Nigerian Equities Market H1-2022 Review & Outlook

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H1-2022: Nigerian equities storm out of the blocks

In H1-2022, we have witnessed major global stock markets plummet on the back of crystallisation of policy normaliation risks as global monetary policy authorities scramble to stem surging inflationary pressures. For example, in H1-2022, the MSCI World Index lost 21.2%. However, the Nigerian equities market has taken a divergent stance from the global market as the NGX-All Share Index (NGX-ASI) kicked off 2022 with strong bullish momentum. In H1-2022, the NGX-ASI gained 21.6%, soaring past 50,000 points for the first time in 14 years, printing at 51,962.9 points at the end of the period.

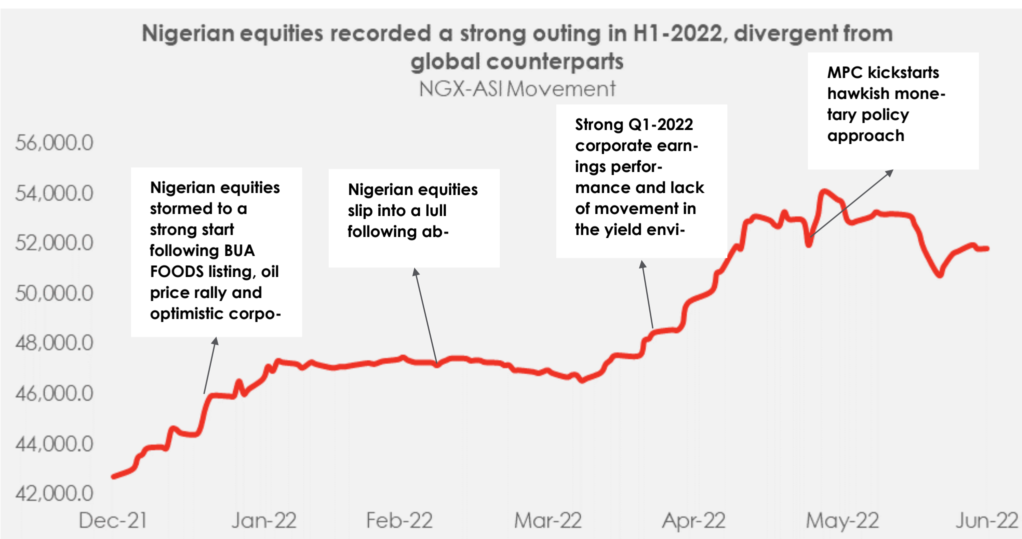
Nigerian Equities recorded impressive outing in H1-2022...

The rally in the equities market was underpinned by several factors combining to lift investor sentiments. At the start of the year, investors' interest in the equities market was first propelled by expectations of a strong FY-2020 earnings performance. The rally in crude oil prices provided a further boost for upstream oil & gas stocks while investors jumped into a frenzy following the listing of BUAFOODS on the stock exchange. All these factors propelled the equities market higher in the first quarter of the year.

In Q2-2022, investors remained upbeat regarding Nigerian equities as listed corporates continued to weather the storm of a hostile operating environment to post solid profit growth. Further aiding the upbeat investor mood, the yield environment remained broadly unattractive as sovereign debt managers' financial repressive tactics ensured movement in interest rates were capped. Thus, given the -interest rate environment, investors continued to build equity positions on solid Q1-2022 earnings outings.

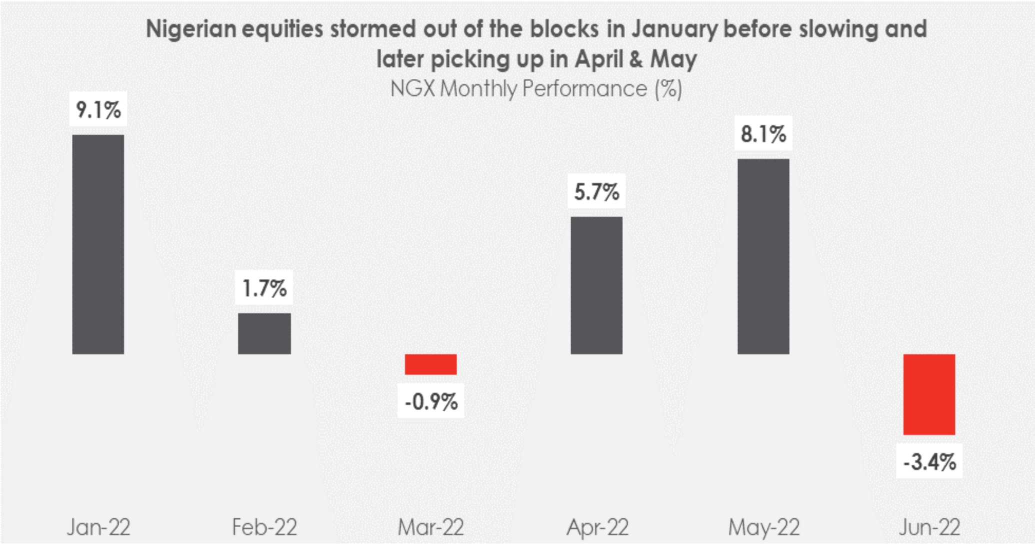
...as listed corporates continued to weather the storm of a hostile operating environment

