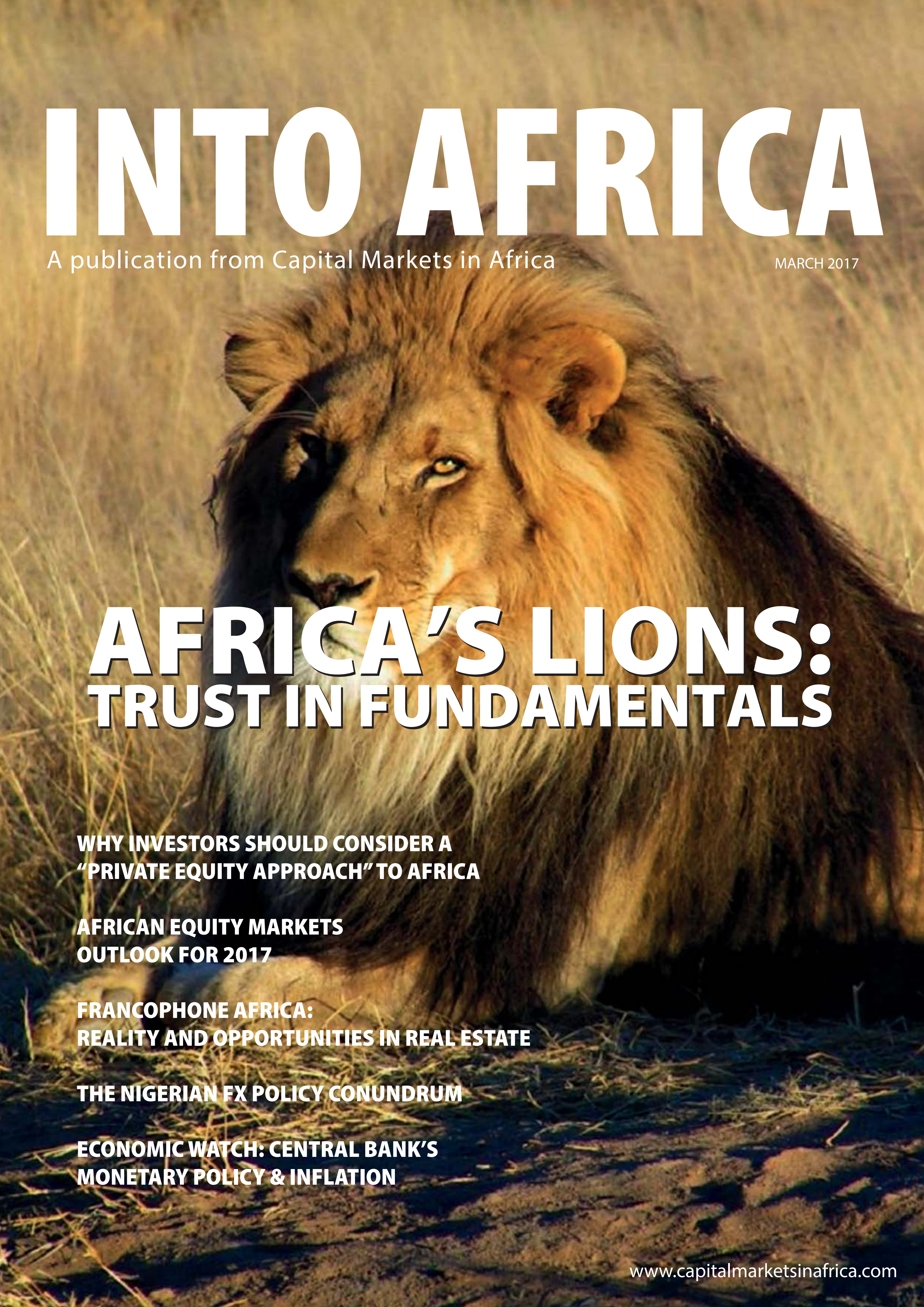

INTO AFRICA

A publication from Capital Markets in Africa

MARCH 2017

AFRICA'S LIONS: TRUST IN FUNDAMENTALS

WHY INVESTORS SHOULD CONSIDER A "PRIVATE EQUITY APPROACH" TO AFRICA

AFRICAN EQUITY MARKETS OUTLOOK FOR 2017

FRANCOPHONE AFRICA: REALITY AND OPPORTUNITIES IN REAL ESTATE

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Cover Image : The King |Lion lying down in Namibia.

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Author: Kevin Pluck.

Welcome to the March edition of INTO AFRICA, a publication with fresh insight into Africa's emerging capital markets.

Recent years have been challenging for Africa: so is the honeymoon over or did the wedding even take place? The oil price crash has had a serious impact on several African countries; the strength of the dollar is causing financing and FX issues; incidences of terrorism are up; GDPs are down; and a number of infrastructure projects have ground to a halt.

In spite of the myriad of challenges, investors can prosper and in so doing Africa, with the right approach and planning, can deliver on its growth prospects. The slowdown has been sharply felt across the African continent but mostly in the large oil driven commodity exporters. This has resulted in a shift towards economic diversification and countries in East Africa providing more economic stability than other regions.

We, at Capital Markets in Africa, believe that despite lower growth rates, the resilience across African countries remains strong; prospects remain high with optimism undiminished, hence the edition title: ***Africa's Lions: Trust in Fundamentals.***

We start off with *Why Investors Should Consider A "Private Equity Approach" To Africa* by **MARTIN WHITE** (Managing Director, Cambridge Associate) and **NICOLAS SCHELLENBERG** (Senior Investment Director, Cambridge Associates), where they noted Private Equity is a viable option to tap into Africa's Returns especially for global investors who have turned to "frontier markets" in search of alpha returns.

Looking at the investment prospects, we invited investment/equity analysts to provide their outlook on African equity markets in 2017. **MARTIN MAKGATLHE** (Chief Executive Officer, Motswedi Securities, Botswana), **JOY D'SOUZA** (Head of Research, ApexAfrica Capital Market Limited, Kenya), and **BHAVIK DESAI** (Research Analyst, AXYS Stockbroking, Mauritius) give their verdicts on Botswana, Kenya and Mauritius equity outlook for 2017, respectively. While **AFRINVEST (West African) Research team**, Nigeria, provides outlook on Nigeria's equity markets for 2017.

On South Africa's investment prospect, **PETER BROOKE** (Head of MacroSolutions, Old Mutual Investment Group, South Africa) gives his judgment in *The World a Better Place for South Africa Investors.* While **JOHANN ELS** (Senior Economist, Old Mutual Investment Group, South Africa) gives a preview of 2017 South Africa's budget speech.

Furthermore, **ATRIA Africa's investment management team** offers views on investing in African equity markets with Zimbabwe as a case study. For a balanced view, in a Q & A session, **MARK MOBIUS** (Executive Chairman, Templeton Emerging Markets Group) and **PHILIPPE KOCH** (Head of Fund Management, iPRO Fund Management) concluded that investors are carefully diversifying amid increased volatility and uncertainty.

In the article *Francophone Africa: Reality and Opportunities in real estate,* **IVAN CORNET** (Managing Partner, Latitude Five, UK), explores real estate opportunities in the French-speaking West African countries. While, in an Exclusive interview session, we asked **OBINNA ONUNKWO** (Managing Partner, Purple Capital Partners Limited, Nigeria) to give his views on challenges and opportunities in the Nigerian real estate sector.

To round off **ABAYOMI ADEBANJO** (Managing Associate, Jackson, Etti & Edu, Nigeria) evaluates Nigerian foreign exchange policy conundrum. Also, **HUGH SIMPSON** (Managing Partner, Bourse Consult, United Kingdom) and **JOHN FALK** (Partner, Bourse Consult, United Kingdom) authored the article: *Are African Markets Large and Instruments Matured Enough To Sustain CCPS?*

Editor
Tunde Akodu

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WHY INVESTORS SHOULD CONSIDER A "PRIVATE EQUITY APPROACH" TO AFRICA

By **Martin White** & **Nicolas Schellenberg**, Cambridge Associates

Investors are desperately searching for new opportunities in order to counter the challenging current low interest rate environment. For those who have turned to "frontier markets"—and particularly Africa—there has been something of a roller-coaster ride.

In 2000, as the world entered the new millennium with great optimism, Africa was viewed with suspicion. It was even branded "the hopeless continent" by The Economist. And yet, between 2002 and 2008, the African stock markets enjoyed some spectacular growth. The MSCI Emerging Frontier Markets Africa ex South Africa Index rose by a factor of 10 in US dollars—an astonishing turnaround.

Like other markets, the global financial crisis dealt Africa a devastating blow. But African stock markets soon began to rally once again, with values doubling between 2008 and 2014. This engendered fresh optimism and a new, positive narrative: "Africa Rising". Even The Economist changed its tune, referring to "the hopeful continent". This followed a decade of GDP growth of more than 5 percent, improved political and corporate governance, foreign direct investment—particularly from China—and increased investment through a growing number of emerging markets and frontier markets funds.

The recent reality: Commodity slump and FX devaluation

Since September 2014, however, when African markets hit a post-crisis peak, stocks and currencies have tumbled, with the MSCI index falling by 35 per cent to end 2016. Some of this decline reflects local setbacks, particularly on the political front. Above all, however, this can be explained by exogenous factors including the slowdown of China's economy, the concomitant effect of falling commodity prices, and the collapse in the oil price.

This has badly affected countries reliant on Chinese investment, commodity exports and oil—notably Nigeria, Africa's largest economy. At the start of 2016, its GDP was forecast to grow by +4.1 percent, but in fact, the economy actually shrank over the year. As a consequence, some investors have been turning away from Sub-Saharan Africa, switching their assets to North African markets—notably Egypt, which has its own challenges but is less sensitive to commodity prices. At the same time, a number of Africa-focused public equity funds have suffered significant redemptions and been forced to close. Of the 40-plus funds that still operate, about half have less than $50m of assets casting some doubt on their profitability – and viability.

But should investors abandon Africa altogether?

In our view, the answer is "No". On the contrary, we think that Africa offers significant opportunities for investors searching for alpha—outperformance. The middle class is growing, there is a youthful population brimming with entrepreneurial energy, and there are vast tracts of uncultivated land ripe for development. But how should investors tap this potential? We believe that they need a different approach. Around the world, we see striking potential in private markets. According to Cambridge Associates analysis, private markets have markedly outperformed public markets over the long term. And Africa reflects this global trend. Comparing public and private markets over 10 years (to September 2016), African private equity returns, measured by Cambridge Associates, have outperformed Emerging Market public investments by more than an annualised 270 basis points—a big difference. This calculation is based Cambridge Associates' Modified Public Market Equivalent (mPME) Index, which replicates private investment performance under public market conditions.

How can investors capture these kinds of returns? One option—for those investors who want to continue to access the public markets—is to look for investment managers who take a more "private equity" approach to stock market investing. This recognises the fact that many of the companies listed on African stock exchanges have some of the characteristics of private companies: among other things, they are often small, traded infrequently, lack transparency, and have little or no analytical coverage.

Managers following this approach seek out the less liquid listed companies, with higher return potential, and may actively engage with the companies to influence and support management. It is important to understand that this does not really work in the popular UCITs fund structure: daily liquidity is an illusion for many African listings—especially smaller stocks — and can force punitive transaction costs. So, in our view, it is wise to look for funds with appropriate lock-ups and liquidity terms.

But, clearly, the main option for those who want to capture the kinds of returns available in the private markets is to invest directly in unlisted firms. The opportunities are significant and the private markets are expected to grow further. A short example to provide some context: although Africa's GDP is more than double that of Scandinavia, it has a similar number of private equity firms and roughly half the investment volume —$12bn versus $24bn— of the Nordic region.

Moreover, private equity funds offer access to a much greater diversity of companies.

For example, the S&P index of African markets beyond South Africa comprises over 50 percent in financial companies (banks especially). By contrast, the Cambridge Associates Africa Private Equity Index is more broadly balanced, with significant weightings in consumer discretionary, financials, information technology, healthcare, industrials and the telecommunications sectors. In other words, private equity funds allow investors to tap into the full, wide-ranging economic potential of Africa.

