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The Personal Investments Quarterly



Ruffled feathers

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Notes from my inbox

“It does not matter how slowly you go, as long as you do not stop.” – Confucius



By Pieter Koekemoer

AT THE HALFWAY mark, 2019 remains on track to be a year in which investment returns from equities may exceed expectations. Global markets recovered very strongly over the half year, with the MSCI All Country World Index, measured in rand, up more than 14%. The local equity market followed suit, with a healthy 11% return from the FTSE/JSE Capped All Share Index over the same period.

Markets delivered these results despite deteriorating economic growth. A big part of the reason for this is the impact on globalisation of the conflict between the US and China, as unpacked by guest writer Professor Barry Eichengreen in this quarter's cover story. While temporary ceasefires are certainly possible, the combination of the US President's ego and politics, and China's history, culture and traditions makes this a very tricky situation to contain. Despite the concerns, global market consensus shifted to factor in a future material relaxation of monetary policy. It is this prospect of lower interest rates that continues to propel markets.



Pieter is Head of
Personal Investments

The local economy remains challenged, with low consumer and corporate confidence levels reflected in a very weak first quarter GDP print of -3.2%. The issues are by now well known: lingering policy uncertainty; factional tension in the ruling party making it more difficult to implement much-needed reforms; and Eskom's balance sheet problems, and the unclear state of its generation and transmission assets all act as constraints on domestic activity levels. These issues are reflected in domestic-focused companies reporting weak results, with even defensive shares struggling to defy the pressures of several years of a weak domestic economy and high structural inflation. We expect these headwinds to persist and remain cautious on businesses heavily exposed to the domestic economy.

This is, however, not the full story. The platinum miners continued their recovery (up between 40% and 100% year to date), as did Anheuser-Busch InBev (+40%), Naspers (+25%), MTN (+21%) and British American Tobacco (+17%). Other resource companies also continued to do well, including Anglo American (+51%) and BHP Billiton (+28%). The prospects for most of these businesses, while they happen to be listed in Johannesburg, have little to do with developments in South Africa.

ALSO IN THIS EDITION

Quinton Ivan reviews the track record of local companies expanding abroad, using Woolworths' acquisition of David

Jones in Australia and Sasol's Lake Charles Chemicals Project as examples. We also cover two interesting global investment opportunities currently included in our funds. Lisa Haakman unpacks the investment case for luxury goods and explains why we prefer LVMH and Kering.

Sport lovers recently experienced a 'super Sunday', with a memorable ICC World Cup Cricket Final between England and New Zealand, an epic Wimbledon men's final between Federer and Djokovic, a home victory for Lewis Hamilton at the Silverstone Grand Prix and Daryl Impey's stage victory in the Tour de France, all happening on one afternoon. This served as a powerful reminder of the inherent value in sports content. Of the great events of the weekend, the only one that is investable via public markets is Formula One, as explained by John Parathyras on page 11.

I hope you enjoy the read. As always, please do not hesitate to contact us via clientservice@coronation.com if any aspect of our service demands attention.



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Key performance indicators and fund performance

AS AT 30 JUNE 2019

| | QTD | YTD | 1 YEAR | 3 YEARS | 5 YEARS | 10 YEARS | 15 YEARS | 20 YEARS |
|---|---------|---------|---------|---------|---------|----------|----------|----------|
| DOMESTIC INDICES | | | | | | | | |
| CAPI (J303T) | 4.0% | 11.1% | 4.7% | 6.3% | 5.6% | 13.4% | 15.9% | - |
| ALSI (J203T) | 3.9% | 12.2% | 4.4% | 6.9% | 5.8% | 13.5% | 15.7% | 14.8% |
| Top 40 (J200T) | 4.6% | 13.5% | 4.6% | 7.4% | 5.6% | 13.3% | 15.4% | 14.5% |
| SWIX (J403T) | 2.9% | 9.0% | 1.2% | 4.3% | 5.4% | 13.5% | 15.9% | - |
| ALSI Industrials (J257T) | 4.0% | 11.7% | (3.7%) | 1.8% | 5.3% | 16.8% | 18.4% | 15.0% |
| ALSI Financials (J580T) | 5.4% | 5.0% | 5.7% | 6.2% | 7.1% | 15.1% | 15.1% | 12.1% |
| ALSI Resources (J258T) | 2.4% | 20.7% | 21.2% | 20.6% | 0.8% | 5.4% | 10.4% | 13.2% |
| All Property Index (J803T) | 1.5% | 2.8% | (5.1%) | (4.7%) | 3.3% | 11.7% | - | - |
| BEASSA (TR) All Bond Index | 3.7% | 7.7% | 11.5% | 9.9% | 8.6% | 9.0% | 9.1% | 11.1% |
| Short Term Fixed Interest 3 Month Cash Rate | 1.7% | 3.4% | 6.9% | 7.0% | 6.7% | 6.2% | 7.1% | - |
| CPI | 1.2% | 2.7% | 4.4% | 4.7% | 5.0% | 5.2% | 5.7% | 6.0% |
| INTERNATIONAL INDICES | | | | | | | | |
| MSCI ACWI (USD) | 3.6% | 16.2% | 5.7% | 11.6% | 6.2% | 10.1% | 7.0% | - |
| MSCI WORLD (USD) | 4.0% | 17.0% | 6.3% | 11.8% | 6.6% | 10.7% | 7.0% | 4.8% |
| MSCI GEM (USD) | 0.6% | 10.6% | 1.2% | 10.7% | 2.5% | 5.8% | 8.7% | 7.2% |
| S&P 500 (USD) | 4.3% | 18.5% | 10.4% | 14.2% | 10.7% | 14.7% | 8.8% | 5.9% |
| BGBA (USD) | 3.3% | 5.6% | 5.8% | 1.6% | 1.2% | 2.9% | 3.8% | 4.5% |
| 3 Month Libor (USD) | 0.6% | 1.3% | 2.6% | 1.8% | 1.2% | 0.8% | 1.8% | 2.2% |
| MSCI ACWI (ZAR) | 0.8% | 14.2% | 8.6% | 10.1% | 12.3% | 17.0% | 13.0% | - |
| MSCI WORLD (ZAR) | 1.2% | 14.9% | 9.2% | 10.2% | 12.8% | 17.6% | 13.0% | 9.3% |
| MSCI GEM (ZAR) | (2.1%) | 8.6% | 3.9% | 9.1% | 8.4% | 12.4% | 14.8% | - |
| 3 Month Libor (ZAR) | (2.1%) | (0.5%) | 5.3% | 0.4% | 7.1% | 7.0% | 7.5% | 6.6% |
| SPOT RATES | | | | | | | | |
| Rand Dollar exchange rate | 14.5 | 14.4 | 13.7 | 14.7 | 10.6 | 7.7 | 6.2 | 6.0 |
| Rand Dollar % change | 2.8% | 1.8% | (2.6%) | 1.4% | (5.5%) | (5.9%) | (5.3%) | (4.2%) |
| Rand Euro exchange rate | 16.3 | 16.5 | 16.0 | 16.3 | 14.6 | 10.8 | 7.5 | 6.2 |
| Rand Pound exchange rate | 18.9 | 18.3 | 18.1 | 19.6 | 18.2 | 12.7 | 11.2 | 9.5 |
| Gold price (USD) | 1 295.4 | 1 281.7 | 1 250.5 | 1 320.8 | 1 315.0 | 934.5 | 395.8 | 261.0 |
| Oil price (USD barrel) | 67.6 | 54.4 | 79.2 | 49.7 | 112.4 | 69.3 | 34.5 | 16.5 |

| | QTD | YTD | 1 YEAR | 3 YEARS | 5 YEARS | 10 YEARS | 15 YEARS | 20 YEARS | SINCE LAUNCH |
|---|--------|-------|--------|---------|---------|----------|----------|----------|--------------|
| DOMESTIC FUNDS (PERFORMANCE IN RANDS) | | | | | | | | | |
| Coronation Top 20 Fund | (0.3%) | 9.8% | 0.2% | 5.4% | 3.4% | 12.7% | 16.8% | - | 17.3% |
| ASISA Mean of South African Equity General | 1.5% | 7.4% | 1.5% | 2.9% | 3.4% | 10.9% | 14.0% | - | 14.0% |
| Coronation Market Plus Fund** | (0.1%) | 8.5% | 1.2% | 4.3% | 4.6% | 12.3% | 14.5% | - | 15.1% |
| ASISA Mean of South African Multi-Asset Flexible | 0.9% | 5.7% | 1.9% | 3.2% | 4.7% | 10.8% | 12.1% | - | 11.5% |
| Coronation Balanced Plus Fund | (0.6%) | 7.8% | 0.7% | 4.1% | 5.0% | 11.6% | 14.2% | 13.4% | 14.2% |
| ASISA Mean of South African Multi-Asset High Equity | 1.0% | 6.9% | 3.2% | 4.0% | 5.1% | 10.0% | 12.5% | 12.6% | 12.3% |
| Coronation Capital Plus Fund | 1.0% | 6.8% | 2.6% | 4.0% | 4.4% | 9.4% | 11.3% | - | 11.7% |
| ASISA Mean of South African Multi-Asset Medium Equity | 1.5% | 6.8% | 4.3% | 4.4% | 5.1% | 9.1% | 10.4% | - | 11.0% |
| Coronation Balanced Defensive Fund | 1.1% | 6.3% | 5.0% | 5.7% | 6.3% | 10.0% | - | - | 9.4% |
| ASISA Mean of South African Multi-Asset Low Equity | 1.5% | 5.5% | 5.3% | 5.2% | 6.0% | 8.5% | - | - | 7.7% |
| Coronation Strategic Income Fund | 2.3% | 4.9% | 8.6% | 8.5% | 8.2% | 9.2% | 9.3% | - | 10.3% |
| ASISA Mean of South African Multi-Asset Income | 2.2% | 4.5% | 8.5% | 8.0% | 7.5% | 7.3% | 8.0% | - | 9.1% |
| INTERNATIONAL FUNDS (PERFORMANCE IN USD) | | | | | | | | | |
| Coronation Global Opportunities Equity Fund | 0.2% | 16.3% | (1.9%) | 9.4% | 4.6% | 9.0% | - | - | 5.5% |
| Coronation Global Emerging Markets Fund | 4.9% | 29.0% | 8.2% | 10.6% | 0.2% | 7.1% | - | - | 5.2% |
| Coronation Global Managed Fund | 2.4% | 13.9% | 2.7% | 6.9% | 2.0% | - | - | - | 6.0% |
| Coronation Global Capital Plus Fund | 1.6% | 8.3% | 3.5% | 4.1% | 1.6% | - | - | - | 4.0% |
| Coronation Global Strategic Income Fund | 0.8% | 2.8% | 2.7% | 2.0% | 1.3% | - | - | - | 2.5% |

* All ASISA averages exclude Coronation funds in that category

** Highest annual return (Coronation Market Plus): 50.0% (Aug 2004 - Jul 2005); lowest annual return: -20.1% (Mar 2008 - Feb 2009); fund launch date 2 July 2001

Figures as at 30 June 2019; for detailed fund performance, refer to pages 38 and 40

Meaningful periods



GLOBAL ECONOMY

Trump's trade war: even worse than you think



By Professor Barry Eichengreen

THE TRADE WAR between the US and China is not ending anytime soon, notwithstanding the efforts of presidents Trump and Xi to make nice on the sidelines of the Osaka G20 Summit. Trump signaled as much, hedging his 'no new tariffs' pledge with a telling "at least for the time being", and noting that "I [still] have the ability to put on [a tariff] if I want to".

These remarks should not come as a surprise, for they are a reflection of Donald Trump's personality and politics. Trump thrives on chaos. He likes nothing more than keeping his enemies and indeed his friends, such as they are, off guard. And nothing is more effective at creating chaos than Trump's tariff tweets. In addition, blaming China for US economic problems is a convenient way of distracting attention from their domestic causes and from the President's failure to alleviate them.

China for its part is a proud country whose leaders have no intention of backing down in the face of threats. Chinese leaders perceive Trump's demands through the prism of the Opium Wars and the humiliating concession of treaty ports to Western powers by the Qing Dynasty in the 19th century. The more aggressive the US President's attacks, therefore, the less likely is a negotiated solution.

Moreover, the trade war is now seen by both sides as part of a larger geopolitical conflict. This is a conflict over geographical spheres of influence, starting with the South China Sea but increasingly encompassing the globe. It is a conflict over who possesses the technological high ground and how economic policy can shift the technological balance. Trade, any economist will tell you, is a positive-sum game in which both sides stand to benefit. The struggle for geopolitical supremacy, on the other hand, is a zero-sum game that only one country can win. The most consequential change in the trade-policy

debate in the course of the last year, therefore, is that trade has come to be seen as subordinate to this struggle for geopolitical primacy.

ECONOMIC FALLOUT

With what consequences for the economy, one might ask? Mainstream analyses suggest that the macroeconomic effects of a US-China trade war are likely to be small. US-China trade is less than 1% of global GDP. Even in a full-scale trade war between the two countries, most of their previous imports from one another would simply be sourced from third countries. To the extent that there is nevertheless a negative impact on aggregate demand, this would be offset by appropriate adjustments of monetary and fiscal policies. Or so mainstream economic models suggest.

Thus, three economists at the Dutch Central Bank have used a global macroeconomic model to estimate the effects of a 10% US tariff on imports from China, together with tit-for-tat Chinese retaliation. They find that these policies will depress global GDP by just 0.1% after one year and 0.5% after three to four years. The Organisation for Economic Co-operation and Development

similarly estimates, using its in-house model, that if the US and China imposed 25% tariffs on each other's exports, global GDP will be just 0.7% lower by 2021 than otherwise.

Three European Central Bank economists, assuming a 10% increase in US and Chinese tariff and nontariff barriers on imports from one another and simulating a suite of multicountry econometric models, conclude that global GDP will be just 0.8% lower after a year.

But the sharp negative reaction of stock markets to Trump's tariff tweets is hard to reconcile with these sanguine conclusions. Moreover, many

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economists instinctively feel that a trade war would inflict significant damage on the economy and the prospects for growth and profitability. They are just unable to back up this intuition using standard models.

UNCERTAINTY AND ITS IMPACT ON INVESTMENT

So, what do these models miss?

First, they miss uncertainty and its impact on investment. If the trade war persists, it will make sense for US firms building productive capacity in China or purchasing inputs from Chinese suppliers to shift their capacity and sourcing to marginally higher cost locations, be these Vietnam, Mexico or the US itself.

Likewise, Chinese companies that previously contemplated expanding their domestic assembly operations with exports to the US in mind may have reason to invest abroad even though overseas costs of production are marginally higher. But if the threatened tariffs never come into effect or turn out to be ephemeral, then relocating production will have been a costly mistake, given sunk costs and irreversibilities.

The Baker-Bloom-Davis Index of trade-policy uncertainty for the US shows major spikes around each of Trump's trade policy statements and tweets. In these circumstances, it clearly pays to wait. Hence, even if the trade war has very limited implications for capital accumulation in the long run, it can still have a large impact in the short run, as uncertain investors hold off making commitments. The consequent sharp fall in investment will then be amplified by multiplier effects familiar from standard business-cycle models, with a large short-run impact on GDP.

Second, standard models miss the negative impact of the trade war on global supply chains. A trade restriction that raises the cost or reduces the availability of imported inputs essential to production in a first sector, by reducing that sector's output, can have a magnified impact on the output of a second downstream sector that uses the output of the first sector intensively in production. As these supply-chain disruptions ramify through the economy, their aggregate impact can be greatly amplified. This kind of nonlinear propagation is not something that is captured by conventional macroeconomic models.

As a case in point, economists have studied the 2011 Fukushima earthquake, Fukushima being an important supplier of electronic components and auto parts. While the earthquake was immediately responsible for a 3% decline in output in a region comprising 5% of the Japanese economy – and hence

for just one-fifteenth of a percent decline in Japanese GDP – the aggregate effect resulting from propagation and amplification via supply chains was fully eight times as large.

Finally, standard models miss the impact of trade restrictions on the intensity of competition. The importance of import competition in applying pressure for domestic firms to maximise efficiency has been invoked in a variety of contexts.

For example, the economic historians Stephen Broadberry and Nicholas Crafts attribute the slow growth of productivity in the UK in the third quarter of the 20th century to the anti-competitive effects of the tariffs put in place in the 1930s and then to postwar Britain's failure to join the European Economic Community. A large literature criticises import substitution in Latin America in this same period owing to its tendency to suppress the chill winds of competition.

Thus, a tariff meant to “make America great again” may only make America fat and lazy again. This should especially be a concern when there already are worries about dominant firms, in high tech and elsewhere, facing limited domestic competition.

There are multiple reasons, then, for thinking that the negative effects of President Trump's trade war will be greater than suggested by textbook macroeconomics.

WHAT IS THE PROSPECT OF A TRADE TRUCE?

This returns us to the question: is there any prospect of a trade truce between the US and China that might avoid these damaging consequences? One possibility is the inauguration in 2021 of a new US president who lacks Trump's antipathy toward trade and fear of China. But few of Trump's prospective general-election rivals are free traders themselves, to put an understated gloss on the point.

The most we can hope for is that the next US president will seek to build a coalition of like-minded countries to push for reform of China's policies toward intellectual property and forced technology transfer, and that (s)he will seek to influence that country's behaviour by strengthening rather than destroying the rules-based trading system.

But the notion that the US and China are now in a struggle for geopolitical supremacy that revolves around technology, and whose outcome will be shaped by trade, is here to stay, regardless of who occupies the Oval Office. The controversy over Huawei and 5G is just the canary in the coalmine. This reality does not bode well for US-China trade relations, for the global trading system, or for the global macroeconomy. +



SOUTH AFRICAN ECONOMY



A winter of discontent

The economic cost of rent seeking



By Marie Antelme

THERE IS NO shortage of articles, policy papers and opinion pieces detailing how weak South Africa's economic growth has become, why this has happened and what remedial action needs to be taken to improve the situation. Some offer very sensible advice. Some don't. What is seldom articulated clearly is what the effects of this very weak growth are and what they mean for the country's long-term ability to manage the structural challenges it faces.

