INVESTING
FOR LONG-TERM
CAPITAL GROWTH

COROLAB

Your guide to investment ideas

10/18

CORONATION

TRUST IS EARNED™

THE CORONATION CLIENT CHARTER

We strive to always put clients first

We have an unwavering commitment to the long term

We focus on producing top performance over all meaningful periods

We are uncompromising about ethics

INVESTING FOR LONG-TERM CAPITAL GROWTH

Investors looking to achieve long-term capital growth have one great advantage – time. Money invested generates returns that can be reinvested to achieve further returns (this process enables compound growth). Given that compounding is an exponential rather than a linear function, the longer investors have to invest, the greater the possibility of dramatically multiplying their purchasing power.

When investing to fund a retirement, investors' time horizons are measured in decades rather than years. This means that optimal decision-making requires counter-intuitive thinking to the short-termism that drives most market participants.

This issue looks at why we believe a long time horizon is the most reliable investment strategy for investors looking to achieve above-average results. We outline investment concepts that drive investor outcomes over the long term, discuss the importance of asset allocation and diversification, and consider the implications of our long-term return expectations on a typical balanced fund. Finally, we present our range of long-term growth solutions aimed at meeting the needs of different investor profiles.

THE CASE *for being patient*

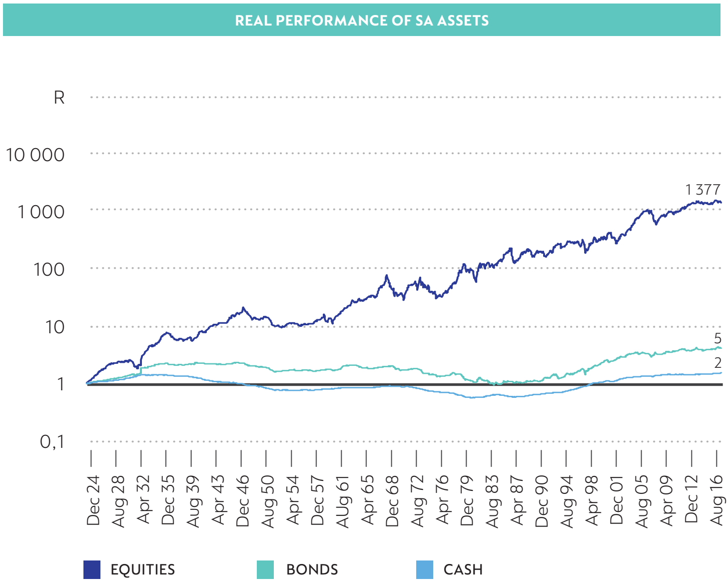
At Coronation, we have an unwavering commitment to investing for the long term. We believe an emphasis on valuation discipline over the appropriate time horizon increases the probability of achieving above-average returns. All our actions are aimed at ensuring that we analyse, debate and ultimately value businesses based on their long-term fundamentals. We do not chase share prices or constantly react to the most immediate news flow.

By working hard to retain the trust of our clients, we are able to examine how a business performs through multi-year cycles, and this is what we believe gives us a distinct advantage over our average competitor.

Figure 1 illustrates the compelling results, in real terms, that are available to investors who are willing and able to put money in the equity market for very long periods of time (regardless of the sentiment of the day) and then let the power of compounding work for them (as detailed on page 4). While an investor who committed R1 to local bonds and/or cash would have seen an increase of 2 to 5 times in their purchasing power over the past 94 years, an equity investor who made the same commitment would be able to buy 1 377 times more today.

Figure 1

REAL PERFORMANCE OF SA EQUITIES, BONDS AND CASH



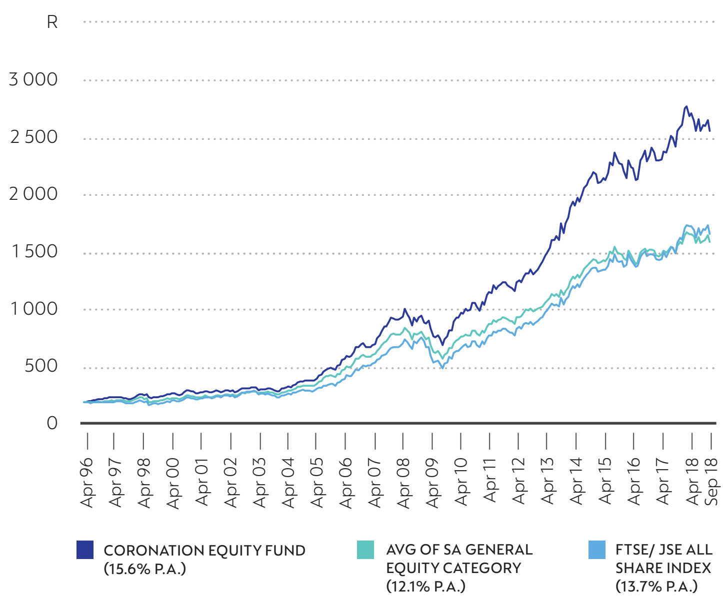
Source: Coronation Fund Managers as at 30 September 2018

