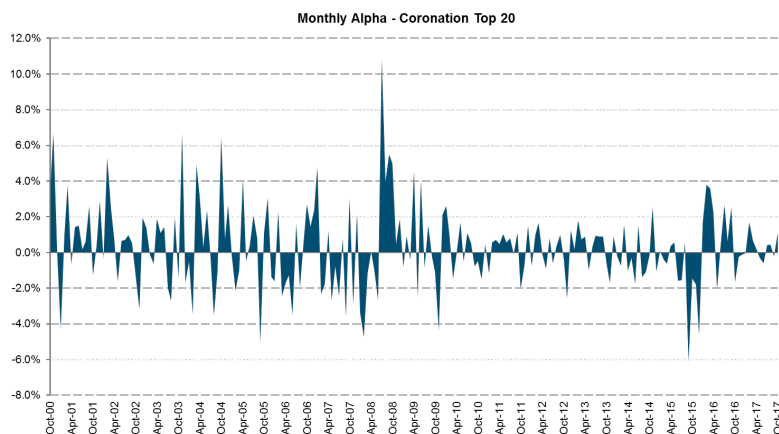
### OUR INVESTMENT PHILOSOPHY

Coronation's key advantage is our commitment to long-term investing. When valuing businesses, we think five or 10 years out. By remaining focused on what businesses are worth through the cycle rather than just the current and next set of results, we have added significant value to our client portfolios over time. However, thinking and acting long-term is much harder than it sounds as it often leads to portfolios that are very different to what conventional wisdom dictates. Further, it cannot be achieved without the support of a dedicated research team that applies a bullet-proof process, underpinned by a valuation-driven approach. It also helps if you have understanding clients!

Very few market participants have the willingness or ability to make this commitment. Typical stockbroker research is focused on the short-term, and often driven by news flow of the day (e.g. company results). If this is your core input, it would be difficult – if not impossible – to make good long-term decisions. Examples of such decisions over the past decade include:

- selling construction and basic material stocks in 2007;
- loading up on equity in 2009 during the global financial crisis; and
- buying resources in 2015.

When you build portfolios that consist of long-term views such as the above, you will end up with significant volatility in the short term as illustrated by the monthly alpha (positive or negative) of the Coronation Top 20 fund since its inception in May 2000.



Source: Coronation

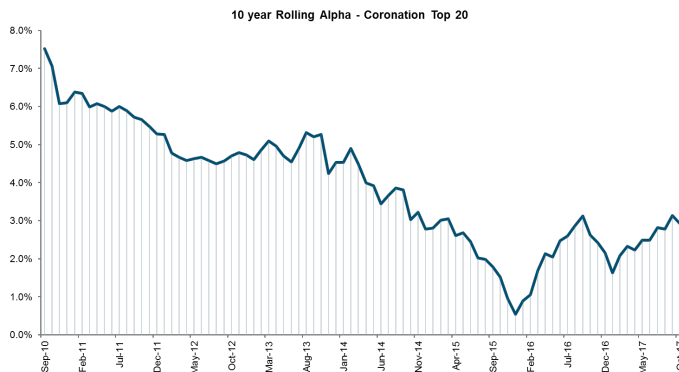
# EXECUTIVE SUMMARY

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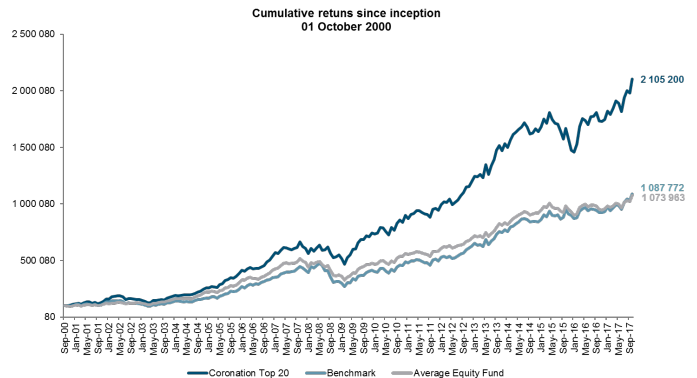
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However, for investors who are completely aligned with our long-term approach, the picture looks vastly different. If you consider the fund's rolling 10-year alpha, it has been consistently positive since launch. Further, that 10-year alpha resulted in significant outperformance relative to the fund's benchmark as well as the average equity fund in South Africa.