But if the opportunities are significant, so too are the challenges. Some of these relate to the characteristics of the regional economy. Africa remains heavily reliant on the Chinese economy. The performance of African private equity funds, as measured by internal rates of return (IRR), shows some link to the rise and fall of the Chinese economy, as measured by GDP growth. In 2007, when China's annual GDP growth exceeded 50 percent, the 5 years rolling IRR of African funds was more than 30 percent. By 2015, as China's GDP growth fell to 7 percent, the 5year-IRR slumped to around 1 percent.

Also, there is the problem of foreign exchange volatility, which can significantly undermine returns for international investors. Taking South Africa as an example: in the three-year period to March 2016, South African private equity funds showed an IRR of +10 percent in the South African rand (ZAR), which translated into negative 6.3 percent in US dollars. However, over a longer 15-year period, the currency effect was more mixed with a US dollar performance "only" 440 basis points below the ZAR returns (8.2% versus 12.6% IRR).

There are some other practical challenges too. For instance, there are relatively few private equity funds, giving investors only a limited choice when looking to enter the biggest frontier market. Also, since the African private equity industry is relatively young, there have been only limited exits to date, providing a less clear picture of the final, true performance of the sector. In addition, given the issues around the liquidity of public markets, these offer less of an exit route. Just 1 percent of private equity exits were achieved through an IPO in 2014-2015.

But, for all of these practical challenges, the trajectory is a good one. Since 2012, more than ten new private equity firms have been launched, and more are likely to be established over the coming years. Moreover, the average number of exits each year has risen from 27 in the period 2007-2009 to 41 in the period 2013-2015. Meanwhile, local institutional investors are increasing their private equity exposure, offering significant support to the industry. African pension funds have started to invest in private equity, with governments encouraging them to do so. In 2015, Kenya's Treasury minister announced that pension funds would be able to invest up to 10 percent of their portfolio in private equity and venture capital funds licensed by the country's Capital Markets Authority.

This is a step in the right direction. But, to be truly effective, investors should consider allocating significantly more of their assets to private markets. Most African markets are classified as "Frontier"—that is beyond the standard "Developed" or "Emerging" market indices. But at Cambridge Associates, we also talk about another frontier: the "15 percent frontier". In some separate research, Cambridge Associates found that global investors allocating 15 percent or more of their portfolio to private investments—ranging across venture capital, private equity, distressed securities, infrastructure, real estate and private debt—have enjoyed significant outperformance over the long term.

In a survey of the trailing returns of 242 endowments and foundations for the ten-year period ending June 30, 2015, we found that the median annualized return for those with 15 per cent or more in private investments was 7.6 percent, 150 basis points higher than the return of the group with less than 5 percent in private investments. Compounded over a ten-year period, this differential can have a meaningful impact on the financial health of an institution. And for institutions that invest in this way for more than ten years, the rewards are greater still. Over a 20-year period, the median return for institutions with more than 15 percent allocated to privates outperformed the median for the group with less than 5 percent in privates by a cumulative margin of 182 percentage points, or 180 bps per year.

In other words, the value of private investments is clear in any region of the world, and, in our view, Africa too merits consideration as part of a "private equity approach".

Contributors' Profile

Martin White is a Managing Director at Cambridge Associates and is based in the firm's London office. He heads the EMEA public equity research team and is responsible for researching managers in Europe, the UK, Middle East and Africa. Before joining Cambridge Associates, Martin worked for 25 years in the investment management industry. He was a Principal at Barclays Global Investors (latterly BlackRock) where he worked as lead portfolio manager then senior strategist in quantitative active equities covering equity long-only, partial short and market neutral Hedge Funds strategies.

Nicolas Schellenberg is a Senior Investment Director at Cambridge Associates and is based in the firm's London office. He co-heads the ex-US private equity and venture capital research team in Europe and is responsible for performing due diligence on private equity and venture capital opportunities in Europe as well as across some emerging markets, including Latin-America and Africa. Before Nicolas joined Cambridge Associates, he worked at Macquarie Investment Management, in the Private Equity Fund of Funds team in London, where his responsibilities included the due diligence and quantitative analysis of primary, secondary and co-investments, as well as portfolio management.

BOTSWANA EQUITY MARKETS: WHERE DO OPPORTUNITIES LIE?

By **Martin M. Makgatlhe,** Chief Executive Officer, Motswedi Securities, Botswana

Banking Sector

The year 2017 is going to be a mixed bag on the Botswana Stock Exchange. The banking sector is likely to grow at a smaller pace mainly due to the tight economic situation mirrored by the low-interest rate environment (Bank rate 5.5%). Impairments are also likely to rise mainly led by the closure of some mines in the country. Already Stanchart and FNBB have issued cautionary statements as they expect an increase in impairments mainly due to the closure of BCL Mine and its subsidiary Tati Nickel Mine. The mines used to employ over 5500 direct jobs and their closure is bad news for Botswana's economy at large which depends on the mining sector. Barclays Bank Botswana seems to have survived this thanks to the fact that some of its facilities extended to the mine are guaranteed by the government of Botswana. The bank's shares are currently in high demand on the Botswana Stock Exchange (BSE).

Micro Lending Sector

The outlook for the micro-lending space is exciting, with Letshego recently acquiring a 100% stake in Ghanaian financial services company AFB, which reported net profits of P10.9million during H1 2016. To date, Letshego now has presence in eleven countries across Southern, East and West Africa and this is helping diversify its income away from the Botswana market which is almost reaching saturation.

FMCG Sector

The outlook for the FMCG sector is exciting with plenty of opportunities for growth. Choppies aggressive expansion outside Botswana has enabled the retail giant to have a presence in eight countries in Africa within eight years. The recent acquisition of Ukwala Stores in Kenya has given Choppies access to the lucrative Kenyan Market. The share price is down and is trading near its 52 week low of BWP2.27 per share. However, should the retail giant turnaround the fortunes from its loss-making South Africa operations, demand for its shares will pick up once again.

Not to be outdone, Sefalana is also expanding outside Botswana and now has a presence in Namibia and recently Lesotho after acquiring TFS Cash and Carry. Sefalana has also acquired a 25% stake in a large consortium in South Africa which already has existing retail and wholesale store network across South Africa, giving the retail giant access to the lucrative but more competitive South African market. Sefalana's strategy of getting a stake in an existing network of retail and wholesale outlets will protect it from some execution and penetration risks normally associated with greenfield expansions. This is because the consortium already has an established customer base, market share and is familiar with local market dynamics.

Property Sector

The sector is stable with average dividends yields of 5.8% which is above the market average yield of 4.6%. Vacancy levels remain low especially in the industrial space boosted by the growth of the local logistics and manufacturing businesses'. In contrast, the office space is saturated with an oversupply of office space brought about by the expansion of new office buildings within the Gaborone CBD area. We expect rentals in the office space to remain under pressure with the possibility of existing tenants even negotiating for lower rentals upon the renewal of their leases.

As a result of the near saturation of the local property market, more local property companies are expanding their horizons beyond Botswana's borders seeking growth and income diversification. In this regard, Turnstar one of BSE listed property company acquired the Mlimani City Mall in Tanzania in 2012. The mall is the first and currently the only indoor fully air-conditioned shopping mall in Dar Es Salaam and is home to fifty-four retail outlets including powerful brands such as Game, Apple i-store and LG. Primetime, another BSE listed property company has just entered the Zambian market and intends to develop a shopping centre in Chirundu and another mall in the capital city, Lusaka.

Other companies where we expect growth this year include recently listed telecoms giant BTCL which is just up 7% above its IPO price of BWP1. We also see growth in tourism and hospitality companies such as Chobe and Wilderness which are currently benefiting from an increase in tourist arrivals especially from overseas markets partly helped by the recovery of the US and to some extent the Euro zone - the major source markets.

> *"The year 2017 is going to be a mixed bag on the Botswana Stock Exchange. The banking sector is likely to grow at a smaller pace, the micro-lending and FMCG sectors are exciting."*

KENYA STOCK MARKETS: IDENTIFYING OPPORTUNITIES IN 2017

By **Joy D'Souza, Head of Research**, ApexAfrica Capital Market Limited, Kenya

The Kenyan stock market is going through a hard-hitting period, one that has been prevalent for the last three years. In 2016, the stock market carried on its lackluster performance registering a 29.7% y/y drop in turnover to USD 1.5B for the second year running, having shed 2.9% y/y in 2015. Foreign investor participation remained dominant, averaging at 67.8% compared to 59.4% in 2015. The NSE 20 share index shed 21.0% and the NASI 8.0%. Out of the 63 listed companies, only 9 closed in the green.

Trading activity is yet to pick up pace noting that the first month of 2017 has been characterized by continued minimal local investor participation with foreign investors displaying little appetite on a handful of stocks. The indices have taken a nose dive, with the NSE 20 share index losing 12.3% m/m in Jan and recording a seven-year low of 2,789.64 within the month. While one could argue that it is still early days, several factors seem to be driving the apprehensiveness that funds and investors have displayed. Some of the factors that will see us continue to adopt a cautiously optimistic stance in 2017 include:

- Too strong a dollar appreciation on the back of renewed optimism on the US economy as well as the rate hike in Dec and expectations of additional tightening within the year exerting pressure on the Kenya Shilling.
- The possibility of a rise in crude oil prices attributable to supply cuts resulting in the widening of Kenya's current account deficit and a downside risk to inflation.
- General Elections– Political risk will remain a key driver of investor sentiment as the General Elections are set to take place on August 8th, 2017.
- The impact of capping of interest rates on the banking sector– While the fourth quarter of 2016 will give a glimpse into how the new regulation will impact the performance of the banking sector, 2017 will paint the full picture. Worries about profitability erosion amid margin compression besets the sector. We remain neutral on banks in the interim.
- Drought in 2017: The Met department has forecasted a severe drought to be experienced in Kenya this year, more so in the first quarter. Consequently, the Government may spend more than the KES 21.5B budgeted to support 1.3M people. With agriculture accounting for 22% of the country's GDP, dented agricultural productivity may dampen the country's GDP growth and impact inflation.
- Foreign capital flight? We remain cautious of capital flight owing to recovery of the US. However, we believe that much as US growth will accelerate in the short run, SSA continues to present faster growth prospects, currency and political risks notwithstanding.
- The slowdown in GDP growth to about 5.7% from 5.9% in 2016 mainly owing to adverse effects of the prevailing draught and constrained private sector credit growth.

That said, we see some opportunities in the following sectors:

- Telco (Safaricom- Fair Value KES 22.60, upside 22.2%) with growth pegged on accelerated mobile data, sustained MPESA revenue growth and opex optimization.
- Oil and Gas (Kenol Kobil- Fair Value KES 15.00, upside 20.0%) owing to excellent inventory management, expansion of retail network and focus on high margin business segments.
- Tourism (TPS Serena- Fair Value KES 27.35, upside 36.8%) as other markets (Tanzania, Uganda, Rwanda) continue to contribute more to the bottom line and the tourism industry in Kenya makes a recovery after the General Elections.
- Media (Nation Media and Scangroup)-both companies trade at historically low multiples, have zero leverage, are cash rich and may benefit from increased ad spend on political advertising in 2017.
- Cement (Bamburi)- continued investment in infrastructure by the government including phase 2A of the Standard Gauge Railway coupled with a burgeoning Real Estate sector will continue to drive cement consumption. Bamburi's balance sheet is fully deleveraged and pays attractive dividends (8.7% div yield).

Contributor's Profile

Joy D'Souza is the Head Of Research at ApexAfrica Capital Limited, a subsidiary of AXYS Group- Mauritius. Prior to this role, Joy was a Research Analyst with Kestrel Capital (EA) Limited for five years. She holds a Bachelor of Science in Statistics degree from the University of Nairobi and is working towards the Chartered Financial Analyst (CFA) designation.

MAURITIUS' INVESTMENT PROSPECTS IN A NEW DAWN

By **Bhavik Desai, Research Analyst**, AXYS Stockbroking, Mauritius

The start of 2017 was marked by the resignation of Sir Anerood Jugnauth as Prime Minister (PM) who was replaced by Mr. Pravind Jugnauth. This ended months of speculation and resulted in a reconstituted cabinet. The new PM who kept the "Finance" portfolio, delivered an address which emphasized continuity on the most recent National Budget. Markets prefer certainty – a state of affairs – which this re-shuffled cabinet is poised to deliver despite the uncertain times ahead plagued by a "hard" Brexit, a Trump Presidency and upcoming elections in major EU nations. Should this administration deliver on its renewed promises, we expect prospects to remain positive.

