AFRINVEST

THE VIRTUOUS CYCLE...AGAIN!

The Nigerian Economy and Financial Markets | **2017 Review & 2018 Outlook**

January 2018

Outline

Section One

Executive Summary

Global Macroeconomic Highlights

The global economy continued to record synchronised expansion across regions in 2017. This has been supported by sustained momentum in Advanced Economies (AEs), brought about by favourable financial conditions and cyclical recovery in the Euro Area, resilient growth in China and rebound in frontier markets propped by increase in commodity prices. The strong and synchronised global growth upswing is expected to continue into 2018, with the IMF revising 2018 forecast upward by 0.1% to 3.7% in October 2017 and 0.2% to 3.9% in January 2018. Nevertheless, while near term global growth prospects remains broadly positive, increasing geo-political risk, trade protectionism and policy normalization by systemic central banks are downside risks to forecasts.

Likewise, as the move towards normalization strengthens in 2018, supported by favourable labour market conditions and increased momentum in global growth, systemic central banks in developed markets would be more willing to begin monetary policy tightening despite sticky inflation. As central banks gradually normalize monetary policy from the extraordinary measures taken at the peak of the global economic and financial crisis, associated downside risks of tightening global liquidity and capital flow reversals from emerging & frontier markets and currency volatility will become more prominent headwinds to near term growth and financial market stability.

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Domestic Macroeconomic Highlights

The year 2017, in many respects, was a year of recovery for the Nigerian economy and financial market compared to the sharp business cycle contraction witnessed in 2016 alongside weak market returns. Consequent on the upturn in commodity prices, cessation of attacks on oil & gas infrastructure in the Niger Delta region (which had a positive knock-on impact on domestic crude oil production volume) and adoption of pro-market FX reforms by the Central Bank of Nigeria (CBN), economic activity rebounded while investor and consumer confidence as well as business sentiments strengthened.

The Nigerian economy returned to growth in Q2:2017, exiting a 4-Quarter long recession - its first in 25 years – which lasted between Q2:2016 and Q1:2017. Propped by higher oil exports and administrative flexibility in FX management structure, reflected in increased CBN FX Interventions and opening of the Investors' and Exporters' (I&E) FX Window in April 2017, external sector indicators also turned positive with the Current Account Surplus jumping nearly four times from US$2.5bn in 2016 to US$9.5bn in 2017 while cumulative Capital Importation as of 9M:2017 rose 91.5% Y-o-Y to a 2-year high of US$6.8bn. The favourable Balance of Payment dynamics led to accumulation in External Reserves which climbed to a 3-year high of US$38.7bn (29/12/2017) and stabilized the Naira at the official window with a consequential impact on the parallel market which gained 35.0% Y-o-Y against the greenback to close at N363.00/US$1.00 by yearend. Supported by improved growth prospects and FX liquidity, business sentiment, gauged by the CBN's Manufacturing and Non-Manufacturing Purchasing Managers' Indices (PMI), indicated expansion in activity from April 2017 till date. Consumer Confidence has also been on the rise, with the NOI (Ngozi Okonjo Iweala) Polls survey showing a 4.8 points increase in its Consumer Confidence Index from 62.7 points in Q1:2017 to 67.5 points in Q3:2017.

Although price level growth disappointed for much of the year, persistently falling below Analysts' estimates, due to pressures on food prices, Headline Inflation measured Year-on-Year (Y-o-Y), moderated 3.2ppts to 15.4% in December 2017 while the Core measure of prices fell 6.0ppts within the same period to 12.1%.

Although price level growth disappointed for much of the year, persistently falling below Analysts' estimates, due to pressure on food prices, Y-o-Y Headline Inflation moderated 3.2ppts to 15.4% in December 2017 while the Core Inflation fell 6.0ppts within the same period to 12.1%. Labour market slack was the only blot on the strong improvement in core macro variables as the economy struggled to create jobs for the expanding labour force, forcing Unemployment and Underemployment rates to rise 4.6ppts and 0.2ppts to 18.8% and 21.2% respectively in Q3:2017. On the back of the strong oil price tailwind, our near term prognoses for macroeconomic indicators are broadly positive as we expect the economy to consolidate on recent recovery.