South Africa's economy is unlikely to grow by more than 1% in real terms in 2019. This follows growth of just 0.7% in 2018. After two positive quarters of growth in the second half of 2018 (H2-18), GDP contracted by 3.2% quarter on quarter, seasonally adjusted and annualised (q/q, saa). This was the worst fall since the -6.1% q/q, saa contraction in the first quarter of 2009

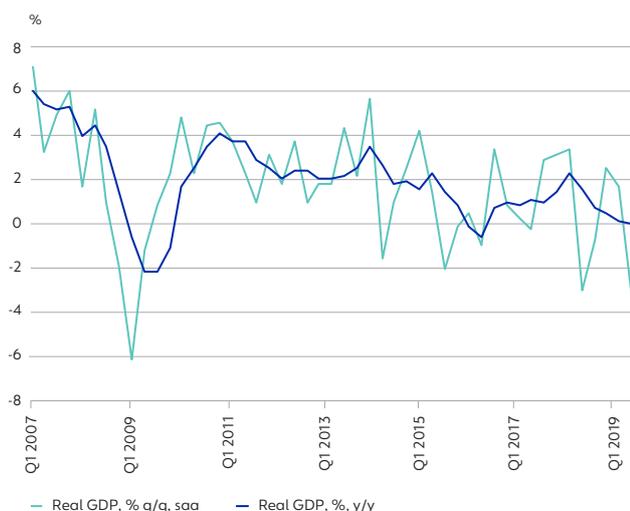
Marie is an economist with 18 years' experience in financial markets.





(Q1-09) over a decade ago, at the height of the Global Financial Crisis when the economy lost almost a million jobs in one year! This recent weakness was exacerbated by electricity outages that intensified in March, but was ultimately broad based, with real output falling across the primary, secondary and tertiary sectors. When measured on an annual basis, real GDP was flat.

GDP, % YEAR ON YEAR AND ANNUALISED



Source: Statistics South Africa

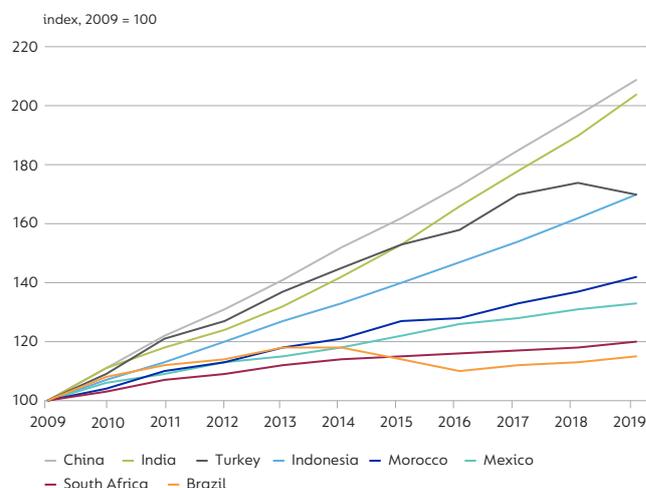
AS COMPARED TO LAST TIME ...

A closer look at expenditure-side data shows very worrying details: real household consumption, which accounts for 62% of GDP and is usually a solid anchor for growth, contracted by 0.8% q/q, following 3.2% q/q growth in Q4-18, shaving 50 basis points (bps) off GDP. The decline in spending reflects very weak real-wage and remuneration growth, weak employment, poor confidence and several years during which the fiscal burden on households has increased. Fixed investment, the critical driver of both future capacity and productivity, contracted by 4.5% q/q and has fallen for 10 of the last 13 quarters. Inventories also detracted, falling R11.6 billion in Q1-19. The final blow came from net exports, which fell by 7.5% q/q in Q1-19 as imports fell 4.8%, but exports collapsed by 26.4%.

Seen as a whole, the shape of South Africa's growth in Q1-19 echoes challenges faced by many other economies at this juncture; economic growth is the fragile balance between the health and resilience of domestic demand and the impact of external factors – falling trade volumes and rising uncertainty, and the subsequent knock-on to confidence.

However, unlike most of the world's advanced economies and a large proportion of emerging markets, domestic demand in South Africa has been alarmingly weak, dragging growth lower instead of providing a buffer. In fact, this is not new – South Africa has lagged global growth for more than a decade.

EMERGING MARKETS GDP: RELATIVE PERFORMANCE



Sources: IMF, Statistics South Africa

ONE THING LEADS TO ANOTHER

As we can now see very clearly, economic weakness isn't just about the economy growing slowly; it's also about weakness relative to other countries' economic performance. By growing more slowly than its peers, South Africa continues to fall behind. Both outcomes deliver fewer resources – slower absolute growth shrinks the pie, while relatively slower growth attracts less capital. This means that there are fewer resources at the disposal of both the private sector and the State, not only to stimulate further growth but also with which to address market failures, structural shortcomings, inequality and poverty.

There are several very dangerous features of economies that suffer extended periods of weak growth. First, the slow process of a decline is often not felt initially in everyday life; the consequences are only felt after a delay. In the first years, the economy can live off its capital, household and corporate balance sheets are in good health, and institutions are reasonably resilient. However, over time, weak growth triggers microeconomic decisions, such as delaying consumption, which exacerbate the downward spiral. This then leads to the second danger – that periods of growth weakness become reinforcing – and then, thirdly, that it becomes extremely difficult not only to stop the relative underperformance, but also to turn it around.

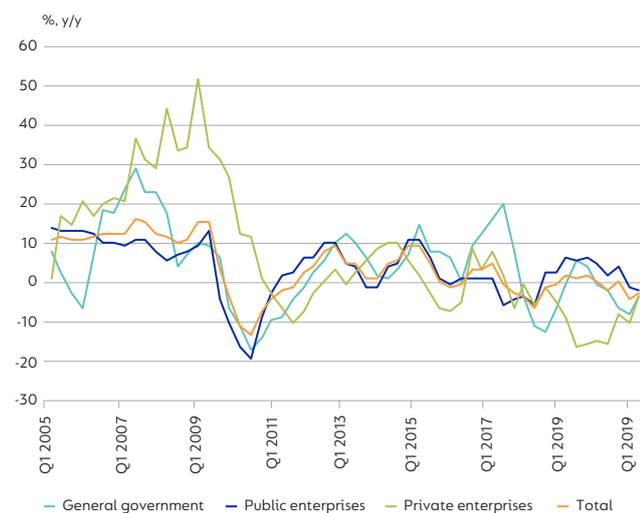
Periods of weak growth can be materially exacerbated by an increase in 'rent-seeking' behaviour among economic actors. Imagine a hypothetical economy where households have to choose one of two ways to obtain income: to engage in activities that produce goods and services that can be sold on the market or working for a salary (rent creation); or to seek a redistributive income, that is, to earn an income paid by the State or private institutions, financed by the work of other economic actors, without generating additional growth (rent seeking).

Through time, the more people who shift from productive to redistributive activity, the lower an economy's aggregate output becomes. For the unproductive, there is also increasing safety in this shift, because it becomes easier for them to hide. The economic cost of this shift from productive to extractive actors intensifies as the allocative distortions increase with the removal of resources from productive activities, and as innovation is lost. This becomes worse if rent seeking is institutionalised within the State. Rent-seeking societies prolong the weakness of growth and can lead to an insidious decline of an economy.

HOME TRUTHS

In South Africa's case, we now know that post-crisis economic weakness has been prolonged by a mal-allocation of resources that is first and foremost visible in both weak aggregate and weak relative growth. The protracted period of negative investment reflects the redistribution of resources away from productive activities and the loss of capacity in rent-creating entities. Pressure on households has increased and spending has suffered because of low income growth and rising unemployment, as well as the higher fiscal burden. Financially unviable and operationally dysfunctional state-owned enterprises (SOEs) are a further casualty of this process. The fiscal cost of this deterioration that has unfolded over the last decade is only now starting to be felt.

GROSS FIXED CAPITAL FORMATION BY SECTOR

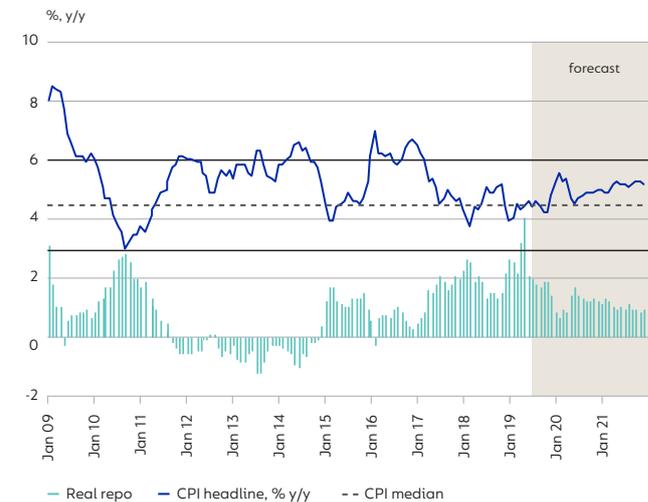


Source: Statistics South Africa

Looking ahead, our base-case expectation is for a modest, cyclical improvement in growth. We expect employment to stabilise, and for a combination of less negative compensation growth and a small, ongoing increase in credit utilisation to allow household spending to grow at 1.5% year on year (y/y)

in real terms. At this stage, we do not expect fixed investment to grow, but we should see some moderation in the extreme contraction of the past three years and possibly some normalisation in inventory levels. We forecast GDP growth this year of 0.7%, and a still-weak 1.5% in 2020. Inflation within this very weak context remains subdued, with average headline CPI forecast at 4.4% in 2019 and 5.0% in 2020. We expect the central bank to provide some monetary support for growth, and we anticipate 50bps in rate cuts this year, with the first 25bp reduction announced at the 18 July Monetary Policy Committee meeting.

CPI AND REAL RATES



Source: Statistics South Africa

On the downside, the economy remains hostage to what is now a long period of growth weakness and the negative consequences of the redirection of resource allocation over the last 10 years. This is most immediately visible in the need to provide financial support for SOEs, notably Eskom. Despite National Treasury allocating R23 billion per annum for the next 10 years in additional funding for Eskom in this year's National Budget, it has become increasingly clear that more will be needed, and sooner. Details remain unclear, but ensuring financial stability for Eskom will invariably add debt to government's already strained balance sheet, increasing the annual deficit and incurring additional financing costs.

We expect debt-to-GDP to exceed 60% in the current fiscal year and to escalate over the medium term. The pace of debt accumulation will depend heavily on the ability of the economy to move from low growth to a sustainable recovery. This, in turn, requires a dedicated enforcement of rent-creating policy implementation and practice to rehabilitate the long period of decline. +



COMMENTARY AND ANALYSIS



Are you not entertained?

How sports content (and fast cars) became frontrunners in the media content race



By John Parathyras

John is a global developed markets analyst with seven years of investment experience.



THE REALISATION THAT people attach a great deal of importance to being entertained is not a new one. One of the earliest observations dates back to first-century Rome, when the poet Juvenal decried the ‘bread and circuses’ used by government to pacify and distract the common man as he was slowly robbed of his democracy. In those days, the ‘circuses’ were the extravagant games put on in coliseums featuring violent, sometimes fatal, bouts between gladiators. Thankfully, much has changed since the days of Ancient Rome, but one thing that has endured is our collective love of being entertained – humans have always loved stories and escapism.

What has, however, changed dramatically over the intervening centuries is the media we use to consume those stories, particularly over the past 100 years or so. That change has not >

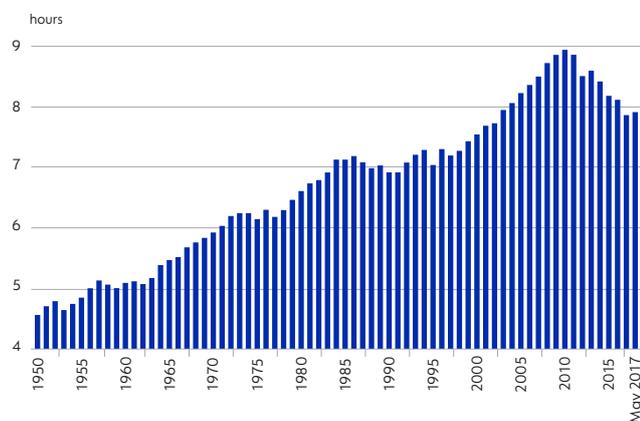
been a steady and cumulative force; rather, there have been long periods of relative stability punctuated by the arrival of a new technology that subsequently disrupted and radically reshaped consumption habits. The arrival of newspapers in the 1700s, cinema and radio in the early 1900s, TV in the 1920s and cable TV in the 1950s all fundamentally changed the media landscape.

For many decades and the entire latter half of the 20th century, TV was a dominant and pervasive form of entertainment. The amount of time the average American household spent watching TV steadily increased after its mass adoption after World War II, reaching a peak of almost nine hours per day in around 2010. Since then, this number has been declining.

WHAT HAS CHANGED?

How we consume our entertainment is undergoing another tectonic shift, this time brought about by the advent of the internet in the 1990s and the smartphone in the 2000s. This was accelerated by the spread of broadband access and the consequent dramatic decline in the cost of downloading data and rapid rise in download speeds.

HOURS OF TV AMERICAN HOUSEHOLDS WATCH PER DAY



Source: Nielsen

Consumers today now enjoy a near tyranny of choice when it comes to how to entertain themselves. The fact that traditional TV viewership is declining does not mean that those missing hours are not being spent on entertainment, but there has been a shift in how people are choosing to allocate their entertainment hours.

Estimates vary, but the average American adult spends more than three hours per day using a smartphone, double the amount of time spent a decade ago. A large proportion of this is spent on web browsing, social media, games or other forms of non-video content. But much is also being allocated to the likes of YouTube, Netflix and other providers of on-demand video content.

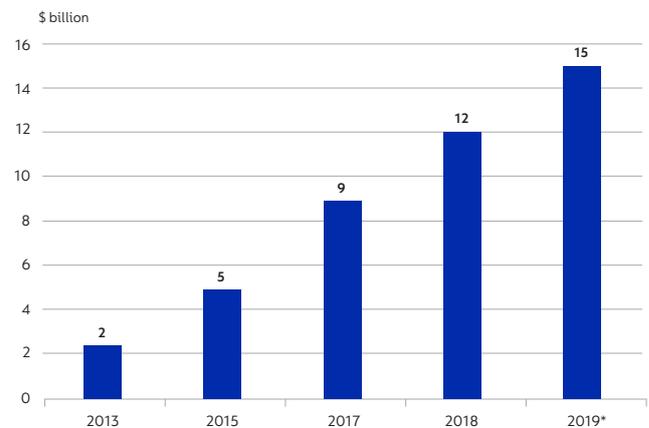
THE RACE FOR VIEWERS

The net effect is that the consumption of video entertainment in the US is not declining, but growing. And it is also growing strongly globally. A recent white paper by Cisco (a US maker of IT hardware used to transmit data over computer networks) estimated that global internet traffic has grown by 23 times over the past decade and will triple by 2022. By then, over 80% of this data is likely to be in the form of video content (up from 75% in 2017) and half will be consumed on smartphones and tablets (up from 23% in 2017).

What does this all mean? The global media landscape is shifting dramatically, given the changes in consumer viewing habits that are being enabled by new technology and new players. The creators of video content and the traditional pay-TV distributors of that content are facing increasing competition for eyeballs (as well as so-called 'cord-cutting' from consumers cancelling their service) from new 'over-the-top' (OTT) players like Netflix, Apple TV, Amazon Prime Video and Hulu that offer video-on-demand (VOD) over the internet.

But these new players now find themselves in a content 'arms race' and they are spending vast sums of money on creating new video content to establish a beachhead in this new world. Netflix is expected to spend \$15 billion this year on original video content, up from only \$2 billion six years ago; Apple is aiming to spend at least \$1 billion on original content ahead of launching its own OTT service; and Amazon is likely to spend \$7 billion this year, up from \$5 billion last year.

VIDEO CONTENT BUDGET OF NETFLIX WORLDWIDE



* statista.com states that "Wall Street analysts see [the] \$12.04 billion figure climbing 25% - to around \$15 billion on a gross cash basis" in 2019. Figures prior to 2017 and 2018, and forecasts for 2019 come from an earlier article.

Sources: eMarketer, JPMorgan Chase, IHS, Netflix, Business Insider, Statista, FierceCable, Variety

All of this is great for consumers who now have more choice of what to watch (the number of scripted TV shows in the US has more than doubled since 2010), where to watch it (on



TV, internet-enabled TV, smartphone or tablet) and when to watch it. This last point is worth noting for an important reason: the rise of video streaming over the internet intensifies what the pay-TV distributors started years ago with the introduction of VOD technology, namely a reduction in the proportion of TV that is watched live. This means that viewers are now less likely to sit through advertisements, which makes video content less attractive to advertisers.

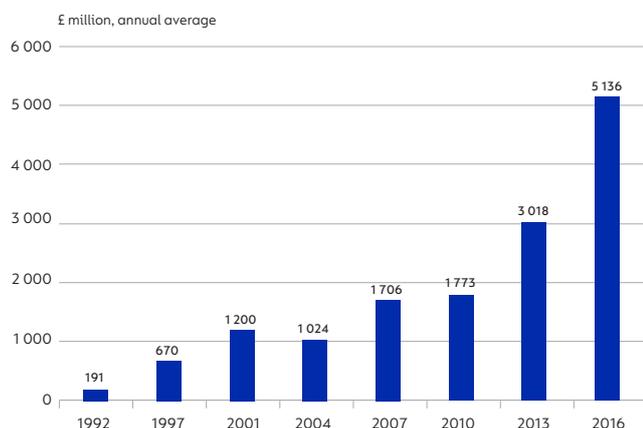
NOT ALL CONTENT IS EQUAL

There is an adage in the media industry that 'content is king'. But this proliferation of original video content available on-demand makes it more challenging for content creators and distributors to capture large audiences and monetise their content. There is one notable exception, however: sports content is hugely valuable and becoming increasingly so.

In the US, the fee that pay-TV distributors are charged by ESPN (the largest sports channel) to include it in their offering is around four times that of the next highest fee channel. And channels like ESPN pay sports leagues increasingly large amounts of money for the rights to broadcast their games. For example, National Football League (NFL) broadcast rights have risen by roughly five times over the past two decades (well ahead of nominal GDP growth).

This is not only a US phenomenon: the domestic broadcast rights for the English Premier League have risen by 27 times in 25 years, and the tech giants are also starting to compete aggressively for sports rights. Last year, Amazon renewed a deal with the NFL for the rights to stream 11 of its games for \$65 million per year – 30% more than Amazon paid for the same rights in the previous season, driven by fierce competition from its rivals Twitter and YouTube, and almost seven times what Twitter paid for these rights in 2016.