In **Figure 2** we illustrate the rewards of adding an active return (as discussed on page 9) to that of the market by having remained invested with Coronation over the long term. An investment in the local equity market more than 20 years ago would have grown your capital just more than 13 times (in nominal terms), whereas a similar investment in the Coronation Equity Fund, which has outperformed the market by 3.1% p.a. after fees (a seemingly small number), would have grown your capital by almost 25 times.

Figure 2

CORONATION EQUITY FUND

CUMULATIVE RETURNS SINCE INCEPTION ON 15 APRIL 1996



Source: Coronation Fund Managers as at 30 September 2018

Please refer to **Figure 8 on page 14 and 15** for further details.

The conclusion is as simple as it is compelling. Invest in the equity markets for long periods of time, stick with winning fund managers for the long haul, and the power of compounding will most likely do extraordinary things for you.

Yet most investors capture only a small fraction of the market return over time. This is because financial markets (and the performance cycle of a fund manager) typically turn when investors least expect them to. Often, the moves are large and, for that reason, a high percentage of the returns that patient investors earn over the long term are made in a surprisingly few trading sessions. For example, since 1960, investors who were not invested in the South African equity market for 12% of those trading months received zero return over the 58-year period.

CONCEPTS WHICH DRIVE *investor outcomes over the long term*

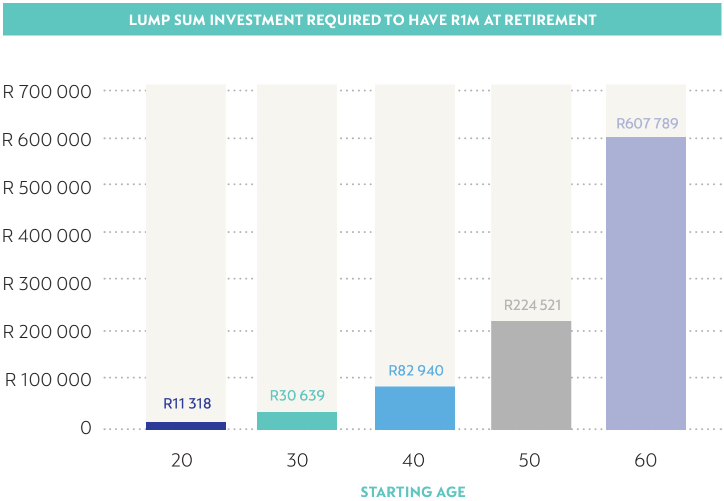
THE POWER OF COMPOUNDING

The power of compounding is critical to long-term wealth creation. Compounding is the process in which an asset's earnings, from either capital gains or interest, are re-invested to generate earnings over time. To highlight the effect that compounding has over long periods of time, consider the charts on the next page.

Figures 3 and 4 illustrate how much an investor would need to save at a given starting age in order to have a R1m at the age of 65 at a 10% p.a. return. **Figure 3** indicates the lump sum investment required, while **Figure 4** provides the monthly amount required.

