

OUTLOOK 2023

Industry experts share their views on the African markets' performance in 2022 and provide their outlook for 2023



Jenni Chamberlain (JC),
Founder and CEO, Altree Capital



Nicholas Piquito (NP),
CEO, African Alliance Asset Management

Tim Staermose (TS),
CEO, ST Funds Management

Fred Steiner (FS),
Managing Director, BCCM Advisors; Portfolio Manager of Blue Clay Pan-Africa Fund



AFRICA GLOBAL FUNDS (AGF): HOW DID THE PUBLIC AND PRIVATE MARKETS PERFORM IN 2022?

JENNI CHAMBERLAIN (JC), FOUNDER AND CEO, ALTREE CAPITAL: 2022 was a difficult year for global stock markets, the worst since the GFC in 2008, with African stock markets trading at valuations not seen for at least ten years. Whilst at the same time 2022, was a good year for exits in the private markets, with 1H22 exits 29% higher than 1H21. This is a good analogy for the year ahead, which holds opportunities for discerning investors in both the public and private markets, in a year where opportunities will be uneven. Most African stock markets closed in the red in US dollar terms in 2022, suffering from weaker currencies and investor outflows, the exceptions were Zambia, where the market performed well, despite an 8.5% decline in the currency, the Nigeria Stock Exchange where the black market rate was trading significantly higher than the official rate and negative real rates, meant that the stock market provided some refuge for local investor, whilst Tanzania proved extremely resilient, the economy continue to perform well and the currency, although not that liquid, weathered the global storm better than expected. At the other end of the spectrum, Ghana, Morocco and Egypt were the worst performing exchanges, plagued by outflows, domestic concerns regarding the local currency and debt sustainability amongst other things.

AGF: WHAT WERE THE KEY THEME(S) FOR YOUR BUSINESS IN 2022?

NICHOLAS PIQUITO (NP), CEO, AFRICAN ALLIANCE ASSET MANAGEMENT: 2022 saw the culmination of a multi-year strategic plan within the business to improve our ability to respond more quickly to investment opportunities (both listed and private) across Southern and Eastern Africa. The historical bifurcation between listed and private assets – and the requirements of local, regional and global investors in those assets – has reduced to a significant degree. We now see far more commonality in the interests and expectations of local and global investors in African assets than has been the case historically. We expect this trend to continue and are working hard to ensure that our business is structured to provide the increasingly sophisticated level of service that our clients expect and deserve.

TIM STAERMOSE (TS), CEO, ST FUNDS MANAGEMENT: At African Lions Fund, we were one of the only frontier Africa funds to make money in 2022. You can see this for yourself in the league tables in Africa Global Funds magazine. We tried to highlight to our investors, and potential new clients,



that in spite of the financial markets turmoil elsewhere in the world, on the back of steep rises in interest rates by the leading Central Banks to combat cost-push inflation precipitated in part by the Russian invasion of Ukraine, the frontier African market businesses that we own shares in were continuing to perform well. It was easy to get caught up in negative macro noise when, at the micro level, many businesses kept delivering for shareholders. Not to mention, since these businesses had never seen the valuation run-ups that stocks in the developed markets enjoyed after the brief Covid crash in March 2020, there was no bubble for interest rates to burst.

Indeed African Lions Fund ended 2022 with a 3.7% gain on our portfolio, outperforming our hurdle index, the Africa Frontier BMI (USD) Total Return Index by more than 12.4 percentage points. It lost 8.75% for the year. Much had to do with our specific market exposure and stock selection.

We have 48% (on a cost basis) of our capital deployed in Tanzania, where we have large stakes in NMB Bank, Tanzania Breweries Limited, and Twiga Cement. There is no other fund in our universe with such a large allocation to Tanzania. These businesses all performed exceptionally well in 2022, even if their share prices have not risen by nearly as much as we might have liked, yet.

AGF: WHAT SURPRISED YOU IN 2022?

TS: I did not think that frontier Africa funds were still so vulnerable to further redemptions, given the huge outflows that had already take place in recent years.

So, I have to be honest and say I was surprised that our peers kept selling shares in high-quality businesses in our frontier African markets, such as Bralirwa in Rwanda, Sonatel in Senegal, Tanzania Breweries, and Twiga Cement, in Tanzania, despite great business performances and excellent future prospects for these companies. We gladly bought shares from these sellers.

AGF: WHAT TRENDS ARE GETTING UNDERWAY THAT PEOPLE MAY NOT KNOW ABOUT BUT WILL BE IMPORTANT?