PREMIER LEAGUE TV DOMESTIC BROADCASTING RIGHTS REVENUE

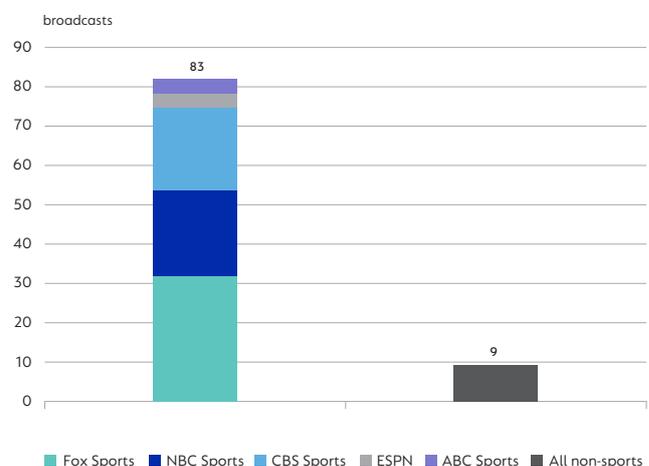


Source: BBC

Sports content is attractive for a few reasons. The first is that people (increasingly) love watching sports. In 1998, 25% of the top 100 traditional TV broadcasts in the US were sports events; in 2018 this figure grew to 88%. Second, at the risk of stating the obvious, no new major sports are being invented. Unlike other forms of entertainment, such as TV shows or movies, someone cannot set up a new sport and churn out content to compete with existing sports. Third, most of the world's big sports have well-established leagues and it is nearly impossible to start a new league that can compete.

This means that the supply of sports content has constraints and is relatively limited versus most other forms of content. Finally, most sports are watched live: sports are viewed live more than 95% of the time versus less than 50% for regular non-sports traditional TV content. What this boils down to is that sports draw large, live audiences who are willing to pay to view them, and thus are highly engaged, making sporting events attractive to advertisers. This is certainly a compelling option in an increasingly fragmented and competitive media landscape. As investors, it would be great if we could capitalise on this.

US TV BROADCASTS DELIVERING 20 MILLION+ VIEWERS IN 2017/2018



Source: Nielsen

THE FORMULA FOR SUCCESS?

Unfortunately, there are few options available to investors in public markets to invest in sports content. There are a few publicly listed football teams such as Manchester United and Juventus, but the real owners of sports content (and hence the broadcast rights to that content) are the leagues themselves; there is a limited number of global sports leagues and even fewer that are directly investable. For example, one cannot buy shares in the FIFA World Cup or the Olympics, as they are not listed or private entities, but rather not-for-profit organisations. However, fairly recently, one truly global sport has been listed and is now investable: Formula One (F1).



1950
ESTABLISHED



10
TEAMS



20+
RACES



500m
UNIQUE VIEWERS



200
TERRITORIES

In January 2017, Liberty Media Corporation acquired 100% ownership of the then privately owned parent company of the F1 Group, which holds the commercial rights to the sport of F1 for the next 90-odd years. The F1 Group was subsequently listed and now trades on the US stock market. F1 is the premier global motorsport series, with a long history and almost 500 million unique viewers in nearly 200 territories watching 10 teams fight it out in around 20 races across five continents every year. F1 is arguably the only global sports league or event other than the Olympics and the FIFA World Cup, but a noteworthy difference is that, unlike the Olympics and the World Cup, F1 happens every year.

PRICED OUT

F1 makes most of its money from broadcasting rights and the fees it collects from race hosts (each roughly one third of its revenue), with the rest coming from sponsorship deals, merchandising, licensing its intellectual property and a few other smaller items. On the cost side, F1's largest cost of doing business is by far the roughly half of its revenue that it pays to the race teams. Fielding an F1 race team is horrendously expensive – there are no budget caps in the sport and so there is an incentive to spend as much as possible to create the fastest car possible to improve one's chances of winning.

A mid-tier race team is estimated to spend roughly \$150 million per season, while top teams like Ferrari and Mercedes likely spend as much as three times that amount. This means that despite the F1 league paying \$1 billion of its revenue over to the race teams every year, most, if not all, teams are loss-making. The high cost of competing makes many teams unsustainable (since the first F1 race in 1950, over 150 race teams have come and gone), deters even large automakers from entering the sport and can make for duller racing on the track as deep-pocketed teams simply outspend the rest of the field.

DRIVING EFFICIENCY

There is reason to be optimistic that the new managers of F1 can better monetise the sport and, potentially, reduce how much revenue flows to the teams. For example, on a per-viewer basis, F1 earns \$1 in broadcast rights for every \$5 the NFL makes and every \$3 the English Premier League earns. There is also room for improvement on sponsorships: when Liberty took over, only 13 of the races had title sponsors and F1 had only nine official partners (versus 47 for the PGA, 34 for the Olympics and 33 for the NFL).

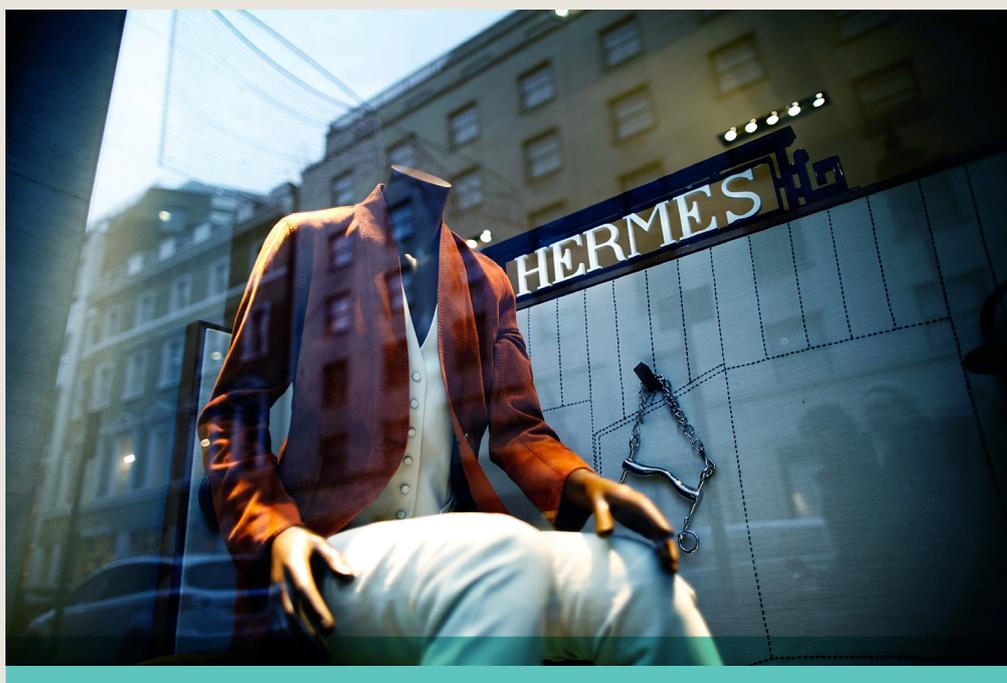
On the cost side, although perhaps easier said than done, if Liberty can successfully negotiate better cost controls, it will improve team economics, increase how much profit it can retain, and possibly even make for a better racing spectacle by creating a more level playing field. Liberty is currently in negotiations with the race teams to make this happen and has some capable people in its ranks working on it.

Beyond this, Liberty is focused on growing awareness of the sport, including a recent 10-episode Netflix documentary and investing in an F1 esports series. After declining in recent years, F1's global viewership rose by 10% last year. A standalone F1 OTT product is also being rolled out to monetise hardcore fans.

F1 is a very rare and iconic asset, and one of the most watched events on the planet. As an investment, it is a way to capitalise on the heightened competitive environment and demand for sports content discussed above, while also offering levers that can be pulled by F1's management to improve the sport and strongly grow its revenue and profits. We recently took a position in the F1 Group in our Global Equity Strategy on behalf of our clients. Like the Ancient Romans did with theirs, we will be watching the F1 circus closely. +



GLOBAL STOCK ANALYSIS



The luxury goods love affair

When desirability becomes necessity



By Lisa Haakman

Lisa is an equity analyst with 13 years of investment experience.



YOU'RE 25, AND you spot an object of desire across the room. You ask around, find out their name, and then set out to do some research on them. You stalk them on every available social media platform – check how many mutual friends you have on Facebook and see how many followers they have on Instagram – verifying their ‘desirability’. Having established their suitability as a partner, you express some interest.

So the courtship begins. They woo you at every turn ... invitations to prestigious events, flowing champagne, playful flirting, subtle compliments and charm. They seem to know exactly what you like. What began as infatuation evolves into falling in love. It's exhilarating, you're obsessed. They're all you can think about. You begin planning a future together, you picture them on your arm forever.



Not your future marital partner, but a Hermès Birkin bag. Or a Chanel 2.55. Or a Lady Dior. All of them are classic enough to be on your arm forever. In fact, Louis Vuitton still sells two bags it designed in the 1930s, the Keepall and the Noé.



LOUIS VUITTON KEEPALL



LOUIS VUITTON NOÉ

The relationship between a consumer and a luxury goods company can ebb and flow and, much like the dating game, the rules are changing in this increasingly digital world. Many of the luxury companies are struggling to keep apace, while others are thriving in this new paradigm.

FOREVER LOVE

Our work on the luxury sector has identified a number of key tenets to ensuring a lasting romance:

Luxury companies are clearly polygamists but need to create the illusion of being in a monogamous relationship with you. This is the largest conundrum for luxury companies; creating and maintaining perceived exclusivity while still selling millions of products each year. It is a very fine balancing act between growth and ubiquity, and brands that grow too quickly run the risk of losing brand cachet and desirability. Successful brands such as Louis Vuitton and Hermès have achieved this by continually putting through price increases rather than increasing volume, increasing product ranges, launching exclusive capsule collections with known artists and celebrities, and expanding product categories into areas such as luggage, accessories, beauty, perfume and cosmetics.

Luxury companies must never devalue your relationship. Many luxury companies sell entry-priced items but manage to do so without devaluing their core brand. Selling entry-priced items is important in courting 'new-to-luxury' customers and serves to reduce the cyclical nature of the business. But doing so without devaluing the brand is a balancing act. Brands achieve this by only ever advertising their most expensive products. This has the additional positive outcome that when a consumer finds a less expensive item, they feel like they are getting a bargain, perhaps even a mispriced item. In addition, brands ensure that entry-priced items are

never readily available. There is often a lengthy waiting list, such as for the Rolex Submariner Hulk.

Luxury companies must never undersell themselves. Louis Vuitton is famous for saying they would rather incinerate unsold products than sell them at a discount. Luxury brands have all come to realise this is the correct strategy, but many have opted still to have specific outlet stores which sell the off-price items, minimising the impact to the brand while still allowing them to clear unwanted inventory. Christian Louboutin, Hermès, Tiffany and Louis Vuitton are four brands that have zero promotions and no outlet stores either, cementing the strength of their brands and serving as an aspiration for peers.

PROPORTION OF OUTLET STORES IN THE STORE BASE

| Brand | Full-price stores | Outlets | Ratio |
|---------------------|-------------------|---------|-------|
| Michael Kors | 760 | 114 | 6.7 |
| Coach | 859 | 127 | 6.8 |
| Ermenegildo Zegna | 482 | 60 | 8.0 |
| Valentino | 272 | 31 | 8.8 |
| Alexander McQueen | 74 | 8 | 9.3 |
| Tod's | 268 | 27 | 9.9 |
| Versace | 339 | 34 | 10.0 |
| Saint Laurent | 242 | 24 | 10.1 |
| Gucci | 594 | 58 | 10.2 |
| Dolce & Gabbana | 313 | 29 | 10.8 |
| Loro Piana | 167 | 15 | 11.1 |
| Burberry | 486 | 43 | 11.3 |
| Salvatore Ferragamo | 366 | 29 | 12.6 |
| Givenchy | 129 | 9 | 14.3 |
| Moncler | 224 | 15 | 14.9 |
| Prada | 420 | 25 | 16.8 |
| Armani | 2 070 | 92 | 22.5 |
| Miu Miu | 185 | 7 | 26.4 |
| Bottega Veneta | 344 | 12 | 28.7 |
| Celine | 209 | 7 | 29.9 |
| Balenciaga | 181 | 6 | 30.2 |
| Bulgari | 322 | 10 | 32.2 |
| Christian Louboutin | 147 | 0 | n/a |
| Hermès | 315 | 0 | n/a |
| Louis Vuitton | 490 | 0 | n/a |
| Tiffany | 480 | 0 | n/a |

Sources: RE Analytics, Bernstein Analysis

Luxury companies must get to know you and control the path of the relationship. Luxury brands that sell wholesale and rely on third-party companies to sell to the end-consumer are not in control of their own destiny. They cannot get to know their



customer, are not in control of the customer experience and run the risk that the end-customer winds up loyal to the third party rather than to the brand.

The truly successful brands are those that sell 100% retail, own all their own stores and operate their own ecommerce sites, or operate via a concession on an e-tailer. This allows them to build up knowledge of their client in order to generate personalised recommendations and utilise the data to drive revenue.

PROPORTION OF SALES VIA WHOLESALERS

| Brand | Wholesale |
|---------------------|-----------|
| Armani | 70% |
| Coach | 62% |
| Christian Louboutin | 60% |
| Alexander McQueen | 49% |
| Balenciaga | 49% |
| Ermenegildo Zegna | 45% |
| Salvatore Ferragamo | 41% |
| Moncler | 37% |
| Michael Kors | 35% |
| Saint Laurent | 32% |
| Loro Piana | 32% |
| Givenchy | 32% |
| Celine | 32% |
| Bulgari | 32% |
| Tod's | 30% |
| Versace | 27% |
| Dolce & Gabbana | 20% |
| Burberry | 20% |
| Prada | 18% |
| Miu Miu | 18% |
| Bottega Veneta | 18% |
| Gucci | 15% |
| Hermès | 15% |
| Valentino | 12% |
| Louis Vuitton | 0% |
| Tiffany | 0% |

Sources: RE Analytics, Bernstein Analysis

Luxury companies must ensure you continue to feel special.

Luxury companies can achieve this with specialised treatment for their VIP customers, as well as through exclusive offers. Many luxury brands invite their most important customers to exclusive events and fashion shows. Louis Vuitton offered its Supreme/ Louis Vuitton capsule to VIP customers on an invitation-only basis.

Luxury companies must relentlessly maintain their beauty.

Luxury companies need to invest continuously in their store network, their creativity and their marketing. Stores are expressions of art, style and beauty – they need to provide an experience, not just a clothing rail, and need to be continually revamped. Creative directors need to keep designs fresh and unique, and marketing directors need to keep the brands alive and relevant.

Luxury companies must be good at social media.

Social media likes, comments and followers are becoming increasingly important in creating brand desirability. Chinese consumers and millennials are becoming bigger luxury consumers, and they are often digitally native consumers. Many luxury goods companies are currently launching Instagram click-through sales and this channel looks set to become increasingly important. Kering is currently the leader in embracing digital, with Gucci the largest-selling online brand.

In an increasingly narcissistic world, luxury goods companies are thriving. Their products allow consumers to look and feel better about themselves by owning an item which they perceive as special and exclusive. Even better, they can Instagram themselves, earning kudos and credibility in an increasingly superficial world.

ATTRACTIVE IN MORE WAYS THAN ONE

Luxury companies are better businesses than we at first appreciated. This is for a number of reasons:

There are a finite number of brands. The majority of the truly successful brands have two things in common – heritage and provenance. One of the things required for a luxury brand to gain legitimacy is time. Relatively ‘new’ brands such as Dior, Saint Laurent and Ferragamo are more than 50 years old. Gucci, Fendi, Loro Piana and Prada are over 100 years old, and Hermès, Cartier, Louis Vuitton and Burberry are more than 200 years old. Provenance is equally important. With only a few exceptions, such as Burberry in the UK or Loewe in Spain, nearly all of the luxury houses are either Italian or French. As a result, it is highly unlikely that new brands or new competitors would spring up overnight.

Barriers to entry are high, especially with the demise of department stores.

A certain level of scale is required in order to afford a very expensive store network located in prime retail locations, an ecommerce platform and expensive marketing. This has raised barriers to entry for newcomers.

Pricing power and exponential price relative to quality.

Brands are able to charge exponentially higher prices for slightly higher quality items. This enables luxury goods companies to deliver extremely high margins and high returns on capital, compounding returns for shareholders.

Excellent cash flow generation. Many of the luxury goods companies are excellent cash flow generators, converting c. 90% of earnings to cash.

Luxury goods companies with strong portfolios of brands are relatively defensive. The LVMH Moët Hennessy Louis Vuitton (LVMH) portfolio of brands is both geographically and divisionally diversified, creating a defensive portfolio. In 2009, revenue declined by only 0.8% while operating income fell by only 7.6%, an admirable achievement during the Global Financial Crisis.

As a result, we believe luxury companies are far better businesses than often perceived. In our view, they are among the best businesses in the world.

We particularly like those luxury companies that are run by astute management teams with large shareholdings in their personal capacities, such as LVMH, owned by the Arnault family and Kering, owned by the Pinault family. Both businesses have generated significant returns for shareholders over all meaningful time periods, and we look forward to long and lasting relationships with both of them. +



GLOBAL ECONOMY



Global chill

World economy balancing on regional tensions and precarious geopolitical alliances



By Marie Antelme

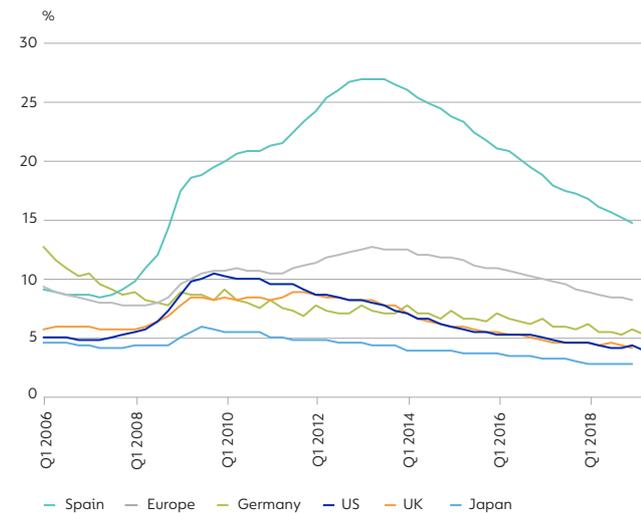
IT'S HARD TO judge whether global growth is bottoming out, or on the brink of a sharper, more aggressive moderation. After slowing for most of 2018 and into the first quarter of 2019 (Q1-19), global growth momentum seemed to be showing signs of stabilising early in the second quarter (Q2-19). Activity indicators remain mixed but, in general, developed economies continue to benefit from durable domestic demand, underpinned by tight labour markets with low unemployment and positive real wage growth and, in some cases, more supportive fiscal policies. This source of resilience is, however, increasingly challenged by a considerably weaker external environment, broadly reflecting a combination of weak Chinese economic activity, the escalation in trade tensions globally (not limited to the US and China) and the ever-increasing associated uncertainty that threatens to undermine domestic demand.