Figure 1



Source: Bloomberg, NGX, United Capital Research

Figure 2



Source: Bloomberg, NGX, United Capital Research

The Oil & Gas sector closed H1-2022 as the best performing sector, with SEPLAT (+100.0%) leading the gainers...

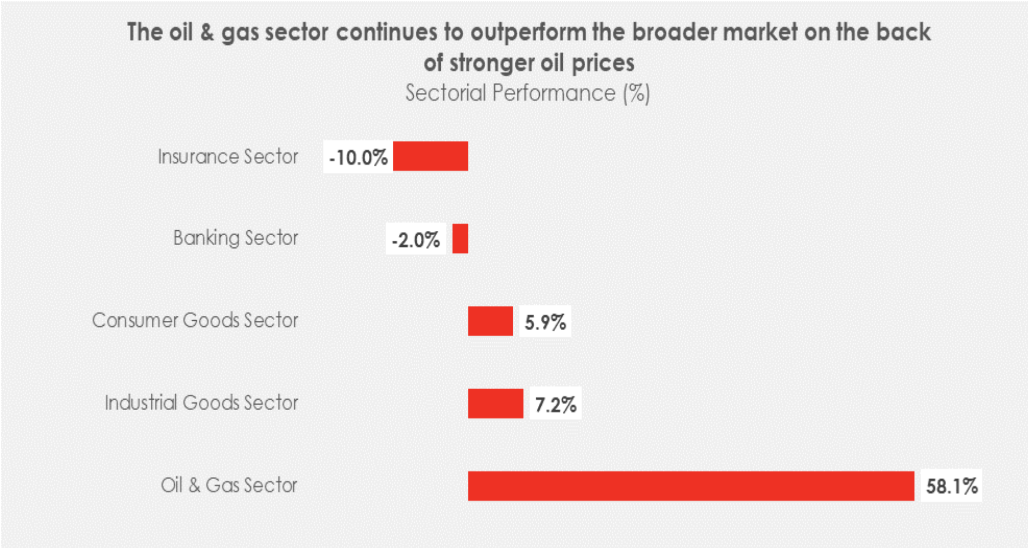
Sector Performance: The Oil and Gas sector extends bloom

Accessing sectorial performance reflects the clear value drivers for equity investors in H1-2022. The Oil & Gas sector closed the period as the best performing sector, with the NGX Oil & Gas index gaining 58.1%. The strong performance from the sector reflects the strong gains recorded in crude oil prices, benefitting upstream oil & gas companies like SEPLAT (+100.0% in H1-2022). In addition, strong earnings outing and dividend announcement from CONOIL (+30.9% in H1-2022) contributed to the gains in the sector. The Industrial Goods and Consumer Goods sectors also closed in the positive as most cement, FMCGs, and brewers rode on the back of surging inflation to raise prices, boosting revenue. Buying interest in counters like DANGCEM (+7.0% in H1-2022), WAPCO (+10.2% in H1-2022), GUINNESS (+132.1% in H1-2022), CADBURY (+96.0% in H1-2022) and NB (+17.6% in H1-2022) drove the NGX Industrial and Consumer goods indices higher by 7.2% and 5.9% respectively. The telecoms sector was another upbeat sector propelled by sustained growth in earnings from MTNN (+16.8% in H1-2022) and AIRTELAFR (+81.4% in H1-2022).

Conversely, the financial services sectors recorded a lacklustre performance in H1-2022. First, the Insurance sector lost 10.0% in H1-2022 on the back of sell pressures in MANSARD (-13.8% in H1-2022) and AIICO (-8.6% in H1-2022). Similarly, the Banking sector lost 2.0% following selloffs in GTCO (-21.2% in H1-2022) and ZENITH (-13.7% in H1-2022). Across the sectors, regulatory constraints and a weaker interest rate environment were key dampeners of investor sentiment toward the financial services sector.

The financial services sectors displayed lacklustre performance in H1-2022...

