

‘Working on safety - watching the market’

## The Africa perception gap

Source: Christine Senior - Professional Pensions.com, 06 Sep 2012



### **Christine Senior brings good news from Africa that some investors may have missed.**

For once a good news story is coming out of Africa. Parts of the continent have made huge strides in economic development in the last few years, making it an increasingly attractive target for external investors. Pension fund cash is beginning to head Africa’s way.

The IMF predicts output growth in sub Saharan Africa to rise to 5.5% this year, an improvement on 2011’s 5%. It is also confident that subSaharan economies will still produce solid growth despite current world economic uncertainties. According to the United Nations Development Programme in Africa, the continent’s growth could rise to 7% by 2015, driven by inflows of investment in infrastructure.

Africa’s prime attraction for investors is its positive demographics, which are expected to drive expansion in consumer industries. The population is young and growing, which should translate into an increasing demand for consumer goods. Claire Peck, client portfolio manager in J.P. Morgan Asset Management’s emerging markets equities team, says: “According to the UN, population growth in Africa to 2015 is forecast to rise faster than anywhere else in the world at a rate of close to 2.5%.

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Africa also carries low levels of debt compared to the developed world. The Paris Club, the organisation that seeks solutions to payment problems experienced by debtor nations, has enabled many African nations to reschedule or postpone their debt, resulting in a positive stimulant to growth.

However, generalisations are dangerous and mask huge differences across the continent. While hunger and wars are constant features, South Africa boasts Africa’s most developed economy with first world quality infrastructure, and a liquid and broad stock market. But it has

suffered from reliance on trade with the US and Europe, and its growth rate of 2% is among the lowest in Africa.

For pension funds, African frontier markets can be useful for portfolio diversification, as markets elsewhere are moving more closely into alignment. Russell Investments' senior consultant, Europe, Middle East and Africa, Lloyd Raynor says: "While emerging markets have become increasingly correlated to developed markets a number of frontier markets are less correlated."

But alongside the opportunities, Africa is also beset with difficulties. Investors must be prepared to embrace risk and to stick with the investments for the long term. The continent has a reputation for political instability and poor infrastructure, and its investment markets can be plagued by low liquidity, capital constraints, poor accounting standards, and lack of transparency from companies invested in.

#### **Low liquidity**

Lack of liquidity is a major issue, which alongside volatility, is a dangerous combination. Raynor says: "Clearly, low liquidity doesn't sit that well with the volatility of these markets. When sentiment is strong, liquidity rises sharply but it evaporates quickly if sentiment turns."

Corruption is a widespread scourge. Nigeria, Uganda, Ivory Coast, Kenya, Democratic Republic of Congo and Zimbabwe all appear in the bottom 40 countries ranked by perceived levels of public sector corruption by Transparency International.

In Nigeria, a source of problems is fraud in the oil industry. While the nation is an oil producer, it has no refineries so domestically produced crude oil has to be exported for refining then re-imported. When oil imports were heavily subsidised, inflated claims for subsidies cost the government dearly.

The problem has been substantially reduced as subsidies have been cut. Political risk is also a concern where democracies are still relatively young and fragile. But democracy is gradually spreading across the continent. Alongside the growth of democracy has been the growth of capital markets, which are expanding step by step.

Particular problems taint investment markets. One is that standards of disclosure and transparency still fall short of those in the developed world. Investec Asset Management portfolio manager Joseph Rohm says: "Disclosure at company level – the availability of financial statements and the degree to which accounting standards are adhered to is generally of a lower standard than in many other parts of the world. But that is improving and many companies have disclosure and transparency that is as good as anywhere globally."

One of the brightest stars in the African universe is Nigeria, where progress has been made on several fronts. An oil producer with an active stock market, Nigeria is a huge country of 160m people.

Its banking sector got a major boost when the government set up an asset manager, Amcon, to take toxic loans off bank balance sheets and at the same time took steps to reduce the number of banks. Now the sector is looking attractive.

"Amcon bought bad loans at discounted prices which enabled the banks to start lending again," says Insparo Asset Management portfolio manager Jamie Allsopp.

"The government cleaned up the banking system, and reduced the number of banks. Now it's a very good sector to be invested in with some attractively priced banks. And credit growth is increasing."

It is financials, consumer industries and infrastructure that are the sectors pulling in investor

funds. J.P. Morgan AM has a bias to financials, says Peck. "We have been adding back to Nigerian financials in particular.

As more confidence returns to the sector we have greater conviction that returns on equity will return to historical levels. We also have a very large overweight in consumer staples. That's a reflection of our longterm view of where opportunities lie. It links to demographic trends in Africa."

### ***Infrastructure***

A key theme for Investec is infrastructure, as governments focus on improvements. Rohm says: "We've seen governments spend a lot more on road, rail, and ports. We're invested in cement companies, and a rail company in east Africa. We see a theme that will grow because governments have realised they need to spend more on infrastructure." But it is the potential of consumer industries that is probably grabbing most attention.

Young expanding populations are driving demand for products and services that western consumers take for granted. "Consumption is probably the most dominant theme in Africa," says Rohm. "Consumption of beer and food is very low by global standards. We see middle class and discretionary spend growing. We have a number of brewers and food producers in the portfolio that play into that."

A constant flow of bad news stories is likely to have blighted perceptions of the continent. Wars, famine, HIV, piracy: these are the themes that dominate press coverage of Africa. But these are just one aspect of African life. A more positive story often gets lost to the rest of the world.