The sector expected to benefit most in 2017 is the construction which is expected to renew with growth after several years of contraction and/or stagnation. Major public infrastructure projects have been delayed by bottlenecks; however, this situation appears to be improving. Key public transport infrastructure projects expected to be green-lighted during 2017 which include decongestion works (bridges/flyovers), a light-rail system linking the Plaines-Wilhems (where the majority of the population lives) and Port-Louis, as well as a programme to replace leaky decades-old water pipes. This reinforces our view of upbeat prospects for building materials companies during 2017.

Since the Great Financial Crisis, tourism and construction sectors - two key industries with wide-ranging spill-over effects - have not had positive prospects at the same time. 2017 marks a departure from that with Government maintaining an "appropriate" air connectivity policy to further diversify markets, and encouraging new developments following a moratorium. Both arrivals figures and tourism receipts are expected to increase in 2017. Room rate increases and higher occupancy are expected to boost hotel group's earnings, however, the net effect would be uneven among hotel groups due to renovations works poised to take place during the low season.

The manufacturing sector is one experiencing most headwinds and uncertainty. Manufacturing growth has stagnated in recent years, and is likely to remain subdued. The GBP's plunge against the MUR is hurting exporters, coupled with a cyclical demand slowdown for non-edible consumer goods. On plus side, Mr. Trump's decision to stymie the USA's adhesion to the Trans-Pacific Partnership (TPP) means that Mauritius can remain competitive in the US market through the Africa Growth and Opportunity Act (AGOA); however, given uncertain US policies, AGOA's future is also unknown. Further, the recent stabilisation of commodity prices, especially the sugar price rally, bodes well for sugar conglomerates who will likely churn a profit in the sugar cluster in 2017 on the back of both a better harvest and higher prices. Sugar conglomerates are increasingly diversifying into capital intensive property developments which are likely to weigh down on earnings in the short term only to reap benefits in the longer-term.

The financial sector has remained resilient in recent years averaging a 5.5% growth rate. Government interventions in the aftermath of the collapse of a bank and life insurer appear to have stymied contagion. Given the weak investment rate, credit growth has been tepid which has resulted in excess liquidity in the system which in turn has driven sovereign yields to record lows. Consequently, core banking growth at large banks has been subdued.

> *"The new PM who kept the "Finance" portfolio, delivered an address which emphasized continuity on the most recent National Budget."*

The renegotiation of the Double Taxation Avoidance Agreement (DTA) with India in 2016 sent shockwaves through the sector; however several months down the road, India has renegotiated several other DTAs and Mauritius' remains the most advantageous. The Global Business (GB) sector will have to re-invent itself as other sectors have had to in the past. The Sanne Group, listed in London, acquired The IFS Group - a leading GB player with a large focus on the Indian market - for $127M in Q4-16 signals that scope for a healthy GB industry exists. In conclusion, 2017 should - if construction gets going as predicted - be one the best years for the Mauritian economy since 2010.

Contributor's Profile

Bhavik Desai leads the equity research and valuations department at AXYS Stockbroking which he joined in 2010. His primary foci are Mauritian equities and the burgeoning Mauritian fixed income market. Prior to joining AXYS, Bhavik worked on the implementation and monitoring of corporate strategies for the Office of the CEO at SAP Labs LLC in California. Bhavik holds a Double Bachelors in Arts in Physics and Astrophysics from the University of California, Berkeley.

NIGERIAN EQUITY MARKETS: KEY DRIVERS STILL UNDER SIEGE

By **Afrinvest (West Africa) Limited Research Team,** Nigeria

Analysis of market performance in 2016 indicated that although a combination of poor corporate releases as well as weak macroeconomic fundamentals contributed to the negative return for the year, market volatility remained largely consistent with instability in the currency market. More specifically, while bearish sentiments persisted for most of 2016, equities rallied between May and July 2016 due to reforms in the Oil & Gas sector and adoption of the floating exchange rate regime. We also observed that the periods of widening exchange rate spread (between official and parallel market rates) and the imposition of currency control measures correlated with the lowest points of the index.

It is apparent that key market drivers such as exchange rate, oil prices, oil production volumes and government revenue are still under siege while policy risk remains the biggest factor to watch. Thus, our fundamental view of market performance in 2017 is bearish as uncertainties remain so long as impediments to economic expansion stay unaddressed. We expound on the determinants of performance of the local bourse in 2017 below:

1. Policy Uncertainty.... the Biggest Factor to Watch!

At the epicentre of Nigeria's recent economic difficulty is policy uncertainty and the major factor responsible for the unresolved crisis in the currency market is a confidence deficit. This was highlighted in our 2016 Banking Sector Report when we noted that:

As against the oft-repeated investment case for Nigeria which had previously been predicated on the resiliency of the economy in terms of its vast and unexploited natural and human resources, attractive demographic features as well as high profit margins; confidence metrics, such as policy consistency, sound governance, regulation, and reforms, are now the new arguments being put forward by investors in making investment decisions.

Notwithstanding blunted monetary policy tools, we do not see the Apex Bank deviating from its history of policy volatility in 2017. Even so, the capacity of the fiscal policy managers to implement policies to counter the raging economic recession remains a concern in the absence of a major policy response by the Ministry of Finance since the cabinet was constituted late 2015. Thus, the direction of policy framework is still blurry. The short to medium term implication of the above is, therefore, a protracted episode of stagflation justifying a bearish outlook for equities.

2. The "Troika": Oil Proceeds, External Reserves and Exchange Rate

The historical trend of the Nigerian equities market indicates that performance has been tightly correlated to crude oil prices, accretion to gross external reserves and exchange rate stability. This is because capital flows into Nigeria are fundamentally driven by exchange rate stability and accretion to reserves - which is largely a function of oil proceeds.

However, the exchange rate crisis which has lingered for more than 24 months is expected to persist in 2017 given a benign outlook on proceeds from oil as well as poor policy responses. Despite a last minute agreement by OPEC and some non-OPEC members to cut output, short to medium term outlook suggests oil prices are likely to stay at sub-US$60.00/b while militancy in the Niger Delta region will likely keep domestic production depressed. This combined with the absence of a clear-cut economic road map by the federal government to recalibrate the economy away from recession implies a blurry outlook for equities.

Our interactions with several foreign investors with interests in Nigeria suggests that a decision to stake any position in the Nigerian market will be a function of currency liquidity and a greater certainty on their ability to repatriate capital anytime they divest. As a result, we do not see significant foreign capital flowing into Nigerian equities in the short to medium term as the discrepancy between the parallel and interbank market rates continue to deter interest in Nigeria.

Additionally, the likelihood of a further adjustment to the current interbank market rate which remains controlled despite recent reforms by the Central Bank of Nigeria (CBN) will keep investment in Nigeria soft. Meanwhile, FX bottlenecks are expected to continue to pressure operating metrics for corporates, given the negative impact on input cost, capital expenditure and financing. On the other hand, pressure on disposable income implies a soft outlook for revenue. Therefore, improvement in operating metrics will take a medium to long-term to materialize. As such, we expect that appetite for equities will stay soft until the market has bottomed out.

"It is apparent that key market drivers such as exchange rate, oil prices, oil production volumes and government revenue are still under siege while policy risk remains the biggest factor to watch."

3. Constrained Corporate Earnings

In addition to the above, indications are that output contraction or subdued growth may persist in the services and industrial sectors of the economy as observed in 2016. However, the agricultural output may further improve on the back of the renewed drive to increase domestic productivity and export earnings as seen in 2016. Expectedly, growth prospects for corporates in the Consumer Goods, Industrial Goods, Health Care and Banking sectors may stay constrained in the short to medium term except for the Agric. Sector operators. Upstream Oil & Gas companies may also benefit from higher prices of crude oil if militancy is brought under control. Ultimately, market performance may be largely constrained by this uncertainty.

> *"We do not see significant foreign capital flowing into Nigerian equities in the short to medium term as the discrepancy between the parallel and interbank market rates continue to deter interest in Nigeria".*

Where is the Bottom?

Notwithstanding the foregoing, our technical analysis indicates that a continuous downtrend in the market will trigger a rebound even in the absence of fundamental drivers as soon as market actors perceive prices to have reached its long term support level or bottomed out. As such, we are of the view that despite bearish indications from a fundamental point of view, there is a technical basis for an uptick in the index level immediately market valuation becomes ridiculously cheap (unless there is an unexpected policy misdirection from the CBN or the fiscal authorities).

To give credence to our position above, we analyze the 10-Year trend of the All Share Index (ASI) to determine the long-term support level. The long term support level for the ASI is established at 20,000points. In the last 10 years, this support line has not been breached even during the global financial crisis of 2008 and the Eurozone market rout of 2011 both of which had the most devastating impact on financial markets around the world. Accordingly, we expect that despite a bearish outlook for equities, the index may not breach the 20,000 points support line in 2017 notwithstanding market sentiments.

A further implication of the above is that short term speculative opportunities will persist in equities regardless of the broader sentiments in the economy as active traders can swiftly long the market once the index bottoms out or near the 20,000 points support level and take profit when return targets are achieved. We also see opportunities for speculative positioning ahead of foreseeable policy pronouncements by the Apex Bank and the fiscal authorities during the year as events in 2015 and 2016 have clearly shown. The market rallied significantly during these periods, touching the short-term resistant levels in response to cheery news such as President Buhari's victory at the poll, the announcement of the downstream oil & gas sector reforms and the initial rally that greeted the implementation of a floating exchange rate regime by the CBN.

> *"We expect that despite a bearish outlook for equities, the index may not breach the 20,000 points support line in 2017 notwithstanding market sentiments."*

Our Scenario Analysis in 2017

In view of the observed weaknesses in the system, our base case scenario in 2016 predicted a 5.9% Y-o-Y decline for the index if FX rate was adjusted to N265.00/ US$1.00, oil prices stabilizes above US$30.00/b, a 100bps hike in MPR to 12.0%, an appreciable performance of the 2016 budget and an improved global sentiment for equities. Although oil prices stabilized well above US$30.00/b while the CBN hiked MPR to 14.0%, initiated reforms in the FX market during the year and adjusted FX spot rate to N305.00/ US$1.00, liquidity crunch persisted in the currency market and the 2016 budget was sub-optimally implemented.

Crisis in the Niger-Delta region also escalated while policy responses to teething economic woes stayed largely insufficient. Hence, the benchmark index depreciated 6.2% Y-o-Y in 2016 (Afrinvest base case projection was -5.9%) as macroeconomic and corporate operating metrics worsened.

In 2017, we envisage market performance to be broadly predicated on three critical economic outcomes. These include:

1. The implementation of an economic recovery plan to restore economic growth;
2. Resolution of the on-going crisis in the Niger Delta region and the impact on oil production volumes as well as revenue;
3. Apex Bank's resolve to fix the currency market crisis and close the huge gap between official and unofficial market rates once and for all.

INVESTORS ARE CAREFULLY DIVERSIFYING AMIDST INCREASED VOLATILITY AND UNCERTAINTY

MARK MOBIUS
Executive Chairman, Templeton Emerging Markets Group. Mark has spent more than 40 years working in emerging markets all over the world. He joined Franklin Templeton in 1987 as president of the Templeton Emerging Markets Fund, Inc.
He is the author of the following books: Trading with China; The Investor's Guide to Emerging Markets; Mobius on Emerging Markets; Passport to Profits; Equities: An Introduction to the Core Concepts; Mutual Funds: An Introduction to the Core Concepts; Foreign Exchange: An Introduction to the Core Concepts; Bonds: An Introduction to the Core Concepts; The Little Book of Emerging Markets; and the subject of Mark Mobius – An Illustrated Biography.

PHILIPPE KOCH *has over 16 years of experience in the financial services industry. He is responsible for the management of Pan African equity and fixed income portfolios at IPRO Fund Management. Philippe is also the lead Fund Manager of the African Market Leaders fund, a long only Pan African equity fund with a track record of about eight years. Setup in Mauritius in 1992 and present in Botswana since 2007, IPRO manages a small range of investment funds dedicated to the African Continent and its home markets Mauritius and Botswana, both in equities and bonds.*

CAPMARKETSAFRICA: *As market volatility increases and outsized returns in equities and other high-yield assets give way to more subdued performance, how are investors adapting their portfolios to stay ahead of the curve?*

Mark Mobius: Investors are being careful to diversify to ensure that they are not caught in a risky position.