NP: The combined impact – both good and bad – of technology, changing global demographics and ultra-loose monetary policies is not yet fully appreciated. The impact of demographic changes among both developed and emerging nations in particular is not well understood. This presents both a risk and a golden opportunity for Africa, particularly in the provision of digital services as technology makes the world an ever smaller place. We expect that the notion and practice of longitudinal arbitrage will be commonplace within the next few years.

FS: Central Banks have raised interest rates at an astonishing clip and have embarked on quantitative tightening to combat inflation. This will come to no surprise to your readers, but what also is happening is governments are seemingly taking a greater role in allocation of capital in economies. This is to assuage their constituents via investing in preventative climate change measures, national security, ballooning physical infrastructure deficits, and perversely spending on initiatives meant to offset inflation. The overarching consequence of this argument is there will be higher capital expenditures in the decade to come; and the only way to pay for the past decade's debt binge is via higher nominal GDP growth – which is to say, the developed

world needs inflation to pay its bills just as it did following World War II.

Emerging and frontier markets have historically been driven by investor's appetite for risk and USD earnings growth, the latter of which is propelled by the change in the price of commodities and change in the volume of global trade. This broadly positions African markets well with high prospective returns.

AGF: WHAT WAS THE HIGHLIGHT OF 2022?

FRED STEINER (FS), MANAGING DIRECTOR, BCCM ADVISORS, PORTFOLIO MANAGER OF BLUE CLAY PAN-AFRICA FUND: For us at BCCM focused on the Africa strategy, the highlight of 2022 marked the end of a paradigm. From roughly 2010 till 2020, the environment was defined by low inflation, weak real economic growth, and low to negative interest rates. Quantitative easing over that period did not lead to money supply growth in developed markets because banks were deleveraging from the Great Recession. Specifically, central banks asset purchases were primarily targeted at commercial banks, which did not use the proceeds from their asset sales to lend, but instead toward new excess reserves, which helped banks delever. This process helped keep inflation at bay, interest rates low, and pushed asset allocators out on the risk curve and into longer duration assets. As a result, traditionally defined growth investments outperformed value and developed markets with the United States technology sector and venture capital in particular outperforming the rest of the world by a large magnitude.

In response to the economic fallout of Covid-19, central banks began purchasing assets from economic agents and governments to fund their enormous fiscal deficits, some of which went directly to consumers' wallets. As a result, global money supply exploded. In our 2020 fourth quarter letter to investors, we wrote about this, explaining that while increased global money supply does not directly translate into inflation, it does mean there is a greater potential to spend all that extra money on goods, services, and financial assets. Combined with supply chain woes, demand simply overwhelmed supply, causing inflation to be let out of the bag, and effectively welcoming the end of the past decade's paradigm whose seeds were planted amidst the Global Financial Crisis. These paradigms tend to last for a decade and exhibit their own distinct characteristics, but typically are the opposite of the prior decade.

AGF: WHAT ARE YOUR EXPECTATIONS FOR 2023?

NP: We expect a volatile global economic backdrop with continued inflationary pressure. This will have implications for real yields in developed markets which are mispricing this scenario, thus impacting the relative attractiveness and required return on African investment opportunities. We also expect a more realistic assessment of the challenges and benefits of the global move to socially conscious investing, whether under the banner of ESG, SRI or impact.

JC: The key macro concerns to watch include high levels of inflation, a recession in developed markets, supply-chain bottlenecks/shortages, the cost of living crisis – growing poverty and local currency weakness; however, the African continent has proven its resilience in previous global economic downturns, beating to the African drum, less correlated to the rest of the world, in particular the smaller economies outside of South Africa, Egypt and Nigeria. Despite the shadow cast by the global macro economic outlook, the African consumption driven story

remains intact, with new angles and opportunities, investors should take advantage of lower valuations and selectively add exposure to the continent. Africa is starting to receive more attention from the developed world due to the global geopolitics of the last few years, with investment destinations such as Eastern Europe and parts of Asia becoming increasingly difficult, owing to the Russian war and tensions with China. These stark reminders of the need for diversification have led investors to look to Africa. There is also growing recognition that Africa will become the breadbasket, workshop and service centre for the world, not only does Africa have favourable demographics, but its strategic position and abundance of natural resources, means it is can no longer be ignored. The United States has taken strong initiatives to partner with Africa, with Janet Yellen's visit to Zambia, South Africa and Senegal later this month, on the heels of the US Africa Leaders Forum held in December 2022.

TS: For 2023, I expect more of the same. Though, I do expect to get some relief from the apparent weakening, finally, of the US Dollar. Frontier markets may get some respite performance wise, with the dollar exchange rate not being quite as big a headwind.

