Africa FM Fund Manager

Expert in the field

Finch Africa CIO Jenni Chamberlain shows there is no substitute for experience in sub-Saharan Africa

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ANTONY IRELAND, Editor

A fine example

This issue's cover interview with Jenni Chamberlain, CIO of Finch Africa (*see page 20*), is a perfect illustration of how committing to growth markets when they are nascent can pay off in the world of fund management. Chamberlain's rise from roving analyst hunting for annual reports on the ground in sub-Saharan Africa in the mid-1990s to pre-eminent expert on the region sipping tea at 10 Downing Street shows that there is no substitute for experience nor first mover advantage.

However, young managers seeking the next big thing have not missed the boat when it comes to Africa. Transparency, visibility, liquidity and market sophistication may have increased markedly in the continent's showpiece markets, but such is the diversity of Africa that there is still a deep pool of economies waiting for their time in the sun. Back in the 1990s, Chamberlain was digging up information in what are today's frontier and next 11 markets, but the opportunity still exists for fund managers with an appetite for risk and a hunger for alpha to put in the hard yards in the markets we will all be raving about in 20 years' time.

As the lead news story on page 7 proves, there are major investors out there willing to delve deep into Africa's untapped markets too.

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PROFILE

FINCH AFRICA

Expert in the field

Finch Africa CIO Jenni Chamberlain's ascension mirrors those of the African financial markets themselves. Having cut her teeth as an Africa analyst in the murky mid-1990s, Chamberlain is now considered one of the pre-eminent authorities on sub-Saharan investment

By Antony Ireland

When Jenni Chamberlain was first exposed to Africa as an analyst at Natwest Markets in the mid-1990s, there were only three dedicated Africa funds and Zimbabwe was one of the best performing stock markets in the world.

Like the African markets themselves, Chamberlain has grown considerably since those early days and she is now widely regarded as one of the foremost experts on the African capital markets.

En route to her current position as CIO of Finch Africa, Chamberlain was *Reuters* top-ranked analyst for African Research from 1997–99, held executive positions as HSBC, Société Générale and Securities Africa, and recently participated in high-level African development meetings at the United Nations' 63rd General Assembly and 10 Downing Street. At Finch, Chamberlain focuses primarily on running the Bermuda-domiciled flagship Finch Africa Fund and related accounts. Since inception in 2006, the Finch Africa Fund has returned +76% versus +28% by the MSCI EFM Africa (ex-SA) Index. "The African markets have seen their fair share of volatility, but it has been a truly rewarding journey," says Chamberlain.

Nigeria is typically the fund's largest single country exposure, but the fund's investments are well diversified across sub-Saharan Africa *(see box out)*. "It's always been one of our key strengths to ensure the portfolio remains as diversified as possible," says Chamberlain. The fund imposes caps on country and company exposure while employing proprietary in-house tools designed to incorporate liquidity and market depth when determining when to enter and exit individual holdings.

"The logistics of investing across the African capital markets is operationally intensive and requires intimate knowledge of trade execution, post-trade settlement, custody and foreign currency requirements," says Chamberlain. "To put it simply, it takes considerable time, skill and resources to successfully navigate institutional money across more than 40 individual currency regimes and 18 active stock exchanges over numerous economic cycles."

Structured as a hedge fund but essentially operating as a long-only fund due to the prohibition of shorting in sub-Saharan Africa, Finch invests around 85% in listed equities with the remainder in fixed income and cash.

"One of the impacts of the global financial crisis is that we now tend to look at the underlying liquidity of investments more seriously than we had previously," says Chamberlain, recalling how daily trading volumes in Nigeria dropped from up to $100m in August 2008 to as low as $3m-per-day in the depths of Africa's crisis in early 2009. Volumes have come back since then and are now closer to $25m-per-day in Nigeria – but remain well shy of peak levels.

"When placing fairly large amounts of money, market depth is a strong consideration and we pride ourselves in knowing where various pools of liquidity exist across our universe. That's where established relationships with local players such as pension funds and local investors do pay off,"

> "Our hedge fund structure is in place so that when the markets mature we will be ready"
>
> - ***Jenni Chamberlain***

Africa's movers and shakers

Jenni Chamberlain, CIO of Finch Africa, shares her views on the outlook for some of sub-Saharan Africa's key markets: "We have increased exposure to **Ghana**, which could be the world's fastest growing economy in 2011 with GDP forecasts ranging from 12-18% and 1Q11 GDP growth of 23% year-on-year. With oil production coming on-stream, rising demand for commodity exports (for example gold, cocoa), strong foreign direct investment and a benign political environment, we remain optimistic on the Ghanaian economy's prospects.

"We have also increased our allocation to **Nigeria** as the nation is poised to benefit from elevated oil prices, an expanding current account surplus and the positive outcome of April's election. Over the medium-term, Nigeria should profit from favourable demographics as its population accounts for roughly 16% of Africa's total population and more than 40% of the population in under the age of fourteen. Although the Naira has depreciated slightly YTD, we think there is an opportunity for NGN/USD to appreciate back towards 150 should the Central Bank of Nigeria (CBN) succeed in bringing inflation under control. From a sector perspective, we favour banks as they are well positioned to benefit from continued margin expansion, balance sheet improvement and strong credit growth, whilst 80% of the population remains unbanked. We are also looking at consumer staples (for example food producers) and other fast moving consumer goods, which offer diversified portfolios and are trading on reasonable valuations. At this stage, we believe Nigerian brewers are fully priced and rising competition and input costs may negatively impact margins over the near-term.