Source: Coronation



### ACTIVE MANAGEMENT – WE'VE GOT A GOOD STORY TO TELL

The prior cumulative return graph is a powerful illustration of the merits of active investing, specifically in the South African market. However, there is a lot of noise - typically coming from the proponents of passive investing - about the 'pitfalls' of active investing. Some of the sweeping statements include that all active managers underperform their benchmarks; active fees take half of your returns; active is a zero-sum game; and given that there are too many active funds to choose from, it's far simpler just to invest in a passive product. Below we provide a little more context to each of these statements.

- *All active managers underperform*

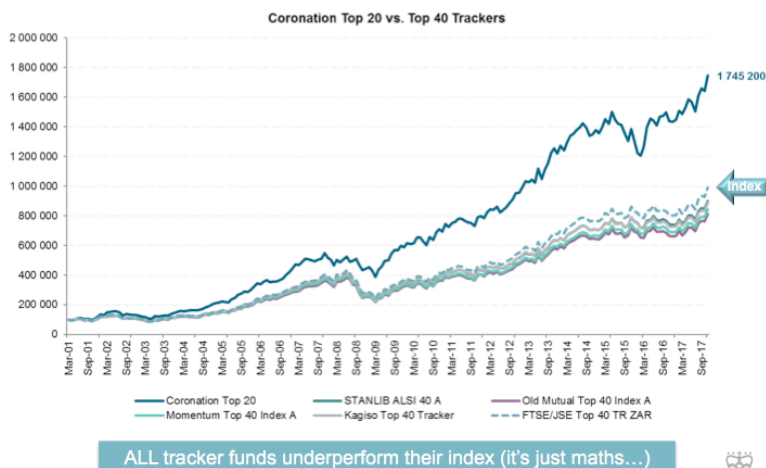
While actively managed funds will go through periods of underperformance (at Coronation we expect to underperform in one out of every three years), every single passive fund will always underperform the index it is designed to track. That is a simple mathematical fact. When you are tracking an index and charging a fee (passive products still charge a fee) as well as incurring transaction costs (as these products constantly need to rebalance against an index) you *will* end up underperforming the index (see graph below).

In turn, if you compare Coronation Top 20 to these index funds, it has outperformed every single one over the long term; whether it is the Satrix 40, the SWIX Top 40, the Satrix Divi Plus or even the smart beta Satrix Rafi 40 (all index funds with longer-term track records).

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- Active fees take half your return

Compounding costs without the benefit of an additional return (alpha) *will* have a significant effect on your final investment value. Equally, compounding alpha over time *will* result in a significant uplift in your final capital value. And this is what often gets lost in the argument about the reason investors need to opt for funds that charge lower fees.

As an example, over its 17-year lifespan Coronation Top 20 has *doubled* investors' capital (after the deduction of all fees and costs). In the current environment of low returns, and where people are battling to retire with sufficient funds to sustain them through their golden years, one cannot ignore the opportunities created by good active management.

- Active investing is a zero-sum game

The zero-sum game theory goes that each market participant's gain/loss is balanced by the gain/loss of the other participants. It therefore follows that one active manager's outperformance will always be balanced by another's underperformance. But this argument presupposes that every participant in the market is an active manager, which is not the case. In fact, less than 20% of the JSE's market cap is under the management of long-term active managers on behalf of unit trusts and retirement funds. Foreign investors, with very different biases and objectives, make up 40% of the JSE. There are also day traders, stockbrokers and other speculative investors with very different time horizons. Further, the market also consists of many passive index trackers, strategic shareholders, developmental shareholders and family shareholdings. The market therefore does not just simply add up to a number of active managers competing against one another. Given this market structure, we believe that it is possible for disciplined active managers to consistently deliver alpha over the longer term.



- *There is no such thing as passive*

The argument of 'just buy passive' is no longer true. In South Africa, there are 57 different equity tracker funds and ETFs tracking 32 different equity indices, making it increasingly confusing to know which index to choose as each will give you very different exposure. Investors do not always think about what is inside the tin when they invest in passive products: some are tech heavy, others resource heavy, or have a bias towards shares held by foreign investors. Importantly, these biases are implicit (active) views you take when buying any one of these products.

Fortunately, South African investors are smart enough to have recognised that of the 222 actively managed equity unit trusts with more than a 100 different managers available only a few have delivered consistent alpha over time. As such, 80% of these assets are managed by the top 10 managers. So whenever the passive camp argues that 50% of active money underperforms the market, that statistic merely reflects the number of underperforming funds, and not the percentage of assets, the bulk of which is invested in those active long-term managers who have managed to outperform over time.