Marie is an economist with 18 years' experience in financial markets.



The outlook for global growth for the remainder of the year and into 2020 will depend on the balance of these two forces – can domestic demand and supportive monetary and fiscal policies offset the drag on growth that weak global trade and pervasive uncertainty exert?

GLOBAL UNEMPLOYMENT RATE BY COUNTRY



Source: Datastream

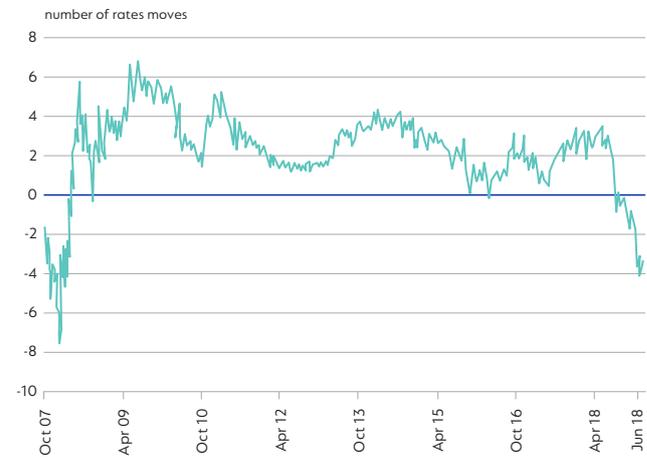
In the face of weaker activity data, global central banks have committed to ongoing monetary support. The clearest message has come from the European Central Bank (ECB), which has not only guided that the policy rate will remain low well into 2020 but has also announced an extension of its quantitative easing programme.

The US Federal Reserve's (Fed) communication turned more dovish early this year (after having hiked the policy rate 25 basis points [bps] to 2.5% in December 2018), but recent policy meeting minutes suggest actual easing is in fact imminent. Consensus expectations have built for a 25bps to 50bps cut at the July Federal Open Market Committee meeting, while the market pricing is for aggressive easing of a full 100bps over the next year.

In Europe, ECB policy rate guidance appears to be in line with what is becoming a more prolonged period of European growth weakness. As trade comprises a large proportion of Europe's GDP, especially in countries such as Germany, and supply chains are highly integrated, the region is more broadly exposed to trade tensions.

The outlook at this stage for US interest rates is less clear, given more mixed domestic data, particularly in the case of recent employment and investment indicators. Global risk assets have nonetheless been well supported by falling rate expectations, and we expect this dynamic to remain in play for now, as growth remains soft in larger developed economies, with downside risk.

MARKET PRICING OF FED CUTS



Source: Morgan Stanley

TRADE TENSIONS REMAIN CENTRE STAGE

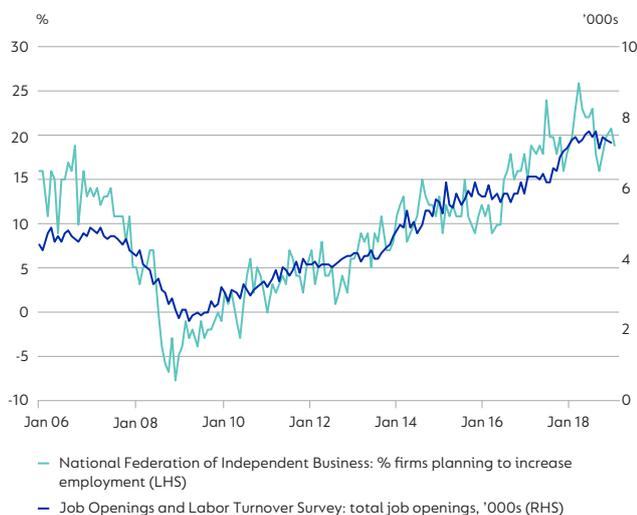
Looking ahead, the suspension of planned tariff increases agreed to at the G20 Summit in Osaka in June has provided some temporary relief and pushed out the more immediate and damaging risk that would have been posed had they come into effect now.

The economic impact of trade wars is addressed by Professor Eichengreen in the cover article on page 5, but it is nonetheless pertinent to mention here too. The tariff increases implemented since early 2018 have raised the weighted-average US tariff from c. 1.8% to 4.5%. While the next step would have elevated this significantly, the tariff increases alone have already diverted traditional trading arrangements, disrupted supply chains, raised the cost of intermediate goods (as well as some end-products) and are more likely in the short term to have undermined new activity supporting orders and longer term, investment plans. In addition, the ancillary effect of tighter financial market conditions compounds the economic impact and will continue to do so as issues arise, as we expect them to, over time.

The US economy has been relatively resilient through this period of rising uncertainty. GDP growth accelerated in Q1-19 to 3.1% quarter on quarter, seasonally adjusted and annualised (q/q, saa), from 2.9% in 2018, despite higher policy rates. Strong inventory building contributed positively to growth, with a solid underpin from consumer spending and relatively good capital formation, outside of housing. Net trade benefited from lower intermediate goods imports (reflecting higher tariffs). Despite some weaker data which followed in Q2-19, including a weak jobs report for May, most recently available data point to healthy employment gains, stronger housing activity and healthy durable goods orders. US GDP growth is expected to moderate to about 2.7% in 2019 from 2.9% in 2018, and to trend at about 2% in 2020.



US LABOUR MARKET TIGHTNESS

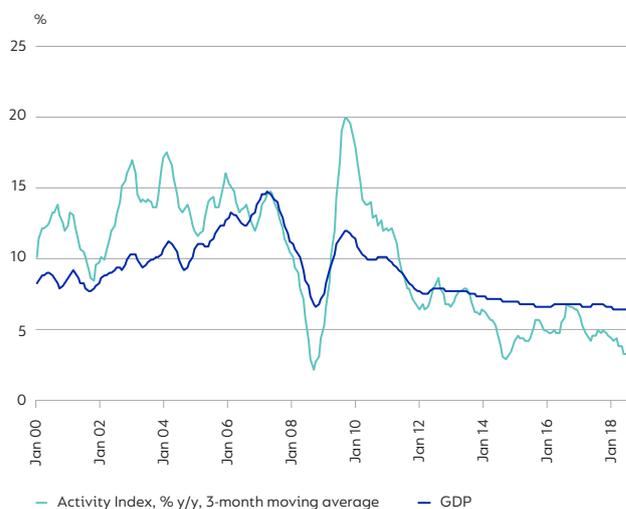


Source: Datastream

European growth has suffered both idiosyncratic shocks and a general drag from weaker global trade. Germany, Europe's largest economy, suffered a contraction in growth in Q3-18 as new emissions regulations disrupted motor and other manufacturing activity. This was compounded by weak growth out of China and the general deterioration in global trade volumes. With strong supply chain links to broader Europe, GDP growth was 1.6% q/q, saa in Q1-19, from 1.8% in 2018. Strong labour markets have been a solid support of consumer spending, but some cracks are emerging. Where the services sectors have shown strong growth and relatively little impact from weak trade (which has severely impacted manufacturing), forward-looking indicators have deteriorated, and some labour indicators are less strong. Broadly, growth expectations have been revised lower as trade uncertainty persists and risks of a broader economic contagion increase.

The UK economy, after a period of relative resilience despite the messy Brexit process, is now also showing stronger signs of slowing. GDP growth was 1.9% q/q, saa in Q1-19, from 1.4% in Q4-18, but is expected to slow to 1.2% by 2020. Politics will continue to dominate economic outcomes in the UK. Following the resignation of Prime Minister Theresa May, the Conservative Party must now elect a new leader to navigate an increasingly chaotic Brexit process, with Boris Johnson currently the front-running candidate. Mr Johnson's seeming willingness to deliver a no-deal Brexit should new terms not be agreed is a meaningful threat to UK growth. At this time, it is hard to see what political agreement can possibly be reached, given the actors involved, and even less likely that the EU will be open to further negotiations under new UK leadership.

CHINESE ACTIVITY VERSUS GDP



Source: Emerging Advisors Group

GDP growth in China remains subdued, hostage to the changeable and fraught trade negotiation process. Chinese policymakers have intervened to bolster demand by cutting the reserve requirement ratio 350bps since March 2018, in an increasingly responsive manner. Total tax and fee cuts amounting to an estimated 2% of GDP have also started to be implemented, and there has been an acceleration in both credit availability and social funding. Official GDP growth was 6.4% in Q1-19, from 6.6% in Q4-18, but most activity data remain well below this. While activity is no longer slowing, for now there seems little evidence that interventions have helped boost demand yet.

Given the ongoing economic impact of the prolonged period of credit tightening which started in 2017, we expect the Chinese economy to continue to grow slowly through 2020. Elsewhere in emerging markets, the impact of higher tariffs and the threat of further escalation remains a drag on growth. Some improvement in GDP growth in Turkey and Argentina after recessions in 2018 helped lift the aggregate, but the external risk is likely to remain a dominant drag on growth.

In closing, an ongoing, escalating risk to global economic outcomes is the loosening of traditional geopolitical alliances and an escalation in regional tensions, any number of which could have a significant impact on markets in coming months. The recent intensification of hostility between the US and Iran is almost certainly not over, but the longer game remains the strategic tension between the US and China, which we expect will continue for the foreseeable future. +



COMMENTARY AND ANALYSIS



The grass is not always greener

Offshore acquisitions by domestic companies



By Quinton Ivan

"I'm no genius, but I'm smart in spots, and I stay around those spots." – Tom Watson Snr, founder of IBM

WARREN BUFFETT FREQUENTLY uses the concept of the 'circle of competence' in his letters to Berkshire Hathaway shareholders to illustrate the importance of staying focused. This applies equally to capital allocation decisions in a business. Despite building formidable businesses and raising the barriers to entry for new entrants during years of operating in a closed, domestic economy pre-1994, there is a preoccupation among many South African management teams that the grass is greener elsewhere. This has led many domestic companies to expand offshore, usually by acquisition, the majority of which have had disastrous consequences for shareholders.

There is the odd success story, but they are the exception rather than the rule. Offshore acquisitions by domestic companies have been pervasive across sectors – as an example, virtually every major South African life insurer and commercial bank has acquired a business outside of South Africa. Of the numerous examples in our market, two of the larger transactions recently undertaken are interesting case studies.

Quinton is Head of South African Equity Research and a portfolio manager.





ACQUISITION OF DAVID JONES BY WOOLWORTHS HOLDINGS

Woolworths Holdings announced in April 2014 that it would pay R21.4 billion (A\$2.1 billion) for David Jones, the iconic Australian department store. David Jones services the more affluent Australian consumer through a network of 38 stores, four of which it owned, including the flagship department stores in Sydney and Melbourne. This was a sizeable transaction, comprising nearly a third of Woolworths' market capitalisation at the time, and valued David Jones at a 21 times price earnings multiple based on its last reported earnings.

Fundamentals in place

While South African retailers have a dismal track record in acquiring businesses in Australia – most notably Pick n Pay's failed acquisition of Franklins and Truworths International's unsuccessful foray with Sportsgirl – investors were prepared to back Woolworths CEO Ian Moir.

Moir was appointed CEO in November 2010 after successfully turning around Country Road, another Australian retailer acquired by Woolworths in 1998. Up until the acquisition of David Jones, Moir had an enviable track record – Group revenue and profits grew strongly during his tenure, compounding at 14% and 23% per annum, respectively. Although department stores have come under threat globally, losing market share to specialist and online retailers, the rationale for acquiring David Jones sounded compelling:

- It had been undermanaged for several years and basic retail discipline had slipped, which was evident in its steadily declining trading densities.
- Underinvestment in IT systems and poor processes meant that it lagged its peers in online retail, lacked a compelling loyalty programme and had a poor omnichannel offering.
- Private label product was nonexistent (only 3.5% of revenue) and there was an opportunity to improve operating margins and profitability by selling more David Jones and Woolworths brands through its store network.
- There were significant scale benefits that would allow the enlarged Group to leverage its buying power and design capabilities, which would improve price efficiency. This would allow Woolworths to strengthen its southern hemisphere platform as a defence against northern hemisphere entrants such as H&M and Zara, both in South Africa and Australia.

The net result of these initiatives was an expected uplift of between A\$130 million and A\$170 million per annum in incremental earnings within the next five years. This was significant in the context of David Jones having generated A\$143 million operating profit at the time of acquisition.

VALUE CREATION OPPORTUNITIES IN EXCESS OF ~R1.4 BILLION PER ANNUM WITHIN 5 YEARS

| | EBIT impact | Timing of benefits |
|---|-----------------|--------------------|
| 1 Introduction of Woolworths Holdings private label | A\$70m - A\$80m | FY15E - FY17E |
| 2 Growth of Country Road Group concession brands | A\$30m - A\$40m | FY15E - FY17E |
| 3 Introduction of David Jones loyalty scheme | Nil assumed | FY16E - FY18E |
| 4 Enhance omnichannel performance | Nil assumed | FY15E - FY19E |
| 5 Optimise Group real estate portfolio | A\$20m - A\$30m | FY17E - FY19E |
| 6 Improved margin through Group sourcing strategy | A\$10m - A\$20m | FY16E - FY19E |
| Total | ~A\$130 million | |

Source: Woolworths roadshow presentation: acquisition of David Jones, 9-10 May 2014

This target was described as 'conservative' by Woolworths, indicating its confidence in extracting these synergies, thereby justifying the high price paid. Initially, this confidence was vindicated as profitability improved at David Jones. Woolworths appeared to be executing flawlessly and seemed to uncover further opportunities to enhance value, including launching a fresh and prepared foods business in Australia.

David Jones grew sales ahead of the market, gaining market share from its major competitor, Myer. Margins expanded and nearly a fifth of the purchase price was recouped when it sold its Market Street property in Sydney to the Scentre Group for A\$360 million.

These proceeds would be used to fund its capital expenditure programme, including the implementation of new IT and finance systems, relocating its head office to join that of Country Road in Melbourne, refurbishing its flagship Elizabeth Street store, and trialling its food concept.

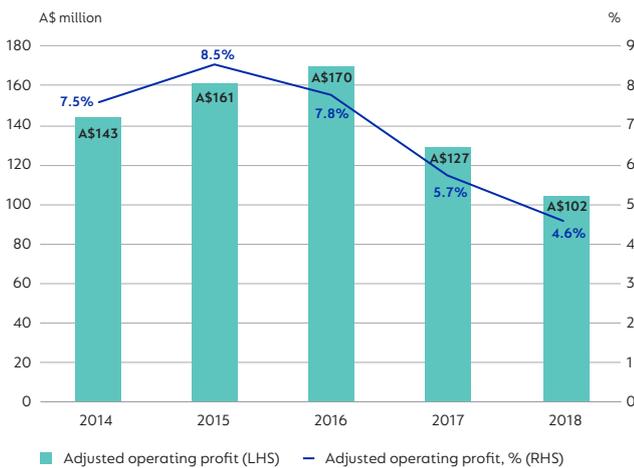
Conditions deteriorated

All appeared to be going according to plan, until trading took a turn for the worse in 2017, due to the following factors:

- The Australian retail environment deteriorated as discretionary spend came under pressure, exacerbated by high levels of consumer indebtedness. This resulted in heavy discounting as retailers competed aggressively for market share, leading to pressure on both revenue growth and gross margins.
- The introduction of private label product failed to resonate with the David Jones consumer. This was a significant setback, as it was anticipated that this move would generate around half of the synergies announced at the time of acquisition.

- The deterioration in financial performance resulted in several management changes within a short period of time. As a result, Moir and other South African managers were forced to become increasingly involved in the daily running of David Jones. This was at the expense of the South African operations, which were also experiencing a highly competitive retail environment and a declining economy.
- These setbacks occurred during a period when David Jones was implementing various transformative projects, such as the Elizabeth Street refurbishment, investment in an omnichannel and loyalty programme, new merchandising and finance systems, head office relocation, and a food concept trial. The associated implementation costs further reduced profitability.

DAVID JONES' PROFITABILITY TRAJECTORY SINCE BEING ACQUIRED BY WOOLWORTHS



Sources: Woolworths results presentation, Coronation analysis

The above graph shows how profitability grew during the first two years post-acquisition, reaching a peak of A\$170 million before collapsing and eventually troughing at A\$102 million – a decline of 29% since acquisition and 40% from the peak.

This decline weighed heavily on Woolworths' investment in David Jones and culminated in an impairment charge of A\$712.5 million (R6.9 billion) taken in January 2018, effectively writing off a third of its initial investment.

Transformation push

Woolworths' transformative initiatives appear sound – a similar strategy has been adopted by successful department stores elsewhere in the world such as John Lewis, Selfridges and Bon Marche – and should enable David Jones to compete more effectively against online and specialist retailers, and to address the impact of undermanagement.

While Woolworths may be able to extract some value from David Jones in the short term, there is a significant risk that it has acquired a 'melting ice cube' – department stores globally are increasingly under threat from online retailers and changing consumer shopping patterns. It is possible that it will continue to lose relevance over time.

This would be a disappointing outcome for shareholders, not only in terms of the potential value at risk, but also the significant management distraction away from the core South African operations. It will become evident over the next 18 months which way this investment is panning out.

SASOL'S LAKE CHARLES CHEMICALS PROJECT

In late 2012, Sasol announced that it was progressing the front-end engineering and design of the Lake Charles Chemicals Project (LCCP), an ethane cracker and gas-to-liquids (GTL) project in Lake Charles, Louisiana, on the Gulf of Mexico.

The advent of the US shale industry meant that it would have surplus natural gas, including ethane and methane gas. An ethane cracker uses ethane gas, and processes or 'cracks' it into ethylene and other derivative products. A GTL plant uses a refinery process to convert methane gas into longer-chain hydrocarbons, such as diesel.