"Although inflation and adverse weather conditions continue to plague **East Africa**, we are growing increasingly optimistic on the region's economic potential. Inflation remains the primary concern with local currencies (for example KES, UGX, TZS) experiencing sharp devaluations on the back of rising food prices. We implemented an inexpensive FX hedge which successfully protected the portfolio against some of these concerns. Equity valuations across the financial, material and utility sectors are starting to look more compelling for investors with a 12- to 24-month time horizon. Although we have almost halved our exposure to the region, we are re-evaluating our medium-term allocations, with **Kenya** looking more attractive at current levels. That said, we have concerns regarding some of the consumer names, for example the Kenyan brewers, as disposable income remains under pressure and higher excise duty will hamper sales growth.

"In Southern Africa, a country that is often overlooked is **Zambia**. Most investors view Zambia as a play on copper production, and ignore some of its truly fabulous attributes, in particular its agricultural potential. For example, Zambia has 35% of Africa's fresh water supply, and there are interesting opportunities in both agriculture and hydro-electric power generation."

"The flow of financial data has considerably improved over the course of the past fifteen years"

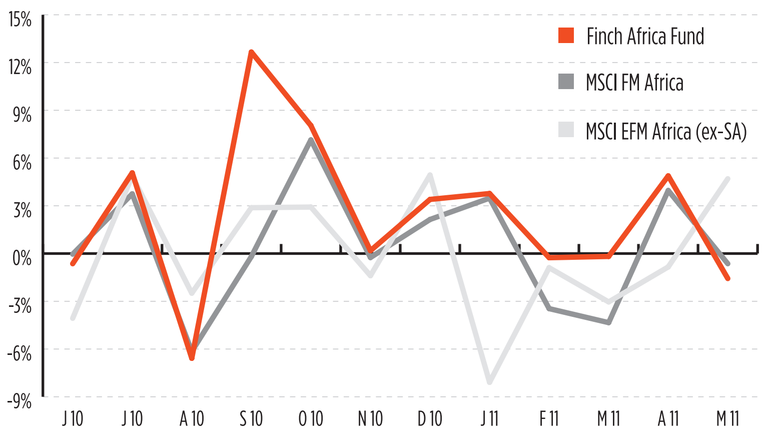
- ***Jenni Chamberlain***

says Chamberlain. "[Pre-crisis] there was huge competition for African assets, and you were forced to find value in pre-IPO plays. These days there is quite a lot of intrinsic value in secondary shares, and we have not had to allocate to more illiquid securities to extract value."

Market sophistication

Over the long term, Chamberlain hopes the Fund will be able to operate more like a hedge fund in the Western sense, although this may be some years off. "Our hedge fund structure is in place today so that when the markets mature and start to offer new products, which is something certainly being talked about, we will be ready to take advantage," she says in reference to Nigeria's pledge to introduce new investment products over the coming years and Mauritius desire to introduce stock borrow agreements, which points to further product developments.

FINCH AFRICA FUND RETURNS VERSUS BENCHMARKS (% NET OF FEES) Source: Finch Africa



Tapping South Africa's investor base

Finch International Advisors has a diverse global investor base comprised primarily of institutions, family offices and high-net-worth individuals from the UK and Europe. At present, Finch has only a few South African clients, and Chamberlain admits that the firm must do a better job at communicating with local South African investors. "South Africa is going to be a very important market going forward in terms of attracting investment into Africa, and as a strongly growing investor base," she says. Not only are South African investors more comfortable with the opportunities and risks of investing in other African economies, but recent legislative changes are likely to encourage increased investment from South African institutions, including local pension funds where the maximum allocation to alternatives has risen to 10% from 2.5%. "We have already received new subscriptions from a couple of South African allocators, a trend which we believe will continue," says Chamberlain.

"In the long/short strategy you are using your research skills to their full, taking advantage of stocks which you believe are overvalued by putting on short plays. Over time, regulators will come to realise that this will attract a wider range of investors, provide greater market liquidity, and reduce overall market volatility. Yet at this stage, the African capital markets just aren't there," Chamberlain explains. "I do think we will continue to see new products and the introduction of hedge instruments as these markets develop."

Chamberlain's own research skills were honed in an African environment significantly muddier in than it is today. "In the 1990s when I first started looking at these markets, if you received an annual report it was worth its weight in gold," says Chamberlain. "These reports would never make their way overseas and the only way to get an annual report was to visit the companies. I remember coming back from trips to Africa with a suitcase full of annual reports. It used to be incredibly challenging to locate company information, but the flow of financial data has considerably improved over the course of the past fifteen years."

That said, even today and in relatively advanced markets like Nigeria, major companies often release financial results that amount to little more than a few lines, and further investigation is needed to unearth the stories behind the numbers. "One of the biggest concerns is transparency of financial results," says Chamberlain. "One of our key advantages is that we have been investing in these markets for a very long time and we have strong relationships with the management teams in which we invest. I can pick up the phone, talk to management, and quickly try to ascertain what is driving those few lines in the statement."

Transparency is, of course, slowly but surely improving, and part of the driver for this is increased competition within the fund space, which Chamberlain wholeheartedly welcomes. "The more people that can ask a company for meetings and financials, the more likely that company is to create a forum for communicating with investors," she says.

"Competition also increases liquidity; everyone else has an idea where full value is; the markets are easier to invest in; information flow is becoming better, and that makes it easier to make investment decisions. Competition is a good thing."