IMARA Asset Management

Monthly Market Report

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Market snapshot

June was another difficult month, particularly in the larger more liquid markets. South Africa was down 5.4%, Morocco 3.6% and Egypt 3.6%. Nigeria was just in positive territory +0.3%, with Kenya +2.2% and Tunisia +3.9%. Interestingly, most currencies held firm, or even appreciated slightly against the USD, except for the ZAR, which slipped 7%. The 2nd quarter has been challenging for the Fund. Exogenous factors drove negative market performance, despite strong earnings data from our holdings. Frontier markets continue to be under pressure from rising US yields, global trade risks and a higher oil price which historically results in positive inflation surprises. The latter have not filtered through to data in our core markets. The disinflation theme still in place. Central banks in Kenya, Egypt and South Africa more cautious of late on any inflation surprises.

Economic and political overview

Nigeria – Headline inflation continues to fall, with the May number dropping to 11.6%. This is the 16th consecutive month of disinflation. The 2018 budget finally approved after delays with an ambitious 25% increase to NGN 9trn (EUR 22bn) with emphasis on infrastructure and capital spending. We read the population report from the Nigerian Bureau of Statistics which provides interesting insights on the Nigerian demography. Total population of 193m with a growth rate of 3.2% per annum. Very young, with 41% or 79m under the age of 15. To put in perspective, Nigeria has a greater population below 15 than the United States at 62m (19% of 330m) and is about a third of China's comparative of 225m (16% of 1.4bn). The skew to youth can be a blessing or a curse. A blessing if the more dynamic attitudes and better skills of the youth are absorbed into the economy, the 6% growth rate of 2010 to 2014 being a good example. A curse if GDP growth cannot match their population growth. For now, the dependency ratio of unemployed youth remains high, and in the current slow recovery places pressure on disposable incomes. It is an issue we frequently discuss with management teams. Unilever Nigeria has impressed us in this regard, actively recruiting local talent below 30. Currently, 80% of its executive team is Nigerian with middle management talent feeding through.

Egypt – Headline inflation dropped to 11.4% in May. The Central Bank of Egypt (CBE) Monetary Policy Committee chose to keep rates on hold. Like the decision made in May, rising oil prices is the main reason for caution. At the start of 2018, market consensus was for a 500bps cut this year. We argued for a lower cut of 200-300bps back in January as we thought the CBE would start to worry about the carry trade reversing if cuts were too swift. There are also some structural inflation headwinds such as fuel product increases of c45% ahead which argue against inflation going down much further. The IMF updated their forecasts for 12 months to June 2019 after their Third review of Egypt's economic plan. IMF forecasts: GDP at 5.5% (unchanged), inflation 13.1% (previous: 15.2%), budget deficit 8.1% (previous: 7.4%) driven by slower removal of energy subsidies, primary deficit lower at 2.4% (previous: 4%) and credit growth higher at 18% (11% previously). The loans number is an interesting surprise which we confirmed with the banks, primarily CIB. Loan growth correlates to a strong volume recovery this year as Egyptian corporates restock and volumes recover.

Kenya – The 2018/9 budget was announced and aims to bring down the fiscal deficit to 5.7% of GDP from 7.2% in 2017. This was well flagged and the IMF has indicated that reform is necessary for debt sustainability. At the same time, the budget had an interesting positive spin. It announced Kenyatta's ambitious Big 4 growth plan to 2022 to create 1) 1.3m manufacturing jobs, 2) 100% health care coverage, 3) 500k affordable housing units, and 4) food security investments. The manufacturing push is the most interesting for us as it attempts to raise the sector from 9% to 15% of GDP. The manufacturing push is primarily focused on setting up a large investment in textiles, specifically high yielding cotton farming and downstream cotton ginning where it aims to create a total of 600k jobs. Next in line, more investment into food processing plants for a further 200k jobs. In the more immediate future, the budget backtracked on plans to raise the tax rate to 35% from 30% and CGT to 20% from 5% after consultation with the private sector

Morocco – The Central Bank of Morocco, Bank Al-Maghrib, left its benchmark interest rate unchanged at 2.25%. The Governor guided for 3.6% GDP growth for 2018 and 3.1% in 2019.

