



# Nigeria Weekly Update

## Coronavirus: risk and liquidity

Last week was a miserable week for global equities as fear spread faster than the coronavirus itself. However, the world's monetary authorities are responding with liquidity to support markets, which is important for economies like Nigeria which need foreign currency. See page 2. Meanwhile the Nigerian Stock Exchange All-Share Index (NSE-ASI) fell sharply, with unpleasant knock-on effects for our Model Equity Portfolio. See page 3 for our remedies.

### FX

The Central Bank of Nigeria (CBN) over the last few months has employed several means to stabilise the Naira/US dollar rate. These include intervening in the FX market and restricting transfers on US dollar domiciliary accounts funded in cash. While this approach has kept the FX rate stable since the beginning of the year there has been renewed fear of currency devaluation. One is the US\$2.7bn decline in CBN reserves this year and the recent decline in oil prices whose earnings are a component of the reserves. Our view is that the CBN will be able to defend the currency at N362.5/US\$1, or close to it, if Nigeria's upcoming sovereign Eurobond issue is successful (see page 2) and if it continues to sell its open market operation (OMO) bills to foreign portfolio investors (see below), and if there is at least stabilisation in oil prices.

### Bonds & T-bills

The secondary market yield for a Federal Government of Nigeria (FGN) Naira bond with 10 years to maturity fell by 63bps to 10.08%, and at 3 years fell by 107bps to 6.95% last week. The annualised yield on 349-day T-bill, the longest duration available in the secondary market, rose by 29bps to 5.63%, while a CBN Open Market Operation (OMO) bill with similar tenure closed at 12.63%, 126bps down week-on-week. Last week's OMO auction of N350.0bn (US\$964.2m) saw strong subscriptions of N545.2bn, which suggests sustained demand by foreign investors for the OMO-bills (most domestic corporates cannot buy them).

### Oil

The price of Brent declined by 13.64% last week to US\$50.52/bbl, its lowest level since June 2017. The average price, year-to-date, is US\$59.79/bbl, 6.87% lower than the average of US\$64.20/bbl in 2019, and 16.60% lower than the average of US\$71.69/bbl in 2018. A build-up of inventories amid declining demand and the continued spread of coronavirus is responsible for the decline in oil prices, in our view. We think oil prices will continue to be under pressure as the forward curve declined by about US\$1.00/bbl last week.

### Equities

The Nigerian Stock Exchange (NSE) All-Share Index fell by 4.29% last week, the year-to-date return is negative 2.35%. Last week only Arдова Oil (formerly Forte Oil, +1.80%) closed positive. FBN Holdings (-18.26%), Oando (-18.18%), Nigerian Breweries (-16.41%) and Stanbic IBTC (-15.62%) fell. The gains that were recorded by the All-Share Index at the beginning of the year have been completely eroded. The sell-off, which is not limited to the Nigerian equities market, appears inspired by the coronavirus epidemic. Investors are pricing in lower earnings on these stocks even though the fundamentals of many of them are still sound.

- ◆ [Global risk and liquidity](#)
- ◆ [Model Equity Portfolio](#)

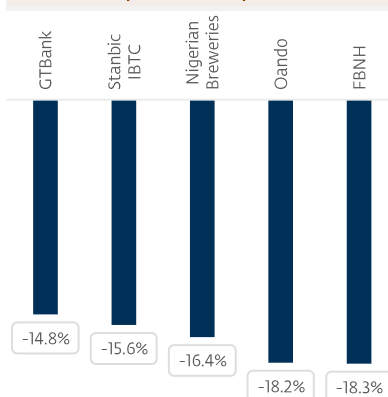
### Naira Sovereign Yields

#### Spot

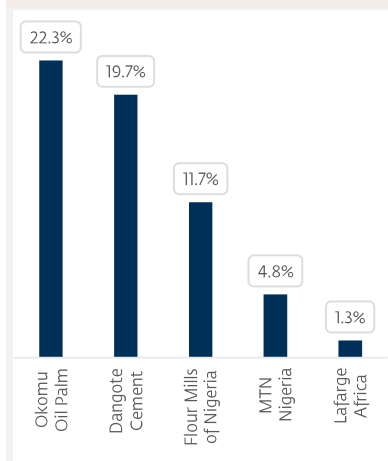
354-day (OMO)	12.63%
349-day (T-bill)	5.63%
3 Year	6.95%
7 Year	9.94%
10 Year	10.08%
Inflation	12.13%