The prices of these finished products are determined relative to the oil price. Effectively, the LCCP was looking to exploit the price differential between cheap feedstock (due to a surplus of natural gas caused by the booming shale industry) and a high oil price.

In October 2014, Sasol announced the final approval for the LCCP, with beneficial operation expected to begin in 2018.

The total expected cost of approximately \$8.9 billion, c. 27% of Sasol's market capitalisation at the time, was roughly \$3 billion to \$4 billion higher than comparable ethane cracker projects being constructed in the region by peers such as Dow Chemical Company and Chevron Phillips Chemical Company. Sasol justified this differential due to:

- Competitors already having considerable polyethylene infrastructure in place.
- Differing downstream chemical derivative configurations – Sasol would have a greater mix of higher valued finished products.
- The LCCP also included some capital expenditure in respect of the GTL plant.

Despite the significant project cost, Sasol's management was confident that the LCCP investment case was sound and ticked all the necessary boxes.



SASOL'S INVESTMENT CRITERIA UNDERPIN A SOUND BUSINESS CASE

| Robust project economics | |
|--------------------------|---|
| Technology | Do we have a technology, scale of plant or operating know-how that provides a competitive advantage? |
| Feedstock | Do we have a leading low-cost feedstock? |
| Market | Do we have a product or market position that provides us with a compelling business case? |
| Capability | Do we have the required project execution capability to execute the project within schedule and on budget? |
| Financing | Do we have access to adequate funding while maintaining our targeted gearing and progressive dividend policy? |

Source: Sasol LCCP investor presentation

Stress test

The economics of the LCCP were initially based on the following key assumptions:

- A long-term real oil price of around \$100 per barrel and stress tested at \$90 per barrel.
- A long-term Henry Hub gas price of \$3 to \$4 per metric million British thermal unit.

Based on these assumptions, Sasol was confident that the case for LCCP was robust and it was expected to exceed its hurdle rate of 10.4% in US dollar terms (1.3 times Sasol's weighted average cost of capital [WACC]).

Anyone who has ever built or renovated a house knows that large projects are unlikely to be completed timeously and on budget. This well-known fact, combined with the vagaries of oil and natural gas price fluctuations, meant that the LCCP was doomed to overrun. The 'robust' economics of the LCCP would soon be tested by external and internal conditions:

- The oil price crashed in late 2014, causing Sasol to reduce its long-term real oil price assumption to \$80 per barrel. Under this scenario, the project's internal rate of return (IRR) would still be expected to exceed its WACC but fall short of the 10.4% project hurdle rate.
- In March 2016, Sasol announced a delay of six to 12 months, shifting the beneficial operation of the smaller derivative units out to 2019 due to the company pacing out the project in line with a lower oil price as well as 'some initial challenges'. These challenges resulted in Sasol revising the cost of the LCCP higher, to \$11 billion in June 2016, due to:
 - construction delays caused by above-average rainfall and subsequent hurricanes (Harvey, Irma and Nate) off the Gulf coast;
 - poor ground conditions;
 - higher-than-expected labour costs;

- certain components of the lump-sum bid contract prices being higher than originally estimated; and
- required quantities of bulk materials overshooting the original estimates.

While these delays resulted in an approximate 25% increase in the cost of the LCCP to just over \$11 billion, conditions deteriorated again in early 2019, as follows:

- IHS, the chemical consultancy used by Sasol on the project, reported a further potential delay of around three to five months. Sasol confirmed this delay in early February 2019, causing it to revise the LCCP cost higher, to between \$11.6 billion and \$11.8 billion.
- Despite reaffirming the revised cost at an investor conference in March 2019, Sasol then shocked investors in mid-May by revising the project's cost higher, to between \$12.6 billion and \$12.9 billion. This latest overrun resulted in Sasol lowering the overall expected IRR to between 6% and 6.5%, which is well below its WACC. This means that even if the remainder of the project unfolds as expected and in line with Sasol's financial assumptions, the LCCP would destroy significant economic value for shareholders.

The significant cost slippage and value destruction from the time of first approving the LCCP are apparent in the following table.

COST SLIPPAGE AND VALUE DESTRUCTION SINCE LCCP APPROVAL

| Date | Cost (\$ million) | % completion | Overrun | Expected IRR (in \$ terms) | % of Sasol market capitalisation |
|----------|---------------------|---------------|---|--|----------------------------------|
| Oct 2014 | \$8 900 | LCCP approval | Initial cost | >10.4% (higher than internal project hurdle rate) | 27% |
| Jun 2016 | \$11 000 | 50% completed | First overrun: higher contract and labour costs | >8%, but <10.4% (higher than WACC, but less than internal project hurdle rate) | 53% |
| Nov 2017 | \$11 130 | 74% completed | Second overrun: hurricanes and lower productivity in ramp-up | >8%, but <8.5% (marginally above WACC) | 55% |
| Feb 2019 | \$11 600 - \$11 800 | 94% completed | Third overrun: additions to project scope and lower labour productivity | <7.5% (lower than WACC) | 61% |
| May 2019 | \$12 600 - \$12 900 | 96% completed | Fourth overrun: correction of duplicate investment allowances and increased cost to repair defective carbon steel forging | >6%, but <6.5% (lower than WACC) | 82% |

Sources: Sasol investor presentations, Coronation analysis

The net effect

The extent of cost overruns is truly breathtaking, and the impact on Sasol and its shareholders has been significant:

- Sasol had R10 billion in net cash just prior to greenlighting the LCCP. The significant cost of the project, coupled with overruns, has caused debt to balloon, with Sasol's debt-to-equity ratio now sitting at approximately 49% and likely to increase further.

This indebtedness has reduced balance sheet flexibility, which means that Sasol has been unable to buy back its shares to take advantage of a depressed share price. It has also meant lower dividend payments to shareholders as it looks to shore up its balance sheet.

- Sasol announced a R30 billion to R50 billion cost-response plan that includes extracting cost savings, reducing dividend payments, delaying capital expenditure on its existing business, and seeking asset disposals for value.

While it's always good practice to extract cost efficiencies, these initiatives raise concerns of plant underperformance if maintenance spend is curtailed, missed potential for value-accretive acquisitive opportunities, and the loss of key employees due to salary freezes and reduced bonuses.

Risks remain

While the value destruction suffered by shareholders is significant, the risks facing the LCCP have not abated. There is the potential for further overruns should the ramp-up transpire slower than envisaged. More importantly, the commodity cycle for the key chemicals that will be produced by the LCCP could change if global demand for these products slows. Given that these are niche products, any small changes in demand will have an outsized impact on the expected profitability of the LCCP, thereby further impacting on the project's ability to add value.

There is a well-known aphorism that states: "The road to hell is paved with good intentions". In a weak domestic economy, virtually every management team must feel the temptation to diversify offshore. However, these are not regions in which they have a competitive advantage and are almost certain to distract them from their local businesses.

Despite having the best intentions when looking to expand by acquiring businesses offshore, history, as demonstrated by the above examples, shows that reality can differ significantly from the attractive returns promised by a spreadsheet. What appears to be heaven can end up as hell for shareholders. With this in mind, as active investors, we continue to engage with the management teams and boards of directors of investee companies where we feel there is a risk of value being destroyed to ensure the best outcome for our clients over the long term. +



BOND OUTLOOK



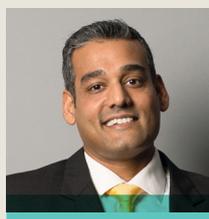
A time for good judgement

*“Invest for the long haul. Don’t get too greedy and don’t get too scared.” –
Shelby M.C. Davis*



By Nishan Maharaj

Nishan is head of Fixed Interest and has 16 years of investment experience.



IN THE EARLY part of this millennium, the US accounted for about a third of global growth. Since then, the country’s contribution has reduced to just under 25%, but arguably its influence on financial markets has increased. The US 10-year bond led the performance of global bonds in the quarter to end-June 2019 (Q2-19). Increasing concerns over lower growth due to the intensification of the US-China trade war, combined with benign inflation expectations, led to more dovishness from the US Federal Reserve (Fed) and the European Central Bank, which fuelled the global bond market rally. By the end of June, the US 10-year bond had rallied to 2% (down from 2.7% at the beginning of 2019), while approximately \$13 trillion worth of global government bonds slipped into negative yielding territory. This spurred a rally in nearly all emerging market currencies and bonds, as the carry trade came back into vogue. >

The All Bond Index (ALBI) was up 3.7% over Q2-19, bringing its return to 11.5% over the last 12 months. This performance is well ahead of cash (Q2-19: 1.7%; rolling 12 months: 6.9%) and inflation-linked bonds (ILBs) (Q2-19: 2.9%; rolling 12 months: 4.0%). The outperformance of the ALBI was driven by the seven- to 12-year area where bonds rallied 30 basis points (bps) to 50bps versus bonds with maturities longer than 12 years that only rallied 8bps to 10bps. Prospects of rate cuts in South Africa buoyed the seven- to 12-year area, while further fiscal deterioration due to lower growth and larger state-owned enterprise (SOE) bailouts weighed heavily on longer-dated South African government bonds (SAGBs). The strong performance of the ALBI over the last quarter, combined with the appreciation of the rand (2.3% versus the US dollar), put SAGB performance at 6.6% in US dollar terms, slightly ahead of global emerging market bond performance of 5.7% in US dollars (JP Morgan Government Bond Index – Emerging Markets Global Diversified Composite).

Top-down valuation of SAGBs is still quite attractive. Ten-year nominal yields of 8.8% with an implied real yield of 3.9% (one-year forward) is well above the emerging markets average nominal rate of 5.7% and average real rate of 1.7%. In addition, 10-year SAGBs yield 6.8% (8.8% minus 2%) more than the US 10-year. This is 1.2 standard deviations higher than the 10-year average, suggesting some degree of cheapness. However, as history has shown us, the bottom-up fundamental drivers of the local economy have been a much larger influencer of bond valuations over time. The two questions that need to be answered are around the sustainability of global bond yields (specifically US bond yields) and what magnitude of fiscal deterioration is being priced into local SAGBs.

In the US, over the next two years, the economy is expected to remain close to full employment, personal consumption expenditure (the Fed's preferred measure of inflation) is likely to remain sticky at around 2% and growth is expected to decelerate from 2.5% to 1.8%. In addition, average hourly earnings of employees (a large indirect contributor to US inflation) have been running well over 3% for almost 18 months and in excess of 2% for at least five years.

These are hardly the signs of an economy that is going into recession, or one that warrants a serious amount of monetary policy accommodation. The market is currently looking for approximately 1% worth of interest rate cuts over the next two years. The Fed's own projections suggest 0.5% worth of cuts over the next six to nine months and rates moving back up to current levels by the end of 2020. Given what is currently known about US inflation, growth and the US-China trade-war truce, the current pricing of the US 10-year bond seems expensive. Fair value for this instrument is probably closer to 2.75% to 3%, based on expected inflation of 2% and a real policy rate of 0.75% to 1% (a real policy rate more reflective of an economy growing at 2% per year and inflation at 2%).

On the local front, fortunately, inflation should average 5% until the end of 2021 due to the poor demand environment and subdued services prices. Unfortunately, growth is expected to average less than 1.5% over the same horizon, given the constraints on consumer spending and corporate investment. This benign growth and inflation environment should allow the South African Reserve Bank to reduce interest rates by around 0.5% over the next six to nine months, which is supportive for local bonds. However, given the slow nominal growth environment (a combination of slow real GDP growth and low inflation) and the need for more extensive support for SOEs (for example Eskom), government finances are set to deteriorate even further. Just using current economic assumptions, the budget deficit is likely to be well below -5.5% over the next three years and the debt-to-GDP ratio above 60% by 2021. Frontloading further support for Eskom will worsen these numbers. The budget deficit and the debt-to-GDP ratio will move to approximately -6% and 60%, respectively, a lot earlier (this does not include a debt transfer from Eskom's balance sheet to the sovereign's). The net effect would be a further deterioration in South Africa's creditworthiness, a downgrade to sub-investment grade by Moody's and an exit from the Citigroup World Government Bond Index (WGBI) by March 2020, if not sooner.

The fair value for 10-year SAGBs is approximately 8.62% to 8.82%. This is based on expectations of a US 10-year bond yield of 2.75% to 3%, South African expected inflation of 5%, US expected inflation of 2% and a South African credit spread of 2.87% (0.2% higher than the spot rate to factor in a further deterioration in South Africa towards subinvestment grade levels). At current levels of 8.68%, the South African 10-year bond sits in that fair value range (8.62% to 8.82%), but does not offer a large margin of safety. At best, it only warrants a neutral to slightly underweight allocation, given the impending fiscal risks.

LONGER-DATED SOUTH AFRICAN GOVERNMENT BONDS LOOKING ATTRACTIVE

In Q1-19, as evidenced by the performance of the various sectors of the ALBI, longer-end SAGBs (in the 20- to 30-year area) materially underperformed 10-year SAGBs. In the last year, the spread that the 20-year SAGB trades above the 10-year SAGB has moved from 0.5% to currently more than 1% above (see the first graph overleaf). On the surface, this looks like an attractive entry point. In the first table overleaf, we show a total return analysis for a few government bonds over three years in a scenario where bonds sell off or rally 100bps (1%). In addition, the last column shows the breakeven move for the longer-dated bonds relative to the 10-year bond (R2030) – that is, by how much those bonds can sell off before their total return equates to that of the 10-year bond. The results of our analysis are supportive of longer-dated SAGBs. In the event that bonds rally aggressively (100bps), longer-dated SAGBs outperform; if bonds sell off aggressively (100bps), one



is no worse off than being invested in a 10-year SAGB. These bonds can sell off 30bps more (and so steepen 30bps relative to 10-year SAGBs) before their performance equates to the 10-year SAGB. Based on these results, the case for allocating capital to the long end of the SAGB curve is very compelling.

20-YEAR SOUTH AFRICAN GOVERNMENT BOND SPREAD OVER 10-YEAR GOVERNMENT BOND



Sources: Coronation, Bloomberg

TOTAL RETURN ANALYSIS: LONG-END BONDS

| Bond | Maturity | Yield | Total return (1% rally) | Total return (1% sell-off) | Breakeven relative to 10-year SAGB |
|-------|-----------|-------|-------------------------|----------------------------|------------------------------------|
| R186 | 21 Dec 26 | 8.09% | 8.90% | 7.00% | - |
| R2030 | 31 Jan 30 | 8.83% | 10.00% | 7.10% | - |
| R2035 | 28 Feb 35 | 9.44% | 11.00% | 7.20% | 0.30% |
| R2040 | 31 Jan 40 | 9.65% | 11.50% | 7.10% | 0.30% |
| R2044 | 31 Jan 44 | 9.70% | 11.70% | 7.00% | 0.30% |

Sources: Coronation, Bloomberg

SHORTER-DATED INFLATION-LINKED BONDS MORE FAVOURABLE THAN SHORTER-DATED NOMINAL BONDS

ILBs have underperformed nominal bonds for over 10 years now, with the underperformance being most pronounced in the last two years (ALBI 10.8%; Composite Inflation-Linked Index [CILI] 3.1%). This underperformance has been driven by a rally in nominal bonds and a sell-off in ILBs. Real yields have moved higher by approximately 150bps to 200bps over the last five years, depending on which area of the curve one is looking at. Most of the ILB yield curve trades close to, if not above, a real yield of 3%. This absolute level of real yield does seem attractive relative to history. In the table that follows, we run a total return analysis for nominal SAGBs and ILBs for parallel shifts in the yield curve (+50bps, +25bps and -25bps) and two inflation scenarios (average inflation over the next two years of 5% and 6.3%). For the ILBs, we show the relative total return to that of nominal bonds; for example, 0.7%

implies, for that bond and scenario, that the ILB outperforms the nominal bond by 0.7%. As demonstrated in the table, the shorter-dated ILBs are more attractive than nominal bonds under all scenarios. Shorter-dated ILBs therefore warrant a more favourable allocation in a bond portfolio relative to shorter-dated nominal bonds.

INFLATION-LINKED BONDS: TOTAL RETURN ANALYSIS RELATIVE TO NOMINAL GOVERNMENT BONDS

| Yield curve shifts | R197 (4-year) | I2029 (10-year) | I2050 (32-year) | R197 (4-year) | I2029 (10-year) | I2050 (32-year) |
|--------------------|---------------|-----------------|-----------------|---------------|-----------------|-----------------|
| +50bps | 0.50% | (1.30%) | (6.30%) | 1.50% | (0.30%) | (5.00%) |
| +25bps | 0.70% | (0.90%) | (3.70%) | 1.70% | 0.10% | (2.70%) |
| 0bps | 0.90% | (0.40%) | (1.00%) | 1.90% | 0.60% | 0.00% |
| -25bps | 1.10% | 0.10% | 1.90% | 2.10% | 1.10% | 2.90% |

■ Inflation scenario 1 (base case of 5% average inflation over next 2 years)
 ■ Inflation scenario 2 (stressed case of 6.3% average inflation over next 2 years)

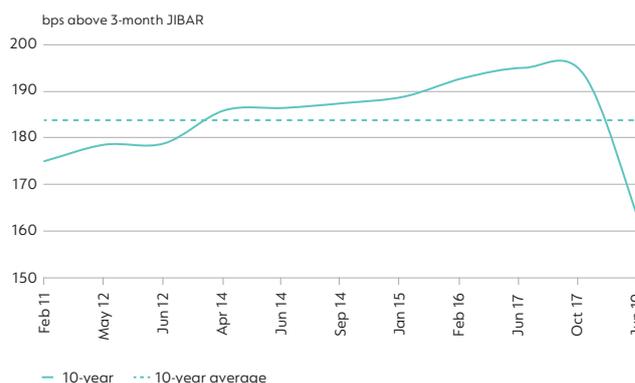
Sources: Coronation, Bloomberg

CAUTIOUS ON ADDING CREDIT AT CURRENT LEVELS

Corporate bonds (credit) have been a valuable tool within a bond portfolio when it comes to alpha generation. In the last two years, there has been a significant compression in corporate bond spreads that has made credit an outperformer among all asset classes.

