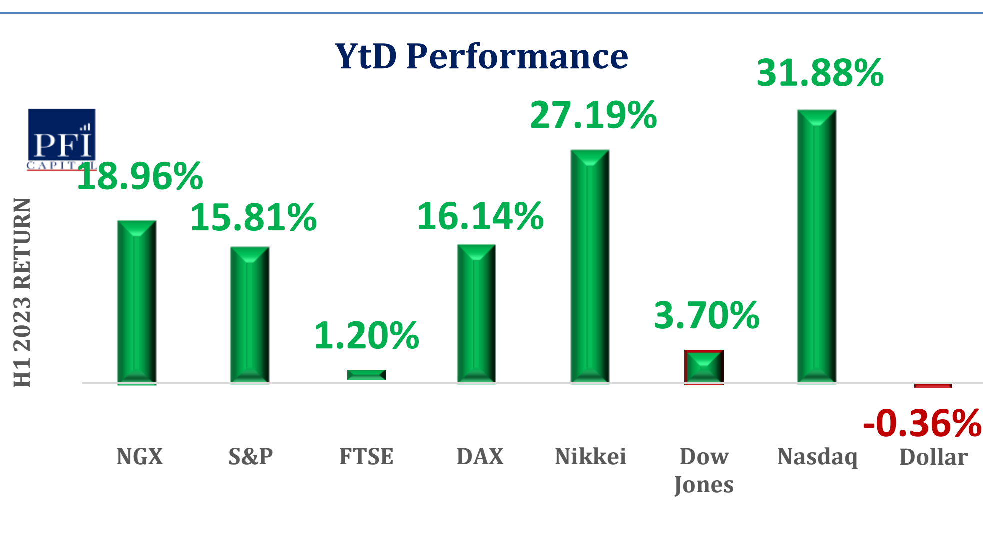
PFI CAPITAL

INVESTMENT STRATEGY REPORT (H2'23)

Global Equities Market Review

It has been an eventful first half of the year for global markets, with many concerns ranging from bank failures in the U.S. and in Switzerland, rising inflation in major economies and the war in Ukraine taking center. Also, the war in Ukraine has impacted energy and commodities prices, resulting in heightened global inflation. In a move to tame the rising inflation, monetary authorities have adopted rate hikes with fears it could result in a recession. However, it is becoming more apparent that the present economic challenges and their effects could linger for long, as the war in Ukraine has not shown any sign of abatement. The period also was characterized by fear of debt default as economies battled with inflation and sluggish economic growth. Consequently, investors became discretional in their choices of investment, as they favoured stocks over fixed income alternatives. The sentiment resulted into a bullish global stock performance, Tech stocks taking the lead on the back of AI transitioning.



Positive performance displayed by companies in Q1'23 financial period also attracted the attention of investors, hence, poised the impressive half year performance as most indices recorded double-digits appreciation.

U.S.

Initially, rate hikes, the failure of Silicon Valley bank and the Signature bank, and fears of debt default weighed on the U.S. economy. Investors think the Federal Reserve will be able to avoid a U.S. recession with its tightening monetary policy to combat persistently high inflation. U.S equities market performance rose with double digits YTD on the back of proactive measures to defend the financial sector and prevent contagion, and also increasing the U.S credit limit to prevent default. The Dow Jones, S&P 500, and Nasdaq composite indices are up by 3.70%, 15.81% and 31.88%, respectively.

Russia's continued conflict with Ukraine raised the cost of essential commodities such as wheat and oil. At the speculation of the OPEC+ supply cut intensified supply chain disruptions, all of which have contributed to the spiraling rate of inflation with businesses contending with increasing input costs, rising interest rates, and a weakening economic outlook.Subsequently, the breadth of earnings revisions has moved into negative territory, which could exacerbate the stock market's losses this year.

The hardest-hit areas of the market included sectors where rising rates challenged their stretched valuations, with growth companies faring the worst. On sectoral performance, as at June 30 2023, the energy sector was the sole gainer, recording positive returns (+32.21%) while the remaining ten posted negative returns. Consumer Discretionary (-23.09%), Communications Services (-21.45%), and Information Technology (-14.25%) sectors house many of the companies hardest hit this quarter. A strong performance lifted the energy sector from oil & gas constituents because of the high global oil price.

EUROZONE

Eurozone shares fell sharply in the quarter. The region has close economic ties with Ukraine and Russia, particularly when it comes to reliance on Russian oil and gas. ECB officials fear the energy price shock triggered by the Ukraine war could severely erode incomes, household spending, and personal savings. One other significant risk is the agreement by the European Union to draw down its dependence on Russia's oil by over 90% before the end of the year, and without having a substantial substitute for the product, this could further drive gas prices northward, driving inflation (6.1% in May 2023) and potentially sending the region into recession, if government actions to contend inflation is sustained.

In response to rising inflation, the European Central Bank (ECB) increase the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility by 4.00%, 4.25%, and 3.50% respectively, which took effected from 21 June, 2023.

H1`2023, the DAX and CAC 40 indices appreciated by 16.14% and 8.09%, respectively. The energy sector was the strongest performer amid ongoing robust demand for oil. The steepest declines came from the consumer discretionary and information technology sectors. Worries over consumer spending led to declines for stocks such as retailers. At the same time, the war in Ukraine also exacerbated supply chain disruption, hitting the availability of parts for a wide range of products.

UK

In early 2022, the UK. economy had expanded beyond its pre-pandemic size, and most sectors were growing. But the Ukraine war shocked the global economy, including the UK. The deteriorating environment has led to a 40-year record inflation level of 9.1%, making investors and consumers cautious amid fears of a potential recession. To subdue the rising inflation, the Bank of England has lifted interest rates five times since December to take the base rate to 1.25%.

The FTSE 100 declined, though it represented the best-performing major equity market for H2`23 compared to other global equities with double-digit losses. The FTSE 100 index fell to 1.20% during the period under review. Most companies within the index generate revenues outside of the UK with high exposure to commodity prices and financial stocks that benefit from higher interestrates and almost no exposure to under-pressure technology stocks.

UK stock market sectoral performance mirrors global sentiment, howbeit less aggressive. Sectors such as Energy minerals, industrial services, communication, and utilities have posted positive YTD (June 30, 2023) returns rising by (28.00%), (9.28%), (6.73%) and (0.86%) respectively. However, consumer services, commercial services, and technology services sectors continue to drag the YTD's market performance. Market sentiment has recently become overly pessimistic, coming into the year's second half. We expect the UK stock market to fair well, unlike their other US and Eurozone counterparts.

Expectations

For the second half of 2022, the weak macroeconomic condition poses an upside risk to a positive return on some investment asset classes, given their high volatility. Inflation has been projected to soar high, driven by high energy and commodities prices exacerbated by the war in Ukraine. Global economic growth is expected to remain frail, with the World Bank slashing its global growth forecast to 2.9%. Overall, this is a time for investors to adopt a cautious approach to investing.