Phillipe Koch: Elevated cash holdings can exhibit positive convexity in volatile times, and it looks like more and more investors are using this tool in the current environment. The flip side of elevated cash holdings is when portfolio managers are pushed by investors to chase returns in a rising market, particularly when investing in illiquid emerging and frontier equities. For any investment, a margin of safety is key.

CAPMARKETSAFRICA: *What new challenges and opportunities have arisen from the turmoil of the past year in emerging markets?*

Phillipe Koch: 2016 has been overall a good year for emerging equities and bonds. For the first time since 2010/2011, EM equities managed to catch up to U.S. equities. Positive currency attribution was one of the main drivers from Brazil (+22%) over Russia (+20%) to South Africa (+13%). Unfortunately, frontier market equities underperformed emerging markets. Africa ex SA performed even worse, largely on the back of economic mismanagement by governments. Government interference into different economic sectors, as well as capital and currency markets, remains one the of the greatest challenges in our universe.

Mark Mobius: Increased volatility and uncertainty.

CAPMARKETSAFRICA: *Looking back at Africa in 2016 there was a clear rethinking of investment focus by foreign Investors, where are we likely to see structural and demographic changes that might present attractive investment opportunities moving forward?*

Phillipe Koch: Structural and demographic changes have been the main reason for international investors to allocate capital to Africa. However, it is not a given that they will "automatically" lead to attractive investment opportunities. A young and growing population can be both a blessing or a curse for any given country as good economic management is a prerequisite to harvesting the demographic dividend. On the structural side, I'd like to say that the electrification theme remains an attractive investment opportunity. It is one of the rare areas where all stakeholders seem to be on the same page, but providers of capital need to get their fair share.

Mark Mobius: Government reform will be the key. The degree to which African governmental are able to eliminate corruption and provide the rule of law for both local and foreign investors will determine the ability of those countries to attract investments.

CAPMARKETSAFRICA: *In your opinion how have recent world events such as Post-Brexit, President Donald Trump etc would affect the opportunities and challenges for African markets and what do you expect the implications will be on African economies?*

Mark Mobius: For Africa, those events such as Brexit or the Trump election will not be critical. It's really what goes on in the individual countries as regards to law and order will determine the future of Africa.

Phillipe Koch: Brexit has certainly an impact for African countries having strong trade ties with the UK, while adverse effects from the Trump administration might play out in the area of donor flows. I believe it is very important to focus on the big picture and potential indirect effects on African countries from any tectonic shifts in the geopolitical and economic order, above all the relation between the U.S. and China.

THE WORLD A BETTER PLACE FOR SOUTH AFRICA INVESTORS

By **Peter Brooke**, Head of MacroSolutions, Old Mutual Investment Group

There are three big themes that we believe will dominate markets in the year ahead. These are Keynes is King, Reflation and South Africa Stabilises. The first two themes are about an improving world and better global growth, while the third theme is South Africa specific and has the biggest impact on the local asset classes in which we invest.

Keynes is King

The world has shifted. The big bond bull market is over and there is a move away from monetary policy stimulus to using fiscal stimulus to revive economic growth. Monetary policy (specifically low interest rates and quantitative easing) has gone as far as it can go in its effectiveness in boosting growth. The next step is fiscal stimulus – increasing government spending and/or lowering taxes to stimulate demand (an approach favoured by economist John Keynes). A more expansionary fiscal programme in the US will support growth and should result in global earnings going up in 2017. That is good for equities relative to bonds and within equities, it is good for value-style investing over growth-oriented shares and for cyclical over defensive shares.

Reflation

With stimulus gaining some traction and global growth finally picking up, we are starting to see reflation – something developed market central banks have been trying to achieve for years. Reflation is primarily being propelled by US wage growth, which is driving increased consumer spending, and hence inflation. A rise in spending means increased demand, which will translate into better profits. While in the global equity bull market we've had multiple expansions, the thing that has been missing is profits. With the better growth, we think that earnings will come through and we believe earnings have the potential to surprise on the upside.

South Africa Stabilises

The other big theme for 2017 is "South Africa stabilises". Effectively, South Africa had a disastrous 2016, but we expect conditions to improve in 2017. There are a couple of one-off factors that should facilitate a better year ahead.

The biggest factor is rain. The drought has broken and that will mean a good agricultural harvest. This, in turn, will bring food prices down and the consumer will have more disposable income.

Another supporting factor is inflation. While it recently hit an annual rate of 6.8%, we believe this is the peak and expect inflation to start coming down. A falling inflation rate will mean that we can expect the South African Reserve Bank to start cutting interest rates. Other factors supporting a stabilising SA are an improving global economic environment and the end of the commodity price collapse. This all translates into slightly better growth prospects for SA. After a tough period in terms of returns, with most investors making very little money in 2016, we think things will start improving in 2017.

Better earnings mean better returns, lower cash yields means cash is less attractive and lower inflation means we can get better real returns. Hence, our outlook is a bit more positive and that comes through in our expected returns over the next five years, which are higher in real terms.

Taking those expected returns on a basket basis for a balanced fund, our expected real return has increased to 4% a year over the next five years (up from our previously expected 3.5% a year). If we can get some alpha on top of that, we will be well placed to reach our target of 5% annual real returns for a balanced fund over the longer term.

Within our funds, we have shifted from defence to offence – investing cash into growth assets. For instance, at the beginning of 2016 the Old Mutual Balanced Fund had 25% in cash and today it has 7%.

This active asset allocation materially increases the chance of us delivering to our clients' long-term return expectations.

Within the different asset classes, our return expectations are as follows:

South African Equities: We have increased our expected real return to 5% a year over the next five years, up from 4.5%. The market is cheaper, driven by the derating of some shares and strong earnings growth coming through from resources. The main headwind for the equity market is the strength of the currency, but following its strength last year, we expect a more stable rand this year.

South African Property: We have increased our expected longer-term real return for local property to 5.5% a year. However, this applies specifically to South Africa- oriented property companies. Those companies that have diversified into real estate overseas will have to contend with a rising cost of capital (as global interest rates rise) and a stronger rand. Conversely, the locally orientated companies will benefit from a falling cost of capital (on the back of expected interest rate cuts).

South African Bonds: We expect a real return of 3% a year from local bonds and our preference is for nominal bonds over inflation-linked bonds, as inflation has peaked and should come down.

South African Cash: Cash has been an attractive asset class over the last year, beating equity, but it is not a long-term option. With the economy on its knees and inflation falling, we expect rate cuts despite US rates rising.

Global Equity: Despite the reasonably high valuations, we're optimistic that global equity will have a decent 2017. This will be driven by the improved macroeconomic environment flowing through into company earnings, especially where margins are depressed. As a result, we have an overweight position in value-orientated shares instead of growth shares.

Global Bonds: The expected returns on global bonds are actually improving as yields rise. However, we remain secular bears and continue to avoid the asset class.

Global Cash: Cash yields remain derisory, although the world will have to adjust to rising US interest rates.

Contributor Profile:
Peter joined Old Mutual in May 2005 and has been the Head of Macro Solutions since 2007. He has specific responsibility for the dynamic funds – the higher return funds within the Macro Solutions range. These include institutional funds, such as the Profile Edge 28 Portfolio, and unit trust funds: Old Mutual Maximum Return Fund of Funds and Old Mutual Flexible Fund.

Having analysed countries and companies, Peter integrates top-down and bottom-up drivers and valuations to create an optimal portfolio. He has won a Raging Bull award for the best risk-adjusted fund in the overall prudential asset allocation category.

Peter is an award-winning analyst who has extensive experience in the investment arena. Prior to joining Old Mutual, he worked at a stockbroker for 10 years, as an analyst and equity strategist, and was the Head of Research and Head of Equities for Cazenove South Africa.

PREVIEW OF SOUTH AFRICA'S BUDGET SPEECH 2017

By **Johann Els,** Senior Economist, Old Mutual Investment Group

The upcoming Budget will be a critical one given there is no more room for the upward revision of deficit targets as seen over the last few years. As a result of the current slow growth environment, the tax increases and expenditure cuts set in October's Medium-term Budget have to be adhered to if Treasury is to deliver a positive Budget. This is according to Senior Economist, Johann Els, who points out, however, that, given that the current fiscal year is running about R5 billion short of the target, Treasury will have to go beyond the tax and expenditure targets set in October requiring an even tighter Budget.

Els says that the Medium-term Budget last year set out targets of R20 billion for expenditure cuts and R28 billion for tax increases in order to achieve the R48 billion contraction target needed for the Budget. "With the current fiscal year running R5 billion short, due to slower tax growth and slight over-spending, they will need to go bigger on tax increases and expenditure cuts this year to make this up," he says.

"Whether or not they actually do take these necessary steps remains to be seen, but it will be a very big positive if they do as it will be a departure from the historical trend."

Els highlights that the rating agencies will be watching this very closely. "Treasury sticking to the 3.1% Budget deficit target they set in October in the Medium-term Expenditure Framework is one of the crucial issues they will be considering in the decision on SA's sovereign rating," he explains.

Els says that they will also be keeping an eye on the actual mix of tax increases introduced by the Budget. "For example, if they decide to increase VAT, this would be viewed as a significant step in the right direction. While most economists are skeptical about the prospects of an actual VAT hike, there is increasing talk of a 0.5% VAT hike, which would contribute R10 billion to the Budget, although I still think the probability of this falls below 50%, despite the market and currency strength that such a move would bring," he says.

A VAT increase is a notoriously unpopular political move among lower income groups, particularly during an election cycle. Nonetheless, Els believes that the chances of a VAT hike are still better than this time last year given the increased pressure that Treasury is under. "If they were to raise the VAT rate, they can still sell such a move politically by, for example, raising the top marginal rate by more, by increasing social grants, zero rates more foodstuffs or even introducing a much higher VAT rate on luxury goods," he says. "While a varied VAT rate structure is not favoured by Government, it can still be done."

The fact that growth is picking up marginally, the improvement of the global economic environment and stabilising employment numbers are all positive factors for the tax take or growth, according to Els. "The risk of tax increases in this year's Budget is that, while we know that hikes will happen across the board, we don't want Treasury to become too reliant on tax increases over the prioritising of expenditure cuts. We need them to focus on both, but expenditure cuts are more challenging given that public sector wages, social grants, and interest payments make up 60% of the total expenditure budget. So where do they cut if they cannot easily cut these components?" he says.

Els believes that the risk of rising taxes hurting the economy through downward pressure on SA's currently improving growth can be avoided through a suitable mix of taxes. "If the tax increases come in at the top level, as we expect they will, then the impact on the man in the street won't be as severe," he says.

"So yes, while a 2% VAT hike would be painful, a 0.5% increase could be manageable in terms of impact on the consumer. And if, as we expect, the mix means hiking the top marginal tax rate, which includes the wealth or rich taxes such as capital gains tax and dividend taxes, then we don't expect the economy and consumer to be put under increased pressure. Of course, there will be tax hikes such as fuel levy and excise increases, but these will be the normal increases we see every year."

Els says that in order to meet the Ministry's tax target of R28 billion, other tax options, in addition to those already mentioned, include an increase in estate duties, securities and sugar taxes. He does not expect the much-talked about Wealth tax to be implemented in the short term.

"A tighter Budget is key when it comes to SA's policy mix as it could give the SA Reserve Bank the room that they need to be able to cut interest rates as we still expect them to in the second half of this year," he explains. "At least some of the tax pain expected from this Budget will be negated by lower inflation and interest rates - but the bulk of the tax pain will be at the top end."

INVESTING IN AFRICAN EQUITY MARKETS TODAY: ZIMBABWE AS A CASE STUDY FOR SUB-SAHARAN AFRICA

By **Atria Africa's investment management team.**

A decade after its first disastrous flirtation with hyper-inflation, Zimbabwe is once again on the economic precipice with the effects being conspicuously similar. Supermarket shelves have started to empty, some public and even private sector salaries remain unpaid, banking hall queues are getting longer and hospitals are short of basic supplies. Whilst the humanitarian state of affairs is critical we find the micro-economic structures persistently durable given that businesses continue to open their doors and survive, albeit under enormous difficulties.