However, one must not forget that holding credit assets in a portfolio is not riskless. Credit spreads do move, as is evidenced in the graph below, and being caught on the wrong side of the credit spread move can be very painful. In the last 10 years, the ALBI has increased in risk (modified duration), as issuance in longer-dated SAGBs (maturity >12 years) has increased, resulting in over 60% of the index now comprising longer-dated SAGBs. In the last decade, the modified duration of the ALBI has moved from approximately 5.5 years to 7.1 years, and the yield of the ALBI relative to a 10-year SAGB has moved from 0bps to 50bps over. This has meant that the hurdle for

STANDARD BANK SENIOR SPREADS



Sources: Coronation, Bloomberg

CREDIT INCLUSION AS PART OF BOND PORTFOLIO

| Bank bond | Year of evaluation | Yield | Years to maturity | Spread to government (bps) | Spread to ALBI (bps) | Breakeven to ALBI (bps) |
|-----------|--------------------|--------|-------------------|----------------------------|----------------------|-------------------------|
| SBS9 | 2009 | 11.42% | 7.0 | 250 | 222 | 41 |
| FRX30 | 2019 | 9.64% | 10.5 | 77.5 | 36 | 6 |

Sources: Coronation, Bloomberg

holding credit assets has moved higher. In the table above, we show fixed-rate credit spreads, relative to SAGBs, relative to the ALBI, and the breakeven-credit spread move relative to the ALBI (how much credit spreads can widen before that credit asset underperforms the ALBI). As is evident, the compression in credit spreads, combined with the increase in yield of the ALBI, has severely reduced the margin of safety when it comes to including credit as part of a bond portfolio, and we would be cautious on adding credit assets at current levels.

Cyclical economic factors are supportive of bond yields. Inflation should remain benign and growth subdued, which will allow an easing in policy rates. However, persistently low growth and the need for further support of SOEs will weigh heavily on government finances, resulting in wider budget deficits and a significant increase in the debt burden. SAGBs are most likely to exit the Citigroup WGBI in the next 12 months as pressure mounts on Moody's to move South Africa into subinvestment territory.

The global environment has turned more supportive for emerging markets and for South Africa, however SAGBs have a very limited margin of safety against a turn in global sentiment or a worsening in local economic conditions. Therefore, it is prudent to maintain a neutral to slightly underweight allocation to SAGBs at current levels. Any exposure to South African bonds should be taken in longer-dated SAGBs and shorter-dated ILBs. +



FUND ANALYSIS

Coronation Strategic Income Fund

An intelligent alternative to cash for medium-term investors

THE CORONATION STRATEGIC Income Fund is our flagship managed income fund that has secured its place as a stalwart of the South African savings landscape with consistent performance and an enviable track record. The fund outperformed by 2.5% per annum since inception in 2001 (after fees), while delivering positive monthly returns 93% of the time.

By leveraging off the depth of our fixed income team and the breadth of Coronation's entire investment team, portfolio managers Nishan Maharaj and Mauro Longano are able to invest across the full range of income-generating asset classes such as government, corporate and inflation-linked bonds, listed property, offshore bonds, money-market negotiable certificates of deposit and preference shares.

The main aim of the fund is to produce a consistent and reliable return for investors with immediate income needs and, as a result, the fund is well diversified, conservatively positioned and aims to limit investor downside. We believe in making small adjustments to the portfolio over time rather than taking big, portfolio-defining views so that we can deliver consistent returns to the fund's conservative investor base. To reflect a low risk tolerance, we only invest a combined maximum of 25% of the fund in what we define as more volatile assets, such as listed property (maximum 10%), preference shares (maximum 10%), international assets (maximum 10%) and local hybrid instruments (maximum 5%). The fund will typically have no exposure to equities.

ENSURING THE FUND IS RIGHT FOR YOUR NEEDS

The fund is a good option for investors looking for an intelligent alternative to cash or bank deposits over a period of 12 to 36 months and who seek actively managed exposure to income-generating investments. The aim of the fund is to

enhance yield as interest rates decline and to protect capital in a rising interest rate environment. It's a great option if you need access to your investment over the short term, which means you don't want to take on much short-term risk.

Investors may need to keep a portion of their capital in cash for different reasons. Business owners with lumpy cashflow may need to park some capital in a conservative asset with a higher expected return than cash to pay monthly bills such as salaries. Individuals may be saving for a near-term goal such as paying a deposit on a house, or retirees may wish to keep the next two or three years' income in a fund that is not exposed to equity market risk.

Whatever the reason for needing access to your capital in the short term, a managed income fund may be a good option, as it aims to deliver a better return than a deposit at a bank, without materially increasing the risk of capital loss.

Managed income funds are typically not suitable for longer investment periods. Their limited exposure to growth assets constrains their ability to provide adequate protection against the eroding effects of inflation on one's purchasing power.

The Coronation Strategic Income Fund is therefore unlikely to be suitable if you can invest for periods longer than 36 months, you need income to cover your everyday living expenses over an extended period of time, and you want to grow your capital to protect your purchasing power.

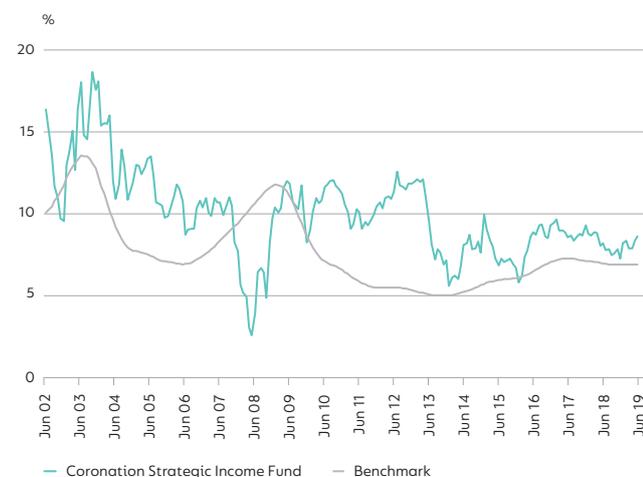
RETURNS AND RISK

We take an active approach to fixed interest portfolio management and all our investment decisions are driven by proprietary, in-house research that allows us to dynamically

respond to changing market conditions. The fund's benchmark is 110% of the STeFI 3-month Index, while our internal return target is cash plus 2% through the cycle. STeFI is an abbreviation for the Short Term Fixed Interest Index, and the three-month version is the most common benchmark used for more conservative money market funds.

To have a chance of achieving a better return than that of a money market fund or a short-term deposit at a bank, investors need exposure to assets with a higher expected return than cash. Unfortunately, a higher expected return comes with an associated increase in risk, requiring a careful trade-off between adding to the return potential of the fund while keeping risk exposures at an appropriate level. The Coronation Strategic Income Fund is managed to achieve this balancing act by taking considered interest rate and credit risk, where appropriate, and through moderate increases in exposure to alternative sources of return when the likelihood of outperformance is high.

12-MONTH ROLLING RETURN SINCE INCEPTION



Notes:
 Highest annual return (A-class): 18.7% (Nov 2002 - Oct 2003)
 Lowest annual return (A-class): 2.6% (Jun 2007 - May 2008)
 Inception (A-class): July 2001
 For the recent portfolio manager commentary as well as more fund performance and risk metrics, please visit www.coronation.com.

Source: Coronation

Our approach to managing the fund remains focused on outperforming cash over the long term, but over short measurement periods, capital at risk can fluctuate and, as a result, the fund will not have a linear return series, as is the case with a money market fund. While cash plus 2% is not

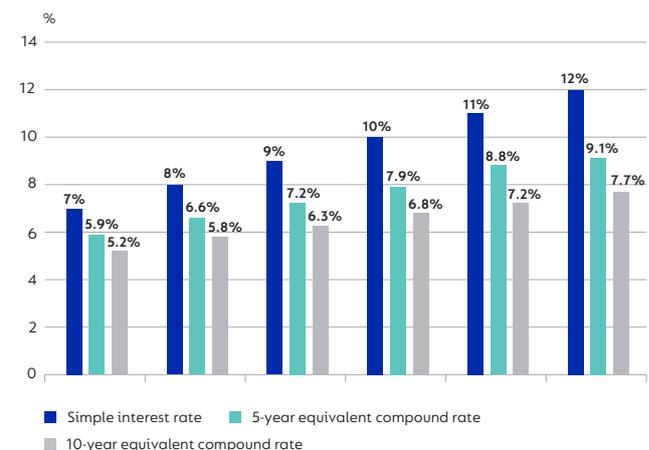
always achievable in the short term, the fund has consistently outperformed cash and the benchmark over the longer term.

UNDERSTANDING QUOTED INTEREST RATES

When making any fixed deposit investment, it's important to understand that the quoted interest rate and the potential return may not be the same. Adverts for fixed deposit products can be misleading and often quote simple interest rates rather than compound interest rates. Simple interest is calculated only on the original investment amount, while compound interest is calculated on the original amount as well as the accumulated interest of previous periods. The power of compounding is critical to long-term wealth creation.

To highlight the effect that compounding has over long periods of time, consider the following scenario: R1 million invested at a 7% simple interest rate means that you get a yield of R70 000 every year, regardless of the capital value and period. With compound interest, this R70 000 is reinvested annually and you then earn 7% on the original amount as well as on the reinvested amount, which grows your investment at a faster rate over time. The graph below compares a simple quoted interest rate with the equivalent compound rate over five and 10 years. It is useful to keep in mind how the power of compounding has a meaningful impact on the effective rate over time. For instance, if you are quoted a simple interest rate of 10% per annum over 10 years, it means that you only require a compound interest rate of 6.8% per annum over the same period to get the same return. +

SIMPLE INTEREST RATES VERSUS COMPOUND INTEREST RATES



Source: Coronation



CORONATION INSIGHTS

Flagship fund update

This article is a précis of our flagship fund commentary for the quarter; for the full insight into the positioning of each fund, as well as insight into the associated macroenvironments, please refer to the factsheets on www.coronation.com.

INVESTOR NEED: LONG-TERM GROWTH

DOMESTIC GENERAL EQUITY FUNDS

Top 20 and Equity

Top 20 is a focused portfolio of our top stock picks on the JSE, while Equity invests in South African as well as global equities. Both funds are suited to investors with a long-term horizon who are seeking high growth and can ride out short-term volatility.

During the second quarter of 2019 (Q2-19), the JSE extended its first-quarter gains, albeit at a slower rate. Despite the conclusion of the much-awaited South African election, domestic sentiment deteriorated during the second quarter of 2019. The election result was broadly in line with expectations, with the ANC maintaining its majority rule despite >

a slight decline in support. The appointment of a new and smaller cabinet was a positive development, reinforcing the message of fiscal discipline. However, the ruling party remains plagued by factional tensions. Policy uncertainty lingers, and Eskom's balance sheet problems remain an overhang. These factors combined to weigh on consumer and corporate confidence levels and were reflected in a very weak Q1-19 GDP print of -3.2%, dragged down by manufacturing and mining. Results released during Q2-19 and the accompanying subdued rhetoric of management reinforced how challenging the underlying economic situation is. The weak domestic economy contained inflation and favourable global interest rate expectations have increased the likelihood of local rate cuts.

In this environment, domestic stocks reported weak results. Even defensive stocks struggled to defy the pressures of several years of weak domestic economic conditions and high structural cost inflation. We expect these headwinds to persist and remain cautious on businesses heavily exposed to the domestic economy. We continue to debate whether these depressed conditions (and earnings bases) provide an opportunity to add meaningfully to domestic holdings but have made no material changes as yet.

The British American Tobacco share price declined during the period as fears related to low nicotine regulation in the US market resurfaced. However, new-generation products are gaining traction. We believe the underlying fundamentals of the business remain intact, and that new-generation products are lower-risk products and present an opportunity to grow the overall market. At current levels, the share offers a 7% to 8% dividend yield. We believe this to be very attractive for a stock of this quality and it remains a large position in the fund.

Within resources, Sasol's share price declined meaningfully (-22%) when the company announced further headwinds to its already beleaguered Lake Charles Chemicals Project, and we added to the position on the back of this price weakness. However, we have limited its size in our portfolios due to heightened risks. Conversely, we saw strong performance from the gold miners (+29.6%) and platinum (+9.5%). Iron ore (+32.9%) has been particularly strong as supply disruptions have driven up near-term prices, supporting the fund's large holding in Anglo American.

We remain meaningfully invested in platinum counters. We reduced our Anglo American Platinum position in response to its strong share price rise, reinvesting the proceeds into names that have underperformed on a relative basis. The demand outlook for platinum group metals (PGMs) remains strong, buoyed by increasingly stringent emissions regulations.

The financial sector (+5.4%) performed strongly, as local banks (+9.7%) defied domestic market headwinds and are expected

to deliver underlying earnings growth. This growth reflects prudent management through the cycle, with limited credit extension resulting in low credit loss ratios. We hold several of the large banks, including FirstRand, Nedbank and Standard Bank.

Global equities performed well, supported by a large holding in Heineken, which has performed strongly and is a business that has consistently focused on putting investment behind its long-term prospects, building a powerful brand. This approach should deliver a combination of strong revenue growth and margin expansion over time from premiumisation and operating leverage. Heineken's ability to compound earnings over time makes for an attractive investment opportunity in our opinion.

Political turmoil continued to reign in the UK and high levels of uncertainty undermine the economic outlook. Despite this, compelling valuation-driven opportunities exist. Quilter remains the largest single holding in the UK. This is a business with a structural growth opportunity stemming from pension reform in the UK market. While we see exciting investment opportunity in the UK market, the funds continue to tightly manage overall UK exposure, given the Brexit-related uncertainty.

Markets have remained challenging this year, with several companies reporting material earnings disappointments that have put these businesses at risk. A rigorous research process and heightened balance sheet scrutiny have protected the fund from several of these examples. We remain committed to building robust, diversified portfolios with a focus on risk management. We believe these efforts will protect the portfolio against unexpected outcomes and position the fund well to deliver inflation-beating returns over the long run.

MULTI-ASSET CLASS FUNDS

Balanced Plus and Market Plus

Balanced Plus and Market Plus offer long-term investors access to a diversified portfolio of local and international assets. While Market Plus has a stronger bias towards shares, Balanced Plus complies with retirement regulations, which limit exposure to risk assets. Both funds are suited to investors with a longer-term time horizon seeking growth.

Equity markets continued to rise in the second quarter of 2019 (Q2-19) as central banks communicated a strong likelihood of rate cuts and US-China trade war tensions eased towards the end of the period. The funds have benefited from its large exposure to global equities.

Global bond yields continued to rally in response to increasing evidence of a slowdown in global growth and



rising expectations of interest rate cuts in the US and Europe. US 10-year bond yields have now traded down more than 100 basis points (bps) since November 2018 and the debt of several European sovereigns is trading at negative rates. Although global bonds have performed well, we remain of the view that yields are too low, and the risk of capital loss is considerable.

In our offshore exposure, we generally have been well positioned and contributed to performance.

In our local equity portfolio, we have maintained a solid weighting to resources, which have continued to perform well. Our very low exposure to Sasol has proved highly beneficial and with the share price now below R350, we are starting to add the counter. We remain meaningfully invested in platinum counters.

The poor performance of the South African economy remains a very worrying trend, and while share prices and earnings have collapsed in most sectors, the lack of identifiable growth opportunities leaves us still cautious on moving too quickly to invest in a local turnaround.

An area that does look compelling is the real yields available in the local bond market. Our real yields of c. 4% are the highest globally and above a number of other emerging markets that are already rated subinvestment grade. We think the concerns over the potential downgrade by Moody's are overdone.

INVESTOR NEED: INCOME AND GROWTH

Capital Plus and Balanced Defensive

Capital Plus seeks to offer reasonable growth over the medium to long term, while preserving capital over any 18-month period, while Balanced Defensive is slightly more conservative and first seeks to protect capital and then achieve reasonable growth in the long term. These funds suit investors who want to draw an income over an extended period of time.

Capital Plus delivered a satisfactory year to date return of 6.8% (not annualised), while Balanced Defensive returned 6.3% (not annualised) over the same period.

Over the quarter ended June 2019 (Q2-19), the global economy showed more signs of slowing and the market consensus clearly shifted to pricing in a future material relaxation of monetary

policy. It is this prospect of lower interest rates that propelled stock and bond markets to deliver very strong returns for the quarter and year to date.

Expectations of lower interest rates also spilled over to South Africa, where the stronger rand and contained inflation is very has allowed the South African Reserve Bank (SARB) the room to start cutting interest rates – announcing a 25bp cut on 18 Julys. Bonds and equities responded favourably to this improved outlook, as well as to the successful conclusion of the elections and the subsequent announcement of the new cabinet. Over the quarter, the FTSE/JSE All Share Index gained 3.9%, the All Bond Index (ALBI) 3.7% and listed property 4.5%.

Although listed property had a good quarter, the returns over the past year are barely positive and remain negative over the past three years. The rand, which strengthened by 3% over the quarter, had the effect of lowering the impact of the strong US dollar returns of global markets.

The stocks that contributed the most to performance over the past year are Anglo American, Altron, platinum stocks Northam Platinum and Anglo American Platinum and our bank holdings of FirstRand and Standard Bank. Detractors from performance include British American Tobacco, Aspen, Sasol and Shoprite.

British American Tobacco is a stock that we have held in the portfolio for many years. We acknowledge that tobacco companies face structural volume declines. This would be a material headwind to most businesses, but tobacco companies have the pricing power to offset these declines. In addition, the shift to new-generation products and demonstrated ability to cuts costs will enable this company to protect and grow its earnings over time. The stock is, however, out of favour with investors and trades on a dividend yield of almost 8%. At this valuation, we find it very attractive.

The past quarter was one of limited trades. We sold more Hammerson property and bought a currency future to hedge against a potential weaker UK pound in the event of either a no-deal Brexit, or a new election and the prospect of Jeremy Corbyn as prime minister. Either event could result in a far weaker pound with a negative impact on the prices of some of the London-listed stocks we own, such as Hammerson, Capco and Intu. Total exposure to the London-listed property market has been trimmed to 1% of portfolio and that is now fully hedged. We also added to our existing platinum exchange-traded fund, as we feel the gap between platinum and palladium has become too large.

>

The portfolios continue to hold a substantial weighting in South African bonds, both fixed rate and inflation linkers. The high real yield is very attractive and provides a solid risk-adjusted building block towards achieving the targeted inflation plus 3% return.

INVESTOR NEED: IMMEDIATE INCOME

Strategic Income

For deeper insight into Strategic Income, please refer to the article on page 31 of this edition of *corospondent*.

Strategic Income is a managed income fund that invests across the full range of income-generating asset classes such as government, corporate and inflation-linked bonds, listed property, offshore bonds, money-market negotiable certificates of deposit (NCDs) and preference shares. The main aim of the fund is to produce a consistent and reliable return for investors with immediate income needs.