Price Level… Benign Outlook as Policy Makers Hold-off on Supply Side Reforms

Unlike 2016 when the spike in food prices pressured the Consumer Price Index (CPI), the major risk-factor for Consumer Prices in 2018 will be coming from the Core Index where delayed supply-side reforms in regulated markets for Power and Fuel could destabilize prices. The Power sector is currently facing a liquidity crunch due to non-cost reflective tariffs and lack of investment in the value chain to ease high Aggregate Technical, Commercial and Collection (ATC&C) losses, resulting in demand for increase in tariff by value chain operators. Furthermore, the "Price-Modulation" template for pricing of PMS (Petroleum Motor Spirit) introduced by the Petroleum Products Pricing Regulatory Agency (PPPRA) in May 2016, in retrospect, is akin to putting Band-Aid on a bleeding artery rather than a landmark reform to liberalise the downstream industry as earlier guided. Already, assumptions included in the template are urgently due for upward review on the back of the increase in the landing cost of PMS – following the oil price rally and the June-2016 Naira devaluation.

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Despite these risk factors, our near-term inflation outlook remains benign due to constrained political will to implement supply side reforms ahead of the 2019 elections. Supportive oil earnings tailwind will also buy the federal government more time to contemplate the reforms. Hence, our base-case scenario projects Headline Inflation moderating further to 12.3% by yearend 2018.

Near Term Growth Outlook … Oil Sector Low Base Effect Will Remain Key Driver

The economy's return to growth in Q2:2017 and acceleration in momentum in Q3 were largely driven by Oil sector GDP which grew 3.5% and 25.9% Y-o-Y in Q2:2017 and Q3:2017 respectively. The sizeable expansion in the Oil sector, particularly in Q3:2017, was due to the low base effect of oil sector production which reached a 6-Quarter high of 2.0mb/d during the period. The Non-Oil sector however remains a pressure point, as it relapsed to negative growth in Q3 after showing positive signs in Q1 and Q2. The disappointing performance of the Non-Oil sector - which was unexpected given the positive readings from leading variables such as the PMI - is evident in virtually all the main Non-Oil categories including Services and Manufacturing which contracted 2.7% and 2.9% Y-o-Y respectively in Q3:2017. The slow recovery of the Non-Oil sector has both cyclical and structural explanations. Cyclical factors include tight monetary policy, subsisting weak fiscal spending – particularly at sub-national level - low real household consumption growth (due to high inflation rate) and benign corporate investment spending consequent on the damaging impact of large FX rate movements in the last 3 years on corporates' balance sheet.

Whilst the structural issues remain headwinds, we note that the cyclical challenges should start to abate from 2018 and buoy Non-Oil sector growth against the backdrop of 1) anticipated expansion in fiscal spending as fiscal balance stabilizes and political parties spend ahead of the election, 2) further deceleration of inflation rate which will directly affect GDP price deflator and support real growth, and 3) Increase in private investments due to favourable aggregate demand outlook and stable FX rate. Similar to 2017, we also expect Oil sector low-base push to remain a key driver of growth until Q2:2018 before the effect wears off as base normalizes. The expected take-off of oil production from Total's offshore Egina field project in Q4:2018 will possibly add approximately 200,000 barrels to daily crude production, but with oil production capped by OPEC at 1.8mb/d (ex- condensates), we do not foresee aggregate oil production (including condensate) breaking its peak of 2.2mb/d.

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Monetary Policy Outlook… Easing Cycle to Enter Full Gear despite Stable Benchmark Rate

As we projected in our 2017 Outlook, the CBN successfully guided short and long-term rates downward in the fixed income market despite retaining benchmark policy rate at 14.0%. Although price level growth disappointed in 2017, with Inflation rate still above MPR, the CBN began an easing cycle with the use of clearing rates at OMO auctions and frequency of auctions as policy instruments to achieve its easing objective. Typically, what should follow the moderation in market rates and signify the full take-off of the easing cycle is a benchmark interest rate cut. However, we believe the CBN would stick to utilizing its recently favoured OMO strategy – which is more flexible - to achieve the same easing objective without tweaking the MPR. Despite our conviction, we do not rule out the possibility of a politically induced benchmark rate reduction in the second half of 2018, in order to make credit available to the real sector. If economic conditions improve further, this could potentially be done in order to score political points with the populace ahead of the 2019 election.

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Our forecast is based on downside risks considerations relating to 1) anticipated fiscal spending in the run up to the general elections and expected volatility in domestic assets market in H2:2018 which will pose a threat to price and exchange rate stability; 2) expected monetary policy tightening by systemic central banks in Europe and North America which could spur capital outflows from emerging and frontier markets and constitute downside risk to domestic exchange rate stability; and 3) benign but double-digit inflation rate which may not necessarily go below MPR but would support a hold on the rate as the CBN tries to consolidate gains on price levels. Hence, our monetary policy outlook favours continued downward repricing of fixed income yields, albeit with a stable MPR.

