MEMO FROM THE CIO

The pendulum is swinging to a happy middle

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Last year saw the unprecedented, unforeseen effects of Covid-19 cut a swathe through unprepared and ill-equipped global markets, bringing economies to their knees. The year 2020 will be forever etched, not only on Ghana's memory, but on the entire planet's collective consciousness. In fact, so deep does the impact remain, that individuals, companies, countries and the whole globe generally are already referring to 2020 as a worldwide marker against which a New Era, a New Normal, is being measured.

Against this backdrop of doom and gloom, we inevitably compare 1Q2021 with the corresponding period last year.

In a sharp contrast, the first three months of the year have been a happy one compared to twelve months earlier, with Ghana able to report on some noteworthy, albeit cautious, milestones.

Cautious milestones

During 1Q2021 Ghana achieved a number of milestones that we can count as significant, among them the successfully adjudicated 2020 presidential election dispute by the Supreme Court of Ghana; implementing a successful vaccine rollout that remains on course; and to the elation of the school-going children, schools were once again opened, and students were able to return to in-person schooling and interaction with their classmates.

However, our guard must not be lowered, as the second wave of the pandemic doubled the number of Covid-related deaths from 336 at the beginning of the year, to 752 to date.

The upswing from gloom during this quarter fueled investor optimism for the year, reinforced with the twin rally in local equities and bonds, creating excitement and expectation. Nevertheless, once again we must remain cautious, as this remarkable performance was achieved with little improvement in the real economy. The local market is now approaching a midpoint where assets are reasonably priced, amid the current low-interest-rate trend across the globe.

A sense of optimism and relief driven by the vaccine rollout is spurring the quest for bargains which were so readily available in 4Q2020. Returns of 7.9% and 14.0%, respectively, in the bond and equities market elevated Ghana's status to that of one of the best-performing markets in 1Q2021. The rally was on account of an estimated USD 1bn worth of portfolio inflows into the local market, resulting in a relatively stable Ghana Cedi, thereby topping the chart as the best performing local currency in Africa during the period.

As the local market eases towards a happy middle line, Ghana's fiscal structure will have more influence on investor sentiments than monetary policies.

Finding a new, improved fiscal solution to the economic reality

While reaction to the vaccine rollout in the early phase created a market sprint, on the other hand, according to the recently presented 2021 budget statement, the long-term economic recovery from the effects of the pandemic will be a slow and arduous journey until at least 2024, as Ghana is unlikely to achieve the return to its 5% fiscal deficit rule.

There are standard methods to explore creating fiscal space, including raising taxes, securing outside grants, cutting lower priority expenditure, borrowing resources (from citizens or foreign lenders), or borrowing from the banking system.

To help expand its fiscal space, Ghana has introduced several tax initiatives, including increased consumption taxes and a 5% levy on banks' profit.

With these strategies in place, it is estimated that the new tax initiatives could increase the country's revenue by GHS 4.6bn (~USD 800m) in 2021. Introduction of new taxes and other revenue measures could help Ghana reduce its cash deficit from 11.7% to 9.5%, according to the 2021 budget statement. Given the post-pandemic uncertainties however, the country's revenue projection of GHS 72.5bn (USD 12.6bn) for 2021 could be overly aggressive and maybe a little too optimistic.

Bearing this in mind and given the country's limited fiscal space to raise debts, a cutback on the projected expenditure of GHS 113.8bn (USD 19.8bn) for 2021 is likely, if the country fails to achieve its revenue target.

Weighing in on the debt debate

Ghana's debt remains high on account of several influences, including two consecutive years —2018 and 2019 — following expansionism policies, energy sector related debts, a financial sector clean-up, and the devastation wreaked by the pandemic. Today, the country's debt is 76.1% of GDP, of which interest payments accounts for 49.5% in 2021's projected revenue, the highest expenditure ticket on the list.

While there are many challenges to reducing national debt, however, the current low-rate environment offers the opportunity for debt recalibrations. Therefore, it is not too surprising that Ghana became the first EM country to issue a zero-coupon Eurobond, as reinvestment risk continues to override credit risk.

If we were experiencing 'normal' times, the country's rising debt levels could result in currency depreciation as the threat of default looms and foreign investors sell government bonds to repatriate their hard currency. The market, however, is flooded with cash in an environment of ultra-loose monetary policies. As a result, an asset price bubble is also looming as more money is chasing fewer ideas.

Given that this new normal is likely to persist until the year 2023/2024 — when the US Federal Reserve hikes interest rates — Ghana has a window of opportunity to rebuild its fiscal structure before the axe falls.