AGF: WHERE DO YOU SEE INVESTMENT OPPORTUNITIES IN 2023?

NP: We believe that private market investing across sub-Saharan Africa will increase in depth and breadth in 2023 and beyond. On a ten-year view this is one of the most exciting investment spaces globally. That said, this opportunity is not immune to changes in global sentiment and short-term capital flows. We also expect a gradual change in the nature of capital flowing into this area – from shorter-term speculative capital driven by essentially free money conditions over the past few years to longer-term capital based on a more realistic assessment of risk and return within a more practical impact-driven framework.

JC: A few themes that will dominate the year include infrastructure development, with a focus on renewables and climate-friendly practices. Technology will continue to be an important theme, not purely VC investments, which are attracting more interest than historically, but where technology can be used to scale and drive efficiencies. Other themes include diversity, equity and inclusion and ESG and impact. A growing body of research demonstrates that diversity, equity and inclusion within companies leads to better financial performance and other research points to the fact that African women reinvest up to 90% of their incomes in the families and communities versus only 40% for men. This has supported the formation of several fund-of-funds, such as the African Women Impact Fund and the MasterCard Foundation's Africa Growth Fund, and institutions, such as the 2X Challenge, these organisations will fund women-led, owned and oriented businesses on the continent and aim to change the face of the financial sector, providing capital to a largely ignored part of the population.

Africa is well positioned when it comes to ESG and impact, most public companies have implemented strong ESG policies and are driving this further focusing on impact and the UN Sustainable Development Goal's (SDGs). Whilst in the private markets, where development finance institutions have been the lead investors, ESG has been 'du jour' for some time, included in most mandates for years. A strong ESG policy and clearly defined Theory of Change targeting several SDGs lay a strong foundation for African businesses, as they grow and become a leading

example of the importance of driving ESG, impact and sustainability for stronger future returns.

As African investors, Altree Capital has managed through different crises and inflation is no stranger, with boots on the ground and a long track record of excellence, this is the environment that we favour, as there are returns to be made by positioning our portfolios to mitigate against FX risks, focusing on industries which can drive margins and diversifying across sectors and geographies. It is important to carefully define and measure where and how value can be added, this will test the mettle of managers in 2023.

TS: I continue to see excellent potential for the banks in Tanzania. The two dominant players, NMB Bank, which we have a core holding in, as well as its rival CRBD Bank, have both been compounding their earnings per share at more than 30% per annum since 2017.

And yet, the share prices are not building in any valuation premium for this extraordinary performance. They continue to languish on trading multiples around 3.5x projected earnings and shy of book value. Dividend yields are in the high single digits and may even reach double digits this year, when the pay-outs come in May or June.

For the more intrepid investor, 2023 may finally be the year we see a change to the current regime of de facto capital controls in Nigeria. If the election goes smoothly at the end of February and we see a reform-minded candidate come to power, who has the political will to tackle vested interests, we might see some positive developments there.

There are many well run businesses in Nigeria which, if un-schackled from the macroeconomic chains holding them down, could really deliver excellent returns for shareholders.

I spent a week in Lagos visiting companies last September, and I plan to go again in March, shortly after the election. I am cautiously optimistic there will be opportunities in Nigeria, despite all the negative press the country is (rightly) currently getting. It is always darkest before the dawn.

I want to be positioned to move on that, and have put a little bit of the African Lions Fund's capital in Nigeria in anticipation, by buying Nigerian shares in London and moving them to Lagos. You get a much better effective exchange rate that way.

FS: With a roughly fifteen-year period of complete apathy toward African public markets, we believe 2023 will begin to resemble a murky mirror opposite of the past decade. That is not to say there will not be challenges – many African countries are amidst or staring down the result of their own debt binges. Defaults are inevitable, but as debt is forgiven and government balance sheets cleaned up, the cycle begins to look like the decade that succeeded the Internet Bubble and 19 African nations accepting debt relief at the turn of the century.

Egyptian company valuations have become increasingly attractive. Many Egyptian companies have weathered the past few years' series of crises superbly by leveraging pricing power to sustain margins and beating out weaker competition for market share. With the series of currency devaluations mostly in the past, we note that according to Bloomberg data, the EGX30 Index is trading at roughly half the valuation multiples it did immediately following the 2016 devaluation. USD investors did well then over the following 17 months, returning over 50%. Following the 2001 and 2002 devaluations, however, USD investors generated a 20x return between 2003-2007. This was a period during which the price of commodities and the volume of global trade consistently rose.

