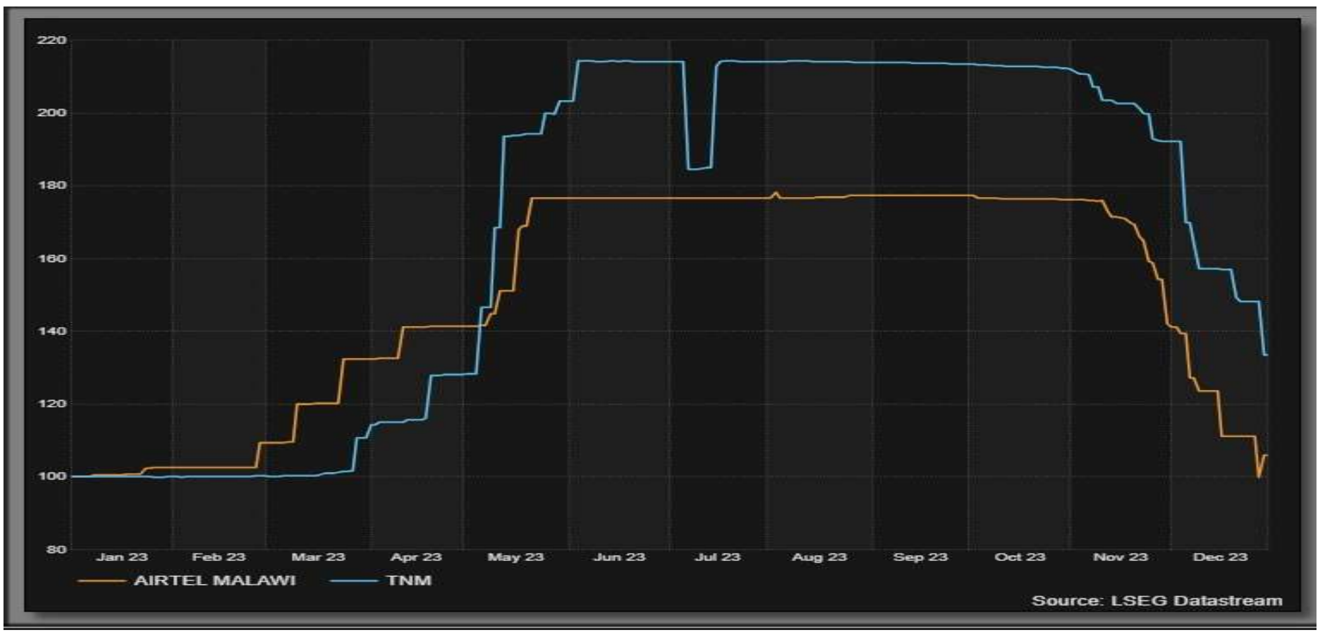


MALAWI STOCK EXCHANGE 2023 PERFORMANCE REVIEW

Armstrong Kamphoni 12 January 2024

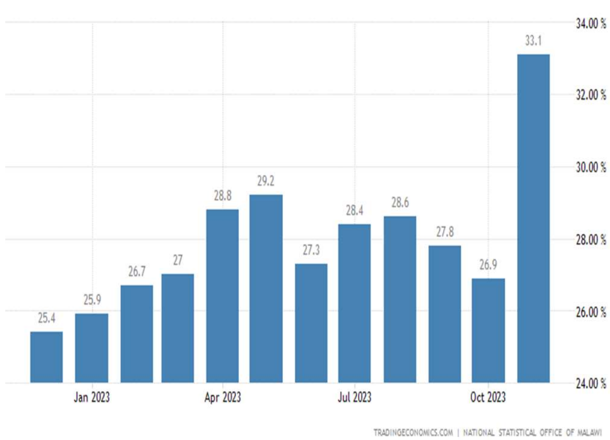
What a year 2023 turned out to be…

As the curtain comes down on a very difficult 2023 and an uncertain 2024 is unveiled, investors should take a moment to celebrate their investment wins and learn from missed opportunities and mistakes made. Reflecting on the year gone by and one's portfolio performance isn't just about looking back—it's a crucial step in forward planning. Reviewing investments allows the investor to assess what worked, what didn't, and why. It's a chance to refine strategies, adjust goals, and optimise for the future.