- Focus on Asset allocation: Asset allocation involves dividing your investments among different assets, and an excellent way to achieve this is to key into equity ETFs and mutual funds. Focusing on high-quality companies rather thansector selection isthe most considerable approach given the rising geopolitical and stagflation risks. Companies with pricing power and the ability to protect margins should perform relatively well in this environment.

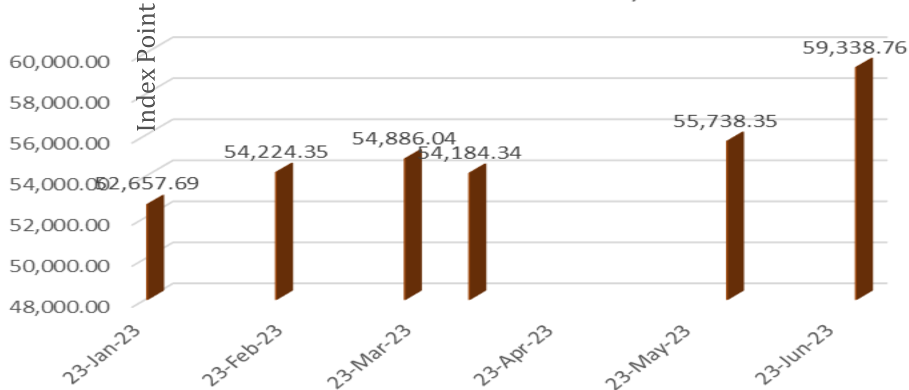
- Favour value and quality in equities: With rising interest rates, global growth stocks valuations have declined in line with higher capital costs. Profitability, strong cash flow generation, low debt, liquidity needs, and high and stable margins are some elements we must look for in our stock selection. Now is a good time to buy into fundamentally sound stocks as they are currently trading at a discount.

- Tactical and active portfolio management: Tighter financial conditions, political instability, and the risk of a monetary policy misstep means that market volatility will persist; hence, we must adopt an active portfolio management strategy to ensure that we can navigate through the changes as they come. Also, tactical discipline remains key as asset allocations must adapt quickly to rapidly

Nigerian Equities Market Review

Nigerian equities market sustained its bullish streak for the first half of 2023. The NGX ASI, which tracks the exchange's share price movement of all listed stocks, appreciated by 12.68% to close at 59,338.76 points. As a result, the market capitalization rose by 18.93% to close at N33.24 trillion, with investors gaining N5.28 trillion in the period under review.

The market performance was driven by impressive corporate FY'2022 and Q1'2023 earnings by major listed companies (mainly from bellwether stocks) that saw some of them delivering robust dividend payout to shareholders. Also, the CBN altered MPR by 200bps to close the period at 18.5% to tame rising inflation. This brought a relatively low appetite in the fixed income segment, especially on the longer date papers as investors take advantage of the equities market rally. Lastly, the rise in activities of domestic investors, especially institutional investors in the equities market, increased liquidity in the local bourse.



Activity Level in the Nigerian Equities Market

In line with the recent trajectory of domestic and foreign participation in the Nigerian equities market, domestic investors continue to dominate activity levels. According to the Nigeria Exchange's (NGX) data, between January to May 2023, domestic investors accounted for 90.49% (N945.02 billion), while foreign investors accounted for 9.51% (N99.34 billion) of activities on the exchange. Hence, bringing the aggregate value of transactions executed by investors for the review period to NGN 1.505 trillion higher than NGN1.51 trillion in the same period of 2022.

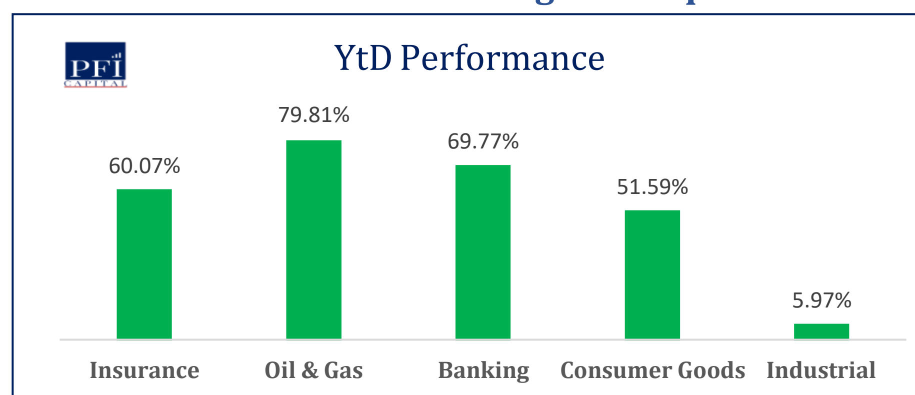
We believe bargain hunting activities in dividend-paying stocks following corporates' announcement of 2022FY and Q1'2023 dividends, coupled with the negative real return in the fixed income market, supported domestic investors' improvement in activity levels.

Foreign investors' appetite for Nigerian equities would likely improve in the subsequent quarters on the back of exchange rate unification and improved liquidity in the foreign exchange market. Investment-friendly policies of the current government would also help in driving in FPI. For context. Foreign investors have remained net sellersof Nigerian equities, as the total outflows of NGN50.04 billion between January to May 2023 outstripped inflows of NGN49.30 billion in the same period.

Months	Foreign (N'bn)	Foreign %	Domestic (N'bn)	Domestic %	Total (N'bn)	Foreign Inflow (N'bn)	Foreign Outflow (N'bn)
Jan-2023	24.90	12.76%	170.20	87.24%	195.10	9.84	15.06
Feb-2023	19.62	10.39%	169.29	89.61%	188.91	3.68	15.94
Mar-2023	9.19	6.29%	137.03	93.71%	146.22	4.60	4.59
Apr-2023	8.47	4.43%	182.74	95.57%	191.21	3.67	4.80
May-2023	37.16	11.51%	285.76	88.48%	322.92	27.51	9.65
Total	**99.34**	**9.51%**	**945.02**	**90.49%**	**1,505.53**	**49.30**	**50.04**

NGX: Domestic & Foreign participation

Sectoral Performance in the Nigerian Equities Market



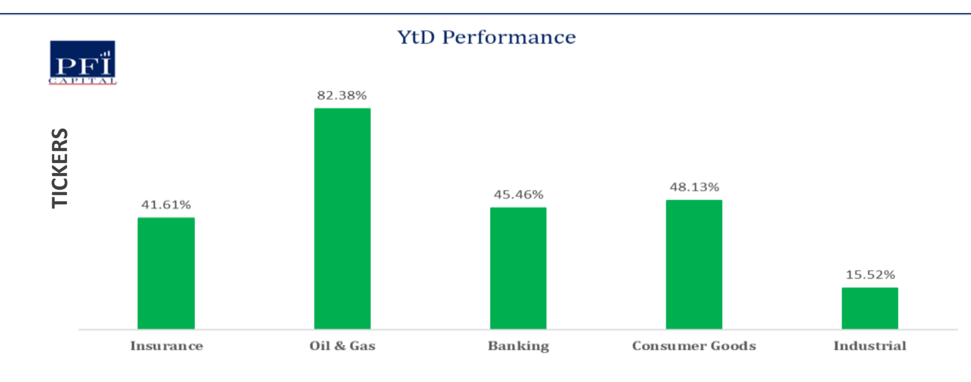
H1'2023 sectoral performance strengthened as we witnessed an appreciation in all of the five indices under our coverage.Specifically, the Oil and Gas Index topped the gainers' chart as it advanced by 79.81%, with the next best performer, the Banking Index, with an increase of 69.77%, followed by the Insurance Index appreciating by 60.07%. The Consume Goods and Industrial Indices appreciated by 51.59% and 5.97% respectively.