Fiscal Policy Outlook… Focus on Reducing Debt Service Obligations amidst Rising Expenditure Pattern

Nigeria's increasing debt burden and rising servicing cost have come under focus in recent times for justifiable reasons. Whilst current debt to GDP ratio (18.2%) appears non-threatening, rising servicing cost relative to revenue (47.0% in

FY:2016) and slow growth of non-oil revenue post-crisis have increased debt sustainability risk – a key consideration of Moody's in recent sovereign downgrade. The FGN responded by changing its 10-year long conservative debt strategy of relying more on domestic market for debt to tilting towards cheaper external sources in the global market to reduce servicing costs. Thus, the FGN returned to the Eurobond market after a 4-year hiatus in 2017, raising US$1.5bn in Q1:2017 and US$3.0bn out of a US$5.5bn approved Medium Term Note Project in Q4:2017. Despite the steep decline in domestic market rates, we expect the FGN to stick to the new strategy in the near term due to the favourable global market environment and its ambitious expenditure plan.

As with prior years, the 2018 Budget projects a reflationary spending of N8.6tn, a 16.2% increase relative to the N7.4tn of 2017, with a focus on consolidating on gains recorded in the previous year whilst also prioritizing the need to bridge the investment deficits in the Infrastructure, Agriculture and Health sectors amongst others. While the budget's macroeconomic variables assumptions are not far off from current realities, perhaps even prudent with regards to crude oil prices, we are of the view that achieving >70.0% implementation of capital component will be difficult due to the ambitious non-oil and independent revenue assumptions. As of 9M:2017, performance of the "Budget of Recovery and Growth" had been rather underwhelming with fiscal authorities falling short of revenue targets, especially Non-oil revenue (N0.7tn actual vs. N1.0tn pro-rated projection) and Independent Revenue (N155.1bn vs. N605.9bn pro-rated projection). Thus, the Non-core revenue lines which contain non-recurring items such as Exchange Rate difference and Paris Club over-deduction refund were leveraged to finance the budget. While the Presidency hopes to improve on existing tax reforms to boost income from the Non-oil sector as well as enhance activities in other sectors of the economy, the odds of a significant increase in tax revenue in the short term remains low as Non-oil sector growth remains below historical trend.

Polity Stability: Security Concerns and Ethnic Divide Setting Stage for Volatile Election Cycle

One of the major downside risks to asset prices or capital markets and polity stability in 2018 is politicking ahead of the General Elections holding in February 2019. President Muhammadu Buhari of the All Progressives Congress (APC) is widely expected to seek re-election in what would potentially be a keenly contested poll due to the waning popularity of the incumbent in Southern Nigeria (see NOI polls) and divisions in the ruling party which has already led to the defection of Former Vice-President Atiku Abubabar to the opposition People's Democratic Party (PDP).

Typical of election cycles in frontier markets, we expect to see some volatility in financial assets in the period leading up to the polls whilst policymaking will take a shorter-term perspective. Key issues we expect to dominate debates include Job Creation, Security and Political Restructuring. Slacking labour force despite improving growth profile has led to an increase in Unemployment and Underemployment rate with 34.0m people either without jobs or underemployed. Whilst secession agitation in the South East appears to have lost momentum and government's efforts to placate Niger Delta militants has largely succeeded, the impact of climate change – which has ravaged grazing fields in Northern Nigeria – has increased incidences of trespassing in farmlands in North

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Central and Southern Nigeria by nomadic Fulani cattle herdsmen searching for greener pasture. This, perhaps appears to be the prime near-term security risk, setting the stage for a potentially volatile election cycle in 2019.

Nigerian Financial Markets

The Nigerian equities market posted its first positive annual return in four years (+42.3%) in 2017, ranking the benchmark All Share Index (ASI) as the 11th best performer in the world and 2nd in Africa. The launch of the Investors' and Exporters' FX window in April,2017, was a turning point for the market during the year while a rebound in economic activities, supported by rising oil prices above US$60.0/b and improvements in company earnings kept investors vested in the market all through the year.

From our analysis, average Trailing P/E and P/BV for the Nigerian equities market in the last one month as at 17/08/2018 stood at 13.1x and 1.7x, which are lower than 15.1x and 2.0x respectively for the MSCI Frontier markets index.

With the market now at an all-time high in terms of market capitalisation and the NSE All Share Index at a 9-year high, there are justifiable fears of overvaluation of the market which raises concerns with regards to a near term correction. Our approach is to diagnose and probe the fundamental as well as technical merits and demerits of the overvaluation hypothesis.

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Average T-bills yields on 91-day, 182-day and 364-day benchmarks settled at 17.3%, 18.7% and 20.3% in 2017 relative to 12.5%, 14.3% and 15.0% respectively in 2016.

