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MEMO FROM THE CIO

2H2021: From Sprint to Crawl…

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After an extraordinary 1H2021 high, the next half of the year will be a lot more sobering following on from the glut created by an expansionary monetary policy, with the sprint slowing to a crawl as we approach the end of the year.

The writing is already on the wall, with the vaccine supply crunch, gridlock in the local rates market, and rebalancing of global risk themes. As seen in the first few days of 2H2021, some lofty valuations in the rates, equities, and credit market will be challenged as a more temperate reassessment occurs.

Against the backdrop of this strong rally in almost all local asset markets, our thinking continues to be shaped by the pandemic and the anticipated subsequent economic rebound on the wheels of global monetary easing. Since our views remain extremely sensitive to the virus and its subsequent mutations, we will continue to pivot agilely between chasing a few points and protecting our gains.

Our default setting as a safety-first money manager is to ponder over what could go wrong, rather than what could go right. At IC Asset Managers, we hold the view that you are set up for a win if you can handle what could go amiss. With that caveat in place, three themes will occupy the attention of today's investors.

Theme 1: Uncertain vaccine supply could shift the pandemic from a humanitarian crisis to only a poor man's problem

To date, 2.5 billion people globally have received Covid-19 jabs, with 748.0 million fully vaccinated, representing 9.6% of the world's population. However, the African landscape is cause for concern. While 41.0 million people have received jabs, only 15 million are fully vaccinated, reflecting 1.2% of the continent's population. Ghana is no different from the larger African picture as 1.2 million have received at least a Covid-19 jab, but only 381 thousand people are fully vaccinated, representing a mere 1.3% of the country's population.

Global support to vaccinate the most impoverished countries against the Covid-19 is waning as the impact of the pandemic shifts from developed to developing countries. So far, the COVAX initiative has delivered 45 million vaccines out of a target of 2 billion, which paints the picture of donor fatigue as developed countries ramp up the vaccination of their citizens. The slowdown in vaccine supply is widening the vaccination gap and shifting the pandemic from a humanitarian crisis to a poor man's problem.

With new variants circulating, low vaccination take-up, population fatigue in adhering to preventive measures, and the easing of restrictions, conditions are ripe for a resurgence of a virus hotspot. The Ghana

Health Service has already confirmed 137 cases of the Delta variant in one of the country's premier high schools, raising alarm bells of possible community spread. As seen in South Africa and other countries, the new variants are more contagious and could pull the reigns on the country's attempt to recover from the economic havoc wreaked by the pandemic.

With Ghana's fiscal prospects tenuous, Fitch's revised long-term outlook for Ghana came as little surprise when the credit agency downgraded Ghana to negative from stable while maintaining a B rating. Consequently, a third wave of the pandemic amid a vaccine supply crunch could further add to the country's woes. Now more than ever, Ghana cannot endure additional shocks. On the contrary, the external environment needs to stay favourable to ensure Ghana's growth recovery.

Theme 2: Tightening liquidity taps could leave investors parched

During 1H2021, despite rising debt levels, the rates market witnessed a surge in bond prices, suggesting no limit to investors' appetite for bonds. However, in the past few weeks, markets have traded under pressure, with both the local rate and currency market showing some vulnerability, as growth in debt levels and the size of net issuances have ballooned, offering little wriggle room.

The first week of July 2021 witnessed this stampede when Treasury Bill auctions fell short by 37.0% as the Ghana Cocoa Board flooded the money market with a GHS2.7bn (USD 457.6m) issuance of a six-month paper at 17.3%. The size, high rate of 17.3% and short tenor of six months of the cocoa bill, unsurprisingly wiped liquidity from the local market. This was expected, considering that the three-year Treasury bond was selling at 16.8% at the time of this issuance. The resultant effect has been Treasury bond yields increasing by about 75bp with a further domino effect of a bear run commencing in the same period.

The decline in bond prices resulting from the high yields alarmed some offshore investors, slowing portfolio inflows. Coupled with corporate profit repatriation, this has pressured the local currency, leading to the USDGHS exchange rate briefly touching GHS 6.0. If the liquidity flow lessens, the uncertainty in the rates and currency market could dull bourse enthusiasm.

Until the annual Cocoa syndicated loan of about USD 1.5bn releases cash into the local system, we believe that the liquidity crunch will continue to dominate the local market until September or October. In real terms, private sector credit has contracted since the beginning of the year with an annual growth rate of -3.0%, -2.7%, -5.0%, and -1.5% month to month from January to April, respectively, a direct consequence of the economic havoc wreaked by the pandemic.

However, as economic activities specifically within imports ramp up, we expect heightened lending activity. As Ghana potentially reverts to a degree of normalcy, banks will either slow down their purchase of government securities or unwind a few positions to fund lending. A slowdown in trading activities is already evident, with May 2021 recording the lowest trade value since the beginning of the year — GHS 13.5bn (USD 2.3bn).