Quotes at 28 February 2020

### WoW Performance of C-30



### YTD Performance of C-30



Source: NSE, FMDQ



## Coronavirus: global risk and liquidity

Global markets have taken a beating since the outbreak of the coronavirus became known in January. Although China, where the virus originated, reports fewer new cases with each week, new cases are on the rise around the world. Markets do not know whether to factor in the coronavirus as a temporary setback for a few months (as was the case with the SARS outbreak in 2003), or as a long-term threat that could push the world into recession. Last week, when the US S&P 500 Index fell 11.5% in a week, it looked like the latter.

### Performance of selected global equity indices, year-to-date

US, S&P 500	-8.6%
US, NASDAQ	-4.5%
Euro Stoxx 50	-11.1%
UK, FTSE 100	-12.8%
China, Shanghai Composite	-5.4%
Hong Kong, Hang Seng	-7.3%
Japan, Nikkei 225	-10.7%
Brazil, Ibovespa	-10.3%
Russia, RTS \$	-16.1%
India, S&P BSE Sensex	-7.2%
South Africa, JSE T40	-9.8%
Nigeria NSE-ASI	-2.3%

Source: Bloomberg, Coronation Research. \*In local currency unless otherwise stated, up to close of business on Friday 28 February

What is important to Nigeria (and other developing markets) is how monetary authorities in developed markets react to the outbreak. Since global investors have a tendency to head to safety in times of trouble (e.g. buying US dollars and gold) this can spell trouble for developing markets which need to issue foreign currency debt to stay afloat. Nigeria has yet to sell its planned US\$3.3bn issue of eurobonds this year. So it is good news that Italy has announced a €3.6bn stimulus package and that the Bank of Japan has announced an injection of liquidity into the financial system. Anticipating other such moves around the world, Asian markets rallied this morning.

There has been some deterioration in Nigeria's sovereign US dollar eurobond spreads since the beginning of the year, but not much. Nigeria's eurobond due in 2027 began the year with a yield to maturity (YTM) of 6.134% and at the end of last week this had risen to 6.566%. Nigeria's eurobond due in 2038 began the year with a YTM of 7.629% and at the end of last week this had risen to 8.044%. And, as global markets have rallied, so too have these yields tightened this morning. We still rate the chances of Nigeria placing its eurobonds as high.



## Model Equity Portfolio

### Take action but don't panic

We need to make changes to our Model Equity Portfolio which, as of Friday, was down 7.75% versus 2.33% negative for the Nigerian Stock Exchange All-Share Index (NSE-ASI) year-to-date. 542 basis point (bp) underperformance in two months is a big problem which demands to be fixed.

### Performance attribution

The first technique we need is performance attribution, which is presented in full on the following page. We tried to outperform the market by being underweight consumer stocks and very overweight bank stocks (and, briefly, we succeeded), but this has backfired. It is important to separate out how much of this was due to poor strategy (overweight banks) and how much was due to poor tactics (the timing of our purchases).

### Strategy versus tactics

Our tactics were poor. In order to fill the portfolio near the calendar start date of 1 January 2020 we chased stocks that were rallying during the first full trading week of January (6 January to 10 January). Our weekly performance attribution model tells us that, if we had owned these stocks on the first trading day of the year, our performance would have been negative 5.80% rather than negative 7.75%. In other words, poor tactics cost us 195bps.

In terms of re-setting our strategy, therefore, it is more helpful to think of a portfolio down 5.80% than one down by 7.75% (though the reality is that it is down by 7.75%).

### How to fix the strategy

The strategy to be underweight consumer stocks has worked well but is limited by the fact that they only make up about 10.0% of the index. The strategy to be very overweight banks has turned sour. There are two key events that sent bank stocks reeling. First, on 24 January the Central Bank of Nigeria (CBN) raised banks' cash reserve requirement (CRR) from an already-high 22.5% to 27.5%. Second, on 21 February, Zenith Bank reported Q4 2019 results showing that banks are having difficulty in adjusting to declining interest rates. We were wrong to think that they would benefit from declining rates, just as we were wrong to think that they would benefit from a positively-inclined yield curve.