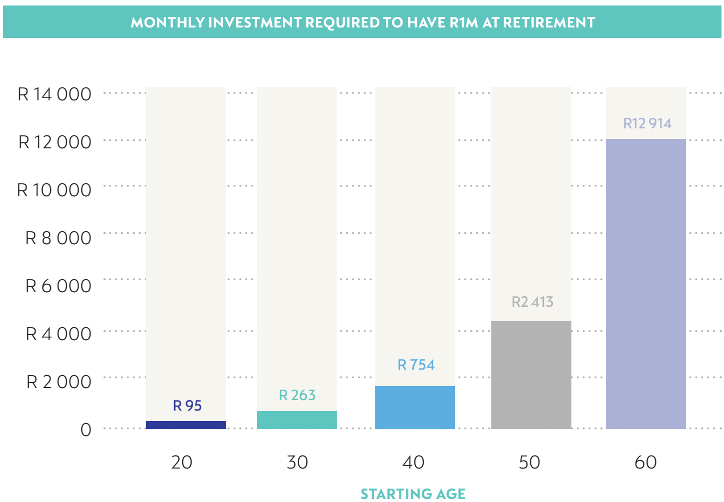
Figure 3

THE POWER OF COMPOUNDING



Source: Coronation Fund Managers

Figure 4



Source: Coronation Fund Managers

The important point to note is the significant benefit of saving earlier due to compounding of returns. A 20-year-old investor only needs to save a little over R11 000 in order to reach their R1m goal at retirement, whereas they would need to save nearly three times as much when they reach the age of 30.

TIME DIVERSIFICATION

A long time horizon allows investors to take greater risks - making it possible to have more exposure to growth assets with higher expected returns and the attendant variability from year to year.

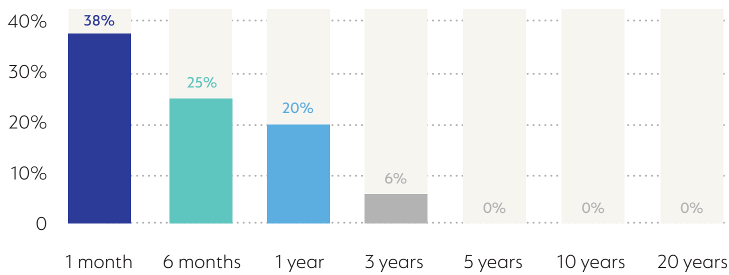
In The Effective Investor (Pan Macmillan, 2009), Franco Busetti writes that 'after compounding, time diversification of risk is your second-best friend in the market'. The concept of time diversification refers to the decrease in risk of holding growth assets as an investor's investment time horizon increases.

Take for example an investment in equities. Given the volatility inherent in this asset class, the possibility of suffering a capital loss in any one year is far greater than if you were invested in cash or bonds. However, the longer the investment period, the lower this variability becomes.

Figure 5 below shows the odds of losing money invested in the FTSE/JSE All Share Index over different investment time horizons (rolling 5, 10, 15 years, etc.). Using returns from 1960, the likelihood of losing capital diminishes drastically as your investment horizon increases to the point where one has never had a negative return over a 5+ year investment horizon.

Figure 5

ODDS OF LOSING MONEY IN THE JSE ALSI (1960 - 2018)



Source: Coronation Fund Managers as at 30 September 2018

ASSET ALLOCATION AND DIVERSIFICATION

Investors also need to be aware that investment markets are not static. New opportunities arise as companies, industries, countries and asset classes develop and contract. Relative valuation levels between local, developed market and other emerging market assets, as well as between equities, bonds and cash, change over time. The emergence of new asset classes such as inflation-linked bonds, or a deepening of an existing asset class through new listings and more activity (as was the case in the domestic listed property market) add to the investable universe. Regulations that restrict or enhance the freedom to invest in foreign markets may also change. Investors can therefore enhance their eventual outcomes by making good strategic and tactical asset allocation decisions in response to this dynamic environment.

While equities typically have the highest expected return over time (as we will illustrate in **Figure 7 on page 10**), this is not always the case. Market price levels can change both for fundamental (sustainable earnings and dividend growth) and sentimental reasons (investors in aggregate are more/less optimistic and hence prepared to apply higher/lower ratings to companies). This insight supports the use of a strict valuation discipline when deciding what the optimal portfolio structure should be, informed by the difference between current price levels and well-considered long-term fair values in different markets.

