Bellevue Asset Management

Market commentary of April 4, 2017

Africa – signs of a turnaround

African stock markets have given investors little to cheer about compared to markets in the West, where central bank policies have propelled stocks to record highs, but it appears that they are now bottoming out. African economies and financial markets are expected to enter a more constructive phase driven by a recovery in commodity prices, the global glut of liquidity, and reform efforts. Egypt stands out as a positive example. Its main stock index surged more than 70% after a courageous package of reforms was passed. The country could serve as a model for the entire region.

African financial markets were not very rewarding for investors during the past two years. Foreign investors looking for positive returns in hard currency were clearly disappointed. They've been spoiled by the monetary policies of major central banks worldwide, which have supported asset prices in developed countries. African economies were thrown off balance by the global recession in 2008, not to mention political and social tension and commodity price shocks. Many of these countries reached their low points in 2016, as witnessed by the sharp decline in the value of their currencies.

Egypt's bold reforms

It seems that the worst part of the crisis is now behind us. We expect African economies and financial markets to enter a more constructive phase, driven by a gradual recovery in commodity prices, the still abundant global liquidity and the many reforms put in place by governments. Egypt recently embraced bold reforms. With the support and oversight of the IMF, its government passed a package of reforms at the end of 2016: The Egyptian pound was floated, scores of administrative barriers to investment are being eliminated and subsidies for electricity and fuel are being scaled back, the aim being to completely eliminate such subsidies over the coming years. Thanks to these reforms, the Egyptian equity market surged to life, ending a long period of trading at very depressed levels. The EGX30 index gained 76% in 2016, with nearly all of the gains coming after the reforms were implemented.

30% upside potential

The Egyptian stock market's returns in USD were nowhere near as good because the EGP lost more than 50% of its value against the USD, which made foreign investors wary of entering the market. However, there are numerous indications that the Egyptian currency overshot on the downside by more than 30%. Various factors should allow the currency to strengthen against the USD going forward: Increased gas production (new fields were developed during the past 12 months), foreign direct investment is growing (more than USD 3 bn since early November 2016), the trade balance will adjust to the new FX regime, and tourism is slowly making a comeback. The prospect of a stronger currency after the current phase of adjustment will give a strong boost to both the economy and foreign investor returns.

Huge shadow economy

Furthermore, economic conditions in Egypt appear healthier than what official numbers suggest. Banks are generating returns on equity in excess of 30%; some second-tier banks are still trading around book value with no signs of major risks in their credit books. Sales of real estate are breaking records despite sharply higher prices. Corporates exposed to infrastructure projects are booking record earnings. According to the CEO of one of the country's largest banks, conditions on the ground do not match the official economic data, as large parts of the economy are informal and not accounted for in the official figures. In his view, the informal economy is at least as large as the formal economy – meaning the actual size of the Egyptian economy must be twice as large to explain the level of activity he has observed.

Africa's financial markets have lagged the recovery seen in other emerging markets. 2017 might well be the year they close the performance gap. Egypt is a good example of a recovery from the doldrums and it could act as a model for other nations on the African continent.

Focus on reforms

Investing in African stocks is not easy and often impossible for retail investors. Bellevue has specialized in exactly such niche markets. Its BB African Opportunities Funds was launched in 2009. Experts hailing from the region invest in primarily reform-minded countries in Northern and Sub-Saharan Africa. Unlike many other providers whose portfolios are tilted toward cyclical and commodity stocks, the Bellevue team focuses its investments on structural growth opportunities. It follows a bottom-up approach and places a special emphasis on company transparency, liquidity, resilience to external factors and growth in its stock selection process. This gives the Fund an attractive risk/return profile compared to its peer group.

The investment fund is offered in euros, Swiss francs and dollars. Geographically, the portfolio's approx. 50 investments are currently concentrated in Egypt, Morocco, Kenya and South Africa. Financials, infrastructure, telecommunications and consumer goods are the dominant sectors. The fund's return for the past year is 6.6% and 44.1% since its launch in the summer of 2009 (in EUR, data as of March 31, 2017, ISIN B-EUR: LU 0433847240).

For further information please contact:

Bellevue Asset Management AG, Seestrasse 16 / P.O. Box, CH-8700 Küsnacht/Zurich
Tanja Chicherio, Tel. +41 44 267 67 09, tch@bellevue.ch

www.bellevue.ch

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