Figure 3

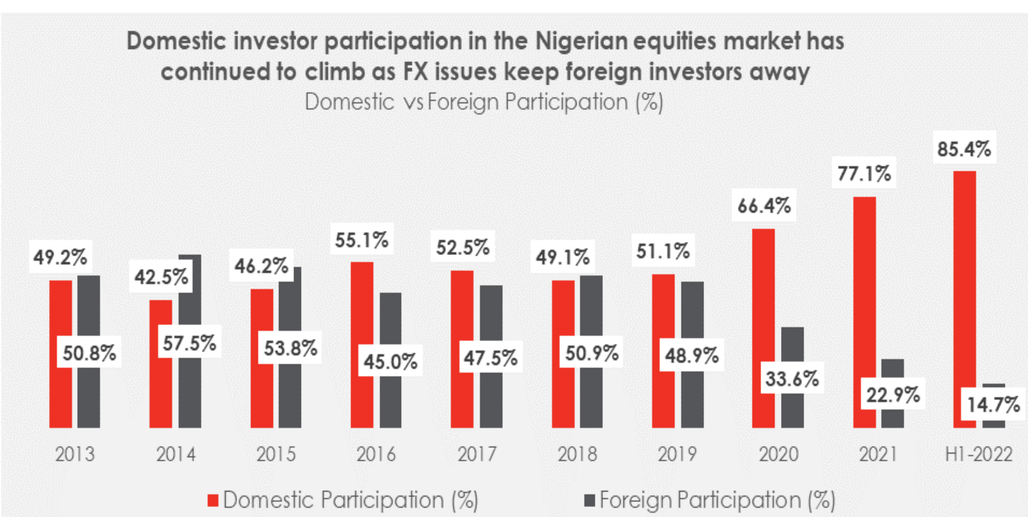


Source: Bloomberg, NGX, United Capital Research

Portfolio Flows: The locals continue to dominate local bourse activities

In line with our expectations, domestic investors' participation in the equities market was primarily driven by domestic investors. According to NGX data on Foreign and Domestic investor's participation in the equities market at the end of Jun-2022, the breakdown of the market participants in the period under review shows domestic investors have primarily driven the market with 85.3% of total transactions, leaving foreign investors with 14.7% of total transactions in H1-2022. This data suggests the continuation of the declining trend in foreign players' participation. Plausible factors highlighted in our FY-2022 economic outlook document, "Navigating Stormy Seas" remain valid, particularly with the absence of positive catalysts, sustained FX illiquidity concerns and crystallisation of policy normalisation risks, thus creating a wet blanket on the attractiveness of the local equities market.

Figure 4

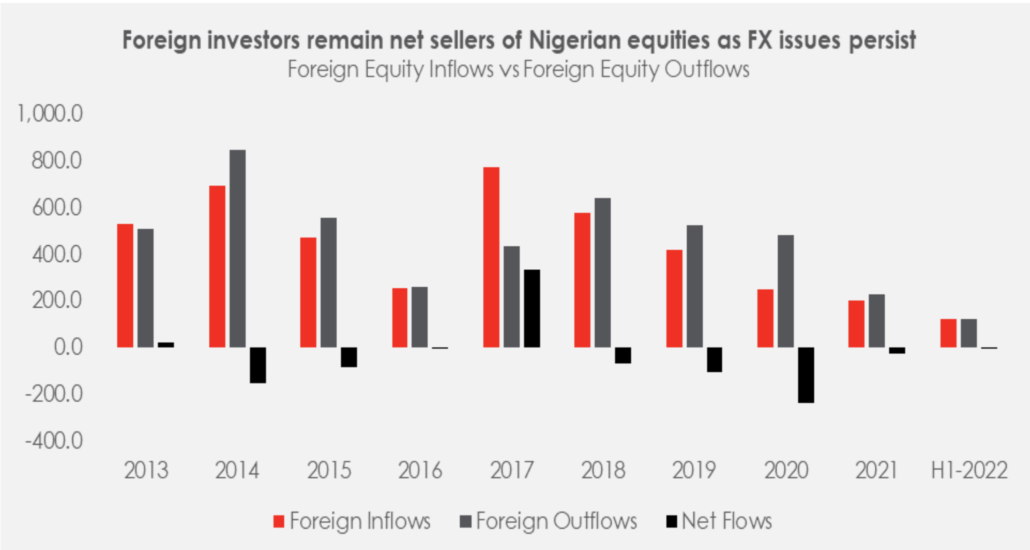


Source: NGX, United Capital Research

Domestic participation outweighed foreign participation in the equities market H1-2022...

In H1-2022, domestic investors' trading activities in the market has seen them record transactions worth N1.4tn, as of Jun-2022, while international investor trading activities printed at N243.5bn. Analysing the activities of foreign equity investors along equity inflows vs equity outflows line shows a net outflow of N2.5bn, following total inflows of N120.5bn vs outflows worth N123.0bn at the end of H1-2022.

