AFRICA | PORTFOLIO INSIGHTS | REVIEW & OUTLOOK | STRATEGY

PORTFOLIO REVIEW-IC AFIF

2Q2023 REVIEW: RISING TIDE LIFTS ALL BOATS

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IN BRIEF

- Three themes were dominant over the course of the second quarter: policy response that was data dependent, debt-ceiling debacle, and commodity sell-off. Bond indices, and our IC Africa Fixed Income Fund, whipsawed in the second quarter but closed in a much-improved shape.

- Data dependency has been policymakers' guiding principle although other undertones as was the case with the US debt ceiling debacle strengthened the hand for policy pause, even amidst historic high inflation level. China's economic slowdown more than offset the announced OPEC+ production cut, resulting in relatively weaker global oil price in the second quarter.

- Risks somewhat faded in the quarter, with debt-restructuring progress for Ghana and Zambia under the Common Framework. The market cheered the progress as the Zambian Kwacha emerged as the region's top performing currency (+20.8%) whereas Ghanaian Eurobonds (+18.5% average price return) had a terrific run in the second quarter.

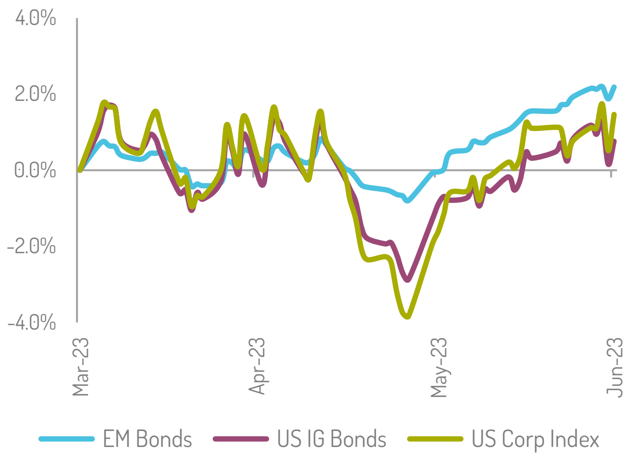
- The return of FX orthodoxy in both Angola and Nigeria resulted in currency dislocations in those economies. Nevertheless, the point of divergence is the policy response as the former has embarked on an easing path whereas the latter is expected to maintain a hawkish bias.

- Our IC Africa Fixed Income Fund (IC AFIF) returned -2.0% YTD compared to 0.4% YTD by our relative benchmark S&P Africa US Dollar Sovereign Bond Index at the end of 1H2023. Our underperformance against the relative benchmark is partly explained by our lack of exposure in lower-rated sovereigns (below B+) such as Egypt, Ghana, Nigeria and Zambia, whose USD bonds rallied in the review period. We bought our first corporate bond exposure, which trimmed the sovereigns to 60.0%. Across sovereigns, we had our first voyage to East Africa region to expresses our conviction of the sub-region's relatively higher growth prospects.

- The tea leaves off recent Federal Open Market Committee suggests the end of tightening bias is nigh. This should give a lift to emerging markets as they seek some form of equilibrium. Furthermore, this should be supportive of local currency positions that we are currently screening. Our cash allocation allows us some degree of tactical flexibility for some convincing opportunities during the quarter.

Three themes were dominant over the course of the second quarter 2023: policy response that was data dependent, debt-ceiling debacle, and commodity sell-off. Bond indices, and our IC Africa Fixed Income Fund, whipsawed in the second quarter but closed in a much-improved shape. Data dependency has been policymakers' guiding principle although other undertones as was the case with the US debt ceiling debacle strengthened the hand for policy pause, even amidst historic high inflation level. The debt progress in Ghana and Zambia were refreshing and a return to FX orthodoxy in Angola and Nigeria, although positive, led to currency pain points. That said, these pain-now gain-later emerging themes across the African macroeconomic landscape gives us tactical opportunities of adding carry to our portfolio as risk sentiment improves.