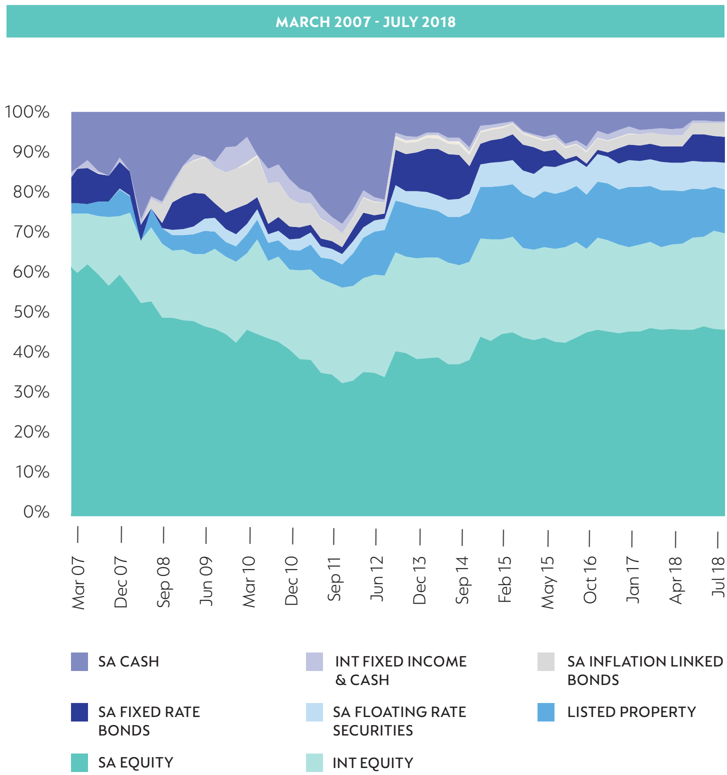
Figure 6 on the next page illustrates how the asset allocation of our flagship balanced fund, Coronation Balanced Plus, has changed over the past 10 years. The stand-out features are:

- Our comfort with temporarily holding relatively high levels of cash at times when we believe valuations to be stretched in higher return/higher risk alternatives such as bonds, property and equity; and

- The increase in offshore equity exposure over time, primarily at the expense of local equities. This trend was partly due to regulatory action, as exchange control limits were gradually relaxed to the current 30% foreign asset limit, but more importantly, driven by the more attractive relative valuation of global compared to local shares at certain times.

Figure 6

ASSET ALLOCATION FOR CORONATION BALANCED PLUS



LONG-TERM *growth solutions*

EXPECTED RETURNS

The expected rate of return on a portfolio of assets is difficult to assess in the investment planning process. The investor's current contribution level will vary dramatically based on the expected rate of return selected. If you are too optimistic, the investor will end up with less purchasing power than required, but if you are too conservative, the investor will unnecessarily defer consumption, thereby reducing quality of life in his/her younger years. The future is by its very nature uncertain and we have at best partial information to inform our forecasts.

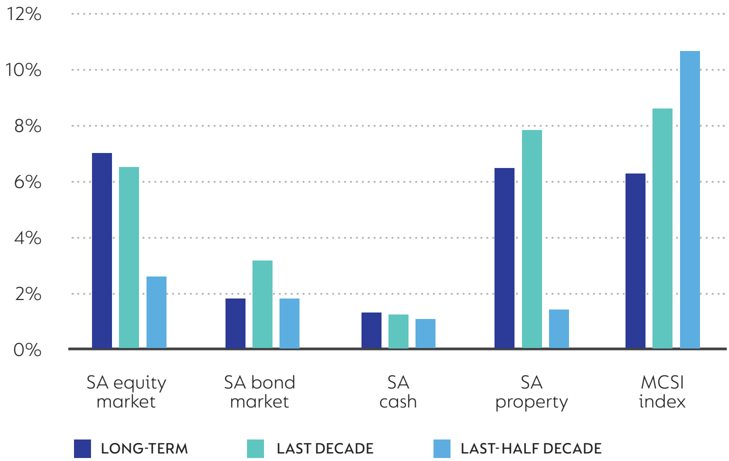
The long-term saver is primarily interested in the real, or after-inflation, rate of return. Inflation measures the general increase in prices over time. If the rate of return selected equals the inflation rate, the investor is merely protecting the purchasing power of what has been saved. It is only the real return that can be viewed as a 'reward' for delaying gratification, as earning a positive real return will enhance an investor's eventual purchasing power.

A good starting point in setting prudent return expectations is to look at the very long-run asset class returns (**Figure 7 on the next page**): growth assets (property and equity) produced a real rate of return in the 6% – 7% range; while income assets (cash and bonds) earned 1% – 2%. This implies an expected long-run real rate of return of around 5% p.a. for a typical balanced fund (assuming exposure of between 70% – 75% to growth assets and between 25% – 30% to income assets). Actual real returns achieved over the past decade were, in line with the long-term average, explaining why the typical balanced fund achieved a real return of 4.5% p.a. Coronation Balanced Plus, due to a positive active return contribution, achieved a real return of around 5.6% p.a. over the same period.