2023 was more than difficult for households and businesses, with the economy undergoing some turbulent times characterised by an acute shortage of foreign currency, fuel shortages, and runaway inflation. Other shocks included the outbreak of cholera and Cyclone Freddy.

Economic growth in Malawi exhibits a lot of volatility, reflecting heavy dependence on donor aid and reliance on rain-fed agriculture. For 2023, The Reserve Bank of Malawi (RBM) projects that the economy grew by 1,9% (the IMF puts the figure at 1,7%), which will be an improvement from the 1,1% (IMF figure is 0,8%) chalked in 2022. The growth is premised on an expected rebound in the manufacturing, utilities, wholesale, and retail trade sectors.

Inflationary pressures remain elevated, with the figure for November 2023 coming out at 33,10%. This gives an average annual inflation for the 11 months of 28,2%, compared with the 2022 average of 20,9%. Inflation was driven by food and non-food items, reflecting pass-through effects from May 2022's 25% currency devaluation, high global fuel, fertiliser, food prices, and prolonged supply disruptions.



Persistent current-account deficits, high public debt and a large positive inflation differential with main trading partners undermined the value of the MWK. For instance, when inflation was 33% in Malawi, it was 6% in South Africa.

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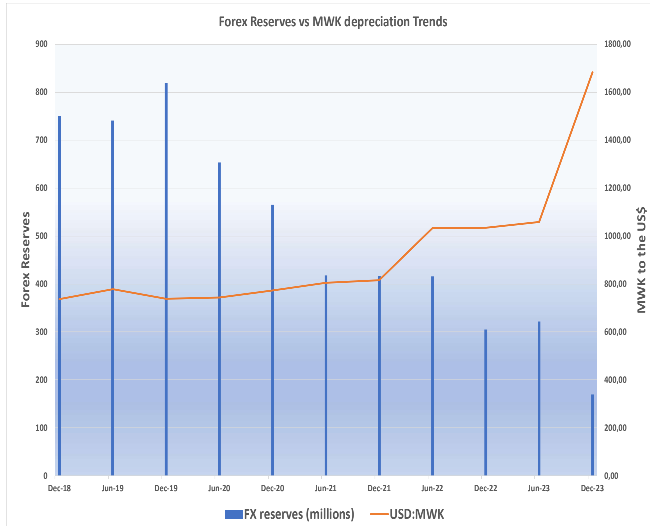
Consequently, the MWK lost value both on the official and parallel markets. The RBM officially devalued the MWK by around 44% in November 2023, to approximately MWK1 650 against the US$. This was the second time in 18 months that the RBM had significantly decreased the value of the MWK.

The devaluation coincided with the approval of a 4-year IMF Extended Credit Facility for an amount equivalent to SDR131.86mln (about US$175mln), with an immediate disbursement of about US$35mln.



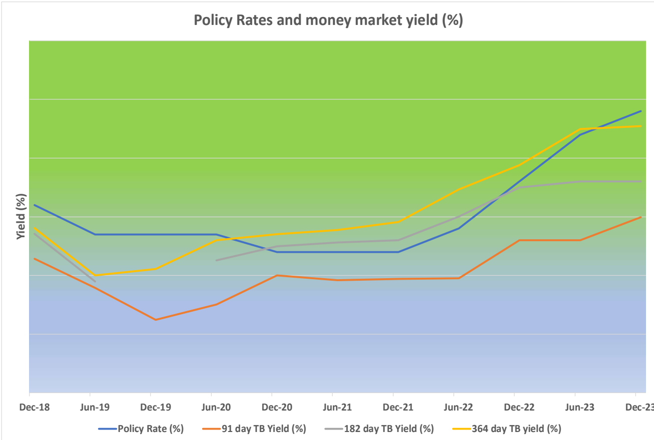
The chart above shows that gross official reserves (excluding private sector reserves) have declined since December 2019. Before the IMF disbursement, official reserves had declined to US$169mln, which equated to 0,7 months of import cover. The chart also highlights the relationship between forex reserves and the currency's value. The fact that the value of the MWK had remained flat between 2018 and 2021, when the reserves were declining, meant that a devaluation was inevitable. The fate of the MWK is not surprising given that the economy has an export/GDP ratio of 8,4% compared to an import/GDP ratio of 26,5%.