SELECT BOND BENCHMARK INDICES'

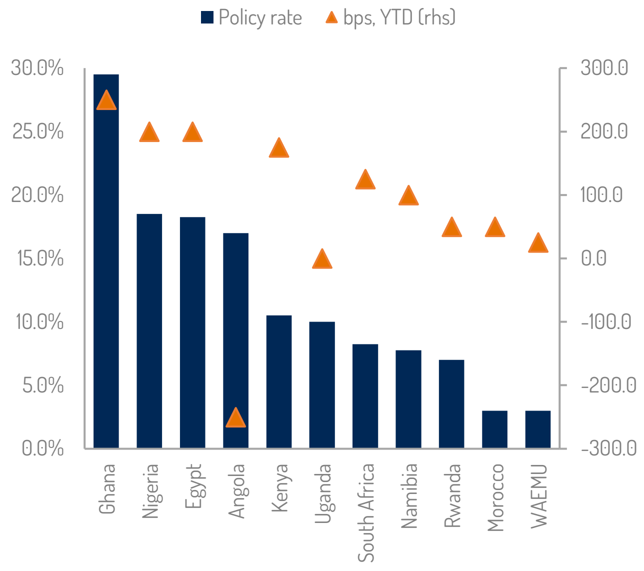


SOURCE: BLOOMBERG

Data dependency; policymakers' toolkit in inflationary fight

Data dependency remained dear to policymakers' response to fight off inflation. We think this ideology warranted some merit amidst a "higher for longer" inflation environment. Policymakers are inclined to protect their credibility, more so in the current tightening cycle that has heightened the expectation of economic slowdown further down the road. Faced with this dilemma, one can understand the proclivity for signals that may warrant a change in course. With the inflationary genie out of the bottle, African policymakers were firmly entrenched in their tightening bias, with a possible exception being Angola.

SELECT YTD POLICY RATE (END 1H2023)

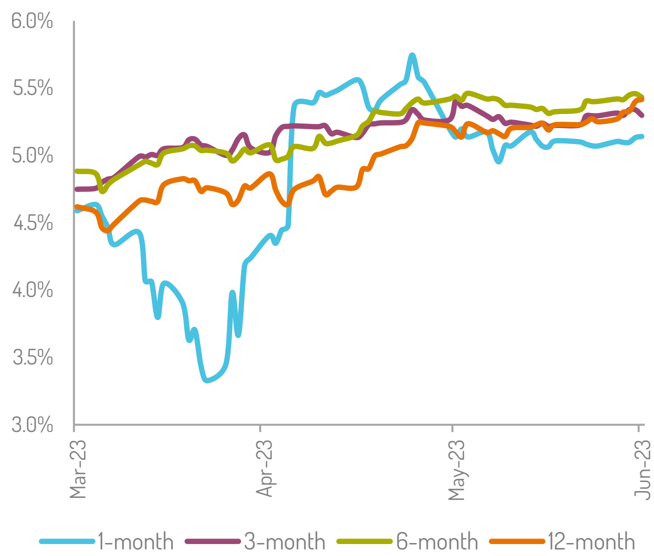


SOURCE: Various Central banks

Debt ceiling debacle proved a time sink

Data dependency was not the cardinal principle and the 'skip' decision by the US Federal Open Market Committee in June 2023 cements this point. There is an argument to be made that the underlying data for policymakers' response is in the rearview mirror. Extrapolating this idea, a fair degree of judgement was baked in by the policymakers. But the debt ceiling overhang that engulfed the US added a nuanced backdrop to the June pause decision. As per recent history, the self-imposed debt ceiling debacle proved to be a time-sink; with a deal struck between President Joe Biden and House of Representative Speaker Kevin McCarthy. This episode of brinkmanship resulted in volatility for short-term US T-Bills.

