Ninety One

Africa Fixed Income Opportunities

Market background

It was a solid quarter for EM fixed income markets. In the US, falling inflation and expectations of rate cuts led to a sharp drop in Treasury yields. The Federal Reserve subsequently reduced interest rates for the first time in four years in its September meeting; after much debate across markets around its potential size, the 50bps cut reflected a slowing labour market and increased confidence around inflation dynamics. Against this positive backdrop, African debt markets performed well.

Egypt's positive external funding story continued – the country received over US$800 million from the IMF under the Extended Fund Facility (EFF), and a €1 billion disbursement from the UAE. This shifted its net foreign asset position into a surplus. After five months of disinflation, cuts to fuel subsidies led to a higher inflation print, but it is believed this will be short-lived and that interest rate cuts are still likely in the first half of 2025. Also in the quarter, the Egyptian government announced some measures to encourage private sector growth, including simplifying the tax system for businesses.

In other positive developments, Ghana exited its default status. Further encouraging dynamics in Ghana included: inflation remaining on a downward path; the country's reserves continuing to increase; and ongoing strength in economic growth momentum. Meanwhile, Zambia completed the restructuring of US$1.5bn of Chinese commercial loans. While the ongoing drought is impacting Zambia's economy, signs of rising copper production give cause for optimism. Elsewhere, following the IMF's mission to Senegal, it issued a very negative press release highlighting significant fiscal deterioration in the economy. This prompted a strong negative reaction in the country's bond market.

Performance

The Strategy produced a positive absolute return over the quarter*. Exposure to African local currency and hard currency debt markets added to performance, while positioning in currency markets detracted.

Exposure to the Egyptian pound and Egypt's hard currency bonds helped the portfolio. The country's positive external funding story continued over the quarter, with financing received from both the IMF and UAE shifting Egypt's net foreign asset position into a surplus and helping asset returns.

The portfolio's holdings in hard currency bonds issued by Côte d'Ivoire boosted performance, helped by the fall in US Treasury yields and risk-on tone seen through much of the quarter.

Good appetite for risk in Kenya was evidenced by strong demand for a newly issued infrastructure bond. This helped to allay fears around the country's ability to access local market financing, boosting the local currency market. Exposure added to performance.

Ghana's central bank cut its policy rate over the quarter following supportive inflation dynamics. This, plus strong economic growth, supported domestic assets; the portfolio's exposure to local currency bonds added to returns.

Exposure to some currency markets detracted from performance, including the Zambian kwacha. Drought continues to weigh on the country's growth and inflation.

The Nigerian naira came under continued pressure from domestic demand for US dollars and the central bank rebuilding its reserves. Although the central bank tightened monetary policy, real rates remain negative. Exposure detracted from performance.

*Where performance is gross of fees, returns will be reduced by management fees and other expenses incurred. Net performance is net of highest institutional segregated portfolio management fee.
Not all securities held have been discussed. For further information on how the overall strategy performed during the period covered, please reference the relative performance noted in the Performance review section.

Past performance does not predict future returns; losses may be made.

Portfolio activity

We added some exposure to hard currency bonds in Côte d'Ivoire. The country continued a progressive reform of its fiscal and external balances, with positive data seen over the quarter, and the political situation remains stable.

In Nigeria, the government's strategic reforms have helped the country rebuild external buffers and reduce credit vulnerabilities. We increased exposure to Nigeria's hard currency bonds. We also increased exposure to the Nigerian naira as the currency remains attractively valued.

We heavily reduced exposure to hard currency bonds in Senegal due to concerns around growing political risks, while debt sustainability risks also remain high.

We reduced some exposure to Ghana's hard currency bonds after they outperformed and in light of potential risk relating to the forthcoming election.

We increased exposure to the Egyptian pound. Although short-term inflation rose toward the end of the quarter, we believe it is likely to drop in the first half of 2025.

We sold some exposure to the Zambian kwacha as we are entering a seasonally weaker period for the currency.

We increased exposure to Kenyan hard currency bonds. These had underperformed following domestic protests and the Moody's downgrade to CCC. However, we are more sanguine on the outlook as the government is still on path of fiscal consolidation, external multilateral support is likely to remain high, and we think risks are well priced.

Outlook and strategy

African economies have continued to rebound, and reforms continue at a healthy pace as the message of 'doing more with less in a world of more constrained market access' continues to filter through to policymakers. In the likes of Kenya, Nigeria, Egypt, and Senegal, we've seen significant reforms. Although Africa is not out of the woods given the balance-sheet pain inflicted by several crises over the past few years, we are continuing to see a path towards recovery, with African debt balances currently undergoing the largest deleveraging since the early 2000's.

We also continue to see increased bi-and multilateral support across the continent, which reduces financing risks associated with still-constrained market access.

In addition, markets that had investors particularly worried that they would remain in a perpetual state of distress due to disagreements between creditors during debt restructurings have made significant progress in resolving those issues. For example, Ghana exited its default status in early October, following in the footsteps of Zambia (June). In addition, economies such as Ghana, Kenya and Uganda have started their rate-cutting cycles, and we expect Egypt and Nigeria to follow suit in 2025. We think that a combination of high real rates and better fiscal outcomes will be supportive for the returns of local currency bond markets.

From a top-down perspective, we continue to find value in Africa in distressed and select high-yield hard currency markets, especially as non-market funding and lower imbalances reduce credit risks further out, but we have started to trim exposure in markets where risk premia have largely dissipated. On the local currency market side, we are increasingly seeing opportunities arise as better external and domestic conditions, combined with very high nominal yields and cheap currency valuations, are likely to support larger pockets of African local debt.

Specific risks.

Currency exchange: Changes in the relative values of different currencies may adversely affect the value of investments and any related income. Default: There is a risk that the issuers of fixed income investments (e.g. bonds) may not be able to meet interest payments nor repay the money they have borrowed. The worse the credit quality of the issuer, the greater the risk of default and therefore investment loss. Derivatives: The use of derivatives may increase overall risk by magnifying the effect of both gains and losses leading to large changes in value and potentially large financial loss. A counterparty to a derivative transaction may fail to meet its obligations which may also lead to a financial loss. Emerging market: These markets carry a higher risk of financial loss than more developed markets as they may have less developed legal, political, economic or other systems. Equity investment: The value of equities (e.g. shares) and equity-related investments may vary according to company profits and future prospects as well as more general market factors. In the event of a company default (e.g. insolvency), the owners of their equity rank last in terms of any financial payment from that company. Interest rate: The value of fixed income investments (e.g. bonds) tends to decrease when interest rates rise.