Figure 7

ANNUALISED REAL RETURNS PER ASSET CLASS

PAST DECADE TO 30 SEPTEMBER 2018 VS LAST 118 YEARS



Source: Deutsche Bank, IRESS, Triumph of the Optimists – Dimson, March and Staunten

**Shorter history for foreign equities (48 years) and local property (38 years)*

After a sustained period of below-average returns, our 10-year forecast for local equity is now slightly above the experience of the last decade as a result of more attractive valuations. The strong performance from global markets has contributed to global equities outperforming local equities over the past decade and warrant caution in future expectations. Current market conditions, influenced by extraordinary monetary policy accommodation and relatively full valuation levels lead us to a lower return forecast range for both global equity and global bonds (**as set out in Figure 8 on page 14**). However, it is reasonable to expect better returns from the average balanced fund over the next decade based on a more favourable outlook for local growth assets. Based on the mid-point of our 10-year return expectations and asset allocation on the composite index we use as benchmark for Coronation Balanced Plus, it is prudent to assume a weighted real rate of return of around 5% p.a. for the typical balanced fund.

Figure 8

EXPECTED ASSET CLASS RETURNS

	PAST 10 YEARS (ZAR)	10 YEAR FORECAST* (ZAR)
Local equity	12.1%	8 - 12%
Global equity	14.6%	8 - 12%
Local property	13.5%	9 - 12%
Local bonds	8.6%	8 - 9%
Global bonds	7.9%	4 - 5%
Cash	6.8%	6 - 7%
Inflation	5.2%	4 - 6%

*Source: Deutsche Bank as at 30 September 2018 and *Coronation Fund Managers forecasts. While these forecasts are not guaranteed to occur, they are based on our best estimates for possible future returns and represent a more prudent basis for informing planning assumptions than historical results achieved over the past decade.*

IMPLICATIONS FOR INVESTORS

Your expected real return will have a material impact on your future purchasing power (**Figure 9 on the next page**). The ability to compound at a 5% real rate of return, as has been achieved by Coronation Balanced Plus over the last decade, increases your purchasing power by 1.63 times over 10 years and 7.04 times over 40 years. Being able to add an additional 2% p.a. over the average competitor fund improves purchasing power by 25% - 30% after a decade, and more than doubles purchasing power over 40 years.

Figure 9

INCREASE IN PURCHASING POWER

	REAL RATE OF RETURN (%. P.A.)			
INVESTMENT PERIOD IN YEARS	2.5	5	7	10
10	1.28	1.63	1.97	2.59
20	1.64	2.65	3.87	6.73
30	2.01	4.32	7.61	17.45
40	2.69	7.04	14.97	45.26

Source: Coronation Fund Managers

THE VALUE OF ACTIVE RETURNS

Coronation, like all active managers, pursues the outperformance of market indices or benchmarks (net of the fees we charge and costs that our portfolios incur). Since the launch of Coronation Balanced Plus in 1996, we have added 1.3% p.a. to the returns produced by its benchmark (comprising a combination of indices representing local and global equities, bonds and cash), and 2% p.a. more than the fund's average competitor. Both measures of outperformance are shown after the deduction of all our management fees and portfolio costs (refer to page 14 for further details).

CORONATION'S LONG-TERM CAPITAL GROWTH SOLUTIONS

Coronation offers a range of funds specific to achieving long-term capital growth. These include both domestic and international multi-asset and equity-only funds as listed on pages 14 and 15.

We strongly believe that multi-asset class funds address the majority of investor needs and reduce the complexity of decisions the investor needs to make. They diversify risk across asset classes, reduce the risk of poorly timed asset allocation decisions, and allow investors to invest with a manager who has the skill and experience to invest beyond equities, bonds and cash into niche asset classes.

But not all multi-asset funds are the same. Different funds meet the needs of different investors. The level of risk that an investor is willing and able to take, as well as appetite for offshore exposure, will determine which fund is right for their needs.

For the more sophisticated investor who prefers to construct his or her own portfolio, we offer equity-only funds that can be used as building blocks: domestic equity-only -Top 20 and Equity, and international equity-only - Global Emerging Markets, Global Opportunities Equity and the more recently launched Global Equity Select. Details on each fund are included in **Figure 8 on pages 14 and 15**.

CONCLUSION

In this issue, we discussed some of the guiding investment principles for the long-term. Compounding real returns over multiple decades provides investors with a much higher chance of reaching their goals, however it does require discipline and rational behavior.