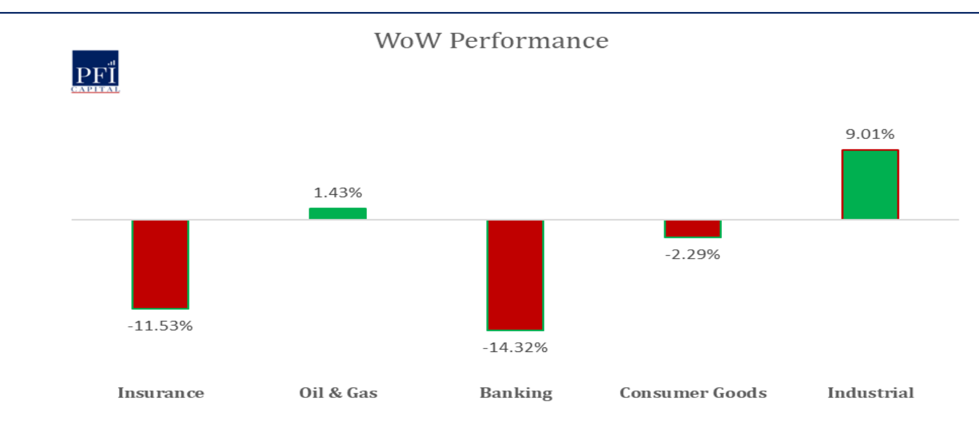
The gains in the Oil and Gas Index were largely driven by the elevated global oil price as well as the growing domestic demand for petroleum products which consequently led to a rally in the shares of SEPLAT (+24.81%), ETERNA (+303.39%), MRS (+583.125%) and CONOIL (+324.52%).
For SEPLAT, the buying interest was bolstered by strong corporate 2022 FY earnings as revenue, gross profit, and profit before tax grew by 29.8%, 63.0%, and 15.3%, respectively. ETERNA FY''2022 financials were positive as revenue and PBT grew by 41.69% and 124.03%, respectively. Likewise, CONOIL's Q1'2023 revenue and PAT appreciated by 33.7% and 397.0% respectively.

Gains in FBNH (+90.59%), ACCESSCORP (+111.17%),
and GTCO (+49.06%) supported the Industrial Index. We highlight that an impressive Q1'23 performance by the banking giants in PAT, FBNH (+54.58%), ACCESSCORP (+23.91), GTCO (+34.62), attracted investors attention in the banking sector, especially in the tire-1 banks.

The Consumer good Index recorded a positive first-half return as the breweries industry exhibited strength and sustainability after a difficult cash crunch season. Impressive financial earnings spurred investors interest as evident in gains recorded in NESTLE (+11.10%), CADBURY (+53.71%), and PZ (+117.82%). PZ plc, the biggest gainer, continued its impressive growth trajectory, posting a profit after tax of +140% in FY'2022.

It is essential to mention that TELCO stocks contributed significantly to driving the overall bullish sentiment in the equities market. Q1'2023 GDP growth was largely buoyed by the ICT sector driven by growth in Telecom, where companies like Airtel Africa and MTNN continue to drive growth in that sector. Notably, AIRTELAFRI and MTNN posted increase in revenue generation in Q1'23 by 17.6% and 20.62%, respectively, for H1'2022. We expect both companies Payment Service Banks (PSBs), to impact positively on their earnings in the subsequent quarters.





Inflation Concern, Rising FI Yield and Global Risk and Uncertainty could Mask Fundamentals

Inflation is adjudged the prevalent economic theme across the global economy, attributable to the increasing energy prices and disruption the global supply chain, occasioned partly by the war in Ukraine, among others. Consumers are constrained by the rising cost of essential goods and services, which has destroyed their purchasing power. In a move to tame theincreasing inflation, the CBN MPC, in its last meeting in in April, took an aggressive hawkish stance, raising the interest rate by another 50bps, now printing at 18.5%. The hawkish move is expected to drive an uptick in fixed income yields. Furthermore, an increase in interest rate will increase the cost of capital of companies which could dampen their bottom-line performance and lower the future discounted valuations of growth stocks.

Global risk and uncertainty persist with worries over stagflation and a likelihood of a recession in global economies (already, the Chinese economy has witnessed a negative growth. Consequently, global stock markets have seen massive selloffs, which could drive domestic investors to taper down on their exposure to the equities market.

Also, the impact of the prolonged war in Ukraine is bound to trickle down into the Nigerian economy as a result due global interdependencies, with rising energy costs impacting the bottom line of the financials of several of the listed companies, resulting in declined earnings. These crises have also resulted in the rise in prices of commodities such as durum wheat, flour, maize, cereals, etc., given a shortage in supply from Russia and Ukraine. The increase in the prices of these commodities will impact the companies under the Consumer goods index that rely on these commodities as raw materials for their production.

Overall, we believe the factors that will shape market performance in the year's second half will pose a substantial test for the monumental gains (+18.93% H1'2023) accumulated by investors. For one, government economic roadmap, expectations of an uptick in Fixed Income yields, are likely to increase participation in the equities market. Notwithstanding, we expect gains to be supported by the continued rise of domestic participation in the equities market.

Nigerian Equities Market Outlook H2'2023

Given the impressive performance recorded in H1'2023 amidst economic headwinds, which is not far-fetched from our expectation that corporate earnings and dividend releases in FY'22 will sway investors' interest in the equity space, we expect such sentiment to continue in the coming second half of the year, backed by government's investment-friendly policies. We further expect low activities in the Fixed Income Market on rising inflation. However, risk-averse would continue to patronize the FI segment of the market. Also, the current macroeconomic conditions such as inflation, scarcity of FX, unending structural challenges, increasing cost of financing, and political uncertainties could hurt the margins of listed companies.

Equities Market Investment Strategy

Based on our outlook, we still maintain the following strategies for the equities market this second half;

- Avoid exposure to stocks with little earnings growth; for instance, most banking stocks struggle to find much potential for earnings owing to the tight liquidity conditions (increased CRR debits), instability in the FX market, and the intense rivalry for margins in the sector. However, there is a potential to enjoy dividends from long-term investing in some banking stocks, as most of these stocks have been shunning dividends consistently.

