Africa

The outlook for 2016

Sharat Dua, Lead Portfolio Advisor, Magna Africa Fund
looks forward to the year ahead after a challenging last 12 months

January 2016

2015 was a difficult year for African stockmarkets, and the New Year has started with more of the same. However it is at times such as these that excellent opportunities often present themselves, and with that in mind we seek to provide an update on the markets, the Fund's positioning, and remind ourselves of the African investment case.

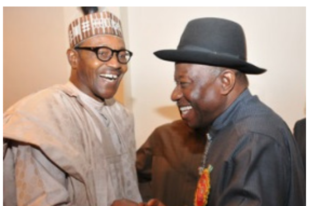
African stockmarkets have been under pressure in the general environment of US dollar strength, a Chinese slowdown, commodity price weakness, and emerging market vulnerabilities. In some cases there are obvious links, for example Nigeria produces 2 million barrels of oil per day, and oil revenue accounts for the bulk of foreign exchange receipts. Therefore the low oil price has unsurprisingly led to a halving of GDP growth and shortages of foreign exchange, which in turn has put a great deal of pressure on the local currency, the naira. Similar short-term pressures have been seen on a number of commodity producing frontier markets, for example Angola (also oil), Zambia (copper) and Mozambique (coal and gas). In all these cases the global situation is forcing governments to reconsider their economic policies and adjust their priorities. Currency devaluations have taken place, although more may be necessary. Nigeria will hopefully finally do away with the distortive fuel subsidies that cost up to USD 10 billion per annum. Local production is being encouraged by central bank policies designed to reduce demand for FX.

Egypt

The first market of significance is Egypt. Although certain stocks did extremely well last year, the overall picture was one of disappointment after a very promising start to the year, when businesses talked of growing investment for the first time since the Arab Spring, and infrastructure projects were being announced and funded. In the short-term Egypt will face difficulties, as the tourism industry suffers from the impact of recent terrorist outrages, and with the Gulf unable to provide the financial support to which Egypt has become accustomed. We suspect a further devaluation of the Egyptian pound is necessary. However we are comfortable that our investments are in high quality businesses, in industries that will not suffer as inflation rises and growth stalls. These are businesses in the healthcare, consumer staples and banking industries that have consistently grown revenues and profits throughout Egypt's turbulent recent past.

The Egyptian Exchange

Nigeria

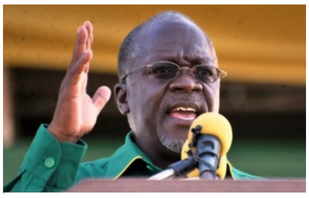


General Buhari and Goodluck Jonathan

While Sub-Saharan Africa has in general had a more difficult year from a macroeconomic perspective, there were further encouraging signs as far as politics was concerned. Nigeria surprised the world by voting General Buhari in as president ahead of incumbent Goodluck Jonathan, the first time in the country's history that an incumbent president has been booted out democratically. For all his failings, Jonathan also showed leadership and dignity in his departure. As we have identified the new president faces challenges, but has already begun to make progress in the battle against the terrorists of Boko Haram, and has similarly turned his attention to the battle against corruption, for example with the arrest of the previous oil minister. An austere man himself, Buhari took a long time to appoint a cabinet he could be confident would not let him down, but now has a number of big hitters with excellent track records in prominent positions.

East Africa

East Africa is in general a beneficiary of low energy prices, as for now the main countries remain energy importers. Real GDP growth remains north of 5% in places like Kenya, Tanzania and Uganda, and business confidence is high. These economies have also experienced currency pressures as a result of the global dollar strength, but unlike in 2011 the central banks responded promptly to choke off inflation. This may have led to a short-term deferral of some investments, but with rates now stable this is much preferable to the 2011 scenario where inflation spiralled out of control, forcing for example the Central Bank of Kenya to raise rates 11% in a matter of weeks. The medium-term investment outlook therefore continues to look strong.


