

Into Africa

Written by Maïke Currie for Investors Chronicle | June 14, 2011

Most investors understand emerging or frontier markets to mean Asia and Latin America. But perhaps a far more exciting frontier market opportunity lies in Africa. The past few years have seen more ways to invest in Africa emerge, but old stereotypes and new conflicts have dented sentiment - creating an opportunity for the patient and the risk-tolerant.

Africa was long regarded as a lost continent, forever plagued by extreme poverty, disease, violent unrest and epic corruption. The recent political upheaval in the north of the continent has merely added to the list of reasons not to invest there. But while many challenges remain, those in the know insist that these perceptions are inaccurate, and that investors are missing a trick.

"The conventional view is not matched by my experience on the ground," says Nick Price, manager of the Fidelity Emerging Europe Middle East and Africa Fund. "To me, Africa is a classic example of the gap between perception and reality which leads to investment opportunity."

Unparalleled growth

Although African equity markets have failed to recover as dramatically as most developed and emerging markets since the financial crisis hit in 2008, African gross domestic product (GDP) growth averaged over 2 per cent in 2009, over 4 per cent in 2010 and is forecast to hit almost 5 per cent in 2011. Not only is that superior to that of developed economies, it is also better than the 2011 growth forecast for many of the more established emerging markets, such as Brazil and Russia.

"Africa has not experienced a recession since 2000, whereas the global economy has experienced two, the first in 2001 - 2003 and the second in 2008 - 2009," says Dylan Evans of Africa investment manager Stanlib, which runs the Standard Africa Equity Fund.

As the table below shows, six out of the world's 10 fastest growing economies between 2001 and 2010 were in Africa, and over the next five years, it is expected to contribute seven of the top 10. African growth as an average bears favourable comparison with other emerging markets and growth in individual markets such as Ethiopia, Mozambique and Tanzania are expected to be up there with the likes of India and China. If you want to invest where the growth is, you cannot ignore it.

World's ten fastest-growing economies, annual average GDP growth (%)

Country	2001-2010*	Country	2011-2015**
Angola	11.1	China	9.5
China	10.5	India	8.2
Myanmar	10.3	Ethiopia	8.1
Nigeria	8.9	Mozambique	7.7
Ethiopia	8.4	Tanzania	7.2
Kazakhstan	8.2	Vietnam	7.2
Chad	7.9	Congo	7.0
Mozambique	7.9	Ghana	7.0
Cambodia	7.7	Zambia	6.9
Rwanda	7.6	Nigeria	6.8

Source: Economist, IMF, January 2011

Notes: Excludes countries with less than 10m population and Iraq and Afghanistan.

*2010 is an estimate, **IMF Forecast

Much of this growth has come from internal sources. "Limited integration into the global economy may have helped - Africa is less reliant on exports than Asia for example, but as important were the strong fundamentals of many countries, namely low national debts and lower inflation than in the past," says Mr Price.

That lack of integration also means stock markets are less correlated with those of the developed world. "African markets have their own drivers and do not march in lockstep with developed world markets. This provides portfolio benefits," says Peter Townshend, co-manager of two Africa portfolios, the Coronation Africa Fund and the Coronation Africa Frontiers Fund.

Eric Kibe, manager of the Sanlam African Frontiers Fund launched in July last year, agrees. He says that African capital markets are evolving, with a growing number of issuers seeking to raise funding from the local and foreign investment communities. "These issuers include governments and the private sector, both needing capital to maintain investment in infrastructure and rapid business growth, all of which is supported by buoyant economic growth rates."

In any case, Africa's aggregate economic data understates its potential because so much economic activity goes unrecorded. "This is clear when you see the huge amount of cash-based activity taking place at taxi ranks in Africa - from unlicensed bars to hairdressing...it is this unreported economy that lies behind the recent upwards revision in Ghana's GDP by a staggering 70 per cent in 2010," says Mr Price.

The cash-based nature of Africa's economy also means demand is resilient. "When the credit crisis hit the western world, we quickly discovered that some of demand was illusory. US automobile sales, for example, fell from 17m units to 10m units, as much of the earlier spending had been funded by credit. In Africa, the demand numbers stand up far better to scrutiny because there is practically no personal credit."