A third factor is that, in the absence of foreign institutional investors, local Nigerian institutional investors have shown very little interest in bank stocks. This does not make sense to us. Zenith Bank has a gross dividend yield of 15.51% and UBA has a gross dividend yield of 15.51%, and we forecast a gross dividend yield for GT Bank 12.33% and 10.31% for Access Bank. Meanwhile, T-bills yield 5.63% and the 10-year Federal Government of Nigeria (FGN) bond yields 10.08%. Never mind. If institutional investors don't want to know (what is good for them) they don't want to know.

### Volatility versus risk

If it were not for the reasons we list above (the CRR, bank results and domestic institutional investors who are apparently indifferent to dividend yields) we would attribute most of the Model Equity Portfolio's underperformance to negative investor sentiment which obviously comes from the outbreak of the coronavirus. We might even be so bold as to say that these price corrections reflect volatility rather than risk – presuming the viral outbreak will be over in matter of months. But they don't. The sector-specific risks have mounted. And coronavirus may be round for a while.



## Model Equity Portfolio

### Reducing downside risk

It is late in the day, but this week we will take a lot of the bank stock risk out of the Model Equity Portfolio. Among the top 15 stocks by weight in the Nigerian Stock Exchange All-Share Index (NSE-ASI) banks makes up 18.30% of the total index weight but 67.70% of our notional portfolio. We will cut our notional positions in FBN Holdings, Zenith Bank, UBA and GT Bank back to close, or slightly under, their index weights.

Not having a neutral weight in Dangote Cement has cost us 207bps of performance this year (performance attribution, again) so we will *take on* notional Dangote Cement shares to reach a neutral weight. Our notional overweight in MTN Nigeria looks exposed and we shall make this a neutral weight. We will cut our notional Nestle Nigeria position by two-thirds. We shall have a lot of notional cash, but this may be no bad thing.

### Model Equity Portfolio for the week ending 28 February 2020

Security	February 21, 2020	February 28, 2020	Security weighting	Weekly change	ytd change	Performance attribution (bps)	
	position, N	position, N				Past Week	ytd
FBNH	690,000,000	564,000,000	6.1%	-18.3%	-28.8%	-127	-232
Zenith	1,389,500,000	1,295,000,000	13.1%	-6.8%	-5.7%	-95	-84
UBA	1,332,000,000	1,206,000,000	12.2%	-9.5%	-11.6%	-127	-164
GT Bank	1,397,500,000	1,190,000,000	12.0%	-14.8%	-21.2%	-209	-328
MTN	2,436,000,000	2,310,000,000	23.3%	-5.2%	0.7%	-127	4
Dangote Cement	850,000,000	850,000,000	8.6%	0.0%	16.1%	0	115
Nestle Nigeria	282,500,000	282,500,000	2.9%	0.0%	-23.1%	0	-87
Cash	1,527,648,540	1,527,648,540	15.4%	0.0%	0.0%	0	0
<b>Total</b>	<b>9,905,148,540</b>	<b>9,225,148,540</b>	<b>94%</b>	<b>-6.87%</b>	<b>-7.75%</b>	<b>-687</b>	<b>-775</b>

### Risk-on / risk -off

If there is one phrase we do not like it is 'risk-on / risk off' as it reduces all investment judgements to a simple binary question of willingness to invest and, worse still, embodies the confusion between risk and volatility.

Yet it has its uses. We need to make a judgement about whether investors in the Nigerian equity market will be able to see through the fog and begin to build positions in stocks for their undoubted fundamental value (for instance, bank stocks with gross dividend yields in the mid-teens). Our judgement, necessarily highly subjective, is that such a change in attitude is some way off. We see little inclination on the part of Nigerian institutional investors to take risk. Why else would they tolerate T-bill yields of 5.63% when inflation is 12.13%? Perhaps they are waiting for news of the spread of the coronavirus to get worse, in which case a cautiously constructed (or in our case, reconstructed) Model Equity Portfolio may be justified.

*Nota bene: The Coronation Research Model Equity Portfolio is an expression of opinion about Nigerian equities and does not represent an actual portfolio of stocks (though market liquidity is respected and notional commissions are paid). It does not constitute advice to buy or sell securities. Its contents are confidential to Coronation Research up until publication. This note should be read as an integral part of the disclaimer that appears at the end of this publication.*



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