As forex reserves dwindled, international banks stopped confirming letters of credit, and suppliers ceased offering credit terms. The RBM started stepping in to fill the gap in trade credit to priority sectors, resulting in the depletion of forex reserves.

By the time of the devaluation in mid-November, the spread between the official rate of MWK1 180 and the informal market/street exchange rate had widened. However, the devaluation did not reduce the spread, with estimates putting the closing rate on the street at around MWK2 700.

The authorities implemented several fiscal and monetary policies in response to these challenges. On the issue of forex shortages, the central bank, in January 2023, introduced a foreign currency auction system.

To tame inflation, the RBM, in April 2023, raised the policy rate to 22% before another hike to 24% was effected in July. However, the hikes needed to be complimented by a deceleration in money supply growth, reduction in the fiscal deficit and related government borrowing, which has been driving money creation and crowding out private sector access to credit. The latter is work in progress.



However, in a strange twist, the yields in the treasury bill market rose but did not maintain the correlation to the policy rate, suggesting that the policy rate has ceased to influence treasury bill yields. In December 2020, when the policy rate was 12%, the yields were 10%, 12,50% and 13,50% for 91, 182 and 364 days, respectively. In other words, the shorter-dated paper's yield was slightly below or at par with the policy rate, but the 364-day paper would be above the policy rate.

The relationship is now out of kilter. For a clearer picture, the table below shows that whereas the policy rate is now at 24%, having effectively doubled, yields have remained subdued. This is further evidence of the dislocation that has occurred in the economy.

	Dec-23	Jan-23
Policy Rate (%)	24,00	18,00
91-day TB Yield (%)	14,97	13,00
182-day TB Yield (%)	18,00	17,50
364-day TB yield (%)	22,72	19,50

According to the RBM, lending rates have responded to the policy rates, with a minimum of 23,50% and possibly a maximum of 35%.

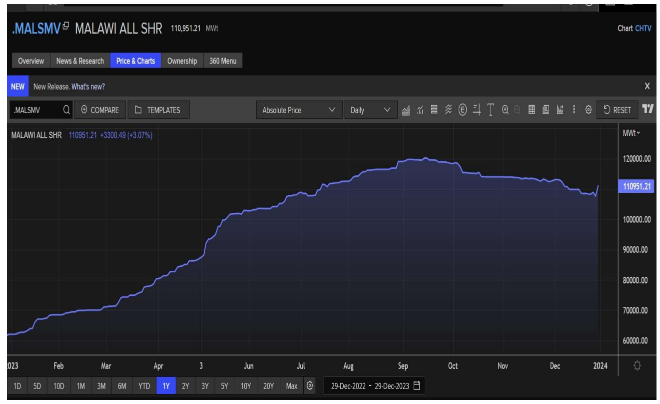
An investor who bought 91-TBs in January 2023 would have earned 31% by the end of the year, assuming a rolling over of capital and interest on maturity. Those who bought 182-day TBs in January would have earned 18,84%, and investors in the one-year paper, which does not have the benefit of rolling over, would have earned 19,50%. Only the buyer of the 3-month paper would have earned above-inflation returns.

Performance of the MSE in 2023…

In our 2022 review, we noted that; "Many *investors try to use the stock market, in this case, the Malawi Stock Exchange (MSE), to beat inflation or preserve value. Hence, whilst inflationary pressures and currency depreciation are bad news, share prices might rise with inflation as investors try to preserve value*".

The MSE was buoyant in 2023, recording increased volumes and values traded whilst the number of counters remained at 16. As represented by the Domestic Share Index, the MSE returned 70% in MWK terms and 4,5% in US$.

However, the gains were not acquired in a linear pattern. The market rallied strongly for the first nine months before plateauing. By then, it was clear that the market was overheating, and valuations were stretched. As an illustration, the average P/E on the MSE had reached 21,71x on 30 September from 15,21x at the beginning of the year. The market then slowed and regressed a little, with the P/E closing at 18,44x.



