# Experts needed in Africa Mutual Funds

If there are going to be exciting investment returns from Africa, the best way to get access to African equities for a retail investor has to be through a mutual fund (a unit trust, for example) w a dedicated African mandate.

By Stephen Cranston 7 Oct 2011

Trying to run a portfolio of African shares, with numerous stockbroking accounts, is not very practical and i expensive. Retail clients in most African markets would feel lucky to pay just 2% commission on deals.

And there is an even stronger case for diversification because of liquidity. In recent weeks, for example, Nigeria has traded about US$17m/day, Kenya $4m/day and Zimbabwe 2m/day. By the time it gets to less liquid markets, such as Ghana or Zambia, a good week's trade is $1m/week.

A cautionary tale for fund managers is New Star Heart of Africa, a UK-based unit trust that offered daily trading. But in the 2008 financial crisis it could not sell shares fast enough to pay out its unit holders. Eventually it had to sell its entire remaining portfolio at a deep discount.

Renaissance Capital took a bold step in allowing daily trading in its Sub-Saharan Africa (SSA) fund when it opened in October.

"It is much tougher to try to sell a whole month's demand in one go than allowing daily trading," says portfo manager Sven Richter

But the SSA fund (which excludes SA and North Africa) is recommended only to hard-core Africa investor

Others are steered towards the RenCap Frontier Fund, which is about 50% invested in Africa. "Kenya, Nigeria and Egypt certainly stack up well in valuation terms against the other main frontier markets such as Indonesia, Vietnam, Pakistan, Argentina and the Ukraine," says Richter. "In particular, I believe the pessimism about Kenya has been overdone. There has been a severe drought as well as anxiety about ne year's elections, but the share prices discount this and more."

Dylan Evans, who markets the Stanlib fund range in Europe, says many international investors don't disagr that there is a compelling case for investment in Africa but it is taking a while for them to act.

John Legat, who manages the Imara African Opportunities Fund, agrees. "Our clients in London are like rabbits in the headlights: they agree with our arguments but will not sign a cheque."

Memories of the New Star debacle are still fresh.

Investec has the best-developed Africa franchise in SA, with $1,5bn under management. Investec Africa fund manager Roelof Horne says though there is no lock-in to the fund - clients have the opportunity to get out of it once a month - they have almost all remained in the fund with at least a five-year view. It has been the middle of the pack of the Africa funds, 22nd out of 45 over five years with a negative 6% return in rand Even with Africa's high growth, external factors have hit the continent's shares.

Horne says he adopts a low turnover investment style, but that this does not make the fund a low tracking error fund. As it is there is no definitive Africa excluding-SA benchmark - both Horne and his main SA-base rivals, Coronation Africa Frontiers and Stanlib Africa, measure themselves against London interbank cash rates (known as Libor) rather than the performance of an index.

African markets are dominated by banks - which might be appropriate as a strong banking sector is essen for economic development.

It follows that most of the largest non-SA shares on the continent are banking shares. There are a few exceptions, such as Dangote Cement; Nigerian Breweries; the Senegal-based cellphone provider, Sonate and its Kenyan counterpart, Safaricom.

Horne has about 40% of his fund in banks as he believes they are almost all conservative institutions involved in straightforward corporate lending, with little exposure to potential consumerbased bad debts.

Banks such as Kenya Commercial Bank and its rival, Equity Bank, as well as Mauritius Commercial Bank feature in many of the mutual fund portfolios. And there is no doubt that the listed subsidiaries of Barclays and Standard Chartered in Botswana, Zambia andelsewhere provide investors with a level of comfort whe comes to governance standards.

Horne says that after the 2008 shakeup there are some promising bets among the Nigerian banks. He argues that the 2008 crisis, which led to almost half the country's banks disappearing in a huge consolidation, was a special case.

"One factor was that the price of oil fell in a few weeks from $150/bbl to 30/bbl. A core activity of the bank was funding refined oil imports and they took a big loss. explosion of margin lending to private investors w acquired a taste for stock market trading. They were paying 5% or 10% of the value of the shares and borrowing the rest. When the market collapsed in the 2008 financial crisis, banks were hit hard," says Horn

He believes that the Federal Bank of Nigeria's (the country's reserve bank) reaction to the crisis has been prudent.

There are certainly a number of blue-chip stocks on the Nigerian Stock Exchange, such as First City Monument Bank and Guaranty Trust Bank.

Peter Townsend, co-manager of Coronation's Africa funds, says the house has decreased its exposure to financials as they have performed badly recently.

"I don't believe African banks offer investors a great business model. Disclosure is poor, which makes it hard for us to know how well managed they are."

One of the dilemmas of Africa, Townsend says, is that some of the better-quality markets, such as Botswa and Morocco, are expensive, mainly because they are propped up by institutional investors subject to exchange controls.

Horne says the most exciting theme for Africa investors is growing consumer spending.

John Mackie, who runs the Stanlib Africa Fund, says that, historically, mines have been more exposed to threats of nationalisation than other businesses - whether it was Zambia in the 1970s or Zimbabwe today.

The Stanlib fund has investments in Zimbabwe such as brewer Delta, cellphone operator Econet, seed producer Seedco and retailer and snack business Innscor, but no mines there. But it does have a few miners in more benign climates, such as African Barrick in Tanzania.

Townsend is somewhat less timid. "Even if Zimplats is given zero credit for its indigenisation programme and you take the worst case, it still potentially has 100% upside."

Ten years ago, an Africa fund might have focused more on the continent's rich endowment of commoditie Yet there are few natural resources shares listed on African bourses other than those on the JSE.

"I do not want to invest too heavily into companies whose future depends on the global price of copper or iron ore rather than on Africa's unique economic fundamentals," says Horne.

One of the ways to reduce risk might be to invest in SA companies with exposure to Africa. But only a few would qualify in comparison with most of these funds as more than half the turnover should be accounted from Africa outside SA. MTN is one of the few SA blue chips to qualify.

Even Shoprite and Standard Bank, which have been successful in Africa, do not qualify.

Fungai Tarirah, who runs the Momentum (previously RMB) Africa Fund, has the mandate to invest up to 15 in SA but chooses not to, as it is not what his clients are looking for.

He warns that Africa is particularly vulnerable to external events - the Egyptian market fell 21% in the wake the revolution. But, he says, "It is essential not to panic about these prices in the short term."

To maintain liquidity, the fund invests only in shares with trade of more than 100m a quarter, and this mean can only invest in a universe of 90 stocks.

Tarirah says Kenya provides the greatest variety of shares in which to invest, including Africa's only listed mainstream advertising business, the Scan Group.

Old Mutual was one of the latecomers to the Africa party. Its fund is about a year old.

"It all depends on when you launch the fund," says fund manager Godwin Sepeng. "When we started, ban and cellphone companies were cheap. The consumer story sounds great, but with Unilever and Nestlé's Nigerian businesses and breweries such as Guinness Nigeria on p:es of more than 20, they were not offering good relative value."

Imara's Legat says it can take years to build up a portfolio, particularly when looking at positions in promisi but illiquid markets such as Ghana. "Whatever happens to the world economy, people will want to drink an smoke, which is why I like shares such as BAT Kenya, BAT Zimbabwe and breweries," he says.

As Legat is based in Harare, he was one of the few managers bold enough to hold Zimbabwe shares throughout the inflationary times, and his fund was rewarded in the aftermath of dollarisation in Zimbabwe.

But Legat is digging in for the long haul. "The key to Africa is water but, as a fund manager, I need to translate that fundamental truth into investment success."

*Source: Financial Mail*