Market Update
07 March 2019
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CEDAR CAPITAL

Equity research | Market Update Report

MALAWI

Introduction

"We should always allow some time to elapse, for time discloses the truth. He who indulges in empty fears earns himself real fears." – Lucius Annaeus Seneca

If there are many misconceptions about Africa and portfolio investing in Africa, one can imagine how the picture becomes even more confused when Malawi is thrown in. The common refrain is that Africa is a high-risk investment with a high potential return. By extension Malawi is then taken to be riskier.

This could not be further from the truth, especially if one examines available data. If we use the benchmarks, MSCI index for Africa excluding SA (Africa FM), and the S&P All Sub-Saharan Africa and compare the returns and volatility of these indices to a range of other global indices, we can see that the assertion that Africa is high risk and high return market is misleading. Performance data – see table below - undoubtedly dispels the myth that investing in African equities can be associated with higher volatility, even if the returns are better. In any case market volatility is part and parcel of investing.

In addition to providing good risk-adjusted returns, investing in Africa also has diversification benefits for a global portfolio. Theoretically, investors diversify their portfolios to boost returns and manage risk. However, the benefits of diversifying across geographic regions are reduced if markets are highly correlated. For instance, emerging markets (EMs) have historically a high correlation of 0.81 to developed markets, whereas Africa FM has a very low correlation of 0.24. This means a global portfolio including Africa will be significantly more diversified than a simple investment in EM. In fact, correlations are generally low among individual African markets, highlighting the additional benefit of diversification within the African region.

Investors usually need assurance that collectively Africa FM has better economic prospects, and more stable politics going forward, and these would impact positively on the stock markets. But this is another minefield. The news out of Africa FM characteristically focus on the worst issues and incidents. Although true, this not the complete picture. On the ground, growth is continuing, infrastructure is improving, and business conditions are getting better.

Foreign investors have 29 formal stock exchanges on the African continent; 23 Sub-Saharan African exchanges and 6 North African exchanges in Algeria, Egypt, Libya, Morroco, Sudan & Tunisia, to choose from.

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African stock markets performance review

To say, Africa FM delivered disappointing returns in 2018, is an understatement. The MSCI Africa index was down 24%, while the MSCI Africa ex-SA index was down 13%. Almost all the continent's largest markets experienced a huge pull back, explained mostly by the contagion from EMs such as Argentina, Vietnam and Turkey and the subsequent de-risking that ensued. At the same time, the fact that the US Fed was raising interest rates as well as the collapsing of many EM and FM currencies did not help. Most of the big stock markets posted negative United States dollar returns; South Africa (-28%), Egypt (-14%), Nigeria (-18%), Kenya (-17%), and Morocco (-10%).

It was not all gloom and doom, though, with Malawi Stock Exchange being a stand out performer and underlining that, although the correlation between global markets and Africa FM is around 0.24, there are some markets of which the correlation can be estimated to be around 0.

The table below shows the returns coming out of Africa in 2018, 2017 and for a good measure for the past three- and five-year horizons;

Country	5 -year Return (%)	3-year Return (%)	2017 Annual Return (%)	2018 Annual Return (%)
Botswana	(29,40)	(22,20)	2,54	(18,30)
BRVM	(38,38)	(40,30)	(5,16)	(32,30)
Egypt		(18,70)	26,77	(13,80)
Ghana	(42,40)	0,30	43,96	(16,90)
Kenya	(13,00)	(3,20)	28,20	(16,80)
Malawi	19,90	47,60	61,18	22,20
Mauritius	(5,90)	28,30	30,75	(0,30)
Namibia	37,10	34,60	34,34	(10,80)
Nigeria	(66,50)	(39,90)	24,51	(18,60)
South Africa	(21,70)	8,00	30,37	(27,90)
Tanzania	(22,00)	(15,00)	6,60	(14,20)
Uganda	25,50	(15,10)	32,36	(17,80)
Zambia	(53,20)	(15,70)	26,63	(16,50)
Benchmarks				
S&P Frontier Africa	(0,23)	8,46	29,56	(24,26)
S&P All Africa - ex SA	0,45	8,66	30,88	(25,23)
MSCI Frontier Africa	**(15,64)**	**2,03**	**27,69**	**(19,06)**
World Benchmarks				
S&P 500	8,50	9,30	21,83	(4,40)
MSCI World	4,60	6,30	22,40	(8,70)
MSCI Emerging Markets	1,60	9,20	37,28	(14,60)