President John Magafuli of Tanzania

Another new leader who has shown his intentions to battle waste and corruption is President Magafuli of Tanzania. Since coming to power in November he has cancelled Independence Day celebrations, instructing people to use the day off to clean their neighbourhoods and diverting the funds to fight a cholera outbreak, he has banned foreign travel for all public sector staff below the prime minister, and a number of officials have been arrested where corruption or negligence has been suspected. We are impressed with the potential of Tanzania and although it is not an easy market to invest in, we remain invested in Tanzania Breweries, even though the stock has gained 650% since our initial purchase.

South Africa


President Jacob Zuma of South Africa

Unfortunately political maturity is not yet all-pervading through the continent. We were reminded of this by events in South Africa in December, when President Zuma's meddling led to an outcome of three finance ministers in five days. There is no explanation behind Zuma's decision to fire the respected Nhlanhla Nene other than self-interest, as it is believed Nene had clashed with the president's cronies. After two days of market turmoil, Zuma was persuaded of the errors of his ways, and re-appointed Nene's predecessor Pravin Gordhan in place of the nobody he had initially appointed to replace Nene. We may come to look upon the events of December as the beginning of the end for Zuma, and hopes are high that Gordhan has come in with greater power than ever before to force through some much needed change.

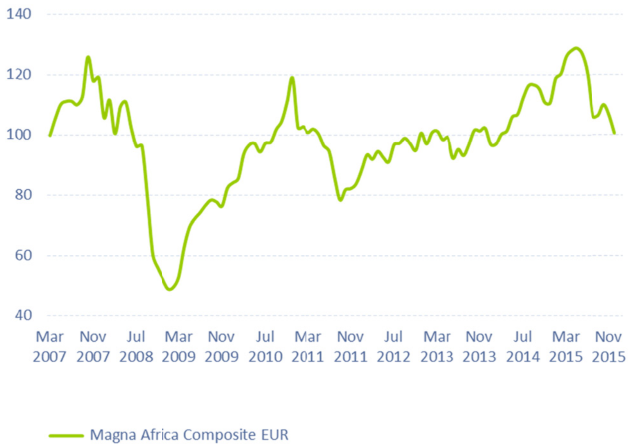
South Africa had already had a tough time, with commodity weakness and slowing growth leading to the rand losing 32% against the dollar. There is a strong possibility that 2016 will see the country's credit rating downgraded to junk status, while growth will be lucky to be much more than 1%. The macro picture looks uncomfortable in the short term. However within the South African corporate sphere are a good number of well run, high quality businesses, with management teams who have dealt with currency volatility, political uncertainty and sub-optimal growth before, and continued to drive earnings growth and returns for shareholders. This is where our bottom-up approach should come to the fore. In the past three months the market has sold off aggressively in rand terms, let alone US dollar, and valuations are now looking attractive. We see opportunities to build positions in those businesses that are best placed to navigate the choppy waters ahead, and South Africa remains our biggest market.

We have relatively low exposure to Nigeria at this stage, sticking to only the very highest quality companies. We have increased our holdings in East Africa to compensate, as mentioned earlier we feel that valuations in Kenya in particular do not reflect the expected earnings growth trajectory.

Outlook

Despite the negative headlines, Africa has been a clear bright spot for global growth and development over the past 15 years. Commodity weakness has come as a shock to some countries, but they have already started the process of adjustment, and if the end result is a more balanced economic profile, with in particular more diversified sources of government income and foreign exchange, this will be a good thing. Politics is improving, and the structural drivers of young, fast-growing populations and rapid urbanisation are here to stay.

Investors can access the African investment opportunity via Charlemagne Capital's Magna Africa Fund, the performance of which is shown below.



Period to 31 Dec 2015	Fund
1 Month	-5.7%
3 Months	-5.6%
1 Year	-9.2%
Annualized data:	
3 Years	0.0%
5 Years	-3.3%
Since inception (30 Mar 2007)	0.1%

Gross EUR

Chart rebased to 30 Mar 2007 = 100

Fund returns are based on a composite of all share classes

The Magna Africa Composite is based on all share classes of the Magna Africa Fund. Charlemagne Capital claims compliance with the Global Investment Performance Standards (GIPS®), as verified for the period 1 Jun 2000 through 31 Dec 2014 by Ashland Partners. A copy of the verification report and a presentation that adheres to GIPS standards are available upon request.

Source: Charlemagne Capital

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