As active managers, we normally focus on explaining our value proposition, rather than emphasising the 'pitfalls' in competing strategies. However, we think there are important perspectives on passive investing that should be highlighted:

- Multi-asset funds are not passive – you are always making active decisions

Investors are increasingly pushed into passively-managed multi-asset funds. We don't believe the sales pitch for these products is completely transparent. When investing in any multi-asset fund, you still need to choose whether or not to invest in a high-equity, medium-equity, or low-equity multi-asset fund. Further, within the fund there will be asset allocation decision-making taking place. And both of these are active decisions, not passive.

- Passive fails terribly in certain asset classes such as bonds

Cap-weighted indexing does not work well in a global bond index fund. The main problem is that a greater amount of your investment will ultimately get steered towards overly indebted countries such as Italy and Japan (two of the most indebted countries in the world today) as opposed to fiscally prudent countries that does not have a lot of bonds in issue (e.g. Germany).

- Passive works better in highly-efficient markets, less so in inefficient markets

Passive investing works well in big diversified equity markets such as the US. In emerging markets, however, this is not the case due to high concentration in a few dominant shares, weaker sector diversification and other market inefficiencies. An increasing amount of research is pointing to the merits of active investing in emerging markets.

In our view, buying something that is cheaper doesn't necessarily mean that you are getting something better. It is the net result that counts.



### TOP 20 – FAIR FEES IN ACTION

We believe that a well-structured performance fee can be in the best interests of your client.

The level of the fee we charge for managing Coronation Top 20 has always been linked to the investment growth we deliver. When the fund produces returns in line with the equity market, we charge a below-average fee. In periods where we add significant value, the fee is increased in proportion to the level of outperformance produced (up to a capped level). If we fail to beat the market index, even by 0.01%, we reduce the fund's fee by 0.5%. This means you only pay a higher fee when your investment has outperformed the market. When it doesn't, the fund charges a fee that is better than most passive options.

Further, we measure outperformance over rolling two-year periods, while we measure underperformance over rolling five-year periods. This means that we keep good past performance in our performance fee calculation for a much shorter period of time than we carry bad past performance. This methodology makes the fee structure asymmetrical in our clients' favour, which is rather unusual in the world of investments.

### ECONOMIC AND MARKET OUTLOOK

The world is generally in a much better shape. Ten years after the global financial crisis, we are seeing a slow and steady synchronised recovery. Europe has arguably been the biggest surprise this year. We've seen consistent growth out of Germany, surprising growth out of France and a continued recovery of the peripheral countries around the Mediterranean, which were in a lot of trouble five years ago. And recently, Japan delivered its longest growth streak since 2001.

Inflation remains very subdued despite the ongoing global printing of money. One of our long-held concerns is the lack of inflationary pressure coming through. But that has effectively allowed central banks to overstay their welcome by maintaining multi-century low levels of interest rates. This has supported growth around the world and this wall of liquidity has resulted in most assets sitting at, or close to, their all-time highs. The consensus view is that the easy and accommodative policy will remain.

But while volatility is at all-time low levels, there are significant risks (see list below), which warrants a conservative rather than aggressive bias when constructing investment portfolios.

Key current risks:

- a disruption to the wall of money invested in a desperate search for yield (emerging market currencies and bonds and global bond markets in general);
- the rising threat of populism, nationalism and protectionism;
- a destabilising Brexit;
- geopolitics (specifically in relation to North Korea); and
- a credit bubble in China.

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In South Africa, we all know that everything is on hold until December. Not just companies, but consumers too are not prepared to make any decision until the outcome of the ANC elective conference is known.

Further, the market responded negatively to the recently delivered medium-term budget policy statement which consisted only of bad news, without any policy direction offered.

A lack of policy certainty also exists across the mining, telecommunications and agriculture industries; business confidence is at an all-time low; and consumers remain under pressure. Coupled with the local economy's structural issues such as poor education and low productivity, which will still remain in place regardless of the outcome of the ANC elective conference in December, the outlook for the South African economy remains very poor.

### CORONATION TOP 20 – PORTFOLIO POSITIONING AGAINST A CHALLENGING BACKDROP

The fund is a very concentrated portfolio that can invest in a maximum of 20 shares. As such it represents Coronation's highest conviction ideas within the local equity market, with the ultimate objective of generating exceptional returns over the long-term. Since inception, the fund has delivered 4.7% alpha per annum net of all management fees and costs.