Figure 5



Source: NGX, United Capital Research

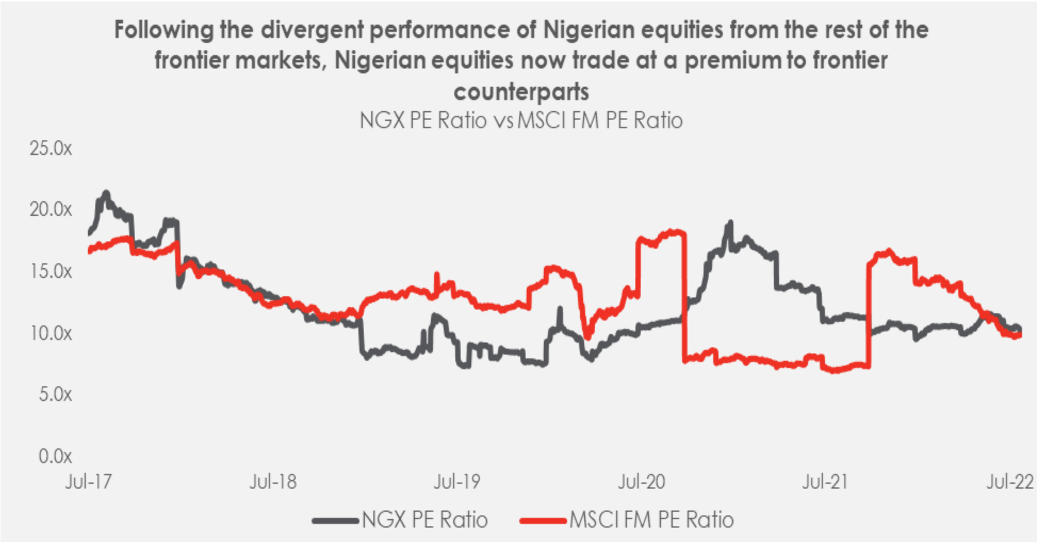
Equities market outlook: Can the good times continue?

As highlighted in the H1-2022 equities market review segment, the domestic equities market rewarded investors handsomely in the first half of the year, with the benchmark NGX-ASI gaining 18.8%. However, heading into H2-2022, the concern for investors is the sustainability of this performance as several headwinds (ranging from monetary policy to electoral activities) pose a substantial threat to the equity portfolios. In this segment, we review the current valuation of the market (relative to peers and history), the various factors expected to shape the performance of the equities market in H2-2022 and the likely behaviour of the different investor classes, with a view to provide equity investors appropriate strategies to maximise their equity portfolios.

1. Is there value in the market?

The rally in Nigerian equities has been antithetical to the performance of broader emerging and frontier market equities, as the limited presence of foreign equity investors meant Nigerian equities have been immune to advanced economies' policy normalisation. Thus, we have witnessed a convergence of Nigeria's and other emerging markets equity valuations. For context, Nigerian equities trade at a 3.6% premium (using the trailing twelve-month PE ratio) to the MSCI FM index compared to a discount of 31.5% at the start of the year. In addition, Nigerian equities now trade at a premium to Kenya, Ghana, South Africa, and Brazilian equities. However, we consider these peers an inappropriate benchmark of value in Nigerian equities EM equities are mostly trading at depressed valuations due to massive foreign equity outflows, which Nigeria has not had to deal with sparse presence of foreign investors in the Nigerian equities market.