- Stocks in the Oil and Gas, telecoms, and agricultural sector are billed to outperform their counterpart owing to the rise in energy price, increasing innovation in the IT space (especially in the AI era), and a rise in the demand for commodities (palm oil, CPOs, rubber etc.), hence, we advise rebalancing of portfolio to include stocks in these sectors.

Overall, we advise portfolio and investment managers to employ an active portfolio management strategy for the remainder of the year.

FIXED INCOME MARKET REVIEW AND STRATEGY

Global Fixed Income - H1'23 Overview

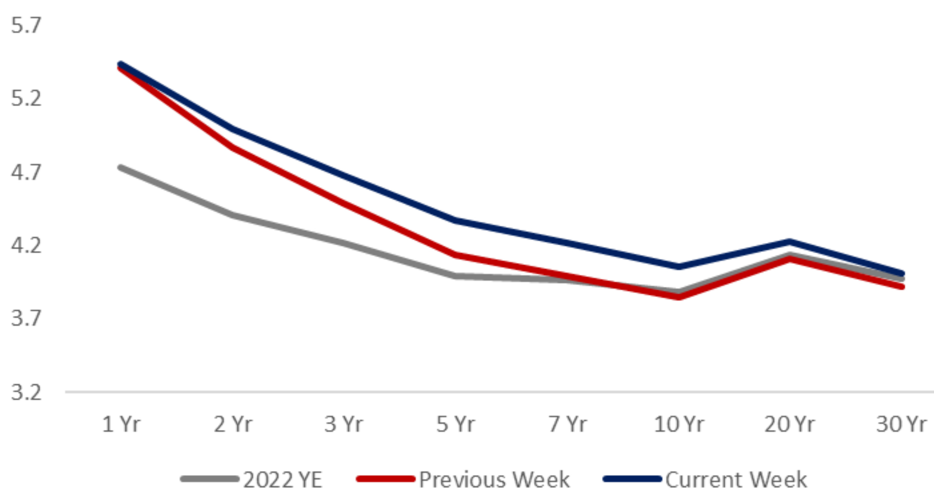
The global economy went through headwinds in H1:2023. The invasion of Ukraine magnified the pre-existing strain that the pandemic exerted on commodity prices and aggravated global supply chain disruption. Consequently, inflation soared worldwide, prompting policymakers' tradeoffs between supporting economic growth and stabilising prices. Systemic central banks' consequent contractionary policy stance to combat rising prices tightened global financial conditions, with adverse implications for global debt dynamics. The global debt stock rose $8.3 trillion in the first quarter of 2023 to hover around $305 trillion. In our view, this quarterly slowdown is more likely indicative of the impact of rising global interest rates on the debt market rather than a seasonal effect.

In the rest of 2022, record-high inflation will be above central banks' target globally. IMF projects average global consumer prices to fall to 6.6% in 2023 against 7.4% in 2022. Thus, sustaining the drive for rate hikes for the rest of 2023, we expect the global liquidity environment to tighten and the global debt market vulnerable in 2023.

On the back of the rate hikes, the fixed income market witnessed bearish sentiment. Bond yields continued to rise, resulting in negative returns, especially between April and May'23, as the 30-year Treasury yield increased from 3.87% to 4.03% andthe 10-year from 3.86% to 4.05%. Also, the U.K. 5-year and 10-yearyields rose from"0.89% and 1.90%" to "1.83% and 1.88%".

In May'23 the global bond yields started the month on a high note in the U.S. before they moderated in the second week of June when the U.S government voted to raise credit limit by $2.5 trillion to $33.8 trillion to meet its maturing debt obligations, which provided some assurance to markets, claiming "inflation pressures may no longer be worsening." Notably, the 10-year Treasury yield decreased from 3.88% to 3.85% in May 2023. However, with the Bank of England's plan to hike rates aggressively this year, the U.K. 10-year Treasury yield rose from 1.92% to 2.10%, and the 30-year yield marginally declined from 3.97% to 3.92%.

In Jun '23, easing global inflation and pulse in rates in the major global economies impacted the yields. Both the 10-year yields of the U.S. and U.K. compressed from "3.88% and 3.85%.



Sub-Saharan Fixed Income – H1'23 Overview

Soaring inflation, central banks' hawkish responses, and the Russian-Ukraine crisis were the major highlights of the first half of 2023. Specifically, the Fed's rate hike to 5.5% from 4% triggered a risk-off attitude toward emerging markets assets. For the Sub-Saharan African (SSA) region, fiscal vulnerabilities, currency depreciation, and debt servicing issues intensified the aversion. These headwinds provoked a repricing of instruments and capital flight from the SSA region to safer havens. Consequently, the performance of SSA Sovereign Eurobond markets under our purview remained weak in the first half of 2023. The waning investor confidence also hit the corporate Eurobondmarket as the average yield on papers tracked increased to 16.4% from 12.2% in H1:2021.

Specifically for the Sovereign market, yields on the ZAMBIA 2022 bond rose the most from 30.560% in H1'23, as the paper nears maturity coupled with the country's failure to service obligations amid fiscal challenges. NIGERIA 2024 paper also recorded an increase in yield to 11.1% as investors reprice due to maturity and increased credit risk Similarly, the Ghanaian instruments recorded selloffs (2026 paper yield rose the most to 49.27% from 23.0%) owing to high debt levels, debt restructuring amid fiscal challenges and depleting reserves. Meanwhile, price adjustment as the SOUTH AFRICA 2025 yield rose to 6.17% from 5.62%, in the reviewed period. Aside from repricing that pushed yields on maturing corporate instruments higher, the yield on ECOBANK 2024 compressed 10.1% from 12.15%, and SEPLAT 2026 compressed to 13.14% from 15.63%in the period.

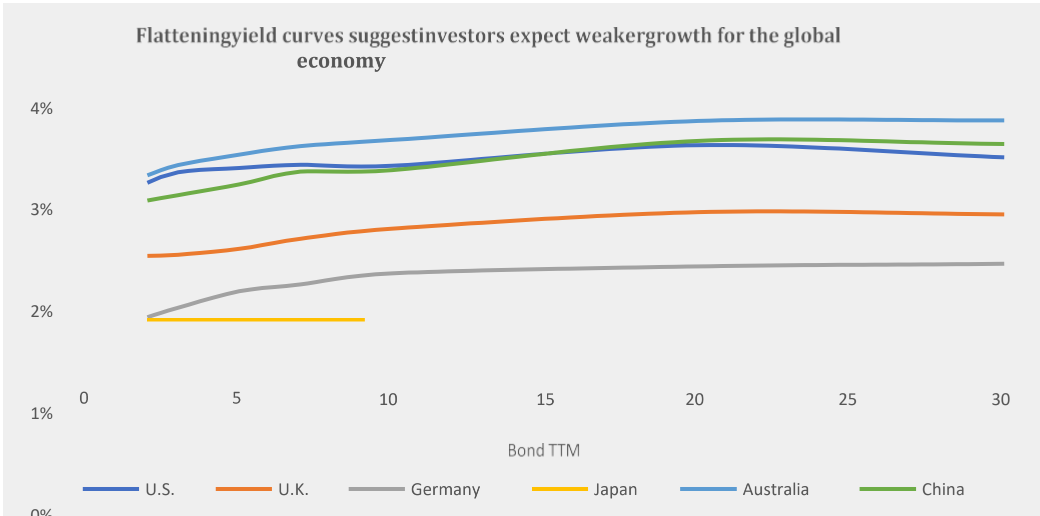
Chart 2: Average Yield Trajectory for SSA Sovereign and Corporate Eurobonds

