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African stocks markets are stepping out of the shadow of the developed world

Malek Bou-Diab, Lead Portfolio Manager, Bellevue African Opportunities (Lux)

Structural growth drivers and low valuations: As global monetary expansion comes to an end, the opportunity cost of owning African stocks has declined. Selected African markets are particularly well-positioned due to the underlying real economic growth and the forces of structural change.

Low potential returns, low market liquidity, at best an "exotic touch" for internationally diversified investment portfolios – most investors gave the African continent no more than a passing glance whenever major equity markets were booming. This was especially true in recent years when stocks in the developed world were clearly outperforming emerging market and frontier market stocks on the wings of ultra-loose monetary policy. Major central banks in the developed world really flooded the markets with cash after the outbreak of the coronavirus disease. Monetary and fiscal measures were ramped up to give the economy a boost. African countries were unable to take similar action on such a scale. This situation increased the opportunity cost of holding African stocks and explains why Africa has been absent in global asset allocation strategies for many years.

This has gradually changed ever since 2021, when stock markets began to price in the end of expansionary monetary policy. The Bellevue African Opportunities Fund (+8.3%) outperformed the developed markets (S&P500, +3.2%), emerging markets (MSCI EM, -6.7%) and frontier markets (MSCI Frontier, +2.3%) during the period from September 1, 2021 to April 29, 2022. In the absence of global monetary expansion, African equities look attractive compared to the valuations in developed markets because many African economies are in a very good position in terms of real economic growth. Top-quality African stocks are inexpensively valued.

Two key performance drivers

From an investor viewpoint, the African continent’s biggest plus point is that it offers access to two major themes: commodities that correlate with global cycles, and compelling local and structural growth drivers that are uncorrelated to such cycles. Companies and countries heavily engaged in the commodities sector profited from the strong recovery in commodity prices after the outbreak of COVID-19 and they have been Africa's top outperformers since May 2020. Conversely, markets with structural growth themes lagged the recovery trajectories of companies and countries with considerable commodities activities as the pandemic waned.

We have tactically modified the fund's investment approach and increased our exposure to commodities to benefit from the stronger positive momentum, but without giving up our focus on structural growth drivers. Our exposure to the commodities sector is currently 50%, compared to 28% at the beginning of the coronavirus crisis. We proactively manage this exposure in tandem with the prevailing momentum of global commodity prices. Our commodity exposure has delivered 65% of the fund's performance over the past year and yet our commodity exposure is still well below that of our benchmark, the Dow Jones African Titans 50, which was 70% as of April 2022.

Examples of structural growth

From a country perspective, Morocco is an interesting market because it is in a good position to benefit from the changes underway in global supply chains and to align its manufacturing sector more closely with the European continent. A good example is the country's successful integration into the European automotive industry. Because structural growth themes show the weakest correlation with global cycles, they can produce more sustainable and less volatile returns in the long run. Moreover, today's currently low valuations offer considerable long-term upside potential.

Commercial International Bank (COMI), Egypt's largest private bank by assets and customer deposits, is a good example here. Over the past ten years, the bank has increased its EPS by 13% p.a. The bank's ability to increase its profits has never been hampered by a crisis. Estimated EPS for 2022 serves as impressive proof of this. It is forecast to be 11% above the bank's pre-COVID-19 EPS in USD. And yet the stock is trading at a discount of 45% to its pre-COVID-19 levels, and at a historical low.

LabelVie is the second largest retailer in Morocco and a major beneficiary of the formalization of trade in the country, where informal trading accounts for 80% of total retail trade. It illustrates the high growth potential that is created when formal trading channels gain market share at the expense of the informal trade sector. LabelVie is expected to have almost doubled its EBITDA over the past five years by the end of this year and it is well-positioned to remain one of the fastest growing companies on the Moroccan stock exchange.

Conclusions

The two companies mentioned above are characteristic of our strategy of investing exclusively in liquid and marketable African stocks that are not exposed to any capital repatriation risks. Selected African markets currently offer outstanding risk-return profiles. Structural growth plays are trading at low valuations, particularly in Egypt and Kenya, and offer substantial rerating potential.

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Author

Malek Bou-Diab joined Bellevue Asset Management in June 2009 as portfolio manager new markets. He is lead portfolio manager for the BB African Opportunities Fund. Prior to that, he worked as investment specialist at Julius Baer, where he was responsible for managing an African equity fund. From 2003 to 2007 he worked as a quantitative risk analyst at Deutsche Bank AG in London. Between 1999 and 2003 he prepared his PhD thesis in theoretical physics at the Swiss Federal Institute of Technology Zurich (ETH). He spent a large part of his youth in the Middle East, where he received an international education and studied Arabic.

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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