

# Smart Investing in 2017



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## 2016: The Year That Was

For investors in the Nigerian financial market, the year 2016 was a year to forget - an 'annus horribilis' to be more exact. Everything that could go wrong did. Stocks closed the year marginally red, even worse when adjusted for sharp depreciation in the naira. Though yields in fixed income markets surged as the Central Bank of Nigeria (CBN) tightened monetary policy – these gains were trivial in real terms after inflation printed at eleven year highs for most of 2016. Given the deadbeat economic landscape, Nigerian equities closed 2016, the third consecutive year, in negative territory as weak corporate earnings, continued foreign reluctance to naira equities, rising yields on government securities and feeble local participation weighed on the domestic equities market.

## Smart Investing in the new year

Set against the macroeconomic backdrop above, the obvious question is: how does an average investor navigate the investing landscape over 2017? While income levels might not have declined in nominal terms, adjusted for inflation and currency movements, personal net worth certainly has declined. Thus, now, more than ever

before, you need to make the right choices regarding your finances to ensure personal economic satisfaction from your asset returns.

Before deciding on what financial assets to purchase, investors need to adopt a disciplined approach to investing which requires that you more actively consider developing that financial plan. A financial plan is a complete appraisal of an individual's current and future financial income which uses current known variables to predict future income, asset values and consumption patterns. The plan allocates future income to likely expense profile of the individual over his lifetime while incorporating short-term and long-term savings.

The major advantage of financial planning approach to investing is that it imposes financial discipline on the investor in terms of desired consumption and saving patterns. It appropriately matches the investor's risk profile to asset classes whose return profile align to his required returns to enable him meet long term financial goals. Importantly, the feedback loop embedded in financial plans allows for plan flexibility to take advantage of changes in the individual's income levels, personal circumstances, and the broader macroeconomic environment.

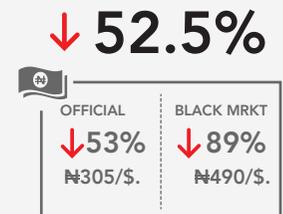
## GDP GROWTH



Nigeria in recession for the first time in 12 years as oil production fell 22% YoY to 1.63mbpd in 2016

Having sorted out the need for investors to adopt a plan approach, we then move to what exactly the action from the plan should be. It would seem the currently elevated yield environment continues to whisper "buy credit, sell equities" as the default view for investors going into 2017. However, our view regarding a tamer inflation trajectory relative to 2016, persisting GDP growth challenges suggest different. Coupled with closure of CBN backdoor financing of budget deficit amid extended fiscal revenue shortfalls these imply that at some point

## THE NAIRA



Weakness stemmed from weak dollar inflows which forced CBN to devalue in June 2016

the apex bank should turn dovish on interest rates. That said, shrinking ammunition to support the naira as foreign reserves decline implies further down-leg to the currency could yet be accompanied by interest rate hikes. Consequently, remaining short duration where yields are likely to remain elevated should prove to be a profitable trade to the retail investor.

Away from fixed income, given historical correlation between Nigerian equities and crude oil, recent rebound in the latter suggests potential for catch-up.

## MONETARY POLICY



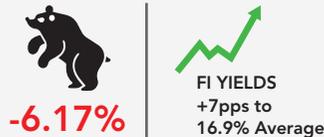
Monetary Policy Rate was raised twice in 2016. March (+1pps to 12%) July (+2pps to 14%).

## INFLATION

12-YEAR HIGH 18.5%

Increase driven by Naira weakness, high electricity and petrol prices.

## FINANCIAL MARKETS



NSE fell -6.17%. Oil & gas (-35%) and breweries (-31.8%) sectors were worst performers. Fixed Income yields increased as a result of monetary tightening.

Furthermore, following three consecutive years of price declines, current equity valuations look compelling across a range of sectors and provide good entry opportunities for investors with longer horizons.

Examining sectors on the NSE for return prospects, we think the recent recovery in crude oil prices, which are now well above break-even prices of upstream Oil & Gas loans should dispel investor concerns over asset quality for Nigerian banks. That said, dollar paucity and the over 50% exchange rate depreciation imply that asset quality fears now revolve over general commerce and manufacturing exposures. The currency movement and views about further downturn imply capital adequacy worries remain on the horizon after the over 180bps shrinkage in capital adequacy ratios across our coverage banks. The capital headches and weak growth outlook for 2017 should translate to muted loan origination. Overall, the underlying earnings

picture across banks is broadly soft. In this climate, we advise that investors place emphasis on banks with net long on-balance sheet dollar positions, higher capital adequacy ratios, excellent grip on loan quality and very liquid balance sheets as these are best placed to weather the macro-economic storm.

Elsewhere in the cyclical frontier, we believe that continuing fiscal revenues struggles which constrain capital expenditure at federal and state level should translate to muted demand for construction materials. Further confounding the revenue picture for cement producers is expected further pull back in demand following an over 47% increase in cement price in September 2016. In addition to this, whilst real estate demand had initially surged on greater need to invest in inflation-protected securities, industry players have now confirmed a reversal of the pattern, leaving further leg-room for top-line weakness for cement and construction players.

To cap the cyclicals, for the oil and gas sector, upstream names should benefit from sentimental buying associated with crude oil. However, production woes imply limited reprieve for battered earnings and a short life-span for any

buying interest. Downstream, the dark side to the double-edged sword of the crude price rally should force upward adjustments to the retail pump price. That said, we think fears of a backlash from the populace would drive the FGN towards absorbing these increases for some time which holds negative portents for petroleum marketers' margins.

For non-cyclical stocks on the NSE, our deadbeat currency outlook implies that traditional defensive names in the food, brewery and personal care space now offer scant downside protection as imported raw material requirements, foreign denominated loans and gas supply issues hurt sector earnings. In this space, we advise that investors favour companies with local raw material sourcing and greater pricing power with focus on agro-allied companies such as palm oil producers. Coincidentally, firms in this group are also on the bright side of government policies now targeted to boost non-oil exports with favourable tax and financing incentives. Overall, depressed valuations, favourable policy positioning and resilient features lead us to advise that investors place bias on agro-allied companies and select top tier names in the banking sector.

Beyond the traditional asset class, our

views regarding the economic environment in 2017 suggests that investors keep an eye out for assets which help mitigate impact of potential naira depreciation. Towards this end, exposure to investments with strong inverse correlation to the exchange rate i.e. help shield investors' assets from adverse currency movements are desired. Thus, investors with future dollar liabilities should explore investment windows into dollar assets to ensure that their portfolio returns meet their natural obligations. This does not constrain investments to financial instruments alone as recent upswing in domestic prices of key agricultural crops and renewed government desire to raise non-oil exports imply that investors should consider alternative vehicles into the value chain.

Should you require further information, write to us at [customerservice@armsecurities.com.ng](mailto:customerservice@armsecurities.com.ng) or connect with us on social media - Facebook, Twitter, and LinkedIn. You can also call 0700 CALLARM (0700 2255 276) or visit our Investment Center nearest to you.

“Investors need to adopt a disciplined approach to investing which requires that you need to consider more actively developing that financial plan.”