We remain vigilant of risks emanating from the dislocations between stretched valuations and the underlying fundamentals of the local economy. However, we believe that the fund's current positioning correctly reflects appropriate levels of caution. The fund's yield of 8.6% remains attractive relative to its duration risk.

The fund maintains some exposure to offshore assets, and when valuations are stretched, it will hedge/unhedge portions of its exposure back into rands/dollars by selling/buying JSE-traded currency futures (US dollar, UK pound and euro).

On the local front, inflation should average 5% until the end of 2021 due to the poor demand environment and subdued services prices. Subdued growth and inflation expectations should allow the SARB to reduce interest rates by around 0.5% over the next six to nine months, which is supportive for local bonds (the first cut of 25bps was announced on 18 July). However, given the slow nominal growth environment and the need for more extensive support for state-owned enterprises (for example, Eskom), government finances are set to deteriorate even further.

The spreads of floating-rate NCDs have dulled in appeal over the last few quarters, due to a compression in credit spreads. There has been a reduced need for funding from banks in South Africa, given the low growth environment. The fund continues to hold decent exposure to these instruments (less floating than fixed), but we will remain cautious and selective when increasing exposure.

In the last quarter, as evidenced by the performance of the various sectors of the ALBI, longer-end South African government bonds (SAGBs; 20- to-30-year area) materially

underperformed 10-year SAGBs. SAGBs are most likely to exit the Citigroup World Government Bond Index in the next 12 months, as pressure mounts on Moody's to move South Africa into subinvestment territory. Therefore, in a conservative fund it is prudent to maintain a neutral to slightly underweight allocation to SAGBs at current levels. Any exposure to South African bonds should be taken in longer-dated SAGBs and shorter-dated inflation-linked bonds.

The local listed property sector was up 1.5% over the month of June, reducing its loss for the rolling 12-month period to -5.1%. Listed property has been the largest drag on the fund, primarily due to generalised equity weakness and idiosyncratic domestic issues. In the event of a moderation in listed property valuations, we will look to increase the fund's exposure to this sector at more attractive levels.

The Preference Share Index was up 2.0% over the month, bringing its 12-month return to 19.7%. Despite attractive valuations, this asset class will continue to dissipate, given the lack of new issuance. The fund maintains select exposure to certain high-quality corporate preference shares, but will not actively look to increase its holdings.

We continue to believe that the fund's 8.6% yield is an adequate proxy for expected fund performance over the next 12 months. As is evident, we remain cautious in our management of the fund. We continue to invest only in assets and instruments that we believe have the correct risk and term premium to limit investor downside and enhance yield.

INVESTOR NEED: OFFSHORE DIVERSIFICATION

Global Managed

Global Managed aims to achieve good long-term investment growth by investing in a range of opportunities available in public asset markets from around the world. It may suit investors who are seeking long-term growth with the appetite for short-term volatility.

Since the beginning of the year, the fund has returned 13.9% in US dollars (well ahead of the benchmark) and since inception it is still ahead of its benchmark, despite its heavy cash and low bond exposure over this period. The fund was defensively positioned over the second quarter of 2019 (Q2-19) and hence partially missed out on the continued bull market in equities. During Q2-19, global financial markets continued to be dominated by a shift in investors' interest rate expectations and the unfolding trade war saga. Markets are now discounting almost three cuts of 25bps each in the US before the end of the year, a stark contrast to only six months ago when the expectation was for at least one rate increase during the calendar year.



Markets continued to take comfort from these dovish developments by bidding up risky assets, and developed markets once again outperformed over the quarter, with the emerging market universe negatively impacted by the trade war developments and some of the country-specific issues referred to above. The US was the star performer, with some help from stronger earnings growth than seen in the rest of the world and a further re-rating in the market.

Fixed interest assets performed well, and listed property had a muted second quarter, while gold had a strong quarter, which was not surprising given the lower opportunity cost on the shift in forward interest rates and the continued political uncertainty. Most industrial metals had a poor quarter on the back of a weaker growth outlook, except for iron ore where supply disappointments supported the price. The oil price was down slightly this quarter after a strong first quarter.

Over the quarter, long-held equity positions such as Blackstone, Charter Communications, Adidas and Carlyle contributed the most to fund performance, with British American Tobacco (after a strong first quarter) and Intu (and other property holdings) detracting the most. Some of the other notable contributors over the longer term include Altice US, Facebook, Airbus and Pershing Square. Other detractors were Aspen, L Brands and Imperial Brands.

Our fixed interest positioning was also too conservative, but the gold position contributed strongly. Stock selection in the property bucket detracted, as we still favour those portfolios with higher retail exposure, given that we believe they offer compelling value. We continue to be reasonably conservatively positioned in terms of asset allocation. We are concerned that the benign interest rate outlook may not materialise and could be very disappointing to investors who are expecting central banks to come to their rescue. +



Domestic flagship fund range

Coronation offers a range of domestic and international funds to cater for the majority of investor needs. These funds share the common Coronation DNA of a disciplined, long-term focused and valuation-based investment philosophy and our commitment to provide investment excellence.

INVESTOR NEED

| FUND | INCOME ONLY | INCOME AND GROWTH | | LONG-TERM CAPITAL GROWTH | |
|--|---|--|---|---|---|
| | STRATEGIC INCOME Cash [†] | BALANCED DEFENSIVE Inflation [†] | CAPITAL PLUS Inflation [†] | BALANCED PLUS Composite benchmark [†] (equities, bonds and cash) | TOP 20 FTSE/JSE CAPI [†] |
| FUND DESCRIPTION | Conservative asset allocation across the yielding asset classes. Ideal for investors looking for an intelligent alternative to cash or bank deposits over periods from 12 to 36 months. | A lower risk alternative to Capital Plus for investors requiring a growing regular income. The fund holds fewer growth assets and more income assets than Capital Plus and has a risk budget that is in line with the typical income-and-growth portfolio. | Focused on providing a growing regular income. The fund has a higher risk budget than the typical income-and-growth fund, making it ideal for investors in retirement seeking to draw an income from their capital over an extended period of time. | Best investment view across all asset classes. Ideal for pre-retirement savers as it is managed in line with the investment restrictions that apply to pension funds. If you are not saving within a retirement vehicle, consider Market Plus, the unconstrained version of this mandate. | A concentrated portfolio of 15-20 shares selected from the entire JSE, compared to the average equity fund holding 40-60 shares. The fund requires a longer investment time horizon and is an ideal building block for investors who wish to blend their equity exposure across a number of funds. Investors who prefer to own just one equity fund may consider the more broadly diversified Coronation Equity Fund. |
| INCOME VS GROWTH ASSETS ¹ | | | | | |
| LAUNCH DATE | Jul 2001 | Feb 2007 | Jul 2001 | Apr 1996 | Oct 2000 |
| ANNUAL RETURN ² (Since launch) | 10.3% 7.7% [†] | 9.4% 6.0% [†] | 11.7% 5.8% [†] | 14.2% 13.1% [†] | 17.3% 13.8% [†] |
| QUARTILE RANK (Since launch) | 1st | 1st | 1st | 1st | 1st |
| ANNUAL RETURN (Last 10 years) | 9.2% 6.2% [†] | 10.0% 5.2% [†] | 9.4% 5.2% [†] | 11.6% 12.8% [†] | 12.7% 13.2% [†] |
| STANDARD DEVIATION (Last 10 years) | 1.4% 0.2% [†] | 4.2% 1.3% [†] | 5.8% 1.3% [†] | 8.1% 7.8% [†] | 13.1% 12.7% [†] |
| FUND HIGHLIGHTS | Outperformed cash by 1.5% p.a. over the past 5 years and 2.5% p.a. since launch in 2001. | Outperformed inflation by 3.4% p.a. (after fees) since launch, while producing positive returns over all 12 month periods. | Outperformed inflation by 5.9% p.a. (after fees) since launch, while producing positive returns over 24 months more than 99% of the time. | No. 1 balanced fund in South Africa since launch in 1996, outperforming its average competitor by 1.9% p.a. Outperformed inflation by on average 7.9% p.a. since launch and outperformed the ALSI on average by 0.9% p.a. (since launch). | The fund added 3.5% p.a. to the return of the market. This means R100 000 invested in Top 20 at launch in Oct 2000 grew to more than R1.9 million by end June 2019 – nearly double the value of its current benchmark. The fund is a top quartile performer since launch. |

¹ Income versus growth assets as at 30 June 2019. Growth assets defined as equities, listed property and commodities (excluding gold).

² Highest annual return
Balanced Defensive: 21.2% (Jun 2012 - May 2013); Balanced Plus: 49.3% (Aug 2004 - Jul 2005); Capital Plus: 33.8% (Aug 2004 - Jul 2005); Strategic Income: 18.7% (Nov 2002 - Oct 2003); Top 20: 68.9% (May 2005 - Apr 2006)

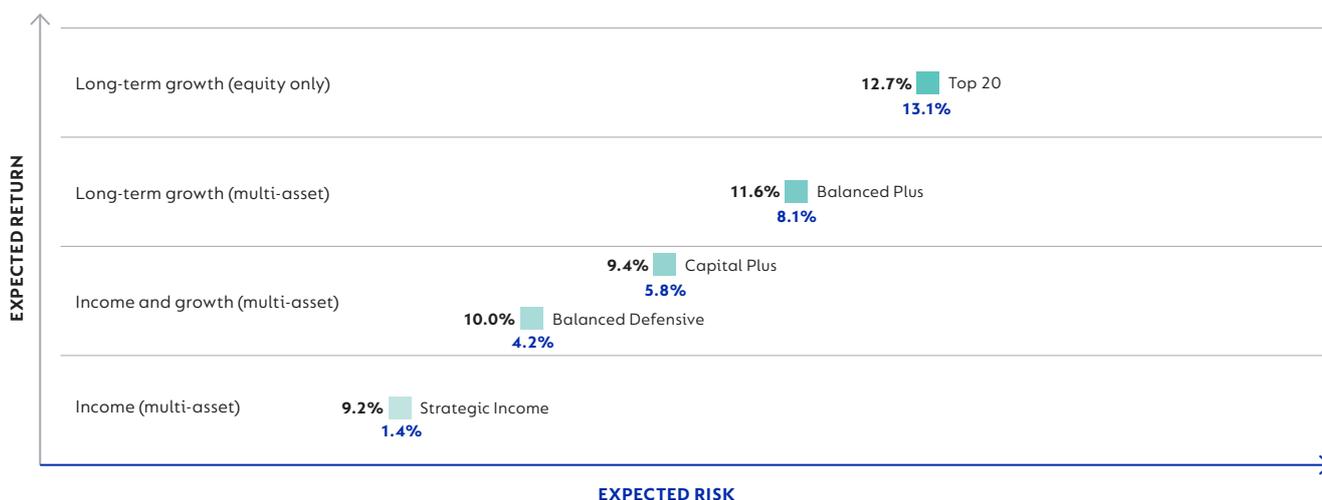
Lowest annual return
Balanced Defensive: 0.5% (Dec 2017 - Nov 2018); Balanced Plus: -17.4% (Sep 1997 - Aug 1998); Capital Plus: -6.2% (Nov 2007 - Oct 2008); Strategic Income: 2.6% (Jun 2007 - May 2008); Top 20: -31.7% (May 2002 - Apr 2003)

Figures are quoted from Morningstar as at 30 June 2019 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.



RISK VERSUS RETURN

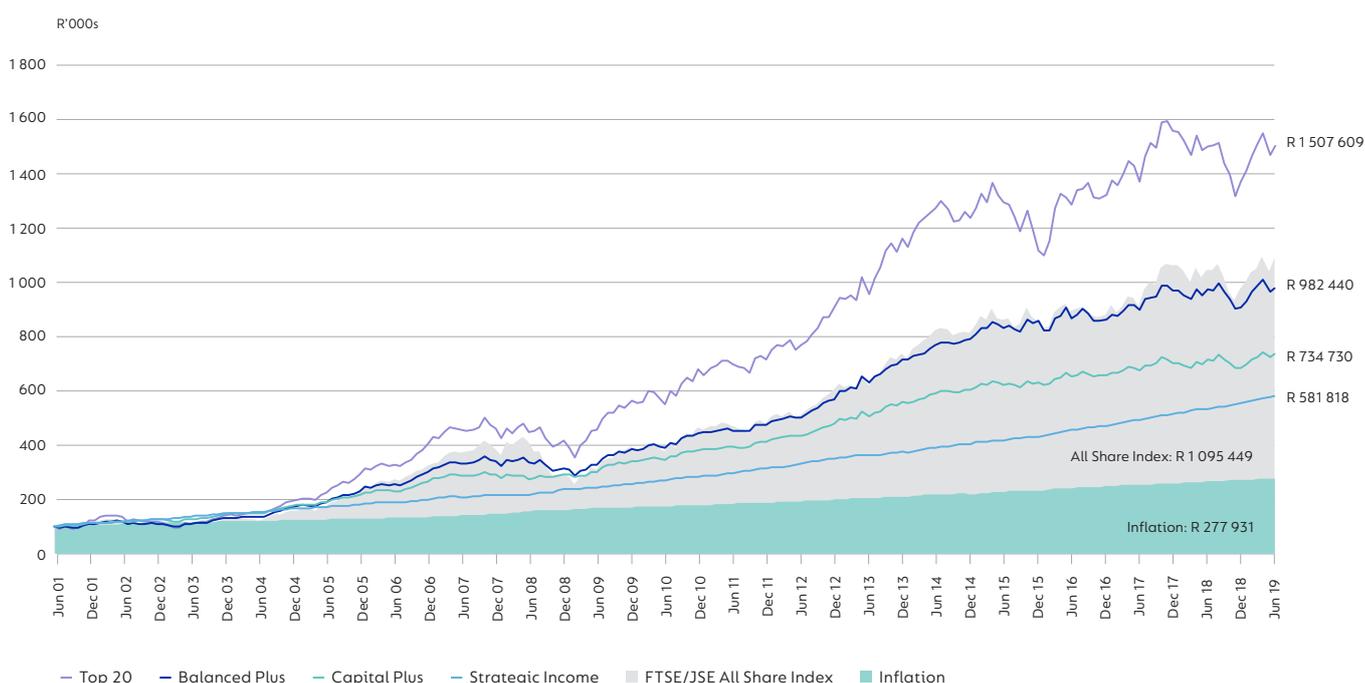
10-year annualised return and risk (standard deviation) quoted as at 30 June 2019.
 Figures quoted in ZAR after all income reinvested and all costs deducted.



Source: Morningstar

GROWTH OF R100 000 INVESTED IN OUR DOMESTIC FLAGSHIP FUNDS ON 1 JULY 2001

Value of R100 000 invested in Coronation's domestic flagship funds since inception of Capital Plus on 2 July 2001 as at 30 June 2019. All income reinvested for funds; FTSE/JSE All Share Index is on a total return basis. Balanced Defensive is excluded as it was only launched on 1 February 2007.



Source: Morningstar



International flagship fund range

INVESTOR NEED

| | DEPOSIT ALTERNATIVE | CAPITAL PRESERVATION | LONG-TERM CAPITAL GROWTH (MULTI-ASSET) | LONG-TERM CAPITAL GROWTH (EQUITY ONLY) | |
|---|---|--|---|---|--|
| FUND ¹ | GLOBAL STRATEGIC USD INCOME US dollar cash (3 Month Libor) [†] | GLOBAL CAPITAL PLUS US dollar cash (3 Month Libor) [†] | GLOBAL MANAGED Composite (equities and bonds) [†] | GLOBAL OPPORTUNITIES EQUITY MSCI ACWI [†] | GLOBAL EMERGING MARKETS MSCI Emerging Markets Index [†] |
| FUND DESCRIPTION | An intelligent alternative to dollar-denominated bank deposits over periods of 12 months or longer. | A low-risk global balanced fund reflecting our best long-term global investment view moderated for investors with smaller risk budgets. We offer both hedged and houseview currency classes of this fund. In the case of the former, the fund aims to preserve capital in the class currency over any 12-month period. | A global balanced fund reflecting our best long-term global investment view for investors seeking to evaluate outcomes in hard currency terms. Will invest in different asset classes and geographies, with a bias towards growth assets in general and equities in particular. | A diversified portfolio of the best global equity managers (typically 6-10) who share our investment philosophy. An ideal fund for investors who prefer to own just one global equity fund. Investors who want to blend their international equity exposure may consider Coronation Global Equity Select, which has more concentrated exposure to our best global investment views. | Our top stock picks from companies providing exposure to emerging markets. The US dollar fund remains fully invested in equities at all times, while the rand fund will reduce equity exposure when we struggle to find value. |
| INCOME VS GROWTH ASSETS ² |  |  |  |  |  |
| LAUNCH DATE OF OLDEST FUND | Dec 2011 | Nov 2008 | Oct 2009 | Aug 1997 | Dec 2007 |
| ANNUAL RETURN ³ (Since launch) | 2.5% 0.9% [†] | 5.0% 0.8% [†] | 6.1% 6.7% [†] | 6.6% 6.0% [†] | 3.0% 1.2% [†] |
| QUARTILE RANK (Since launch) | - | 1st | 1st | - | 1st |
| ANNUAL RETURN ³ (Last 5 years) | 1.3% 1.2% | 1.4% 1.2% | 1.8% 4.5% | 4.5% 6.7% | (0.1%) 2.6% |
| ANNUAL RETURN ³ (Last 10 years) | - | 4.1% 0.8% | - | 8.5% 11.1% | 6.1% 6.0% |
| QUARTILE RANK (Last 5 years) | - | 2nd | 3rd | - | 4th |
| FUND HIGHLIGHTS | Outperformed US dollar cash by 1.5% p.a (after fees) since launch in December 2011. | The fund has outperformed US dollar cash by 4.2% p.a. (after fees) since launch in 2008. | Number one global multi-asset high equity fund in South Africa since launch in October 2009. | The rand version of the fund has outperformed the global equity market with less risk since its launch date. | Both the rand and dollar versions of the fund have outperformed the MSCI Emerging Markets Index by more than 2% p.a. since their respective launch dates. |

¹ Funds are available as rand-denominated feeder funds and foreign currency-denominated funds. The Global Capital Plus fund is also available in US dollar Hedged (launched 1 December 2011), GBP Hedged (launched 1 December 2011), EUR Hedged (launched 1 December 2011) or Houseview currency class (launched 1 September 2009).