Country	Issuer Name	Amount Outstanding ('m)	Issue Date	Maturity Date	Book Size ('m)	Coupon (%)
Corporate						
SEPLAT		100.0	26/6/3	1/4/2026		7.75
ACCESS		250.0	16/6/2023	21/9/2026		6.125
ECOBK		500.0	23/6/2026	18/4/2024		9.5
Sovereign						
SOUTH AFRICA	South Africa Government	1,400.0	4/20/2022	4/20/2032	3,000.0	5.9
ANGOLA	Angolan Government	1,750.0	4/14/2022	4/14/2032	4,000.0	8.8
SOUTH AFRICA	South Africa Government	1,600.0	4/20/2022	4/20/2052	3,000.0	7.3
NIGERIA	Nigeria Government	1,250.0	3/24/2022	3/24/2029	3,600.0	8.4

Global Fixed Income – Outlook

On the back of the rising inflation, resulting in an aggressive tightening monetary policy, we saw significant repricing across financial markets, with lower valuations in the global equities market, while commodities and haven currencies are substantially higher. As the year progresses, the war in Ukraine remains a threat to the recovery, with surging inflation, fiscal and monetary tightening, and flattening yield curves adding additional risks.

Chart 3: Yield Curve across Global Economies



Source: Bloomberg, PFI Research

The continuous rate hike would shape H2:2023 in Advanced Economies, which would further make a case for capital outflow and unattractiveness of the market. Meanwhile, the SSA monetary authorities' responses would be closely monitored and are expected to dictate the market's direction. The region is projected to witness slower economic growth (3.6% by the IMF), even with elevated commodityprices, which is a plus. In addition, socio-political instability, currency depreciation, and revenue constraints amid rising debt levels remain significant headwinds. Nevertheless, we see opportunities for bargain hunting as papers are lowly priced. Also, there is potential for renewed interest if inflation and policy normalisation slowdown in Advanced Economies. Therefore, we foresee a weak outing for the Eurobond markets due to a persistent rise in yields. Likewise, we expect a holdback on new issuances, though SSA's external debt is estimated to increase to $800bn from $781.2bn in 2022.

Generally, in the global economy,

- As inflation continue to decelerate in the US, decreasing from 4% in May to 3% in June. We expect a pause in rate hikes by the Fed Reserve in the short run, while one more hike may occur in September to keep inflation within the Fed target of 2%.

- With EU inflation rate at 6.1% in May, the ECB will likely hike the rate by a minimum of 25bps in July, a 50bps hike in September 2023, before pausing for the rest of the

- year as inflation remain sticky.

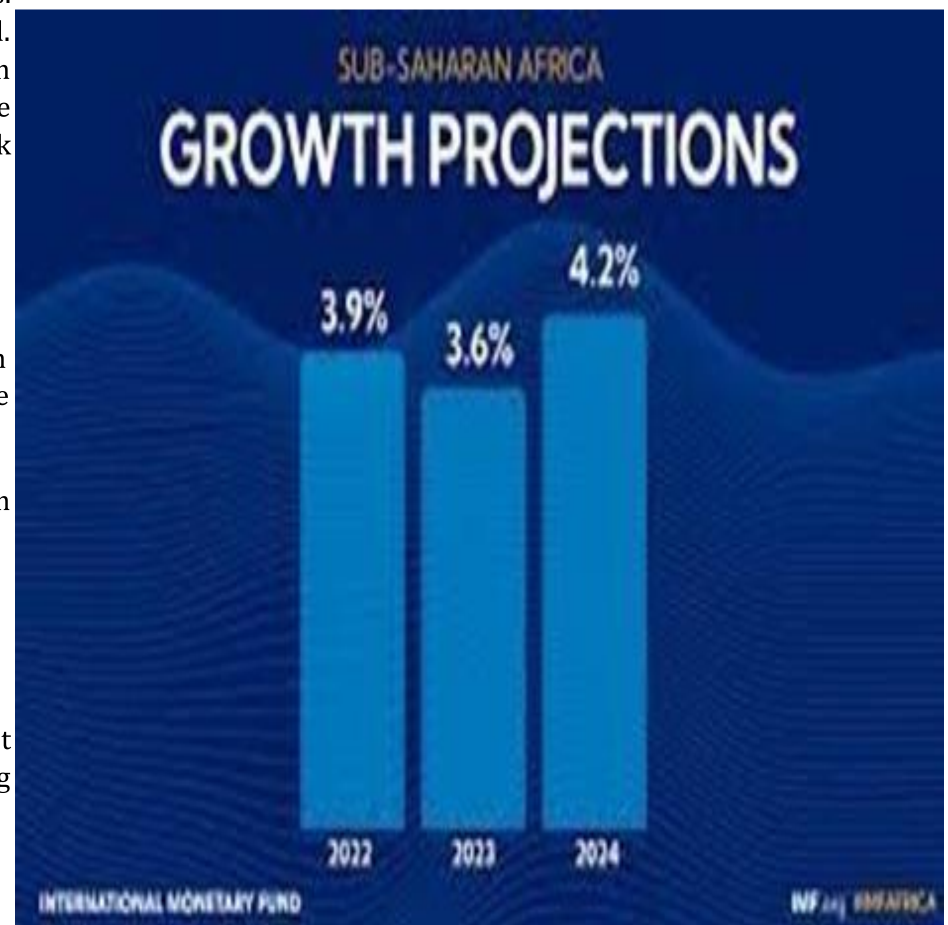
- In the United Kingdom, inflation printed at 8.7% in May. With the above-the-target point, the BoE will likely hike rates further to 150bps to 5.5% in July before pausing its hiking cycle.

Sub-Saharan Fixed Income - Outlook

Yields across Sub-Saharan African (SSA) markets have risen across the board as secondary market participants have reacted to the latest guidance from their central banks. With expectations of further rate hikes in developed markets, monetary officials in the Sub-Saharan region will come under pressure to raise rates as well, as they try to attract and keep flows from the foreign market.

However, risks for investors are uneven across the board, with select countries in the region facing mounting fiscal risks, such as Ghana, Egypt and Zambia. At the same time, a rebound in the tourism sector has boosted investor confidence in other countries in the region, namely Kenya. One of the region's largest economies, Nigeria, is not expected to see significant pressure on the currency from capital outflows, given the limited inflows into the country (N49.30bn in H1'23) during an easing of monetary conditions in 2020; however, FX supply constraints persist. While for South Africa, a low inflation rate (6.3% in May), coupled with higher yields in the fixed income market, has made South African bonds attractive to investors due to the positive real rate of return.