YIELDS ON US TREASURY BILLS

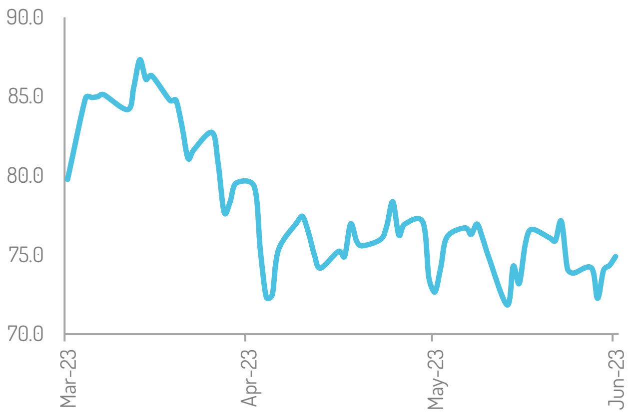


SOURCE: BLOOMBERG

China economic slowdown more than offset OPEC+ production cuts

More broadly, the oil sell-off (-4.7%) in the second quarter of 2023 came as a surprise juxtaposed with the news flow coming off OPEC+. In April 2023, the Cartel announced a 1.15mn oil production effective May 2023 to anchor global oil price higher. In June, the Cartel doubled down with a pledge to extend the oil production cut into next year. That notwithstanding, the commodity price eased, reflecting a more subdued global economic outlook, more so in China. Economic release from China suggested a cooling of the hitherto much-hyped China re-opening tailwind. Chinese manufacturing PMI remained in contractionary territory – below 50.0 neutral mark – throughout the second quarter, signalled muted commodity demand and sniffing out oil price rally.

BRENT CRUDE PRICE (USD, PER BARREL)

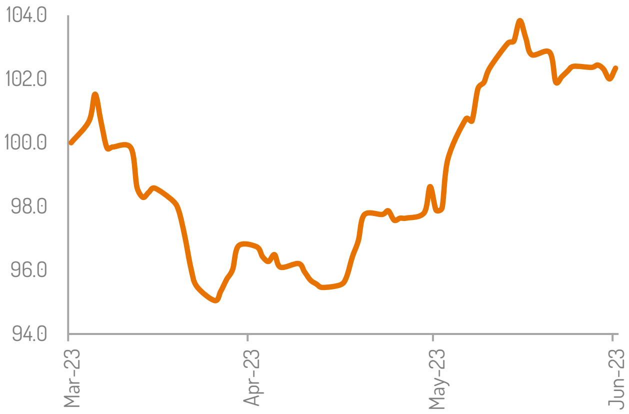


SOURCE: BLOOMBERG

Improved fiscal backdrop although cautious on Kenya and Egypt; return to orthodoxy FX policy in Angola and Nigeria

Risks somewhat faded in the quarter under review, with debt-restructuring progress for Ghana and Zambia under the Common Framework. The market cheered the progress as Zambia Kwacha emerged as the region's top performing currency (+20.8%) following the sovereign's deal to restructure its USD 6.3bn bilateral external debt after previous false starts. Ghanaian Eurobonds had a terrific run in the second quarter of 2023, printing an average 18.5% return in the review period. Morocco (USD 5.0bn) and Senegal (USD 1.8bn) were notable African economies that secured financing arrangements under IMF programmes in the period, bringing the tally to 28 African countries under an IMF programme. East Africa and Egypt announced their FY24 budgets, that have been effective from July 2023. Kenya's Finance Act 2023 although on track belatedly is to be determined substantially by a three-judge High Court bench which may dent its revenue mobilization prospects. Although Egypt announced USD 1.9bn privatization plan, the somewhat open-ended timeline suggests a further derailing of an IMF programme review.

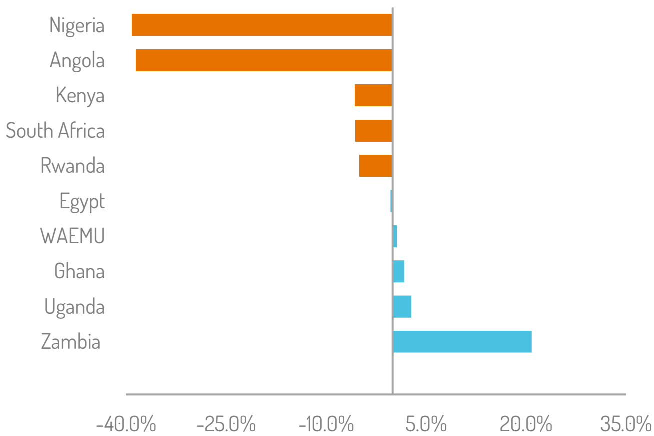
S&P AFRICA SOVEREIGN USD BOND INDEX (USD)



SOURCE: S&P AFRICA SOVEREIGN BOND INDEX

In Nigeria, President Bola Tinubu's new administration has ushered in the much-needed reforms. Notably, there were removal of fuel subsidy and FX reforms with convergence in the official and the parallel market rates at a much faster pace of implementation than anticipated. The exercise has not been a free lunch with the Nigerian Naira emerging as the region's laggard (-39.1%). Angola Kwanza (-38.5%) followed suit as the monetary authorities abandoned currency support amidst rising external debt servicing costs. Notwithstanding the currency dislocation, we flag policy divergence across the economies with Angola slashing its policy rate 250bps in 1H2023, whereas Nigerian authorities increasing its rate by 200bps in the similar period. South Africa's foreign policy uncertainty together with anemic real GDP growth knocked the Rand to record low at 18.5 level against the greenback.