The same pattern is exhibited by the stocks which make up the index, particularly the two smaller banks which had rallied strongly in the first nine-month period. At the end of the year, the tally of the gains was as in the table below;

	2023	2022	MWK Return	US$ Return
FDH	70,00	17,37	302,99%	147,70%
NBS	114,90	34,00	237,94%	107,71%
NITL	409,99	124,99	228,02%	101,61%
FMBCH	315,00	110,86	184,14%	74,65%
NICO	150,40	60,00	150,67%	54,07%
ILLOVO	1 260,00	540,00	133,33%	43,42%
SUNBIRD	191,07	92,06	107,55%	27,57%
SBM	3 950,00	2 000,16	97,48%	21,38%
ICON	17,85	11,95	49,37%	(8,19%)
NBM	2 101,25	1 542,05	36,26%	(16,25%)
TNM	18,07	14,00	29,07%	(20,67%)
BHL	13,00	10,97	18,51%	(27,16%)
PCL	2 506,99	2 181,37	14,93%	(29,36%)
AIRTEL	60,00	56,64	5,93%	(34,89%)
MPICO	15,00	20,64	(27,33%)	(55,33%)
Domestic Index	**86 359,68**	**50 804,03**	**69,99%**	**4,48%**

1.) FDH Bank (303%)

The bank has been one of the best-performing stocks in 2023, supported by strong operational and financial results. According to its trading statement, for FY23, the bank expects profits of around MWK30bln, equating to growth of 31%, marginally ahead of inflation. Although the bank is the best performer, after peaking at MWK76, it did give back some of the gains beginning at the end of September.

2.) NBS Bank (237%)

Yet another stock which remained a top performer despite giving up some gains. NBS Bank reached an all-time high of MWK132 in Q3 before retreating to close at MWK114. Likewise, the performance was driven by a P & L profit surge, projected to be up between 50% and 64% this year.

3.) NITL (228%)

By its structure and operating model, NITL's performance is driven by the MSE gains and the dividends declared by investee companies. As the table of gains shows, capital appreciation has been robust in 2023 which will be reflected in the financials of NITL.

4.) FBMCH (184%)

The regional bank has advised the market that its profit growth is expected to be at least 24%, which is remarkable as the entity reports in US$. We also postulate that given its liquidity profile, FMBCH is overtaking Old Mutual as the foreign currency hedge on the MSE. The stock also allows investors to diversify away Malawi risk.

On the losing side, the wooden stick goes to MPICO which lost 28% on thin liquidity. The government of Malawi occupies a significant number of MPICO's properties, and that huge exposure might have spooked investors. In other economies, the government is a class A client, but given the state of the Malawian economy, the tenant has proved to be a late payer, and concerns are that the delayed payments are beginning to constrain MPICO's cash flows.

Airtel Malawi, a notable performer since its listing, was largely flat in 2023. However, the bottom fell off after the devaluation of the MWK as investors factored in the exchange losses on the US$33mln debt that is likely to hit the P&L. TNM is also likely to book some hefty exchange losses. After the devaluation was announced both stocks slid to close 40% lower than the pre-devaluation levels. The networks have since confirmed the investor fears; both are expected to report PAT losses for 2023, with Airtel putting the forex losses at MWK50bln.

2024 Outlook…

A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty. – Winston Churchill, Former Prime Minister of the United Kingdom

We believe economic pressures will be relentless in 2024, and real returns will remain negative in the money market. For the banking sector, we expect the earnings growth slow down projected in 2023, by the trading statements to continue in 2024.

PAT Growth	FDH	NBS	NBM	SBM	FMBCH
FY22 - Actual	97%	146%	34%	58%	51%
FY23 - Forecast	27%	50%	40%	20%	24%

The other sectors should also show similar patterns. Illovo remains a defensive position, whilst the mobile networks would be under pressure from disposable incomes and forex losses. This then makes stock picking and portfolio structuring of paramount importance.