While we expect the Bank of Ghana to increase its benchmark ratefurther above to a minimum of 32.5% to curb inflationary pressures thatstood at 42.5% in June'23, South Africa, on the other hand, with the positive real rate of return as the current yield on the country's 10-year tenor currently stands around 7.45% outweigh its current inflation of 6.3% in May'23, may continue its marginal rate hike between 25bps to 50bps to counter further inflationary pressures stemming from the Russian-Ukraine crisis.



Nigerian Fixed Income - H1'23 Overview

Contrary to our expectations of rising stop rates at the beginning of the year, we saw rates trend downwards in Q1 2022.

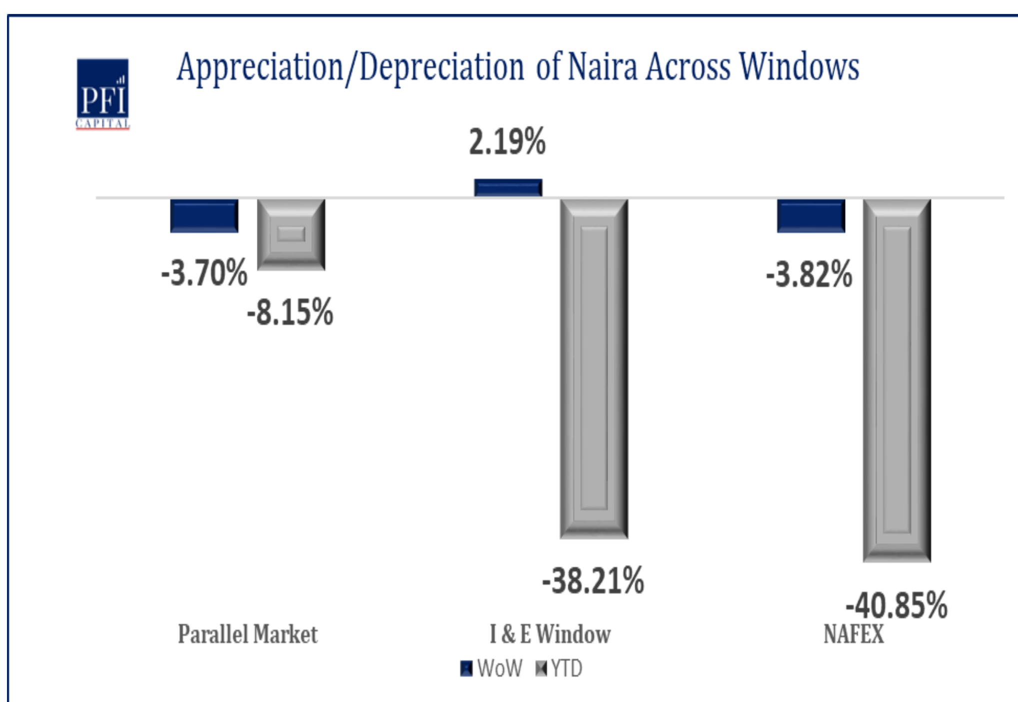
The downward trend in stop rates was driven by elevated liquidity in the system given the huge OMO and bond maturities and expiration of the tax waiver granted to financial instruments (ex FG Issued Bonds). Consequently, investors were mandated to pay income tax on corporate bonds and short-term securities. Given the waiver on FGN bonds, government bonds on the short end of the curve were attractive for investors (compared to buying short-term securities, i.e., treasury bills). Resultantly, the fixed income market in the year's first quarter was characterised by bearish momentum and a sustained decline in yields on FI instruments in the secondary market.

At the short end of the curve, yields for NT-bills and OMO-bills diverged in the secondary market over H1:2023. Precisely, the average OMO yield appreciated 98bps to 4.01% as of June 30, while 91day NT-bills yield rose by 164bps to 6.08%. This divergence can beaccounted for by CBN's decision to maintain stop rates in the OMO Primary Market Auction (PMA) in H1:2023 at prevailing levels despite its unusual switch to a hawkish stance symbolized by a 200bps MPR hike in May.

On the other hand, secondary NT-bills yield was initially on a downtrend up till late March as the consistent decline of stop rates forced market participants to reprice instruments. However, CBN's pegging of interbank lending rates to MPR asymmetric corridors in March, implying a floor of 4.5% per previous MPR of 17.5%,stoked yield higher to maintain the attractiveness of bills. Moreso, the final PMA in March saw the CBN allot bills at a higher marginal rate (average of 4.6% vs. 3.8% inthe prior auction) which added gusto to the upswing in NT-bills yield till June end.

Down the curve, the FGN sovereign bond market was bullish (as stated earlier). Consequently, the FMDQ S&P index, which tracks the price movement of Nigerian government bonds, rose 9.31% in H1:2023.

Despite our outlook hinged on total inflows skewed towards H1:2023, we opine that the DMO's posture also influenced the trajectory of yields to keep a lid on stop rates despite frontloading FG's borrowing. At the same time, we suspect CBN's financing to have placed the FG and the DMO in a comfortable position in the local debt market. Precisely, we note that as of H1:2023, the DMO had raised over ₦2.3tn from FGN bonds (₦1.8tn) and net NT-bills (₦844.3bn) sales. This sum represents 104.3% of FG's initial domestic borrowing target of ₦2.6tn.



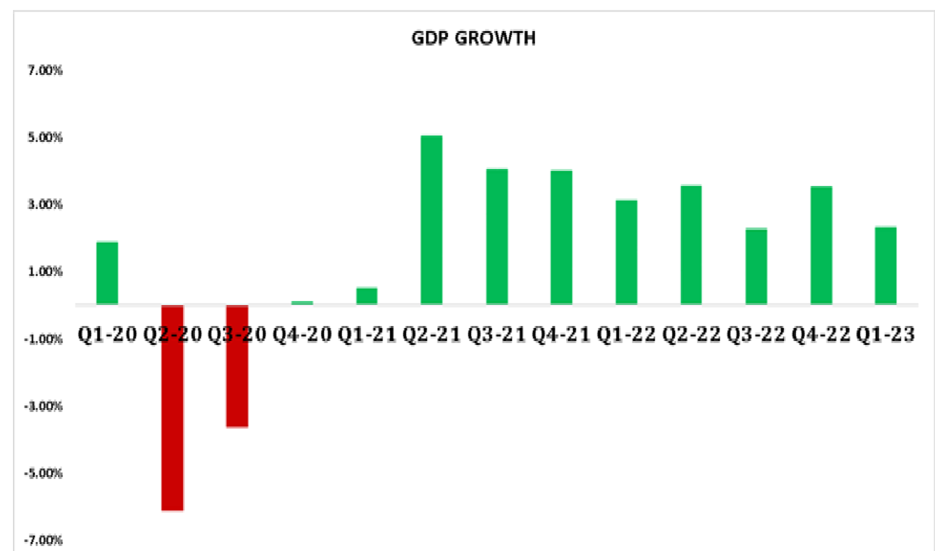
Nigerian Fixed Income – H1'23 Overview

The decision by the National Assembly to increase the Federal Government's expenditure from N20.51 trillion to N21.83 proposed in the 2023 Appropriation Bill has raised the projected deficit from N10.78 trillion to N12.1 trillion. The budget deficit rose by ₦12.1 trillion is to be financed from the domestic market. Based on this development, we estimate a new domestic borrowing benchmark of ₦13.00tn, which implies that DMO has raised 39.43% of the 2023 local debt target.