AFRICA CURRENCIES PERFORMANCE IN 2Q2023



SOURCE: BLOOMBERG

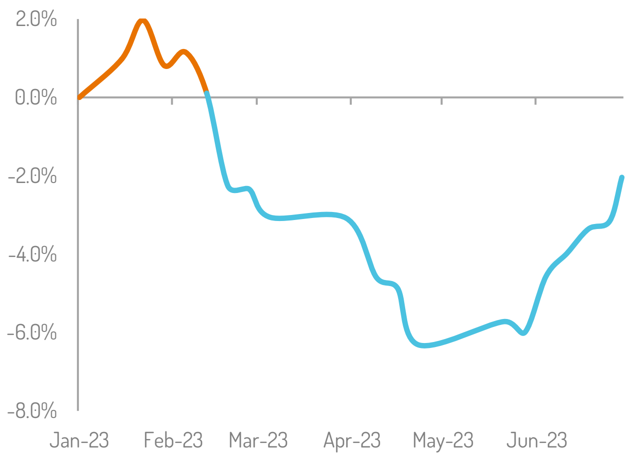
2Q2023 Performance Review: Clawing back gains

Our IC AFIF returned -2.0% YTD compared to 0.4% YTD by our relative benchmark S&P Africa US Dollar Sovereign Bond Index at the end of 1H2023, clawing back gains after wild swings in April - May against a challenging macroeconomic backdrop. Our underperformance against the relative benchmark is partly explained by our lack of exposure in lower-rated sovereigns (below B+) such as Egypt, Ghana, Nigeria and Zambia, whose USD bonds rallied in the review period. We bought our first corporate bond exposure – VIVO 5.125% 2027 – that trimmed the sovereigns pot from 76.5% in 1Q2023 to 60.0% in 2Q2023. With global oil price having eased, this guided our entry positioning as we believe medium-to-long term global growth prospects will uplift the commodity outlook. VIVO (BBB-) exposure improved our credit profile as the portfolio's "BB-" exposure reduced from 42.7% to 27.2%. Across sovereigns, we had our first voyage to East Africa region with exposure on RWANDA 5.5% 2031. The sub-region has a favourable growth theme across Africa and our belly-of-the-curve positioning in Rwanda (-vs- Kenya) expresses our conviction of durable growth amidst a disinflationary environment. Broadly, we remained overweight the front-end of the curve with a 53.8% exposure, as we scouted for a white smoke for a potential start of US easing cycle. This resulted in a slight 28bps q/q decline in the weighted average carry to 5.9%.

IC AFIF YTD CREDIT EXPOSURE (END 2Q2023)	
P1	27.00%
BBB-	13.05%
BB-	27.24%
B+	32.71%

SOURCE: FITCH RATINGS, MOODY'S RATINGS

IC AFIF YTD PERFORMANCE (2Q2023)



SOURCE: ICAMMU

3Q2023 Performance Outlook: Eyeing high conviction carry opportunities

The Rand volatility reduced following the tempering of South Africa's foreign policy uncertainty last month. Inflation came within target band for the first time in 14-months with a 5.4% reading in June 2023, prompting a policy pause by the South Africa Reserve Bank. We expressed our conviction with a SOAF 7.3% 2052 in mid-July 2023 as we look beyond the medium-term load shedding-induced growth weakness. The tea leaves off recent Federal Open Market Committee suggests the end of tightening bias is nigh. This should give a lift to emerging markets as they seek some form of equilibrium. Furthermore, this should be supportive of local currency positions that we are currently screening. We like the proactive reforms embarked on by the high-yielding sovereigns coupled with the fiscal credibility progress made by the heavily indebted names. Our cash allocation allows us some degree of tactical flexibility for some convincing opportunities during the third quarter 2023.

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