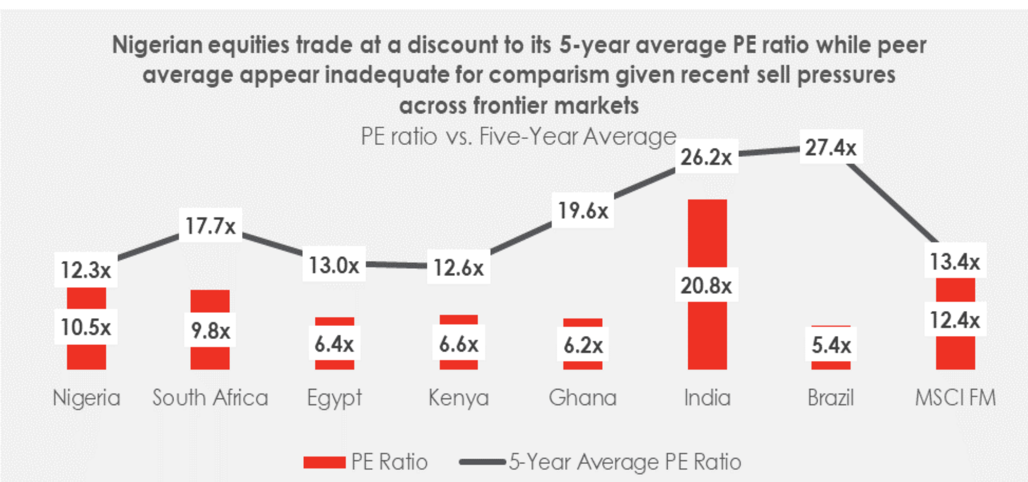
Figure 6



Source: Bloomberg, United Capital Research

A more appropriate benchmark would likely be the current valuation of Nigerian equities relative to historical valuation. The benchmark NGX-ASI trades at a 15.2% and 45.3% discount to its five-year average PE multiple and five-year high PE multiple of 12.0x and 19.0x, despite superior fundamentals such as Return on Equity (ROE), Profit margin and Dividend yield. Thus, in our opinion, we highlight that significant value remains in the equities market as a decent chunk of stocks in the benchmark index remain undervalued.

Figure 7



Source: Bloomberg, United Capital Research

2. Corporate earnings outlook remains strong while fundamentals continue to strengthen

Listed Nigerian companies have continued to weather the hostile business environment to post healthy profitability growth and show strength in fundamentals. For context, EPS growth for the NGX-ASI at the end of H1-2022 printed at 4.0% compared to a decline of 7.7% in MSCI EM index EPS. In addition, the top 10 most capitalised stocks (accounting for

83.4% of total market capitalisation) on the Nigerian stock exchange recorded a weighted average earnings growth rate of 36.3% in Q1-2022. Interestingly, Nigerian equities company fundamentals have continued to improve in the first half of the year. For example, Return on Equity (ROE), Profit Margin and Dividend Yield of the NGX-ASI have all expanded by 2.2ppts, 0.6ppt and 0.3ppt, respectively, to 20.1%, 16.0% and 5.2%, respectively.

Figure 8

Source: Bloomberg, United Capital Research

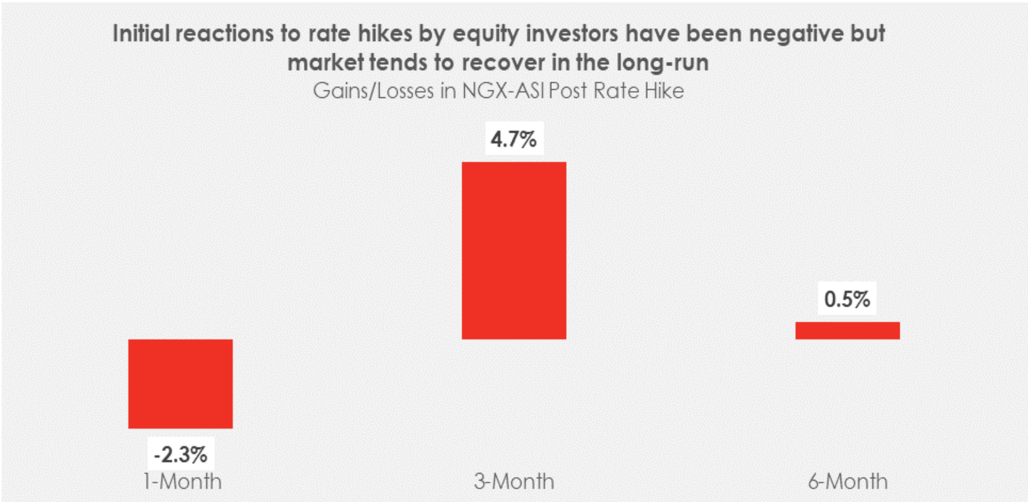
Looking ahead to the rest of the year, we anticipate corporate earnings will remain strong. Our bet is that listed non-financial companies (FMCGs, Brewers, Cement, Oil & Gas, Agriculture etc.) will continue to ride on the back of the high inflationary environment to raise prices. At the same time, volume growth is likely to be sustained on the back of improvement in consumer income and burgeoning consumer credit market.

3. Will hawkish monetary policy pose a threat?

Having established the value in the market as well as highlighted that Nigerian listed corporates are expected to sustain profit growth, we reckon that monetary policy developments would play a significant part in equity market returns for H2-2022. Historically, Nigerian equities have demonstrated a negative causal relationship with monetary policy implied by the negative correlation between the benchmark NGX-ASI and the MPR. However, the relationship appears to be weak, with a correlation coefficient of -0.28. Interestingly, over the past three rate hike cycles (from 2016 till date), the NGX-ASI has lost an average of 2.3% within the first month of the rate hike but has gained an average of 4.7% and 0.5% over the three-month and six-month period from the rate hike. Thus, while the initial reaction to a rate hike has historically been negative, domestic equities have always been able to shrug off the negative sentiments from hawkish monetary policy. This is due to two main reasons; hawkish monetary policy has not been persistent and consistent enough to depress equity valuations in time past, and other supervening factors have outweighed the impact of hawkish monetary policy on

Nigerian equities over a longer period.

