NAM CORONATION CAPITAL PLUS FUND

QUARTERLY COMMENTARY Q2-2022

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

The reality of 2022 is in stark contrast to the high expectations for the global economy at the start of the year. The outlook was for a promising recovery in global growth as the world exited pandemic restrictions. Expectations for a more normalised supply chain environment and a recovery in the service sector would help build on the strong post-Covid GDP rebound we saw in 2021. However, these prospects were rapidly re-set as we moved into the second quarter of 2022 (Q2-22), driven by a polycrisis– the spread of the Omicron variant in China, which triggered lockdowns and disruptions across the country; Russia's invasion of Ukraine and the ensuing sanctions; the war-induced surge in commodity prices, which impacted inflation expectations; and the resultant faster trajectory for normalising interest rates and policy tightening from central banks.

With the anchor of low, steady interest rates on asset class pricing removed, almost all major asset classes posted substantial losses in Q2-22. South African (SA) asset classes, although cheap to begin with, fared better than global asset classes, but did not manage to escape the carnage completely. The FTSE/JSE All Share Index delivered -11.7% for the quarter (its worst quarterly return in 20 years) and the All Bond Index delivered -3.7%. These sharp, negative moves in domestic and global asset classes, together with a rising inflation benchmark, has meant that the Fund's one-year return of 0.3% did not manage to meet its inflation plus 3% target return. However, the Fund has protected capital over the last 12 months and achieved real returns over all meaningful time horizons. The Fund's global exposure has been the largest detractor from performance over the year. We have been sitting below the maximum offshore allocation allowed in the portfolio for some time now as we felt that SA assets were relatively more attractive. Despite this low offshore allocation, the performance of the Coronation Global Opportunities Equity Fund (15% of Fund, delivering -17.7% for the year) and the Coronation Global Emerging Markets Fund (2% of Fund, delivering -35.2% for the year) has contributed negatively to the Fund's performance over the last year. This was partly offset by our global equity put protection. With global equity markets now offering better value, we have raised our offshore exposure. We have not tilted too aggressively as we still think SA assets are cheap and offer the highest potential of delivering the targeted inflation plus returns for investors in the Fund.

The Namibian economy surprised to the upside by expanding by 5.3% during the first quarter of 2022, recording one of the highest growth rates for the first quarter of the year compared to selected developing economies. Local indices were however not spared by the widespread asset price correction, with the NSX Overall Index returning -19.2% for the quarter, largely attributable to the resources and financial sectors. We take comfort that our exposure to Namibian businesses in the portfolio is defensively positioned for an inflationary environment. As a dominant brewer with an attractive offering, we believe Namibian Breweries, as an example, is well-positioned to pass on input cost pressure at a faster rate than many consumer-facing businesses. A fully formed price ladder should ensure that any downtrading will at least be captured by the brewer. We further expect interest rate hikes to be beneficial for our NSX listed bank holdings. As the funding books take longer to reprice, the endowment impact of rate hikes should see the banks being more profitable without taking on more risk. The local banks remain well capitalised and our largest bank position, FirstRand Namibia, took on large provisions at the height of the COVID-19 pandemic. This cautious approach and excess capital should comfortably see it through any possible uptick in credit losses due to a more constrained consumer.

SA assets have contributed positively to the Fund's performance thanks to good equity and bond selection over the last year. Within SA equity, positive contributions have come from British American Tobacco, Anglo American, FirstRand, RMI and Shoprite. The last three shares in particular highlight the opportunity for quality, SA businesses to deliver good returns for investors despite the country's tough macro-economic outlook. The combination of Naspers and Prosus is the largest equity holding in the Fund and has been the main equity detractor. The de-rating in the underlying investment holdings has been compounded by a widening discount at both the Naspers and Prosus level. Encouragingly, management recently announced an open-ended buyback of Naspers and Prosus shares as they believe that the discount has moved to unacceptable levels. We view this as a positive capital allocation move that will be beneficial for shareholders.

From a fixed income perspective, SA government bonds still trade at historically high yields and are elevated compared to their emerging market counterparts. SA has benefited from a significant terms of trade boost that provides more breathing room for the fiscus. The SARB will be under pressure to normalise rates at a pace similar to that of major global central banks, but the current premium in bond yields remains excessive and yields have a significant risk buffer to absorb higher local inflation and higher US bond yields. Our SA bond weighting has remained steady, with our selection providing healthy real yields for the Fund.

Namibian bonds saw strong demand over the past quarter, as auctions saw historically high bid-cover ratios and compression across the yield curve. Relative to SA nominal bonds, Namibian nominal bonds performed better, with spreads to the SA benchmarks on Namibian bonds decreasing on average 27 basis points, with the strongest compression seen at the belly of the curve. The IJG ALBI returned 0.93% for the Q2-22.

The events in the first half of the year have proven that the future is difficult to predict, and we expect that the uncertainty and volatility we have seen so far in 2022 will continue to be a feature for the rest of the year. The vicious de-rating of global equities and bonds are providing us with additional choice and opportunities to diversify at much more attractive valuations than we had a year ago. At the same time, we continue to see good value local investment prospects that can deliver the inflation plus returns the Fund is mandated to provide. Based on our return expectations for the various asset classes at our disposal, we continue to believe that the Fund remains well positioned to deliver on the CPI+4% mandate in the medium term.

Portfolio managers

Charles de Kock, Pallavi Ambekar & Neill Young
as at 30 June 2022