When analysing financial results of certain businesses in Zimbabwe, and comparing them to similar businesses in Nigeria (whose economy is also reeling from a substantial deterioration in aggregate demand), the Zimbabwean businesses are in many cases better off. In Nigeria, we have begun to witness the destruction of formerly impregnable competitive advantages as determined by profitability, return on invested capital and resilience of business models. By comparison, in Zimbabwe, where profitability may be trending negatively, many businesses (which survived hyper-inflation) have retained their skills and chiselled business physique to survive an economic depression and continue to make profits despite the macro-economic situation.

The rub for Zimbabwe, where the government has once again resorted to printing its own medium of exchange, meant to retain equivalence to the US dollar is that it may be the only way for it to remain competitive. This new currency, referred to as a Bond Note, is the Government's answer to reduced liquidity of US Dollar deposits and seeks to enable the monetisation of virtual bank deposits. Virtual, because these bank deposits exist in electronic form but are almost impossible to withdraw without waiting in a daily queue to collect a maximum of 100 US Dollars per week.

Whilst a viable solution at first glance, given that Bond Notes will be printed as part of an export incentive and limited to $200m "Bond Note Dollars", which is estimated to be 4% of total deposits in the banking sector, it will boil down to confidence. If left unchecked without restrictions, what may seem as a perfectly sensible solution with little downside could have potentially catastrophic effects. With limited options, the Zimbabwean government will seek out the path of least resistance. Whilst the announcement of realistic and meaningful policy is relatively inexpensive, in monetary terms, the reality is that it will be the electoral cycle which will take precedence. Economic growth projections at 1.1% of GDP appear optimistic given the state of US dollar liquidity, tax collections and economic activity. What remains unknown is how the issuance of these notes will be viewed by the International Monetary Fund (IMF), broader multilateral funders and the international community. It would be reasonable to assume the IMF and international community would be supportive of an initiative that seeks to promote exports and increase employment.

The Zimbabwe Stock exchange which gained 7.45% in the final quarter of 2016, may be used as a proxy for this confidence. The fact that foreigners were sellers and locals the buyers indicates that there may not be agreement on what will happen in the future.

In any transaction, the perspective of the buyer will be at odds to that of the seller. In this case, both buyer and seller are reacting to a loss of confidence. For the local buyers the concern is destruction of value as occurred during hyperinflation where the Stock exchange is viewed as a natural hedge of value whereas foreign investors are looking to realise whatever real return they can in the shortest possible order. Sadly, there is a flaw in the latter's strategy where investors who have managed to sell shares have their currency locked in the banking system due to insufficient US dollar liquidity to complete the transaction. Similarly, dividends paid by listed businesses cannot be remitted back to the originating bank for the same reason.

> *"A decade after its first disastrous flirtation with hyper-inflation, Zimbabwe is once again on the economic precipice with the effects being conspicuously similar".*

As a foreign investor, real returns are critical on a continent exposed to the vagaries of global commodity prices. Foreign currency shortages in particular US Dollars are not a new phenomenon and in fact have become quite common in African economies since the Global Financial Crisis. Such investment risks are not confined to Zimbabwe, it is just the latest African example with Egypt, Angola, Mozambique and Nigeria all suffering similar fates during 2016. These example with Egypt, Angola, Mozambique and Nigeria all suffering similar fates during 2016. These macro-economic risks affect countries around the world. Generally speaking it helps for capital to be patient as over time liquidity shortages can be worked through and its impact reduced. This enables investors to realise *real returns* as opposed to merely realising performance gains through timing the ebbs and flows of market momentum.

Successfully deploying capital in Africa or any other emerging market requires discipline. Possessing this and the other habits mentioned above improve the likelihood of identifying businesses with the fundamentals to produce sustainable returns, far greater than their cost of capital. We find similarities between such businesses and "rough diamonds" where their resilience and value is of a rare pedigree. Unfortunately not all of these businesses are listed on the stock exchange. Investments therefore require specific expertise in order to navigate the administrative structures which carry a slight difference to those traditionally used in the listed equity space. Over the last four years there has been a noticeable increase in the investible opportunities in corporate debt and trade finance providing access to real returns in the form of US Dollar yields. Such investments allow investors to participate in individual corporate profitability whilst at the same time facilitating the natural progression of an economy by channelling capital towards the more productive sectors of the economy. As such there has been a proliferation of buy and hold corporate debt and trade finance transactions issued and executed which have been targeting yields of between 8% and 15% per annum in US Dollars.

> *"Warren Buffet once suggested to the investment world that "the rear-view mirror is always clearer than the windshield"."*

This adage holds true within African markets where the future is unknowable and therefore is why it is the future. It is important when navigating volatile markets that that any investments are channelled toward businesses that are driven by incentivised management teams with the fortitude to alter or stick to their strategy where necessary. Business models and product offerings must be appropriate to meet market demand within an industry which has sustainable barriers to entry. These are just some of the factors to be considered when investing within African markets and increase the likelihood of a successful outcome.

NIGERIA'S ECONOMIC RECESSION CREATES OPPORTUNITIES IN REAL ESTATE

Obinna Onunkwo, Obinna Onunkwo, Managing Partner of Purple Capital Partners Limited, is a seasoned securities specialist with over 15 years of experience in investment management. He has a rich background in investment banking, asset management, equities research and trading and has over the years played active roles as the lead fund manager in corporate actions. He began his career as a pioneer member of the Guardian Express Bank Plc Team. He thereafter proceeded to Spring Capital Markets Limited where he was the pioneer Head of the Asset Management Unit.

Obinna has an Executive MBA from Lagos Business School and a degree in Economics from the University of Port-Harcourt. As a Founding director and managing director of Alternative Capital Partners Limited (ACAP), Obinna drove the operational success of the business, facilitating the first ever acquisition and merger of two mutual funds from a bank Obinna also sits on the Board of Law Union and Rock Insurance Plc and serves as the Chairman of its Enterprise and Risk Management Committee.

Currently, he serves as Founding Managing Partner and Director at Purple Capital Partners Limited. He has driven the company's growth in the private equity, financial services, and real estate sectors, resulting in the initiation of "purplemoney", a CBN Licensed retail lending microfinance institution which he spearheads, as well as the development and finance of the Maryland Mall a Commercial Retail Development and Redworth Terraces in Lekki, a Residential Development. Obinna is a member of the institute of directors.

***CAPMARKETSAFRICA:** The perfect storm is brewed with the combination of an acute shortage of dollar inflows, the spectre of currency devaluation, increasing inflation and rising interest rates. How are developers and investors facing these challenges as well as assessing potential opportunities?*

Obinna: To mitigate the effects of these harsh economic conditions, developers are having to focus more on domestic solutions. Indigenous manufacturers, retailers, and consultants are the smarter economic choice as foreign alternatives become even less affordable. A greater reliance on these domestic players will increase their capacity and output which should, in turn, benefit the economy.

Cashflows are also being denominated in Naira, these help in providing more clarity in terms of pricing and valuation. While interest rates remain high, access to finance remains challenging for many developers.

Banks and other investors are more stringent with funds, meaning projects will have to be more ironclad in terms of delivery and revenues.

Trading economics estimate the amount of FDI into Nigeria in Q2 2016 at 673.95 USD million, the third lowest amount in the past decade.

***CAPMARKETSAFRICA:** The Africa retail market has revolutionised over the years and has seen considerable growth. Please tell us how the Nigeria retail sector has evolved over the last ten years as well as what the outlook would be going forward?*

Obinna: Formal retail has been on the rise with significant entrants increasing the amount of lettable area in the country, with Lagos at the forefront of this growth. Consumers are more aware of international standards and have begun to demand the same from local developments. Though Nigeria's recent descent into recession has affected citizen's spending power, more and more people are able to shop in these formal retail environments. This is due to shift in tastes and awareness and the emergence of a new Nigerian middle class empowered by the telecommunications and financial services boom experienced in the past decade. In 2015, 17.6% of Nigeria's Adult population were considered middle class. An increase of 6.1% in previous years. An income group estimated between NGN 500,000 per annum and NGN 5,000,000.

Since the entry of the Perianas group with their Palms development, over 25 similar grade projects have been conceived in Nigeria at different stages of the development pipeline illustrating further the large demand around the country.

> *"To mitigate the effects of these harsh economic conditions, developers are having to focus more on domestic solutions"*

Local brands have grown due to the exit of many international retailers finding Nigeria's operating environment too risky as evidenced by the recent completion of our flagship retail project the Maryland Mall, which currently holds about 80% local brands.

The amount of FDI going towards retail has increased over the past decade from 12% average in 2007 to 17% in 2013.

The internet has also had a huge impact on retail in Nigeria. The rise of online platforms like Jumia and Konga has tapped into the market of over 46% of the total population of the country currently online. This emphasizes the effect that technology has on the Nigerian retail space.

***CAPMARKETSAFRICA:** Comparing to developed and emerging markets, Nigerian capital market remains small and underutilized despite the stock market being a great avenue for mobilising public funds. Can we expect this ¬financing avenue to evolve in the short term for financing real estate and can you highlight as well as suggest any initiatives towards this?*

Obinna: The Nigerian Capital Market regulated by SEC has been used for real estate financing, providing access to a larger pool of investors and longer term capital through Real Estate Investment Trusts (REITs). Union homes, Skye Shelter Fund and UPDC have successfully done this but REITS are yet to become a sustainable and common place in Nigeria. However, whilst REITs enjoy a tax-exempt status of at least 90% of its income investors in Nigeria, the tax and investment laws are ambiguous and geared towards more conventional asset classes. The Return on investment on REITs is relatively low when compared to risk-free government securities, thus making investments in real estate assets unattractive to investors. Equally, the cost of transferring assets from the sponsor to the REIT has hitherto been onerous, constraining the ability of the REIT to generate competitive returns.

With the introduction of the Declaration of Trust Structure (DoT), there has been a significant reduction in the charges incurred by REITs when transferring the assets from the sponsor to the REIT and better legislation on taxation will ensure adequate financing of real estate via the Nigeria capital market.

> *“Local brands have grown due to the exit of many international retailers finding Nigeria's operating environment too risky”*

***CAPMARKETSAFRICA:** Where do you think the biggest opportunities lie in terms of asset class in the market right now – in terms of both cities and sectors?*

Obinna: When it comes to Nigerian retail property there is a substantial gap between current capacity and potential demand. In Lagos specifically, We anticipate that it will take the next 20 or 30 years to narrow the variance, so we will continue to focus our efforts in this particular sector and location. AT Kearney estimates that formal retail only makes up 1% of the total retail in Nigeria. Looking more broadly at Nigeria as a whole, it makes up more than half of West Africa's economy and has the continent's largest GDP. Taking this into account, the Nigerian Retail sector is a key sector, but we do see opportunities in other national sectors, such as infrastructure.

***CAPMARKETSAFRICA:** Looking forward, what opportunities do you see for Purple Capital in five years' time?*

Obinna: We are looking to expand our foot print in the Commercial Retail Space as well as in Financial Services. We plan to roll out additional neighbourhood Malls following the same concept as our successful Maryland Mall as we see that it's a sustainable model that combines the retail and entertainment experience, and caters to the lower/mid level income families.

***CAPMARKETSAFRICA:** Thank you very much for granting this interview.*

FRANCOPHONE AFRICA: REALITY AND OPPORTUNITIES IN REAL ESTATE

By **Ivan Cornet,** Managing Partner, Latitude Five

Africa and its potential have been on every investor's lips for some time now. This interest is especially relevant when strong trends are emerging across cities of Africa, whether French, English or Portuguese-speaking, including an emerging middle class and rapid urbanisation.

Early 2000, commodities driven economies with impressive growth rates such a nvestments than other, more advanced, African markets. As a result, investor and operator perception of these markets is now evolving rapidly.

Supporting this interest is also the realisation by new investors and operators that integration mechanisms across a number of Francophone countries provide stability for businesses as well as access to larger markets. Integration is political and economic, as is the case for the West Africa Economic and Monetary Union (a subset of ECOWAS, better known by its French acronym UEMOA), or the Economic and Monetary Community of Central Africa (CEMAC, its French acronym): both have a CFA franc as common currency (XOF for West Africa, XAF in Central Africa), pegged to the Euro with the same fixed conversion ratio. This creates very significant investment and trade zones with fairly harmonised regulation, and facilitates financing to some extent, in comparison with other African markets plagued by high currency volatility. Another aspect of this integration is legal, as 18 African countries, most of which are French-speaking, now apply a harmonised set of business laws, including as concerns security interests: again, this facilitates financing with many international and regional institutions relying on streamlined structures and transactions.