Figure 9



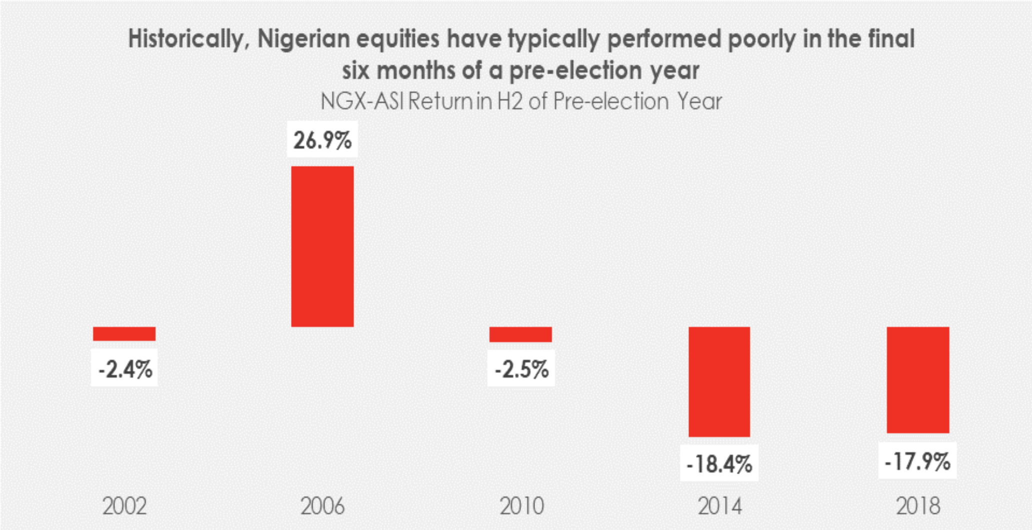
Source: Bloomberg, United Capital Research

However, in H2-2022, we expect inflationary pressures will remain elevated, forcing the MPC to remain persistent in its policy tightening direction. This poses a steep risk to the equities market due to its possible impact on the yield curve. In addition, while sovereign debt managers have been able to neutralise the impact of higher MPR on the yield curve, we expect that ability to wane in H2-2022 as system liquidity turns tighter and force investors to seek higher return. Thus, we recognise hawkish monetary policy as a likely threat to equity market performance in H2-2022.

4. Pre-election year syndrome, a concern?

Historically, the final six months preceding an election year have always been negative for the equities market. Since 2002, Nigeria has had five general elections, of which the benchmark NGX-ASI has lost an average of 2.9% in the second half (July - December) of the pre-election year. Interestingly, the NGX-ASI has lost in four of the five-second half of the pre-election year over the five election cycles. Thus, excluding the single gain of 26.9% in H2-2006 (preceding 2007 general elections), Nigerian equities have lost an average of 10.3% over four-second halves of pre-election years.