While the government forecasts a slowdown in net issuance for 3Q2021, we believe that this would not suffice to ease investors' liquidity burden. The reason being pension funds have already breached their regulatory limit of 60% allocation to Treasury securities.

In our estimation, the monthly contribution to the pension industry is ~GHS 400.0m (~USD 68.7m), of which 70.0% is invested in treasury securities. Therefore, the local pension industry is not big enough to supply adequate liquidity to the market, exacerbated by offshore investors remaining on the sidelines as developed markets strive to adjust global risk.

As it stands now, the portfolios of all three active participant types in the domestic rates market — local banks, pension funds, and offshore investors — are replete with government bonds. Hence, there is a limit on price discovery in the local rates market, given the unending supply of Treasury securities.

Theme 3: Rebalancing of global risk themes underpins a choppy market

Despite the strong rebound from the COVID-19-induced economic contraction, policymakers from the major economies continue to offer strong fiscal and monetary stimulus resulting in revised global growth projections. The International Monetary Fund (IMF), in its updated report in April 2021, increased its global GDP growth forecast for the year to 6.0% from its projection of 5.5% at the beginning of the year. In tandem, driven by robust growth out of Asia, EM growth projection also increased by 0.4% to 6.7%.

With the advent of summer in developed economies, the global economy will maintain its growth trajectory in the second half of the year. Growth will be driven by pent-up consumer demand and the eagerness to regain normalcy as societies reopen and consumer confidence returns — all contributing to increased spending. However, many of these factors are already baked into global market prices. We believe that the inflection point will occur when the U.S. Fed slows down its asset purchases and ultimately unwinds its positions in the market. A slowdown in asset purchases could begin in either 4Q2021 or early 2022, as both the Bank of England and Bank of Canada have all reduced their weekly bond buying. The world awaits the next steps for the big three of central banking: the U.S. Federal Reserve, European Central Bank, and Bank of Japan.

While it is expected that the major central banks will eventually unwind bond purchases, the shift from monetary easing to monetary tightening could unnerve global markets, especially frontier markets like Ghana. International investors will remain vigilant around the challenges posed by the combination of an uneven global economic recovery, a vaccine supply crunch in developing countries, and the doubts surrounding global policy rate hikes. Consequently, we expect this conundrum to dominate the thinking and perspective of frontier market investors as they chart the path towards a potentially hawkish monetary environment in the next 12 months.

IC Asset Managers shares in this conundrum; with this consideration in mind, how have we positioned the portfolio?

Despite the fiscal unsteadiness, local market rates, currency, and equities delivered outstanding performances during 1H2021, with returns of 13.8%, 0.6%, and 36.6% respectively. While our outlook for 2H2021 remains constructive, we must be wary of being overoptimistic based on the recent market performance, as the underlying macroeconomic environment requires significantly more work than estimated.

As markets rallied on a monetary glut from local and offshore investors, we envisage increased volatility by year-end. Therefore, our portfolio duration remains on the cautiously low side of 2.0 years while limiting exposures to credit and equities. That said, we will continue to look for short-term air pockets that could create longer-term investment opportunities for our clients.

On rates, Ghana Eurobonds will continue to move sideways as the exact nature of a potential FED tapering remains speculative. This, together with the relative steadiness of the Ghana Cedi, tilts us towards local currency bonds, especially at the front end of the yield curve. As we seek a hefty safety margin for our clients, we will only sell shorts to buy long when the curve steepens.

In real terms, banks' contraction of private-sector lending is a direct fallout from the pandemic, which has deteriorated credit risk in the local market, leaving us with a weak appetite for credit assets. We are, however, open to credit opportunities that add value to our clients' portfolios.

With the risk of contestation, I will venture to say that the three-year losing streak of the local equities market has officially ended, with the surprising return of 36.16% for the first half of the year. The market liquidity has improved with the rally in MTNGH's 85.5% capital gains, which seems to have lured local investors into the equities market, making it easy for us to exit a few less favourable names. However, we look forward to adding undervalued counters that have not yet caught the market's scrutiny. The cue will be the stock's dividend yield and whether it can offer sufficient cushion against local currency depreciation. Given the depth of the market, much patience is required to acquire the best deal for clients.

We remain positive but patient

We live in extraordinary times where both lives and livelihoods are at risk from the scourge of an unseen virus. The last eighteen months have been testing for investors as we adjust and pivot to the 'New Normal'- monetary glut amid fiscal uncertainty. At IC Asset Managers, we have had to learn, unlearn and relearn while demonstrating agility and adaptability to best serve our clients.

Although the strong rally in 1H2021 lifted the mood of investors, valuations in some areas of the market remain stretched. Hence, we expect the emerging threats of a local liquidity squeeze, rebalancing global risk themes, and a third pandemic wave to serve as a speed limit for the local market in its upward trajectory.

While this could seriously test the pulse of investors in 2H2021, we urge investors to exercise patience during the choppy time, as the crawl after the market sprint is not enduring and the race is not yet over.