Zimbabwe – Official Inflation for May was 2.7% y-o-y, but this number is not representative of the reality on the ground for the average Zimbabwean. The inflation number reflects the prices of goods and services that are, in the main, under some form of price regulation. Money supply growth as at the end of April was +33% y-o-y and the "street rate"/parallel market rate having started the year at $1.40 per USD has weakened sharply to $1.70 per USD, which means one United States Dollar in cash will give you $1.70 local dollars in electronic form. Or put differently, a Zimbabwean wishing to convert his electronic Zimbabwean dollars to cash is now getting 58.8 US cents per Zimbabwean dollar (at a rate of $1.70/USD) compared to 71.4 US cents per Zimbabwean dollar at the beginning of the year(at a rate of $1.40/USD). Despite the difficulties, as we mentioned in prior factsheets, our companies posted very good earnings numbers and indications from the trading updates and AGMs hosted in April and May, are that 2Q18 will be similarly strong. The main issue at hand is the elections, which should happen in a matter of weeks now. We are all hoping for credible, free and fair elections. The elections are scheduled for the 30th of July and the voters roll reflects 5.6m voters registered of which 60% are between the ages of 16 and 40. We are encouraged by the fact that international observers, particularly the European Union and the common wealth will be allowed into the country and this will lend credibility to the result. The only solution to the fiscal imbalances and the chronic currency shortages is a bailout package and a credible election will pave the way for these discussions.

Market outlook

Nigeria – The results season confirms a recovery and clear path to normalisation of the economy. Consumer companies are able to shift volume and we expect pricing to improve, especially later in 2018. We maintain a large allocation to banks and the top consumer names in the food and beverages sector, following the drop in prices during the month, valuations are looking more attractive. Our preferred banks are well positioned to make money from fees. Overall, banks will make less profit from yields as the curve drops in 2018, but higher NGN liquidity, strong growth in trade facilities (LCs) and mobile bank fees will still mean good growth in earnings. Consumer names we hold have traded through tough consumer conditions to gain market share, the announcement of an expansionary budget points to increased liquidity pre-elections, which could be a nice kicker to 2H18. In the same breadth, pre-election instability remains the biggest risk factor to a strong recovery.

Egypt – The economic recovery is continuing as expected and most management teams are positive and expect conditions to improve further. We are seeing volumes recover as wages catch-up to inflation, upside risks to inflation from subsidy removal and rising oil prices, but there is enough positive momentum to maintain the growth trajectory.

Kenya – We expect the modification of interest rate caps despite political noise around the issue. Kenyatta's strong political position, his majority in parliament and public utterances on the need for growth in credit to SMEs supports it. Bank management teams are confident that rate caps will be removed before September. We believe current low Price-to-book valuations and a positive shift in money supply, that rate cap removals will bring, provide a unique asymmetric opportunity. Bullish CAK data supports the mobile money theme we play through Safaricom and Equity Bank. The draft income tax bill is another factor, we believe our investments should be able to absorb the higher taxes given their current growth projections.

Morocco - Our outlook remains unchanged, we continue to search for attractively priced growth investment opportunities, with our team traveling to Casablanca in July. Our existing investments are showing moderate growth and attractive dividend yields.

Mauritius - The country continues its moderate recovery and we are happy to see the BoM continuing to mop up excess liquidity, which is pushing up money market yields. The 3Q18 MCB numbers reflect this, showing NIM expansion and loan growth of 9% y/y.

Zimbabwe – With elections around the corner, Zimbabwe has its highest chance of a positive outcome, a lot depends on credible, free and fair elections. We have always taken a long term view to Zimbabwe, preferring to look through the political noise and focusing on identifying corporate champions that can generate shareholder wealth no matter the environment. The start of the year has seen our companies release very strong results despite the chronic foreign currency shortages. We believe we are well positioned to capture the upside following a positive election and have companies that are resilient if the outcome is negative (nationwide vote rigging, violence, lack of legitimacy).