Calculation of actual annual and real returns…

Equity markets have two classes of investors, namely institutional and retail. Institutional investors are mainly organisations with in-house skills or the capacity to hire or outsource investment expertise. Retail investors, on the other hand, also have two categories, with others utilising the skills and services of asset management companies and others being Do-It-Yourself (DIY) investors. The latter category, also known as self-investment – is when investors choose to build and manage their own investment portfolios.

The main idea behind investing is returns – making and growing the funds invested. It is not just sufficient to make money, but the return should be ahead of inflation – especially given the elevated inflation levels in Malawi - which ensures that real wealth is being created or at least preserved. The main reason for seeking to beat inflation is not to lose the initial capital's purchasing power; otherwise, the purpose of investing is defeated. The second aspect of investing is to beat or at least match the overall market or some accepted benchmark.

Most investors normally receive monthly or quarterly statements from their service providers, either stockbrokers or asset management companies, which detail in most parts the amounts invested, stock holdings and sometimes the current market value of the investments. Although this information is useful, it does not provide enough information about the returns that the investor is making.

In most cases, the statements provide information that enables one to calculate the price return of each holding in the form of the cost of each share and its current market value. In other words, this return works out to just the capital gain as it excludes dividends and sometimes ignores the aspect of time. For example, if the portfolio was set up in 2019, most statements will show the cost of purchasing the shares in 2019 and the current closing values in 2023. It is neither annualised nor broken into time periods. The gains or losses shown in the statement can be huge but meaningless if not compared with some benchmarks like inflation and the overall market. As such, investors must calculate annual returns to measure the progress achieved.

How does the investor calculate the return from the information provided?

In this piece, we propose a method which requires much front-loaded effort but becomes a simple task after that. It also does not require a lot of mathematical skills. The method is based on the *unitisation of the portfolio.*

Suppose an investor has a portfolio comprising shares and a small cash balance that closes on 31 December 2022 at MWK12,32mln. The first step is to unitise it by deciding the number of units to be created. The simplest is that each unit is worth MWK1000. This means that the portfolio has 12 320 units. At the end of March 2023, the portfolio received cash dividends, now sitting in cash and share prices would have moved up, down or unchanged. Suppose the portfolio is now valued at MWK16,55mln. There are still 12 320 units in the portfolio, meaning that each unit is now valued at MWK1 344, so the return in the quarter is 34,37% {((1344/1000)-1) x100%}.

This calculation is easy for a portfolio without monies being added or withdrawn from it. Otherwise, adjustments are required for cash deposits and withdrawals. The basic rule is that fresh external deposits, which are not dividends, increase the number of units, and withdrawals decrease the number of units. Suppose on 01 April, the investor deposits MWK500 000. This amount buys 372,116 units (500 000/1344), meaning that the portfolio now has 12 692,12 units, worth MWK1 344 each, thus valuing the portfolio at MWK17,1mln. The reverse would apply in the instance that the investor would have withdrawn MWK500 000.

In summary, the rise or fall in the portfolio's value, including cash, changes the unit price, while deposits and/or withdrawals change the number of units, not the unit's value. This is a simple way of tracking returns by tracking the unit price.

The second stage compares the earned return with benchmarks such as the MSE All Share Index or generally accepted hurdle rates. Suppose the MSE All Share Index change was a positive 29,44% in the quarter; the investor would have outperformed the market.

The third step is to adjust the return for inflation. The simplest definition of inflation is the sustained increase in prices for goods and services. This means that inflation can reduce the value or purchasing power of the investment portfolio over time. Inflation-adjusted returns refer to the gains or losses of the portfolio after factoring in the effects of inflation. For instance, the March 2023 annual inflation rate was 27%, meaning the inflation-adjusted return would be *34,37% (portfolio return) minus 27% equals 7,37%.* This means that the portfolio had managed to preserve value and create more wealth.

This unitisation method needs some tweaking and adjustments, which are not onerous, to cater for portfolios holding multiple assets such as shares, money market investments, foreign currency, gold, private credit, private equity investments, properties and collectables.

"Let no one be deluded that a knowledge of the path can substitute for putting one foot in front of the other."~ Mary Caroline Richards

In this regard, interested clients can approach Cedar Capital for more information on the quantification of annual returns.