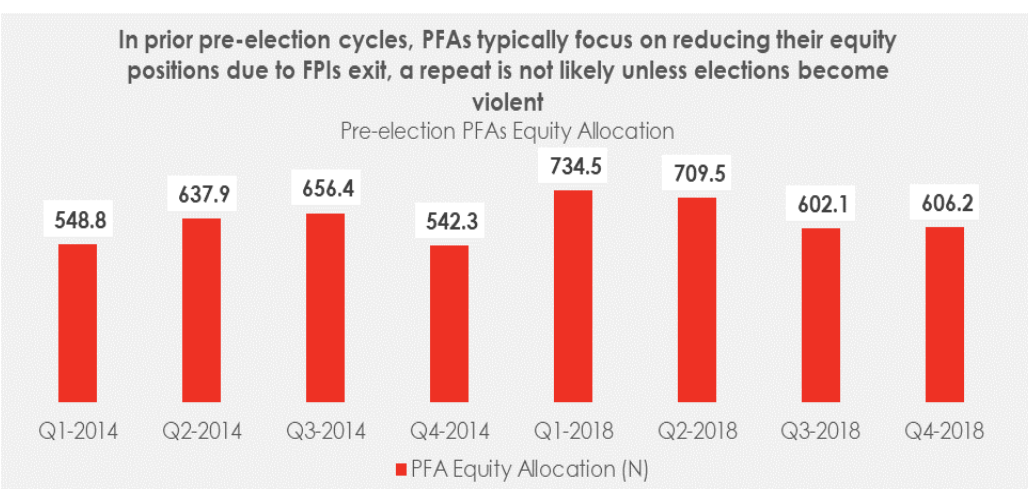
Figure 10



Source: Bloomberg, United Capital Research

The poor performance of Nigerian equities in the second half of a pre-election year is better understood when analysing the behaviour of investor categories during the period. According to data from National Pension Commission (PENCOM), PFA allocation to domestic equities fell by an average of 14.8% in the second half of the last two pre-election years (H2-2014: -15.0%, H2-2018: -14.6%). PFAs who currently set the pace of equity market direction tend to develop itchy feet towards Nigerian equities in a pre-election cycle. For FPIs, the consensus that they tend to exit emerging market equities whenever an election season starts holds true for Nigeria. For context, Over the past two pre-election years, data from the Nigerian Exchange Group (NGX) show that FPIs have been net sellers of Nigerian equities (to the tune of N81.8bn) in the second half of a pre-election year. In addition, data from the National Bureau of Statistics show that equity FPI inflows in the second half of the last three pre-election years have declined by an average of 26.9%, compared to the first half of the same year (H2-2010: -2.2%, H2-2014: -13.4%, and H2-2018: -65.0%).

Figure 11



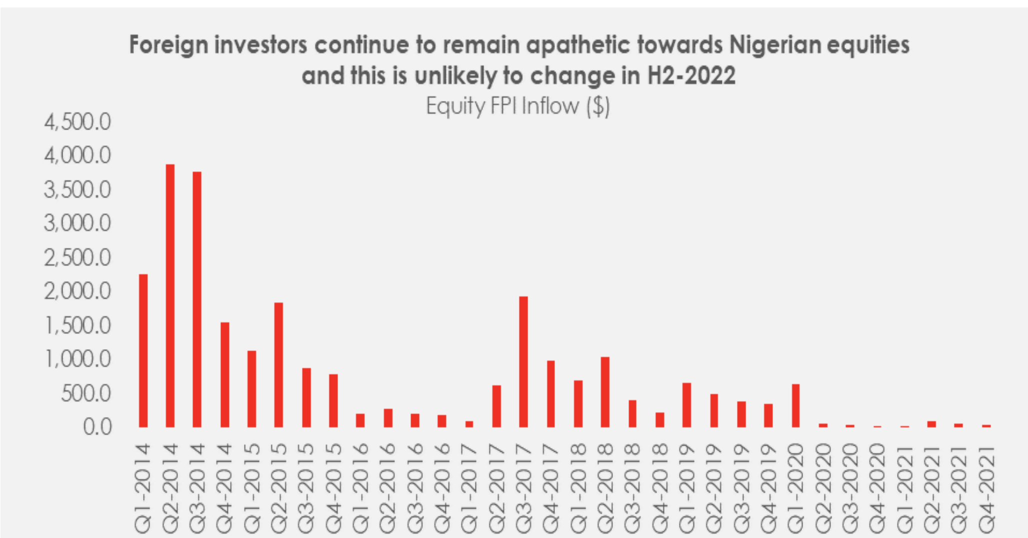
Source: PENCOM, United Capital Research

We can affirm that pre-election jitters represent a significant concern as we head into H2-2022. Although exits by FPIs are likely to be limited, given their constrained exposure to Nigerian equities, PFAs could become active sellers of Nigerian equities if the political environment heats up.

5. Where will demand come from?

First, we rule out the likelihood of FPIs returning to Nigerian equities. A combination of pre-election jitters and failure to resolve the much-maligned FX conundrum will continue to make foreign investors averse to Nigerian equities. Interestingly, MSCI Inc. released a statement on its intention to downgrade Nigerian equities from its Frontier market category to standalone market status due to the inability to resolve the FX crunch facing the economy. This portends significant concerns as Nigeria's remaining foreign investor base are mainly indexed-fund managers who track global equity indices like the MSCI. Downgrading Nigeria to standalone will possibly trigger a selloff across Nigerian equities that are constituents of the MSCI Frontier Market Index. Overall, we do not expect significant fresh inflows from foreign investors into Nigerian equities, with the probability of substantial outflows more likely.