Investing over long periods of time does not come without short-term challenges - especially during times of market stress and volatility. The ability to look through the noise and manage one's own behavior will often be the determining factor when it comes to reaching your investment goals.

Figure 8

INTERNATIONAL RAND- AND DOLLAR-DENOMINATED MULTI-ASSET AND EQUITY-ONLY FUNDS FOR LONG-TERM GROWTH INVESTORS

	Domestic: Equity Only		Domestic: Multi Asset	
FUND NAME *+launch date of oldest fund*	**TOP 20** *October 2000*	**EQUITY** *April 1996*	**BALANCED PLUS** *April 1996*	**MARKET PLUS** *July 2001*
BENCHMARK	FTSE/JSE Capped All Share Index (CAPI)	Composite: 87.5% local equity, 12.5% international equity	Composite: 67% equity (52.5% local and 14.5% international), 33% income assets (22.5% local bonds, 3.5% international bonds, 5% local cash, 2% international cash)	Composite: 67% equity (52.5% local and 14.5% international), 33% income assets (22.5% local bonds, 3.5% international bonds, 5% local cash, 2% international cash)
FUND DESCRIPTION	A focused portfolio of our top stock picks on the JSE.	Best equity view (less concentrated exposure than Top 20).	Best investment views across all asset classes for retirement savers.	Best investment views across all asset classes for discretionary savers.
ANNUAL RETURN (SINCE LAUNCH)	17.8% *14.1%	15.6% *13.0%	14.6% *13.3%	15.6% *13.7%
ANNUAL RETURN (LAST 5 YEARS)	5.2% *7.9%	6.5% *9.3%	7.2% *9.2%	6.6% *9.2%
BEST PERFORMING 12 MONTHS	May 2005 - Apr 2006: 68.9%	Aug 2004 - Jul 2005: 62.5%	Aug 2004 - Jul 2005: 49.3%	Aug 2004 - Jul 2005: 50.0%
WORST PERFORMING 12 MONTHS	May 2002 - Apr 2003: (31.7%)	Mar 2008 - Feb 2009: (28.7%)	Sep 1997 - Aug 1998: (17.4%)	Mar 2008 - Feb 2009: (20.1%)

**Benchmark return figures are quoted from Morningstar as at 30 September 2018 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.*

International: Equity Only		International: Multi Asset	
GLOBAL EMERGING MARKETS FLEXIBLE [ZAR] **GLOBAL EMERGING MARKETS [USD]** *December 2007*	**GLOBAL OPPORTUNITIES EQUITY [ZAR] FEEDER** **GLOBAL OPPORTUNITIES EQUITY [USD]** *August 1997*	**GLOBAL MANAGED [ZAR] FEEDER** **GLOBAL MANAGED [USD]** *October 2009*	**OPTIMUM GROWTH** *March 1999*
MSCI Emerging Markets Index	MSCI All Country World Index	Composite: 60% MSCI All Country World Index, 40% Barclays Global Bond Aggregate.	Composite: 35% local equities, 35% international equities, 15% local bonds and 15% international bonds
Best investment view across emerging markets.	Providing access to the best global equity managers.	Best investment view across global markets.	Best rand risk adjusted returns from a global multi-asset portfolio.
2.1% *1.1%	7.0% *6.1%	6.6% *6.8%	9.5% *7.0%
(0.7%) (5.0% over 10 years) *3.8% (5.6% over 10 years)	7.3% (8.3% over 10 years) *9.4% (8.9% over 10 years)	3.6% *5.8%	3.6% (7.4% over 10 years) *3.7% (6.4% over 10 years)
Mar 2009 - Feb 2010 96.0 %	Apr 1999 - Mar 2000: 56.9%	Jul 2010 - Jun 2011: 23.1%	Mar 2009 - Feb 2010: 72.8%
Mar 2008 - Feb 2009 (51.9%)	Mar 2008 - Feb 2009: (41.3%)	Mar 2015 - Feb 2016: (14.9%)	Dec 2007 - Nov 2008: (49.2%)

- *Returns are quoted in USD for the oldest fund.*
- *Figures are quoted from Morningstar as at 30 September 2018 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested*

NOTES

Disclaimer

For **enquires** you can call us on **0800 22 11 77**
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transact@coronation.com or fax us on **+27 21 680 2100**.

For **more information or to invest online**, visit us on **www.coronation.com**.