Only few international investors are already active in these countries. Most real estate investment to date is completed by local private or institutional investors, including insurance companies or pension funds. We expect this to change in the short to medium term as many international players are currently analysing Francophone African markets and often have a clear mandate to invest and develop their activities in the most promising ones such as Senegal, Côte d'Ivoire and Cameroon. Although most of these are currently European or South African firms, we are noting growing interest from regional investors such as Ghanaian and Nigerian firms, crossing into Francophone African countries where they had previously shown little interest. Chinese and Moroccan firms, often with strong political and economic government backing, are also entering the market for large projects such as the development of the new city near Dianmiadio in Senegal or the redevelopment of the Cocody Bay, in Abidjan, Côte d'Ivoire.

Major challenges however remain, as anywhere else in Africa: lack of transparency, insufficient financing and low levels of local expertise are key among those. Such challenges can be overcome through appropriate structuring and in-depth knowledge of local markets and the investment environment, either through effective local presence or a strong relationship with a trusted local player. Due diligence is as always a key part of any investment decision: it is paramount in these cases to seek a real understanding of local realities, rather than the reassurance of a desktop overview, and to compare and contrast information from all aspects of the sector, including developers, owners/operators, investors, consultants, lawyers and bankers. Information is rare, non-transparent and often inconsistent, and despite their apparent similarities, each country and even each city, presents specificities which cannot be ignored.

Local services focusing specifically on real estate are emerging, in a bid to address the requirements of international and increasingly sophisticated local or regional investors. This is case for example for local commercial banks, which are putting together specialised real estate teams with a better understanding of real estate development and investment structures. New asset and property management firms are also being established; the first RICS regulated company in Francophone Africa has been set up in Côte d'Ivoire in 2016. The availability of skills is a factor in this growth, and certain hubs are already attracting high-quality professionals, depending on the ease of establishing and running services firms and the envisaged growth in the sector over the coming years.

In Francophone Africa, Abidjan, economic capital of Côte d'Ivoire and a leading regional hub, is probably the city with the highest potential. This is due to its geographic location, its history as financial and economic centre for Francophone West Africa and a clear drive by Government, benefiting from renewed political stability, to make Côte d'Ivoire a growth and excellence centre in Africa. The Ivorian growth story is based on strong fundamentals: a liberal economy, developed infrastructure, including in the energy sector, and a well-educated workforce. The recent development of PPP's is also a powerful lever of growth in the real estate market, as is evidenced by the current redevelopment of State-owned high-rise towers, landmarks in the central business district of Abidjan, Plateau.

With the urbanisation of African cities and the growth of the middle class, shopping centres are attracting attention from many international investors. Many such development projects are already on-going, in particular in Abidjan with the recent entry and strong development strategy of retail giant Carrefour.

Other asset classes should not go unnoticed: even if these are more the focus of local developers to date, with high demand and low supply, residential real estate, whether luxury or economic, can provide significant returns. Social housing is an area of focus for most African governments, which offer significant tax breaks and incentives to develop this sector. Similarly, with high economic growth attracting many international companies, the dearth of grade-A office space should attract investment in the short-term, as is already the case in English-speaking Africa. With its strong correlation with economic growth, the hospitality sector is already booming in many Francophone countries with the entry or the strong development of regional and international brands.

Contributor's Profile

Ivan Cornet is the managing partner of Latitude Five, a West African investment and advisory firm where he is in charge of real estate.

With twenty years of experience in Europe and Africa as a lawyer, an investor and a financier, Ivan assists international and local investors and operators active in West Africa, providing market intelligence and identifying off markets opportunities, as well as structuring commercial and financial transactions.

Ivan Cornet holds a business law degree and a Master in European Business law (LL.M) from the University of Brussels as well as an INSEAD Master in Business Administration (MBA) and an Islamic Finance Qualification issued by CISI (London) and Ecole Supérieure des Affaires (Beirut).

Ivan is a Chartered Surveyor (MRICS) registered with the Royal Institution of Chartered Surveyors.

Ivan is also the Executive Chairman of Eburny Property Solutions, a property management firm in Côte d'Ivoire and a director of Sanctuary Student Accommodation Development, a student accommodation development and management firm in Nigeria.

ANALYSING THE IMPACT OF NIGERIA'S FOREIGN EXCHANGE REGULATIONS

By **Abayomi Adebanjo,** Managing Associate, Jackson, Etti &Edu

There have been a few of the adjectives that have been used to describe the recent foreign exchange ('FX') policies emanating from the Central Bank of Nigeria ('CBN') over the past 2 years and while opinion remains sharply divided it is clear that debate on these policies have assumed a life of their own. Unquestionably, the main statutory objectives of CBN's exchange rate policy are to preserve the value of the domestic currency, maintain a favourable external reserves position and ensure macroeconomic stability, in reality though, nothing could be further from the truth in light of the effect of these CBN policies in recent times. It is however impossible to investigate the effect of these policies without a thorough understanding and appreciation of the macroeconomic anomalies that have significantly impacted CBN's policy trajectory in the recent years which then leads to the obvious question, 'how did we get here'?

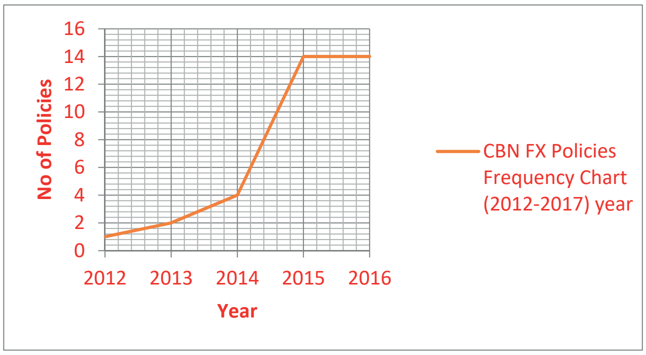
In this article, the immediate and remote factors of the current FX malaise are examined, the substantive policy trajectory of CBN is considered over the past few years and then we dimension the impact of these policies from diverse perspectives ranging from the economic to legal implications.

Understanding the 'HOW'

After a period of relative stability in the exchange rate regime both in terms of FX rates and exchange rates system, the plunge in commodity prices had a cataclysmic impact on the Nigerian economy as a whole and spurned the proliferation of FX policies in a bid by CBN to curb volatility, inflation and arbitrage. In spite of CBN's best endeavours to achieve a semblance of sanity in the otherwise highly volatile and speculative FX Market, the opposite effect has been the case as evidenced by the widening gap between the official market and parallel market, FX illiquidity, FX rationing, reserves attrition, price instability, multiple rate regimes and increased delinquency by those with foreign denominated liabilities; all of which are representative of a dysfunctional FX market.

Since September 2014, CBN has released circa 30 circulars, guidelines, directives and press releases with respects to the foreign exchange market. This explains the spike in Fig.1 below with different policies emanating at an alarming rate over 24 months period.

Whilst it may be true that the immediate cause of the instability in the exchange rate was as a direct result of the massive sharp dip in global oil commodity prices due to the supply glut in the oil industry (as a result of lifting of Iran's embargo as well as intense competition by some OPEC members to maintain market share), there were other germane contributory root factors that precipitated this



instability.

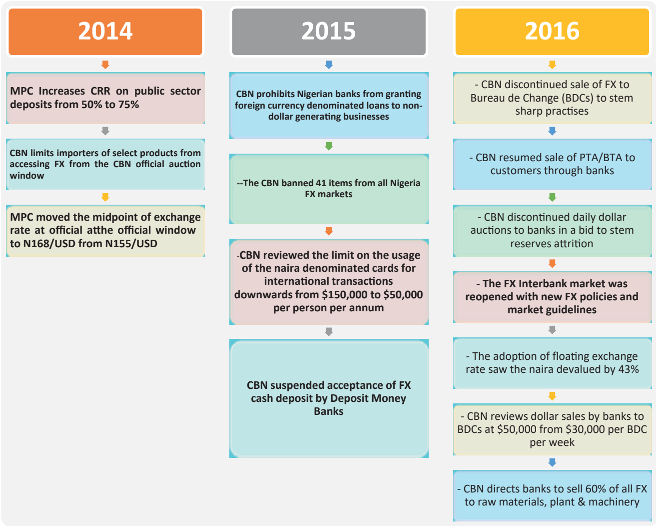
Despite repeated attempts to diversify the economy, there was a lack of consistent policy implementation to rapidly grow other sectors and make the country more efficient in terms of having a net positive balance of trade hence diversified sources of foreign earnings. Therefore, though the economy was diversified by Gross Domestic Product ('GDP') (the GDP rebasing affirmed this economic diversification), it became apparent that there remained an over-dependence on hydrocarbons for foreign earnings and revenue. The over-exposure to this single source of foreign earnings meant that the economy was significantly sensitive to global oil commodity prices.

Another immediate contributory factor was the over-bloated Government recurrent expenditure profile over the years. The indiscipline in spending public funds, or more appropriately the lack of fiscal discipline affected and continues to affect the macro-economic stability of the country leading to reduced savings, fiscal imbalances, increased inefficiencies and also increased chances of inflation.

The consequential effect of trying to manage the issues discussed above explains the surge in CBN's policies which were targeted at reducing the money supply, curbing inflation, rationing FX reserves, preserving currency value and maintaining stability. Below are some of those policies that defined their respective fiscal years.

The Real Impact of CBN's FX Policies

Before analysing the impact of the CBN's FX policies it is essential that these policies are, at the very least, measured on an aggregate basis against the objectives that they sought to achieve. While we have identified some of those objectives above, it is clear that the bulk of the policies can be classified into two broad categories. The first category is those policies that were primarily aimed at ensuring price stability hence mitigating volatility and reducing speculative



forces and the second category were those aimed at price discovery with the intention to ensure transparency, boost investor confidence and ultimately improve liquidity.

It can be argued that until the introduction of the managed float exchange rate regime, most of the CBN policies significantly tilted towards achieving price stability especially as the gap between the official and parallel market widened driven on the back of speculative forces and arbitrage opportunities. Hence the bulk of CBN policies under this category were capital control tightening in nature and also FX rationing in character.

When it became apparent that these policies were not achieving their objective especially in the face of deep seated concerns on the ability of the monetary authority to use administrative measures to continue to keep the exchange rate at its artificial levels without burning through the country's reserves, the policies shifted towards ensuring proper price discovery. Hence after 40 years of officially determined exchange rate regime, often repeated and inadequate devaluation, official allocation of FX leading to unproductive and speculative arbitrage opportunities, the monetary authorities decided to adopt its own form of market determined exchange rate regime i.e. the managed float exchange rate regime.

Even though the debate rages on the impracticability of managed float exchange rate regime and how it achieved anything but price discovery, the incontrovertible truth is that there is a lack of confidence in the pricing, insufficient illiquidity and multiple price regime fostered by CBN.
Notwithstanding the above, the effects of these policies are discussed under the following aggregated headings.

Economic

In terms of dire effects of the CBN policies, it is clear that the Nigerian economy has been the most severely impacted with all economic indices recording negative growth. Foreign Direct Investment and Foreign Portfolio Investment dwindled, inflation significantly increased, Naira devaluation, negative balance of trade, a significant increase in unemployment rate, a spike in interest rates and of course consecutive quarters of negative GDP growth.

The CBN policies have been in sharp variance with fiscal policies of the government which has further exacerbated the effect of these policies on the economy.
While Nigeria is still not out of the woods, it is hoped that the combination of improved global oil prices, stable oil production and successful debut of the $1billion Eurobond will improve external reserves accretion, improve dollar liquidity and alleviate some of the harsh economic conditions.

Sectoral

Generally, the inability of firms to procure FX has impacted on businesses tremendously in Nigeria because of our import-dependent nature. Whilst different sectors have responded differently depending on nature of their business and level of exposure to FX needs, the clear and ever present reality is the contraction in activities of firms both on the supply and demand side. The result of these policies has led to reduced earnings, significant erosion of value, increased costs of production and sales, difficulty in the repatriation of interests/ dividends and reduced FX inflows into businesses.