It is in this heightened atmosphere that the technical adviser to the Finance Ministry, Dr Samuel Nii Noi Ashong said, *"If you look at the Budget, Covid-19 is not expected to abate until the end of 2023... and we're all looking to be tightening our belts for a while."* In addition, the Finance Minister even went so far as to describe the budget for 2021 as a *"battle cry"*, spurring Ghana to action.

Simply put, the time is *now*; now is the time for Ghana to put flesh to the president's words when he said, "*We know how to bring the economy back to life*." Ghana has at least 24 months to put its house in order before the global market returns to normality, with rising debt levels weighing on the local currency, *ceteris paribus*. The risk is that while we dance in the glut created by an expansionary monetary policy, Ghana may be caught on its backfoot as the 'music', in terms of liquidity, might stop unexpectedly.

The million-dollar question put to every investor is: How much premium are you willing to put on this risk?

Aggression or defence?

In my previous missive, dated 15th October 2020, I commented thus: "*the distribution of potential economic scenarios over the next 12 months is unusually broad*". In this light, I advised investors to build "*portfolios that can withstand a range of future paths*".

However, the first-quarter rally means that the risk-adjusted return of most local assets is closer to their equilibrium than six months ago. With bargains in the local market thin on the ground, the range of future paths remains limited.

If we look at today's low-interest-rate global environment, where USD 18 tn worth of bonds offer negative yields, by comparison, our local asset prices are neither cheap nor expensive.

Therefore, in view of the local currency remaining relatively unchanged for the year, implementing a passive-aggressive approach would make most sense for investors, adapting their portfolio strategy accordingly, dependent on prevailing market conditions.

Today's Covid world is more nuanced, fluid and unpredictable, and therefore requires flexible thinking and nimbleness of mind to navigate risk, while achieving the desired returns.

How did we position our portfolio amid a passive-aggressive stance?

At IC Asset Managers, we believe that Ghana is an illiquid market, with few participants and a low volume of activity, driven by sentiment and foreign investor flow. We tend to buy into weakness and sell into strength. This counterintuitive sentiment is expressed by a client when he asked*: "What is the strategy that necessitates the sale of a performing stock?"*

Markets are akin to a pendulum, swinging from one end to the other, never static and always moving, creating uncertainties and an inability to accurately foresee the market's future. Case in point is the unexpected arrival of the global pandemic.

Our key tactic in this shifting landscape is to diligently select bargains when the market bottoms, and reduce our position when prices soar. The risk here is that we may sell prematurely. That said, we are comfortable with this approach, rather than being overly acquisitive and losing everything when the market peaks.

Following this strategy means that when market excitement *does* peak, we tend to hold very little of our position. This stance recently resulted in us selling some of our longer-dated treasury bonds when yields dropped, from 21.5% in December 2020, to 19.65% in March 2021, which translated into price appreciation. When the yield curve bottomed out, we invested the proceeds at the midsection, affording us more room to appreciate than at the longer end of the curve.

Our apparently capricious strategy remains the same for all other assets, including equities and Ghana Eurobonds.

On Ghana Eurobonds, during the quarter, when the bond price reached 104, we sold most of the positions and bought back the same bond at 94. Given the positive correlation between US Treasury yields and the yields on EM debts, including Ghana Eurobonds and the pickup in US Treasury yields, we are confident that Ghana Eurobonds are reasonably priced, compared to the start of 2020.

Owing to the potential yield pickup in US Treasury yields however, the upside potential of Ghana Eurobonds is capped. Nonetheless, local investors may mainly hold Ghana Eurobonds as a hedge against local currency depreciation if the Ghana Cedi disappoints expectation for a strong performance in 2021.

Coming as a pleasant surprise this quarter, the local equities market returned 14.0% compared to -4.3% twelve months earlier. This performance, however, can be attributed to the price appreciation of MTN Ghana, which has a market weight of 18.2%.

In line with our strategy to sell into strength, we sold some of our MTN positions as the price soared from a year opening of GHS 0.7, to the current price of GHS 0.85. Outside of MTN Ghana and a few counters — which have attracted foreign investor attention — equities will continue to struggle this year, as the fragile macroeconomic environment continues to cloud the equities market.

Conclusion

While the first three months have set the rest of 2021 off on a sound and almost idyllic footing, we must caution against ambivalence and banking on a continued bullish run, as this scenario is not permanent. We must prepare for the next market disillusion and take some profit off the table while hoping that the environment does not change too radically in the interim.