Source: Coronation Fund Managers, Ryan Hoover, African Market.com & Cedar Capital Research

After the strong 2017 performance, the slide in 2018, unfortunately reinforces the perception that African markets are volatile and prone to many risks such

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as exchange rates overshooting, unpredictable regulatory & political regimes, commodity cycles, disputed elections, autocratic leaders, endemic corruption and erratic weather patterns. However, as the example of Turkey, Argentina and Vietnam illustrates, excess market volatility is not an exclusively African phenomenon. Even the Nasdaq gave away 18% in the last quarter of 2018. So which market is not volatile?

Some comments on the bigger African markets;

- **Nigeria** – in the aftermath of the collapse of oil prices, the Naira has been repeatedly devalued from N155: USD in 2014 to the current rate of N363: USD, a 57% loss in value. As well, the Nigerian economy went into a technical recession which affected corporate earnings on the back of weak consumer demand. The Nigerian market is also highly liquid with its performance driven by foreign portfolio funds, and when the EM pull out started in 2018, many investors opted out, with an estimated USD145 million in net outflows experienced in Lagos.

- **Egypt** – another market of which returns were affected by the devaluation and floating of the Egyptian Pound in 2016, which in progressive steps moved from EGP8.8;USD in March 2016, to EGP18.25:USD, a 52% depreciation. The EGP has since appreciated to EGP17.61:USD. After having held its own in the first half 2018, the EM bug caught up with the Egyptian stock market in the second half of 2018 resulting in the fall that occurred, again largely driven by foreign sellers.

- **Kenya** – although the Kenyan Shilling was the best performing African currency in 2018, USD225 million was pulled from the stock market by foreign portfolio funds, particularly after July 2018. This was attributed mainly to the EM contagion and negative investor response after the parliament retained the interest rate cap.

- **BRVM** – the laggard, down 32% was weak, throughout the year, affected by negative sentiment and the weakness in banking sector stocks following an increase NPLs, as one of the major borrowers in the market collapsed.

Malawi's competitive positioning

Although overlooked and sometimes derided by many foreign portfolio investors, the Malawian market has returned the highest returns in the last 5 years. And by so doing laying a claim to be part of any foreign investor's portfolio. Some of the attractions of the Malawi market include;

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- **Low correlation** – As the returns show, Malawi is not only uncorrelated to the global markets, but to the other African markets as well. This unique attribute gives an investor true diversification.
- **Solid fundamentals** – using a bottom-up approach, we believe there are a number of companies on the Malawi Stock Exchange with long-run value drivers very much intact.
- **Low foreign investor participation** – a market which is dependent largely on foreign portfolio investor trading is prone to importation of external sentiment in terms of investor thinking. The liquidation of positions in Kenya for example had little to do with banking stocks fundamentals which remain solid even with the interest rate cap in place but more about how foreign investors view regulatory controls. At the same time, most of the companies affected by the sell off, still retain their solid fundamentals.
- **GDP growth** – Although not shooting the lights out, the African Development Bank projects that the Malawian economy is estimated to have grown by 4.6% in 2018 and should notch another 5.6% in 2019. Not bad.
- **Stable exchange rate** – the Malawian Kwacha, has been one of the most performing currencies in Africa trading between MKW710 and MKW735 since 2016.

As illustrated in the quote from *Lucius Annaeus Seneca,* that we opened with; time always discloses the truth. And in this case, regardless of the fact that Malawi is derisively dismissed as poor African country, on a 5 year stretch it has been the richest country in terms of USD portfolio returns.

Conclusion

We see a lot of opportunities in the Malawian stock market which have not been taken advantage of by foreign investors, both from a returns and diversification point of view. As such we would recommend that investors consider including Malawi in their allocation.

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