The contraction has however forced firms to innovate on certain levels as evident in the increased resort to commercial paper as a means of raising capital, use of OTC FX futures and forwards to mitigate exchange rate volatility, sourcing of raw materials locally and resort to backward integration.

Legal

With oil prices hovering above $100, exchange rate pegged at $155 and significantly liquid financial institutions, all pre-2015, firms especially large corporates, manufacturers, oil, gas, power, aviation, and hospitality firms became generally more aggressive in incurring dollar denominated liabilities. Servicing these obligations at inception was relatively easy because of significant liquidity, predictable exchange rates, and relaxed exchange controls; however, the FX volatility exposed the obvious risks associated with incurring dollar denominated liabilities without having the appropriate business model or risk mitigants embedded into such commercial arrangements.

This situation has led to increased contractual delinquencies and results to both restructuring and recovery actions against firms. Additionally, reduced earnings have meant an increase in cost-cutting measures and more redundancies hence there has been a steady rise of contractual disputes and resort to litigation as a means of dispute resolution.

Conclusion

The widening gap between the official and parallel market continues to remain a cause for concern and a clear and present danger factor under each of the aggregated headings above. Nonetheless, it is undeniable that this is the most difficult economic situation Nigeria has faced since the structural adjustment programme of 1986 and it is apparent that overcoming these issues would take more of proactive and coherent CBN policies combined with cohesive fiscal policies and less of rhetoric and inconsistent actions or inactions.

ARE AFRICAN MARKETS LARGE AND INSTRUMENTS MATURE ENOUGH TO SUSTAIN CCPS?

By **Hugh Simpson** & **John Falk**, Bourse Consult LLP, United Kingdom

Since the financial crisis, clearing houses – also known as central counterparties (CCPs) – have come to be seen as having a fundamental role in managing risk in financial markets. So far, Africa has lagged behind other regions in adopting CCPs. Do African markets need CCPs?

The answer to this question depends on understanding more about the ways in which CCPs contribute to risk management and how much of this is appropriate for African markets.

A CCP, as its name implies, sits at the centre of a financial market. After the trades are done, the CCP steps in between the buyer and the seller: it becomes the buyer for the seller and the seller for the buyer. The benefit of this arrangement is that the two parties to a trade are no longer exposed to each other, only to the CCP. The buyer does not have to worry whether the seller will still be around to deliver the asset and the seller does not have to worry whether the buyer will still be around to pay. Always provided of course that they have confidence that the CCP will always be able to meet its obligations.

CCPs ensure that they are able to meet their obligations by using sophisticated risk calculations to measure their exposures and by collecting collateral from the buyers and sellers. This means that if a party fails to meet its obligations, the CCP has enough resources to step in and make sure that the other party does not take a loss and that the market is able to continue without disruption. A critical role of the CCP therefore is to manage the default, even of a major market participant, so that it has the least possible impact on other market participants and on the operation of the market.

A CCP is not the only way to address this risk. Many African stock exchanges provide protection against the failure of a participant by requiring traders to pre-position securities or cash before trading and by requiring contributions to a guarantee fund. These arrangements, if they are well designed, can provide good protection when a market is in the early stage of development, but it is important to understand when they need to be replaced by more sophisticated arrangements, such as a CCP.

The requirement to pre-position securities or cash may be acceptable when turnover is low, but it can hold back development of a more active, liquid market by restricting the activities of active traders. Pre-positioning rules are generally unpopular with international investors and can deter international participation. Most importantly, a simple guarantee fund can provide adequate protection in a securities market, when trades are settled within a few days after being traded: the time period when something can go wrong is quite limited. But this approach is not adequate when futures markets are introduced and the period between trading and settlement may be measured in months. The longer the period, the more potential there is for things to go wrong and for prices to move in the "wrong" direction. This requires the ability to calculate risk exposures and collect varying amounts of collateral – the core skills of a CCP.

While a CCP is optional in a spot commodities or cash securities market, it is essential in any kind of futures market.

Although managing counterparty risk is the core activity of CCPs, they are important in other ways, too. A CCP sits at the centre of a market as the buyer to every seller and seller to every buyer. This means it can provide a benefit by netting multiple trades into a single daily settlement: an active securities trader can make a single delivery to or from the CCP each day for each security rather than having to make multiple deliveries to or from many different counterparties. This reduces operational risk by limiting the number of trades that have to be managed and can help to reduce costs.

A CCP may also become necessary to support the type of market structure being adopted. As markets modernise, many of them are adopting electronic trading platforms with an anonymous order book: participants can see the orders in the book but cannot see who has placed them. This anonymity is important in generating liquidity, as traders can place orders without concern that they are giving away their positions. However, after a trade is done, the two parties need to know who to settle with and here is a dilemma: if the two parties learn each other's identities, then the benefit of anonymity is quickly lost, but if they do not learn each other's identities they do not know how to settle or who they are exposed to. A CCP can resolve this difficulty. After a trade is executed on an electronic trading platform, the CCP immediately steps in. Both parties know that they will settle with the CCP and anonymity is preserved. This support for pre-trade anonymity and the benefits of netting as trading volumes increase mean that the adoption of an electronic trading platform is almost always accompanied by adoption of a CCP.

> *"CCPs ensure that they are able to meet their obligations by using sophisticated risk calculations to measure their exposures".*

Let us sum up.

CCPs are one of a number of mechanisms for managing risk in financial markets. These can be thought of as a spectrum. Different mechanisms are appropriate at different stages as a market evolves, with a CCP becoming more important as the market matures.

What are the indicators that suggest a market needs to consider introducing a CCP?

A critical indicator is the development of a futures market. It is almost impossible to launch a successful futures market, whether for commodities or financial instruments, without using a CCP to manage the risks.

Even in cash or spot markets, a CCP brings benefits. The more the market is open to international investors and the more volume increases, the greater the benefit of introducing a CCP. And a CCP becomes essential to support a market structure based on an electronic trading platform with an anonymous order book.

To answer the question posed by the title of this article, relatively few markets in Africa outside South Africa meet these tests at the moment, but the rising level of international investor interest, the development of more sophisticated trading platforms and futures markets means that we can expect to see a growing number of CCPs being established across the continent in the years ahead.

Contributors' Profile

Hugh Simpson, Managing Partner at Bourse Consult, has over 20 years' experience in securities markets post-trade infrastructure, as CEO of the UK CSD CREST, as expert adviser on capital markets and post-trade infrastructure and as a Non-Executive Director.

John Falk, Partner at Bourse Consult, has over 23 years' experience in securities market infrastructure and market integration as a consultant with Bourse Consult and as Director Securities Market Infrastructures at SWIFT.

ASSET ALLOCATION: WHAT SHOULD IT MEAN FOR PRIVATE INVESTORS?

The term 'Asset Allocation' remains a popular 'buzzword' in investment circles, yet it is possible that some private investors may not understand its importance in practice. A well-constructed asset allocation plan can both lower portfolio volatility and limit downside risk. Studies indicate that up to 90% of investment portfolio returns will be determined by asset allocation. That makes asset allocation – by asset class (i.e. bonds, equities, alternative investments including hedge funds, commodities, real estate and cash) more important than which specific investments are chosen for diversification purposes.

Private investors must realize how important their asset allocation plan is and spend quality time with their financial advisors doing it correctly. The selection of investment vehicles depends on each individual's situation and needs. It also depends on each investor's attitude towards risk, that is risks he/she is willing to accept and their ability to tolerate that risk.

> *"A well-constructed asset allocation plan can both lower portfolio volatility and limit downside risk."*

In his book, 'A Random Walk down Wall Street', Burton G. Malkiel (2004) stated, "The risks you can afford to take depend on your total financial situation, including the types and sources of your income exclusive of your investment income".

There are other factors such as investment time frame (short-term and long-term), liquidity needs and investor-specific constraints, which should be considered while making an asset allocation decision. There are other factors such as age, job stability, income level and its volatility, and the industry in which an investor works are all important to consider prior to making an asset allocation decision.

On one hand, as younger investors have a longer time to work and accumulate wealth, they have greater propensity to invest in risky assets. Therefore, a relatively young investor has a longer time to recoup losses in the case of a prolonged bear market or poor entry point.

On the other hand, an investor who is close to retirement, whose earning capacity from employment is coming to an end, should become more conservative in investment policy, and emphasize regular income over capital gains. In spite of the information received often being good, investors should be careful about investing too heavily in the stocks of the industry in which they are employed. For example, employees working for information technology companies should not become too enthusiastic about investing in stocks of companies in the same industry, as both portfolio returns and salary to greater or lesser degree will be driven by the performance of the industry. Any downturn in the industry will not only adversely impact one's salary level (or existence), but also portfolio returns.

Investors typically consider just stocks and bonds when thinking of their portfolios, yet this is rather old-fashioned. However, other assets classes such as real estate, alternative investments such as hedge fund investments, and precious metals should also be considered in asset allocation decisions. Studies suggest that the correlation between real estate and bonds and stocks is quite low, and hence real estate (over-and-above the homes we own to live in, which should arguably be side-lined in such a discussion) can be an excellent diversifier. Carefully selected, residential and/or commercial real estate can produce regular cash flow from rental income.

> *"Studies indicate that up to 90% of investment portfolio returns will be determined by asset allocation."*

Events such as death, disability or disease can devastate the income of a family, and severely compromise the ability to cover even basic regular liabilities. Hence, the importance of purchasing adequate insurance coverage must be emphasized, and this is especially true if future financial obligations are high. Decisions regarding insurance of all kinds should be made in conjunction with the overall asset allocation framework designed in conjunction with your financial Advisor. Often for cultural reasons in the African, insurance coverage tends not to be considered in the way in which it is in the more fully developed world. There are tentative signs that this may be changing, however, and we very much welcome it.

Lastly, it is also worth mentioning that every private investor should maintain a cash 'buffer', ideally six months to a year's income equivalent, easily accessible in the case of any unforeseen event." To read "months to a year's income equivalent, easily accessible in the case of any unforeseen event.

AFRICA'S CENTRAL BANKS REACTION AMIDST INFLATION AND GROWTH CONCERNS

Angola's central bank left its benchmark BNA rate at 16.0% on 30th January 2017. The National Bank of Angola (BNA), which raised its rate 500 basis points last year - most recently in June - to curb inflation, added its monetary policy committee had also taken note of the trend of declining monetary indicators.

Botswana's central bank left its benchmark lending rate unchanged at 5.5% on 28th February 2017, saying the inflation forecast will remain low and stable in the medium term. Subdued domestic demand and modest external factors point to benign inflation," the bank stated.

BCEAO central bank holds interest rate at 2.5%. The central bank of the eight-nation West African CFA franc zone held its benchmark interest rate unchanged at 2.50% on 1st March 2017. The bank, known as the BCEAO, has kept the rate unchanged since September 2013.

Egypt's central bank left its key interest rates unchanged on 18th February 2017, at a meeting of its Monetary Policy Committee, the third consecutive meeting where it kept rates on hold. The bank kept its overnight deposit rate at 14.75% and its overnight lending rate at 15.75%.

Ghana's central bank held its main policy rate unchanged on Monday at 25.5% on 23rd January 2017. The Bank of Ghana trimmed the rate in November by 50 basis points in the first such cut since July 2011, which may herald further reductions this year as inflation begins to fall at a faster pace after years above government targets.

Kenya's central bank maintained interest rate at 10.0% to anchor inflation expectations on 30th January 2017. he Central Bank of Kenya (CBK), which cut its rate by 150 basis points in 2016, noted inflation eased to 6.4% in December from 6.7% in November, partly reflecting the waning effect of December 2015's excise tax rise.

Namibia Central Bank Leaves Benchmark Rate Unchanged at 7%. The Monetary Policy Committee (MPC) of the Bank of Namibia kept the Repo rate unchanged at 7.00% on 17th February 2017. This rate remains appropriate to maintain the one-to-one link between the Namibia Dollar and the South African Rand, while supporting economic growth in Namibia.

Nigerian Central Bank Leaves Key Lending Rate Unchanged at 14% on 24th January 2017. Nigeria left its policy rate unchanged for a third consecutive meeting to support growth in an economy at its weakest in more than two decades and in which inflation is accelerating.