² Income versus growth assets as at 30 June 2019 (for US dollar funds). Growth assets defined as equities, listed property and commodities (excluding gold).

³ Returns quoted in US dollar for the oldest fund.

Highest annual return

Global Strategic USD Income: 7.1% (Jan 2012 - Dec 2012); Global Capital Plus [ZAR] Feeder: 34.8% (Jun 2012 - May 2013); Global Managed [ZAR] Feeder: 48.9% (Jan 2013 - Dec 2013); Global Emerging Markets Flexible [ZAR]: 49.7% (Mar 2009 - Feb 2010); Global Opportunities Equity [ZAR] Feeder: 66.2% (Apr 1999 - Mar 2000)

Lowest annual return

Global Strategic USD Income: -1.0% (Mar 2015 - Feb 2016); Global Capital Plus [ZAR] Feeder: -10.6% (Jun 2016 - May 2017); Global Managed [ZAR] Feeder: -7.7% (Apr 2017 - Mar 2018); Global Emerging Markets Flexible [ZAR]: -37.5% (Mar 2008 - Feb 2009); Global Opportunities Equity [ZAR] Feeder: -36.1% (Apr 1999 - Mar 2000)

Figures are quoted from Morningstar as at 30 June 2019 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.

Collective Investment Schemes in Securities (unit trusts) are generally medium- to long-term investments. The value of participatory interests (units) may go down as well as up and past performance is not necessarily an indication of future performance. Participatory interests are traded at ruling prices and can engage in scrip lending and borrowing. Fluctuations or movements in exchange rates may cause the value of underlying investments to go up or down. A schedule of fees and charges is available on request from the management company. Pricing is calculated on a net asset value basis, less permissible deductions. Forward pricing is used. Commission and incentives may be paid and, if so, are included in the overall costs. Coronation is a member of the Association for Savings and Investment South Africa (ASISA).

HAVE YOU CONSIDERED EXTERNALISING RANDS? IT IS EASIER THAN YOU MIGHT THINK.

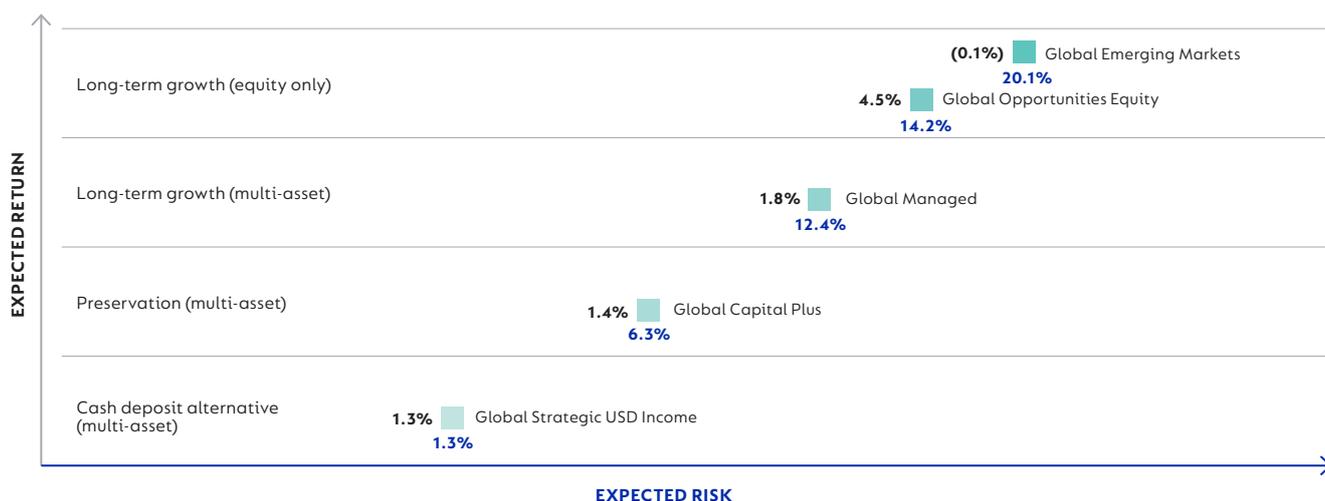
The South African Reserve Bank allows each resident South African taxpayer to externalise funds of up to R11 million per calendar year (a R10 million foreign capital allowance and a R1 million single discretionary allowance) for direct offshore investment in foreign currency denominated assets. If you want to invest more than R1 million, the process is as easy as:

- 1 Obtain approval from the South African Revenue Service by completing the appropriate form available via eFiling or your local tax office. Approvals are valid for 12 months and relatively easy to obtain if you are a taxpayer in good standing.
- 2 Pick the mandate that is appropriate to your needs from the range of funds listed here. You may find the 'Choosing a Fund' section or 'Compare Funds' tool on our website helpful, or you may want to consult your financial advisor if you need advice.
- 3 Complete the relevant application forms and do a swift transfer to our US dollar subscription account. Your banker or a foreign exchange currency provider can assist with the forex transaction, while you can phone us on 0800 86 96 42, or read the FAQ on our website, at any time if you are uncertain.



RISK VERSUS RETURN

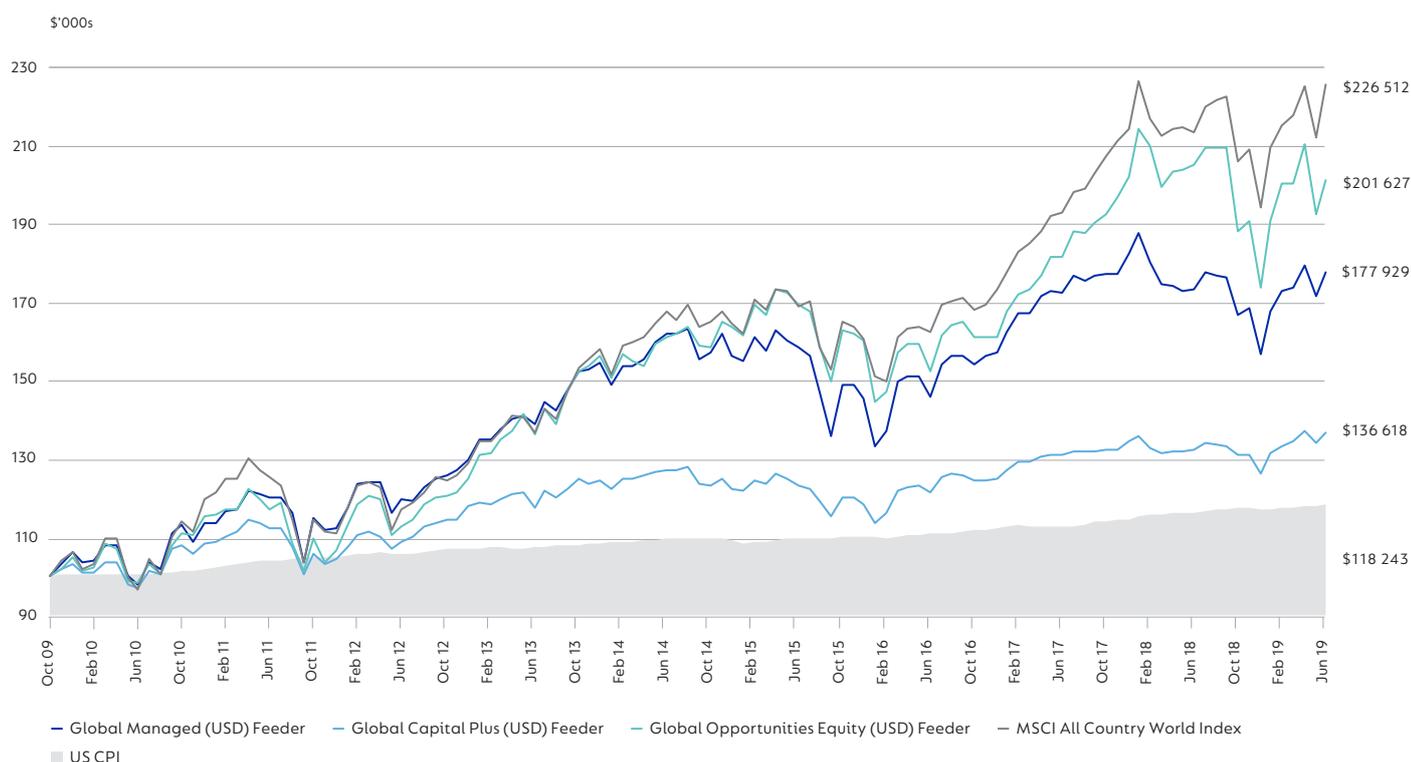
5-year annualised return and risk (standard deviation) quoted as at 30 June 2019. Figures quoted in USD (for the oldest fund) after all income reinvested and all costs deducted.



Source: Morningstar

GROWTH OF \$100 000 INVESTED IN OUR GLOBAL MULTI-ASSET FUNDS ON 29 OCTOBER 2009

Value of \$100 000 invested in Global Managed [ZAR] Feeder, Global Capital Plus [ZAR] Feeder and Global Opportunities Equity [ZAR] Feeder since inception of Global Managed [ZAR] Feeder on 29 October 2009. All returns quoted in USD. All income reinvested for funds. MSCI World Index is on a total return basis.



Source: Morningstar

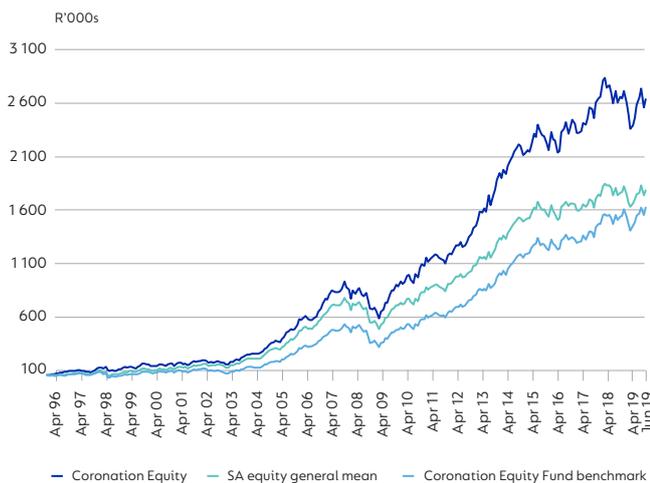


Long-term investment track record

CORONATION EQUITY RETURNS VS EQUITY BENCHMARK

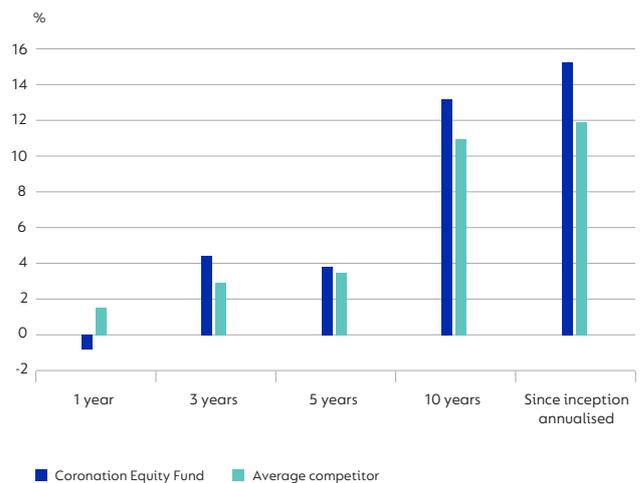
| 10-YEAR ANNUALISED RETURNS | CORONATION EQUITY | AVERAGE COMPETITOR | OUTPERFORMANCE OF AVERAGE COMPETITOR |
|---|-------------------|--------------------|--------------------------------------|
| 2006 | 19.38% | 17.09% | 2.30% |
| 2007 | 21.45% | 19.23% | 2.22% |
| 2008 | 17.62% | 18.47% | (0.84%) |
| 2009 | 16.53% | 16.68% | (0.15%) |
| 2010 | 19.59% | 19.14% | 0.45% |
| 2011 | 18.03% | 16.98% | 1.05% |
| 2012 | 21.12% | 18.94% | 2.19% |
| 2013 | 21.60% | 18.68% | 2.92% |
| 2014 | 18.44% | 16.32% | 2.12% |
| 2015 | 14.86% | 12.62% | 2.24% |
| 2016 | 11.95% | 9.54% | 2.41% |
| 2017 | 11.99% | 8.90% | 3.09% |
| 2018 | 12.77% | 10.54% | 2.23% |
| 9 years 6 months to 30 June 2019 | 13.15% | 9.13% | 4.02% |
| ANNUALISED TO 30 JUNE 2019 | CORONATION EQUITY | AVERAGE COMPETITOR | ALPHA |
| 1 year | (0.84%) | 1.51% | (2.34%) |
| 3 years | 4.38% | 2.89% | 1.49% |
| 5 years | 3.80% | 3.45% | 0.35% |
| 10 years | 13.15% | 10.89% | 2.25% |
| Since inception in April 1996 annualised | 15.16% | 11.83% | 3.33% |
| Average outperformance per 10-year return | | | 1.87% |
| Number of 10-year periods outperformed | | | 12.00 |
| Number of 10-year periods underperformed | | | 2.00 |

CUMULATIVE PERFORMANCE



Source: Morningstar

ANNUALISED RETURNS TO 30 JUNE 2019



Source: Morningstar

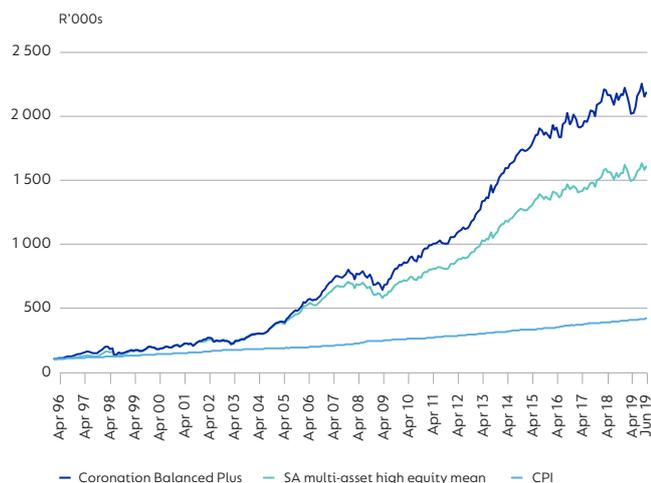
An investment of R100 000 in Coronation Equity on 15 April 1996 would have grown to **R2 629 681** by 30 June 2019. By comparison, the returns generated by the fund's benchmark over the same period would have grown a similar investment to **R1 636 329**, while the South African equity general sector would have grown a similar investment to **R1 795 100**.



CORONATION BALANCED PLUS FUND VS INFLATION AND AVERAGE COMPETITOR*

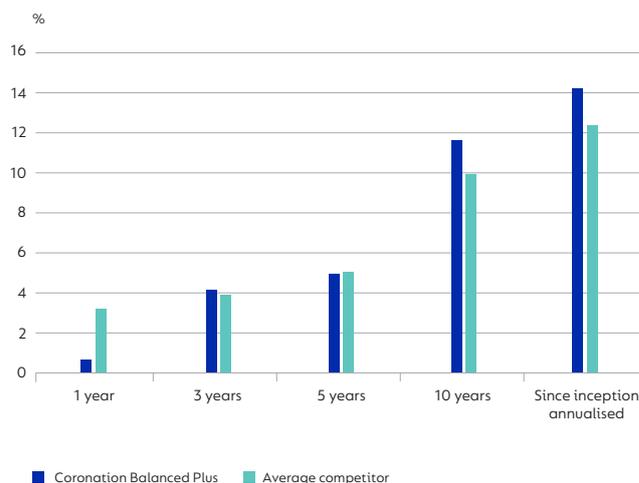
| 10-YEAR ANNUALISED RETURNS | CORONATION BALANCED PLUS | INFLATION | REAL RETURN |
|---|--------------------------|--------------------|-------------|
| 2006 | 18.33% | 6.47% | 11.86% |
| 2007 | 17.81% | 6.59% | 11.22% |
| 2008 | 16.96% | 6.87% | 10.09% |
| 2009 | 15.69% | 6.75% | 8.94% |
| 2010 | 17.20% | 6.28% | 10.93% |
| 2011 | 15.78% | 6.24% | 9.54% |
| 2012 | 17.85% | 5.76% | 12.09% |
| 2013 | 18.63% | 5.90% | 12.73% |
| 2014 | 16.58% | 6.00% | 10.57% |
| 2015 | 14.01% | 6.12% | 7.89% |
| 2016 | 11.08% | 6.30% | 4.77% |
| 2017 | 11.04% | 5.92% | 5.12% |
| 2018 | 11.26% | 5.34% | 5.92% |
| 9 years 6 months to 30 June 2019 | 11.61% | 5.19% | 6.42% |
| ANNUALISED TO 30 JUNE 2019 | CORONATION BALANCED PLUS | AVERAGE COMPETITOR | ALPHA |
| 1 year | 0.67% | 3.20% | (2.53%) |
| 3 years | 4.14% | 3.97% | 0.17% |
| 5 years | 4.95% | 5.08% | (0.13%) |
| 10 years | 11.61% | 10.04% | 1.56% |
| Since inception in April 1996 annualised | 14.18% | 12.31% | 1.87% |
| Average 10-year real return | | | 9.15% |
| Number of 10-year periods where the real return is >10% | | | 7.00 |
| Number of 10-year periods where the real return is 5% - 10% | | | 6.00 |
| Number of 10-year periods where the real return is 0% - 5% | | | 1.00 |

CUMULATIVE PERFORMANCE



Source: Morningstar

ANNUALISED RETURNS TO 30 JUNE 2019



Source: Morningstar

An investment of R100 000 in Coronation Balanced Plus on 15 April 1996 would have grown to **R2 157 568** by 30 June 2019. By comparison, the South African multi-asset high-equity sector over the same period would have grown a similar investment to **R1 586 171**.

* Median of Peer Group is the median of the fully-discretionary retirement portfolios of the largest managers as published in performance surveys and calculated by Coronation Fund Managers.



Trust is rare these days.

That's why when it comes to investing your hard-earned money, we always seek out the best investment opportunities to grow your savings into real wealth over time. It's how we work to earn your trust every day.

Make trust part of your investment portfolio.

Ask your **Financial Adviser** about how our funds can help you to achieve your financial goals or visit [coronation.com](https://www.coronation.com)

Coronation is an authorised financial services provider. Trust is Earned™

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