On a half-year basis, the government borrowed about N3.6 trillion – Bond (N1.84trn), T-bill's overallotment (N687bn), FGN Savings bond (N5.58bn), Ways and Means from CBN (N1.55trn) and Eurobond borrowing of $1.25 billion. Compared with the budget deficitof N7.35trn, it represents c.55% of the fiscal deficit. As a result of the aggressive borrowing, and rising inflation, rates skipped from an averageof 12.4% at the last auction of 2022 to 14.75% at the June 2023 auction.

Corporate Bonds and Issuances rose in H1:2023

The market in H1:2023 as issuers took advantage of the low yield environment to either refinance existing debts or issue new notes. Commercial papers issuances increased to ₦ 921.88 bn in H1:2023 from ₦503.68 bn in 2022 at an average rate of 14.5%. Corporates also issued bonds with a total outstanding value of ₦13.5bn, which includes Eat & Go Finance SPV (₦3.5bn), a 7-year bond at 13.3%, and Pat SPV Plc (GTD) (₦10.0bn) a 10-year bond at 13.60%. With the increasing rates, we believe corporates will be hesitant to borrow significantly as they mull business uncertainties in demand.



Nigerian Fixed Income – H2'23 Outlook

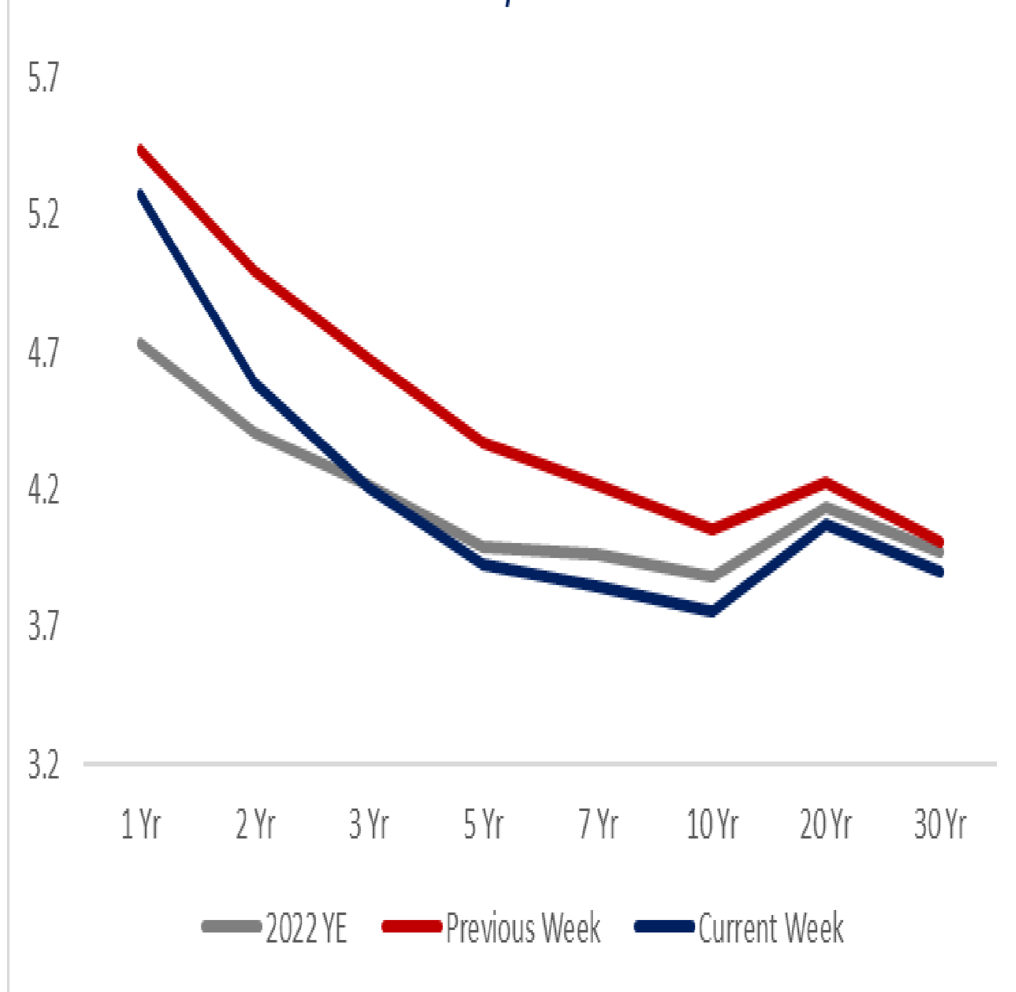
In the coming months, we opine that yields in the fixed income space may continue to trade at current levels or a range of +/-10bps. We neither expect a significant increase nor a decrease in stop rates and yields in the coming months.

We posit that the direction of yields should be determined by demand and supply dynamics, with the current dynamics in favour of investors amid low inflows/maturities and the need to finance the rising budget deficit by the DMO. In addition, we do not see the government tapping the international market given the higher risk premium; thus, we expect these borrowings to be sourced locally (through Ways Means and Advances). Taking all this into account should naturally call for sustained northward movement in interest rates.

However, we believe that interest rates will range bound in H1 2023. Our prediction is based on the fact the body language of the authorities points towards the decline in rates amid concern about its debt service to revenue ratio, which was almost 73.5%, which has already exceeded the threshold of 50%, in Q1 2023, while the pressure on the Naira and the need to sustain local investors' appetite might push the authorities to consider inching up rates at the long end of the curve. Given that the government has borrowed 60% of its fiscal deficit in H1 2023, we believe it gives them the leeway to be less aggressive with expanding rates.

However, the investment-friendly policies of the government may likely drive in foreign investors, and attract FDI and FPI to increase liquidity level in the second half of the year, and subsequently.

Lastly, the uncertainty in the political space might drive apathy towards risky assets as investors stay on the sidelines.