Mauritius central bank keeps the Key Repo Rate unchanged at 4%. The Monetary Policy Committee (MPC) of the Bank of Mauritius unanimously decided to keep the Key Repo Rate unchanged at 4.00 per cent per annum on 20th February 2017. The Bank of Mauritius stated rising business confidence and public investment should support domestic output this year while an uptick in global commodity prices, especially energy, remain a key upside risk to inflation.

Mozambique holds benchmark rate at 23.25%, inflation easing, growth modest. Mozambique's central bank left its benchmark standing facility rate at 23.25% on 13th February 2017. The Bank of Mozambique, which raised its rate 13.50 percentage points last year - including a sharp 600 basis point hike in October - said the decision to maintain its key rate was taken in light of domestic and international risks that could have a negative impact on inflation and the exchange rate if they were to materialize.

Tunisian central bank holds key interest rate unchanged at 4.25%. Tunisia's central bank has kept its key interest rate unchanged at 4.25%, the bank said on 2nd March 2017. The bank last cut its main interest rate in October 2015, from 4.75%.

South Africa's central bank kept its benchmark repo rate unchanged at 7% on 24th January, in line with expectations, saying the near-term outlook of inflation has deteriorated while the domestic growth outlook remained constrained.

Uganda slashes benchmark rate to 11.5% amid shrinking growth on 15th February 2017. The Bank of Uganda lowered the central bank rate by 50 basis points from 12%, set in December, to 11.5%. The bank's monetary policy committee said the cut was necessary to "keep the domestic economic growth momentum". The central bank also reduced the rediscount and the bank rate to 15.5% and 16.5% respectively.

Zambian central bank reduces benchmark interest rate to 14% amid slow inflation on 21st February 2017. Bank of Zambia decided to reduce the rate by 150 basis points to 14% from 15.5% due to the single annual inflation rate the country has recorded in recent months.

WHAT PATH IS AFRICA'S INFLATION RATE TAKING IN JANUARY

Angola's inflation slowed to 40.39% year-on-year in January from 41.95% in December, data from the national statistics agency showed. Prices increases on a month-on-month basis by 2.29% in January compared to 2.17% previously.

Botswana's consumer inflation inched up to 3.1% year-on-year in January from 3.0% in December, data from the statistics office showed. Prices rose 0.4% month-on-month compared to 0.1% previously.

Burundi's year-on-year inflation jumped to 12.9% in January from 9.6% in December after a drop in food harvests, official data showed. Food inflation in the year to January climbed to 20.1% from 13.8% in December, the Institute of Economic Studies and Statistics (ISTEEBU) stated.

Egypt's annualised urban consumer price inflation jumped to 28.1% in January from 23.3% in December, the official CAPMAS statistics agency stated. Food and beverage prices in January rose 37.2% in urban areas, the CAPMAS data showed.

Ghana's annual consumer price inflation fell to 13.3% in January from 15.4% the previous month, the statistics office stated.

Ivory Coast consumer price inflation rose to 1.1% year-on-year in January, up from a deflation of -0.2% in December, data from the National Statistics Institute revealed. The monthly report showed food and soft drink prices in the world's top cocoa grower added 2.4% year-on-year, while housing and utilities prices climbed 1.8% and transport costs declined

Kenya's inflation rate rose to 6.99% year-on-year in January, up from 6.35 in December, the statistics office stated. The rise was partly due to food price increases caused by drought and an increase in the cost of electricity, the statistics office said in a statement.

Malawi's consumer inflation slowed to 18.2% year-on-year in January from 20% in December, according to the official data.

Morocco's annual consumer price inflation rose to 2.1% in January from 1.8% in December due to higher food and non-food prices, the High Planning Authority stated. On a month-on-month basis, the consumer price index rose to 0.2% in January, from 0.1% in December as non-food price inflation rose to 0.4%, up from 0.1%.

Mozambique's consumer inflation slowed to 20.56% year-on-year in January from 25.27% in December, data from the statistics agency showed.

Namibia's consumer inflation quickened to 8.2% year-on-year in January from 7.3% in December, according to the statistics office data. Inflation on a month-on-month basis rose to 3.2% from 0.2% the previous month, the Namibia Statistics Agency stated.

Nigeria January inflation rises for 12th month running to 18.72% in January. Annual inflation in Nigeria rose in January to 18.72%, the National Bureau of Statistics stated, its 12th straight monthly increase. The rise from 18.55% in December, its highest in more than 11 years, was driven by surges in food, transport and electricity.

Rwanda's inflation rose to 7.4% year-on-year in January from 7.3% the previous month, the National Bureau of Statistics said.

Tanzania's annual inflation rate edged up to 5.2% in January, after 5.0% in December, due to a faster increase in food prices, the statistics office said. The National Bureau of Statistics said the headline inflation rate month-on-month in January was 0.8% from 0.7% previously.

South Africa's headline consumer inflation slowed to 6.6% year-on-year in January from 6.8% in December, based on data from Statistics South Africa. On a month-on-month basis, inflation rose to 0.6% from 0.4% previously.

Seychelles inflation was -0.6% year-on-year in January from -0.2% a month earlier, the National Bureau of Statistics said.

Uganda's inflation climbed to 5.9% year-on-year in January from 5.7% in December due to a rise in some food prices, including those for fruit, the statistics office said. Core inflation slipped to 5.2% in January from 5.9% in December, it said, citing a fall in prices of some services, such as transport costs.

Zambia's inflation slowed to 7.0% year-on-year in January from 7.5% in December, the statistics office said. The monthly inflation rate was unchanged from the previous month at 0.9% in January, the Central Statistics Office said.

Zimbabwe's consumer prices declined by 0.65% year on year in January from a 0.93% decline in December, according to data from the national statistics agency. On a month-to-month basis, prices rose by 0.23% after increasing 0.18% previously.

AFRICAN EQUITY MARKET INDICATORS AS AT 28-February-2017

Country Name	Index Name	Index at 28-February	1-month % Δ	YTD % Δ	1-Year % Δ	1-Year Low	1-Year High	30 Days Volatility %
Botswana	BSE DCI	9,053	0.16	-3.70	-11.56	9,006	10,318	4.625
BRVM	IC Comp	286	-0.76	-2.00	-5.79	264	321	8.355
Egypt	EGX 30	11,998	0.51	-2.81	96.19	6,034	13,544	24.095
Ghana	GSE ALSI	1,868	0.71	10.57	-5.15	1,508	1,974	10.521
Kenya	FTSE NSE15	125	-0.79	-6.34	-11.93	121	148	6.981
Malawi	MSE ALSI	13,636	0.02	2.37	-4.40	12,478	14,118	11.322
Mauritius	SEMDEX	1,922	-0.03	6.29	6.13	1,738	1,929	4.568
Morocco	MORALSI	11,916	-0.09	2.33	33.47	8,893	12,951	13.216
Namibia	Local	1,083	0.12	1.38	19.56	877	1,137	15.409
Nigeria	NIG ALSI	25,301	-0.11	-5.85	1.86	24,437	31,073	6.560
Rwanda	RSEASI	128	0.00	0.37	-2.12	127	131	0.419
South Africa	JSE ALSI	51,487	0.67	1.65	2.33	48,936	54,704	10.702
Swaziland	SSX ALSI	383	0.00	0.80	14.41	335	383	1.347
Tanzania	DAR ALSI	2,350	1.99	6.90	-1.79	1,979	2,830	32.670
Tunisia	TUNIS	5,606	-0.02	2.13	5.44	5,273	5,627	5.489
Uganda	USE ALSI	1,412	-0.06	-4.41	-19.26	1,331	1,822	12.789
Zambia	LuSE ALSI	4,217	-0.30	0.49	-24.31	4,010	5,574	6.881
Zimbabwe	IDX (USD)	135.03	-0.21	-6.57	35.33	93	150	7.307

SELECTED AFRICAN CURRENCY EXCHANGE Vs. US DOLLAR AS AT 28-February-2017

Country Name	Currency Name	Index at 28-February	1-month % Δ	YTD % Δ	1-Year % Δ	1-Year Low	1-Year High	30 Days Volatility %
Algeria	Dinar	110.37	-0.35	0.03	-1.50	103.80	112.17	4.303
Angola	Kwanza	166.25	0.23	1.22	-2.48	158.41	169.65	8.288
Botswana	Pula	0.10	-0.10	2.46	8.48	0.09	0.10	6.619
CFA Franc	CFA Franc	626.93	-0.23	0.48	-2.08	567.51	636.39	8.780
Egypt	Pounds	16.19	-2.39	12.03	-51.68	7.77	19.67	20.883
Ethiopia	Birr	22.69	0.22	-1.33	-5.21	20.93	22.86	6.692
Ghana	Cedi	4.71	-0.32	-10.08	-16.45	3.48	4.71	12.132
Kenya	Shillings	102.89	0.01	-0.37	-1.21	100.18	104.18	1.754
Malawi	Kwacha	725.69	-0.18	0.24	2.80	677.50	747.50	1.270
Mauritius	Rupee	35.59	0.60	1.07	1.01	34.61	36.50	11.265
Morocco	Dirham	10.13	-0.28	0.02	-2.20	9.23	10.32	4.318
Mozambique	Metical	68.99	0.83	3.47	-29.42	45.45	79.38	7.508
Nigeria	Naira	315.15	0.03	0.06	-36.84	197.00	350.25	18.544
Rwanda	Franc	821.82	0.39	0.02	-9.35	715.50	828.00	4.660
South Africa	Rand	13.06	0.54	5.23	19.36	12.79	16.24	12.471
Tanzania	Shilling	2,235.00	-0.05	-2.42	-2.10	2,170.05	2,272.50	5.690
Tunisia	Dinar	2.31	-0.47	0.37	-11.08	1.98	2.37	5.578
Uganda	Shilling	3,596.38	-0.28	0.00	-7.13	3,307.35	3,634.00	3.196
Zambia	Kwacha	9,625	-0.1548	3.2446	18.34	9,110	11,400	9.177

SELECTED AFRICAN GOVERNMENT INTERNATIONAL BONDS AS AT 28-February-2017

Country Name	Maturity	Price at 28-Feb	Mid-Yield at 28-Feb	1-month Yield Chg (%)	YTD Price Change (%)	Price 1-Year Low	Price 1-Year High	Amount Outstanding (US$ M)
Angola	12-Nov-25	101.677	9.211	-0.044	4.523	86.101	102.806	USD
Cameroon	19-Nov-25	111.694	7.633	-0.013	3.432	88.365	113.384	USD
Congo	30-Jun-29	67.568	10.705	0.012	5.274	63.766	74.637	USD
Cameroon	19-Nov-25	111.694	7.633	-0.013	3.432	88.365	113.384	USD
Egypt	30-Apr-40	94.721	7.352	-0.039	8.162	80.690	100.290	USD
Ethiopia	11-Dec-24	94.617	7.551	0.024	2.193	87.394	100.503	USD
Gabon	16-Jun-25	98.907	7.125	-0.303	4.942	80.537	98.958	USD
Ghana	14-Oct-30	117.374	8.562	0.053	-1.249	92.437	123.374	USD
Kenya	24-Jun-22	98.458	7.147	0.031	3.685	90.961	101.130	USD
Ivory Coast	31-Dec-32	94.240	6.655	0.011	1.401	88.498	101.499	USD
Morocco	11-Dec-42	105.499	5.113	0.008	3.286	100.026	118.426	USD
Namibia	29-Oct-25	101.715	5.002	0.002	3.352	94.140	108.052	USD
Nigeria	12-Jul-23	103.068	5.790	0.016	6.139	89.684	103.574	USD
Rwanda	02-May-23	101.477	6.330	-0.032	1.828	93.652	102.978	USD
Senegal	30-Jul-24	101.414	6.010	-0.009	1.237	90.932	105.956	USD
South Africa	24-Jul-44	102.197	5.223	0.063	3.622	91.188	116.008	USD
Tanzania	09-Mar-20	105.863	5.262	-0.009	0.556	97.880	105.869	USD
Tunisia	19-Sep-27	108.985	7.028	-0.002	2.571	97.770	110.396	USD
Zambia	30-Jul-27	106.046	8.097	-0.041	6.927	74.182	106.341	USD

Compiled by Capital Markets in Africa