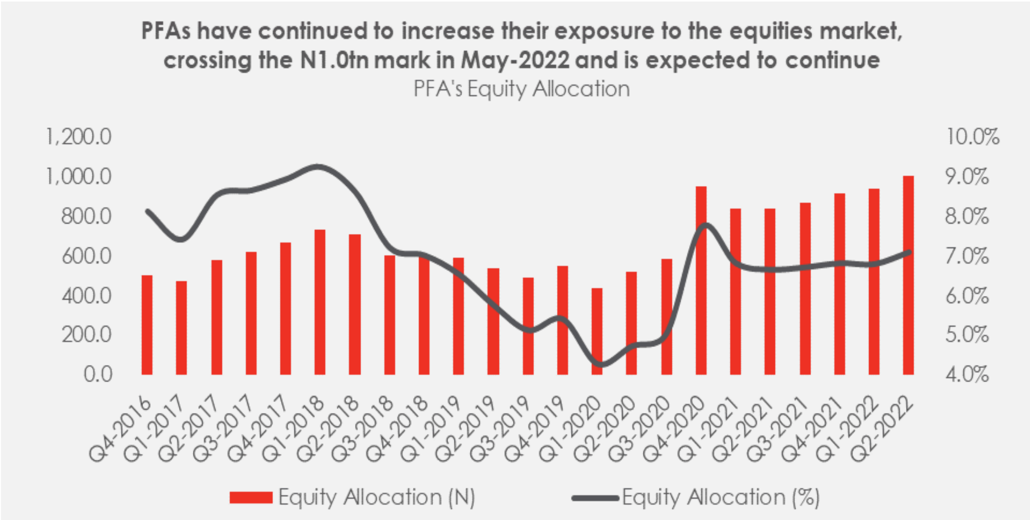
Figure 12



Source: NBS, United Capital Research

For domestic institutional investors, we expect their activities to be mirrored in the investment decisions of Pension Fund Administrators. Over the past six quarters, PFAs have increased their equity market exposure q/q touching the N1,007.7bn mark for the first time in May-2022, from N841.8bn in Q1-2021. Looking ahead, three factors that will shape the equity investment decisions of PFAs in H2-2022 will be the yield environment, corporate earnings, and election developments. We expect the MPC to maintain a hawkish tilt toward monetary policy (our base case projection is a further 150bps hike and possible upward CRR adjustments) with tighter system liquidity, creating an incentive for a faster rise in yields compared to movements observed in H1-2022. Thus, a surge in bond yields and money market rates could likely incentivise local institutional players to tilt towards rotating assets from equity to fixed income instruments.

Figure 13



Source: PENCOM, United Capital Research

As we highlighted earlier, we expect corporate earnings to remain strong, creating a further incentive for PFAs to continue to increase equity market exposure amid a sluggish rise in interest rates. Another major concern in our projection is the election landscape. A seemingly violent and repressive trail to the main election could trigger massive selloffs across the equities market, while a relatively calm pre-election environment would have muted impact on PFA's equity decisions. Overall, we expect a higher yield environment to water down bullish corporate earnings performance from an institutional investor perspective, thus, we see a situation where they may tilt towards reducing their equity exposures.

6. What is our call: Is the party over?

Overall, we see strong headwinds emerging for the equities market. We model three scenarios, including our base case expectations, a bear case and a bull case scenario. In our base case expectation (our highest probability scenario), we expect sovereign debt managers will ultimately continue to succumb to the fundamentals of the fixed income market, which would see fixed income yields rise faster than observed in H1-2022. We also model a bullish corporate earnings performance for Q2-2022 and Q3-2022 but expect to be inadequate to convince investors to shun higher fixed income yields. Lastly, we model muted impacts from election activities and foreign capital inflows. Applying these factor drivers together, we project the equities market would gain 14.7% in 2022, implying a downside of 5.7% in H2-2022.

For our bull case scenario, we model an unlikely plunge in interest rates, representing a significant boost for Nigerian equities given the usual asset rotation that accompanies a significant upward or downward move in interest rates. In addition, we model an ultra-stable political outlook with an in-built probability of the market reacting to early emergence of a "market-friendly" presidential candidate based on polls. We also model bullish corporate earnings growth and muted impact from equity capital flows. Overall, we project a combination of these factors will support a 30.4% return for the NGX-ASI in 2022, implying a 7.2% return in H2-2022.

Lastly, we model a bear case scenario that incorporates a persistent rise in interest rates, a torrid political atmosphere, and a disappointing corporate earnings performance. A combination of these factors produced a 3.1% return for the NGX-ASI in 2022, implying a negative return of 15.3% in H2-2022.

Figure 14

				Performance	2022 Scenario		
Key		Drivers	Weight	H1-2021	Bear	Base	Bull
Improve		Yield Environment	30%				
Moderate		Corporate Earnings	30%				
Muted		Politics & Election Uncertainties	30%				
Bad		Foreign Equity Flows	10%				
		All Share Index	100%	51,962.90	44,020.22	49,012.41	55,694.28
		YTD Return		21.6%	3.1%	14.7%	30.4%

Source: United Capital Research

Investment strategy: What should investors do?

From our projections, we expect investors to see limited opportunities in the equities market for the rest of the year. The market conditions are likely to favour long-term equity holders as a loss of momentum in share prices will create opportunities for buy and hold investors to increase their holdings at lower price points. However, for short-term focused investors (less than 12 months horizon), the focus will have to be on holding cash as well as defensive stocks in a bid to defend portfolio value. A similar strategy is advisable for equity -focused fund managers, by way of exhausting cash limits and holding equity positions at the minimum level of approved asset allocation range. That said, we expect inflation-immune sectors like Agriculture, FMCG and Utilities (Oil & Gas) to remain best-performing sectors in the equities market.

Disclaimer

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