	1 year (p.a.)	3 years (p.a.)	5 years (p.a.)	10 years (p.a.)	15 years (p.a.)	* Since inception (p.a.)
Coronation Top 20 Fund	21.4%	9.3%	13.2%	12.5%	19.0%	19.7%
Benchmark**	17.9%	8.7%	12.9%	9.3%	15.8%	15.0%
Active Return	3.5%	0.6%	0.4%	3.2%	3.2%	4.7%
Peer group average***	12.9%	5.7%	10.0%	7.6%	15.5%	14.9%

\* Since inception – October 2000; P-class

\*\* Benchmark (spliced) - FTSE/JSE Capped All Share Index (CAPI) (from 1 October 2015). Previously FTSE/JSE Africa Top 40 Index

\*\*\* Excluding Coronation funds in that category. Source: Morningstar

Regardless of the negative backdrop outlined above, we remain cautiously optimistic that the fund will also be able to deliver good returns over the next several years. Coronation Top 20's track record was achieved despite the impact of various crises, including 9/11, the rand crisis of 2001, the global financial crisis of 2008, resources booms and busts, as well as all 12 of Zuma's cabinet reshuffles.

In terms of the fund's current positioning we continue to favour those stocks that offer growth opportunities outside of South Africa, including our resource holdings (Anglo American and Exxaro) as well as British American Tobacco, MTN, Mondi, Sasol, Intu and Naspers - all of which have strong drivers in hard currency terms.

In turn, we maintain low exposure to domestic-focused business, but have started to increase our holdings in the fallen darlings (such as Spar, Netcare, Woolworths, Distell and Aspen) that now offer decent upside and a reasonable earnings base.

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For a more detailed discussion on the key differentiators and drivers within the Top 20 fund, please refer to the webcast recording.

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Performance figures are quoted after the deduction of all costs (including manager fees and trading costs) incurred within the fund. Note that individual investor performance may differ as a result of the actual investment date, the date of reinvestment of distributions and dividend withholding tax, where applicable. Where foreign securities are included in a fund it may be exposed to macroeconomic, settlement, political, tax, reporting or illiquidity risk factors that may be different to similar investments in the South African markets. Fluctuations or movements in exchange rates may cause the value of underlying investments to go up or down. The Coronation Money Market fund is not a bank deposit account. The fund has a constant price, and the total return is made up of interest received and any gain or loss made on any particular instrument, in most cases the return will merely have the effect of increasing or decreasing the daily yield, but in the case of abnormal losses it can have the effect of reducing the capital value of the portfolio. Excessive withdrawals could place the fund under liquidity pressures, in such circumstances a process of ring-fencing of redemption instructions and managed pay-outs over time may be followed. A fund of funds invests in collective investment schemes that levy their own fees and charges, which could result in a higher fee structure for this fund. A feeder fund invests in a single fund of a collective investment scheme, which levies its own charges and could result in a higher fee structure for the feeder fund. Coronation Management Company (RF) (Pty) Ltd is a Collective Investment Schemes Manager approved by the Financial Services Board in terms of the Collective Investment Schemes Control Act. Unit trusts are traded at ruling prices set on every day trading. Forward pricing is used. For Domestic Unit Trust Funds, including rand-denominated International Unit Trust Funds, fund valuations take place at approximately 15h00 each business day, except at month end when the valuation is performed at approximately 17h00 (JSE market close). For these Funds, instructions must reach the Management Company before 14h00 (12h00 for the Money Market Fund) to ensure same day value. For International Unit Trust Funds that are denominated in a foreign currency, fund valuations take place at approximately 17h00 each business day (Irish Time) and instructions must reach the Management Company before 12h00 (SA Time) to ensure the value of the next business day. For Tax-Free Investment and Retirement Products, fund valuations take place at approximately 15h00 each business day, except at month end when valuation is performed at approximately 17h00 (JSE market close). For these Products, instructions must reach the Management Company before 14h00 to ensure the value of the next business day. Additional information such as fund prices, brochures, application forms and a schedule of fund fees and charges is available on our website, [www.coronation.com](http://www.coronation.com). Coronation Fund Managers Limited is a Full member of the Association for Savings & Investment SA (ASISA). Coronation Asset Management (Pty) Ltd (FSP 548) and Coronation Investment Management International (Pty) Ltd (FSP 45646) are authorised financial services providers.