

Are investors in African equities poised for wins amidst global turmoil?

By [Rami Hajjar](#)

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Global markets started the year on a very positive note, with the S&P 500 up 9.0% at its peak in early February and the MSCI World Index up 9.4%, driven by expectations that the interest-rate hiking cycle in developed markets would peak earlier than initially expected.



Source: [Pexels](#)

The S&P 500 and MSCI World Index then wiped almost all these gains by early March to bounce again and end the quarter up 7.5% and 7.7%, respectively.

The main event in March was the failure of Silicon Valley Bank and two other banks in the US, and the subsequent takeover of Credit Suisse, one of the oldest and most prominent banks in Europe. This triggered fears of larger-scale contagion and a broader financial crisis. These fears later receded due to high-level intervention that guaranteed deposits in the US.

Amid this turmoil, the MSCI Emerging Frontier Markets Africa ex South Africa Index underperformed the global market, dropping 3.1% for the quarter with diverging country-level performance: Egypt (+12.5%), Ghana (+12.3%), Nigeria (+7.0%), Morocco (-3.1%) and Kenya (-11.5%). The unfortunate fact is that these are local currency performances.

In US dollars, Kenya, Egypt and Ghana dropped 17.6%, 9.9% and 1.6%, respectively. The tightening global liquidity conditions and stronger US dollar are not conducive to stable currency performances in emerging markets. This negatively affects dollar returns over the short term.

Zimbabwe sees some recovery

The Allan Gray Africa ex-SA Equity Fund is overweight Zimbabwe, which has contributed to performance. Part of this year's rally is related to a bounce from last year's highly oversold territories, but another factor at play is renewed doubt in the ability of authorities to control inflation and stabilise the currency.

A large and sudden rally in locally listed shares is associated with a flight-to-safety phenomenon, in most cases, rather than an improvement of the companies' fundamentals. While this may be the case, the listed shares we hold on the Zimbabwean Stock Exchange (ZSE) are valued at the lower of our conservative estimate of the stock's fair value in US dollars or the market price using the official exchange rate.



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There are some positive developments to note on our Zimbabwean in-country holdings. Two of our positions, Simbisa Brands and Inncor Africa, delisted from the mainly ZWL-denominated ZSE and listed on the US\$-denominated Victoria Falls Stock Exchange (Vfex). The Vfex was recently set up in the Victoria Falls Special Economic Zone and listed share transactions are settled offshore. This effectively means that, subject to liquidity availability, proceeds from the disposal of shares can be repatriated.

The remaining ZWL exposure has reduced to 18.1% of the Fund and consists of holdings in Delta, Econet and EcoCash. We hope that these shares will follow suit and list on the Vfex. Many of the Zimbabwean companies' fundamentals have improved substantially since government has allowed the use of US dollars as legal tender. Several of the companies we own are generating revenue in US dollars, growing volumes and seeing improved real profits. Simbisa and Inncor have paid their most recent dividends fully, and Delta partially, in US dollars.

Nigerian exposure generates positive returns

Our Nigerian exposure also generated positive returns during the quarter, mainly through the banks and Seplat. An important development has been the election of Bola Tinubu as president. This removes the "election overhang" in the market that dominated the second half of 2022. We are cautiously optimistic that the new administration will deliver on a number of crucial reforms: allowing market forces to drive the naira, lifting capital controls, removing the highly costly and regressive petrol subsidy, and reintroducing orthodox monetary policies. Foreign exchange liberalisation accompanied by the right reforms is highly conducive to stocks' medium-term dollar performance.

Egypt faces structural problems

An investor who had exposure to Egypt in quarter 1 of 2023 would have experienced underperformance due to macroeconomic concerns. Egypt is facing a balance of payments (Bop) crisis which has resulted in shortages of foreign currency and a weakening Egyptian pound, which is down 19.8% for the first quarter.

This has been exacerbated by low confidence from local and foreign investors in the government's willingness to deliver much-needed reforms. Factors that led to the Bop crisis include higher global wheat prices and inflationary pressures in general, and tighter global liquidity conditions, which are reducing the carry trade appeal of the country.



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But those are cyclical factors. More crucial are the structural problems that Egypt really needs to tackle. At the core, this requires a drastic reduction of the state's presence in the main sectors of the economy to provide private-sector players with a better environment in which to thrive. This should boost the competitiveness of the country, its export base and the sustainability of the Bop.

We recently met with the governor of the Central Bank of Egypt who confirmed the bank's commitment to fighting inflation through orthodox measures and provided some reassurance that the government is on track to deliver certain reforms. Our main in-country holdings include Eastern Company and CIB Egypt. We think these names provide a good hedge against currency devaluation and have a proven ability to grow US dollar profits over time.

Future prospects for investors in African equities

Looking ahead, we are very excited about the medium- to long-term prospects for African equities. The stocks we own are highly undervalued, both relative to where they traded historically and relative to comparable shares in other emerging and developed markets. We are also hopeful for some normalisation in the foreign-exchange environment in our largest country exposures, Nigeria and Zimbabwe. This should contribute to the rerating of the stocks and enable investors who hold these stocks to realise value on the selling of shares at appropriate price levels.

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