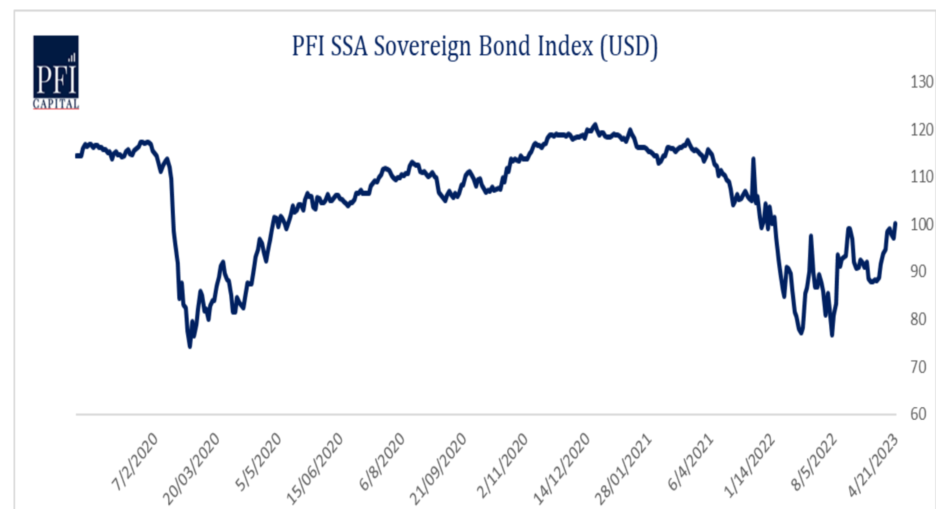


Nigerian Fixed Income – Strategy

While the heightening vulnerability of SSAs assets necessitates cherry-picking across the region, we maintain our buy-and-hold strategy recommendation as the interest-rate shock is likely to wane in H2:2023, and interest in the region's dollar debt is expected to improve. For our passive bond portfolio (which generally comprises corporate bonds that are mostly illiquid), we maintain an existing strategy for investors to continue to hold. We believe it would be difficult for new investors to position in this portfolio; hence, we recommend positioning in short-dated instruments (such as T-bills) and at the short end of the FGN bond market.

Also, considering the expectation of better returns on fixed income instruments on the back of aggressive rate hikes, we opine that duration management is key to an appropriate strategy. Thus, for trading portfolios, we recommend a Short Duration Strategy such that investors consider reducing the duration of their fixed income portfolios. This strategy of buying fixed income instruments with a shorter time to maturity is appropriate given the expectation of a rise ininterest rates and the need to reduce portfolio exposure to interest rate risk. Instruments with longer maturity are more sensitive to interest rate changes, and accumulating short-term instruments, will help to mitigate such risk so that the overall portfolio impact of the rate increase is minimal. Investors could gradually increase the duration of instruments in their portfolios as yields normalise.

We recommend a Short Position in the secondary market for Buy and Hold investors with long-term investment horizons. They continue to operate in the primary market's long end of the curve. This would ensure a weighted average duration of assets. We also favour higher credit-quality instruments, to minimise exposure to default risk.



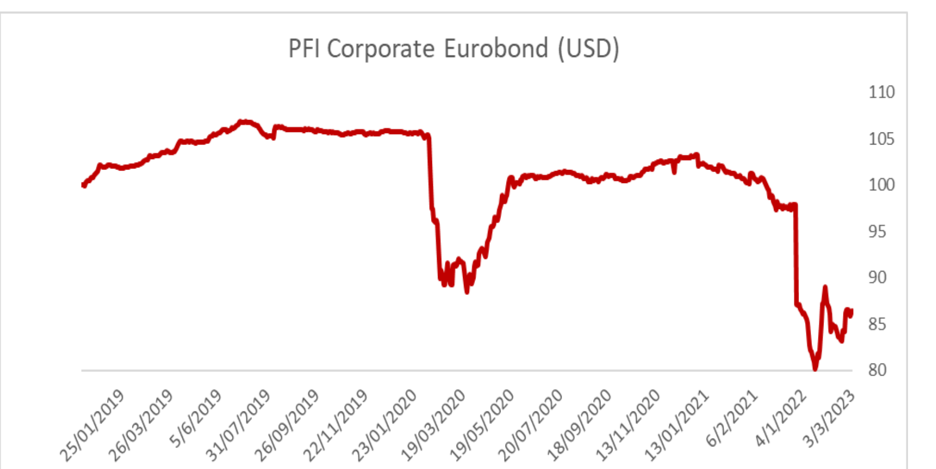


Table 1: Fixed Income Portfolio Recommendation

Instrument Type	Proportion	Duration	Remark
Eurobonds	Up to 20%	Modest	Provides a hedge against Naira inflation and depreciation, low Liquidity.
Commercial Papers	Up to 25%	Moderately High	Modest Real Rate of Return, Low Liquidity
Corporate Bonds	Up to 20%	Moderately High	Modest Real Rate of Return, Low liquidity
Treasury Bills	Up to 20%	Moderately High	Low Real Rate of Return, highly liquid
FGN Bonds	Up to 15%	Moderately High	Low Real Rate of Return, highly liquid

Table 2: Recommended Nigerian Local Bonds

FGN BONDS	Closing Yield	Coupon	Duration	2023 FY ForecastedYield
13.53 23-MAR-2025	10.11%	13.53%	2.39	**11.68%**
12.50 22-JAN-2026	10.59%	12.50%	2.95	**11.92%**
16.2884 17-MAR-2027	12.06%	16.29%	3.59	**13.31%**
13.98 23-FEB-2028	14.07%	13.98%	4.17	**15.15%**
15.00 28-NOV-2028	14.07%	15.00%	4.37	**15.43%**
14.55 26-APR-2029	12.14%	14.55%	4.81	**13.57%**
12.49 22-MAY-2029	12.14%	14.65%	5.01	**13.53%**

Table 3:Recommended African Countries' Local Bonds

Instrument	Fundamentals	Currency Risk	Sovereign Ratings	Comment
Tanzania Sovereign	Strong (Strong growth & revenue outlook; Moderate inflation rate)	High	B2 (Moody's)	R
Egypt Sovereign	Moderate (Strong growth & revenue outlook; high inflation rate)	Moderate	B+ (Fitch) B (S&P)	R
Kenya Sovereign	Moderate (Moderate growth outlook; high inflation rate, improving revenue outlook)	High	B+ (Fitch) B (Moody's)	R
Morocco Sovereign	Weak (Weak growth outlook; high inflation rate)	High	BB+ (Fitch)	NR
Ghana Sovereign	Weak (Moderate growth and revenue outlook; High inflationary pressures)	High	Caa1 (Moody's) B- (S&P)	NR
Mauritius Sovereign	Moderate (Moderate growth outlook; moderate inflation; improved revenue outlook)	Moderate	Baa2 (Moody's)	R
Seychelles Sovereign	Moderate (Moderate growth outlook; strong revenue profile; low inflation)	Low	B+ (Fitch)	R
South Africa Sovereign	Moderate (Strong growth & Moderate revenue outlook; Moderate inflation rate)	Moderate	BB- (Fitch)	R

R = Recommended; NR = Not Recommended

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Contacts Details: PFICapital Limited

Imoh Okoronkwo
Research Analyst

Address: 19B, Babatunde Kuboye Street, Lekki Phase 1, Lagos, Nigeria.
Tel.: +2347013139693
Email: invest@pfi-ltd.com

INVESTMENT STRATEGY REPORT (H2'23)

- Global Equities Market Review
- Local Equities Market Review
- Fixed-Income Market