Rapidly rising income is pushing up the potential for consumption in Africa and fund managers like Mr Townshend are excited about the rise of a very large emerging consumer base across the

continent. "This provides some very interesting investment opportunities in under-researched and generally poorly understood markets."

Increasing stability

In the immediate post-colonial era, Africa was synonymous with staggeringly bad government, personified by the likes of Uganda's Idi Amin and Zaire's Mobutu Sese Seko. Some of the old demagogues live on, most obviously Robert Mugabe in Zimbabwe, and several failed states - Sudan and Somalia - remain. But elsewhere, there has been a sea change in African politics.

"We have seen a major change in politics in Africa in the last 25 years. In 1985 - 84 per cent of the continent belonged to one-party states/dictatorships. Today, more than 90 per cent are multi-party democracies, which means more accountable government and much less war," says Chris Derksen, head of frontier markets at [Investec Asset Management](#).

He adds that investors should not be blinded by the recent uprisings in north Africa, which have essentially been driven by the citizens of these countries pursuing democracy and a free future. Mr Price agrees. "Peaceful democratic transfer of power is becoming the norm," he says, even though violence makes better copy. So while Ivory Coast's bloody post-election standoff was headline news, the recent elections in Nigeria, widely praised as the fairest in decades, attracted far less attention.



Demographics and diaspora

"Africa has a fantastic demographic profile," says Mr Price, pointing out that around half of the continent's billion-strong population is of working age," says Mr Price. That's a huge contrast to European countries, Japan and even China, whose one-child policy is storing up demographic trouble. Africa's labour force is expected to more than double by 2040, keeping its dependency ratio low and ensuring that the various age-related concerns prevalent in the West will not be a problem for years to come.

And while Africa was once an exporter of human capital - many educated Africans could not wait to get out - Mr Derksen says many are now returning, and bringing vital capital and skills with them. "Many CEOs of African companies are Harvard or Oxford educated and are making massive inroads in improving levels of corporate governance and financial reporting." And, for that matter, in politics - John Atta Mills, Ghana's president since 2009, has a doctorate from London's School of African and Oriental Studies.

The risks

Strong economic growth, attractive demographics and increasing stability are all very well. But do they translate into stock market growth for investors? Not necessarily. Mr Derksen concedes that there is little correlation between GDP figures and the performance of individual stock markets, and says that while the overall African growth story is impressive, getting exposure to it

is not that simple. "Africa is often wrongly viewed as collective. This is a collection of 54 very different countries and you need expertise and local, on the ground knowledge to know where to allocate your capital," he says.

There's also liquidity risk. By developed world standards, Africa's stock markets are tiny and illiquidity remains a major issue. This was evident during the 2008 financial crisis, when the much publicised New Star Heart of Africa Fund was forced to suspend its dealings. It cited difficulties in buying and selling stocks during religious holidays in Nigeria and elections in Ghana. This year, stock markets in both Egypt and the Ivory Coast closed for extended periods amidst political unrest. If you are investing in an Africa fund it is worthwhile making sure of its liquidity, as not all of these funds have daily dealing.

Finally, western investors are increasingly going to have to compete for the best opportunities. Resource-hungry China is investing heavily in Africa, and doesn't really mind whom it does business with. Fund managers have differing views on whether this is positive or negative. Mr Price points out that Chinese investments has led to massive improvements in efficiency, from Nigeria's ports to the rebuilding of the old Luanda railway in Angola.

But China's silence on rogue regimes such as Zimbabwe and Sudan, and the high level of secrecy around the deals struck, makes others nervous. Some are also concerned that China is bringing in its own blue-collar workers to work on infrastructure projects, hindering local job creation.

Mr Horne says most China-funded projects tend to be in the public-sector space and none of his fund's portfolio companies is coming up against Chinese companies. In fact, he notes that given the difficulties of operating in Africa, those companies that have made it tend to benefit from low competition - and high profit margins.