Prior to 2017, the Nigerian Yield curve maintained a Humped or Bell-Shaped slope since Dec-2016 – indicating the broadly recessionary environment. However, by the turn of 2017, we observed a bull flattening pattern as investors aggressively positioned in longer-dated bills. Notwithstanding the sustained hawkish monetary policy stance, pressure on general price levels, improved investor appetite for safety and the weak start of domestic equities market amongst others shaped the direction of yields in 2017 as well as the overall level of activities in the fixed income market. Investors displayed overriding interest for shorter term fixed income securities compared to bonds as the supply of T-bills and OMO (Open Market Operations) from the CBN propped up activity levels. While the activity dominance of most institutional investors – PFAs, DMBs and Insurance companies - remained prevalent in the year, the attractive interest rate environment strengthened by the CBN's tight monetary policy stance also attracted retail and HNI investors to the market. Average T-bills yields on 91-day, 182-day and 364-day benchmarks settled at 17.3%, 18.7% and 20.3% in 2017 relative to 12.5%, 14.3% and 15.0% respectively in 2016.

On the medium to long term end of the market, the dominance of the Federal Government of Nigeria as the largest supplier of fixed income became entrenched in 2017 with a total sovereign bond issuance value of N1.5tn compared to N1.3tn in 2016. In addition, the FGN explored alternative long term borrowing windows within the domestic market including the launch of the Quarterly Coupon Paying Savings Bonds (N7.0bn, 13.5%), N100.0bn Sukuk bond issued at 16.5% rental yield and the Green Bond worth N10.7bn issued in December 2017 at 13.5% yield. Also, the Debt Management Office (DMO) successfully raised a total of US$4.5bn (in four tranches) from the Eurobond market at an average marginal coupon rate of 7.3% while also successfully completing a US$300.0m Diaspora bond at 5.6%.

We believe the yield environment in 2018 will be largely determined by market activities as already being noticed since the last quarter of 2017. Nevertheless, we do discountenance the possibility of a benchmark rate reduction in H2:2018 to align with market movement. We are of the view that the demand for safer sovereign instruments by Institutional Fund Managers (notably PFAs, Insurance Companies, DMBs as well as HNIs will propel market activities towards yield moderation. We highlight some of the revelations from gazing at our crystal ball to include:

- Yield Moderation on Long Term Instruments
- Undissipated Inflationary Pressures may Keep Short Term Rates Upbeat
- Flurry of Commercial Paper Issuance as Government Participation Reduces
- Higher Modified Duration Bonds will Support Long Term Fixed Income Strategy
- Eurobonds Market will Favour Active Fixed Income Strategy
- Corporates will Explore Domestic Market Options for Long Term Financing

Our optimism for the Nigerian markets in 2018 hinges on the slow but steady recovery in the general macroeconomic conditions following the upturn in global oil prices. Stable oil price outlook puts less strain on monetary and fiscal policies given the significant dependence of government revenue on oil exports as well as the umbilical reliance of the CBN on the sector's foreign exchange earnings in optimizing FX allocation. As the economy gradually regains its growth momentum, we are confident that improved fundamentals, coupled with enhanced investor sentiment – currently at all-time highs, will continue to drive equity asset prices. Correspondingly, our prognosis on interest rate proposes a market driven moderation in 2018 as the government shifts its focus from short term domestic borrowing to long term foreign debt while investors explore alternative high yielding domestic short/long term securities.

Recovery Driven Fundamentals to Shape Investment Strategy

Against the backdrop of macroeconomic headwinds, our investment strategy in 2017 had advised a cautious strategy focused on capital preservation whilst recommending investors stay overweight on fixed income securities over equities with an advised mix of 80:20 allocation. Looking back, all our crafted portfolios outperformed market benchmarks by significant margins with our equity dividend portfolio returning 77.8% (vs. NSE ASI 42.3%) and the worst performing bond portfolio gaining 16.6% (vs. market benchmark of 11.6%).

Having survived the policy misalignment that enveloped and weakened equities market return in 2016, we are of the view that the recent recovery momentum, which began in 2017, will be sustained in the near term. On the back of a 42.3% return in 2017, the NSE All Share Index is set for another bullish year, in what looks like a repeat of 2013, having gained 17.9% as at 19/01/2018. Similarly, the bull run in the fixed income market in Q4:2017 resulted in a 10.5% return in the Access Bank Bond index in 2017 relative to a 4.5% loss in 2016; yet, expectation of lower yields in 2018 will shape performance on fixed income securities. Consequently, we reason that for the investment strategy in 2018 to be optimal, it will necessarily have to hinge on fundamentals of investible asset classes. However, contrary to our 2016 and 2017 investment strategy that suggested overweight on fixed income securities over equities, we believe 2018 will be more skewed towards a balance of play between the two traditional asset classes.

Whilst we are more cautious about equity market valuations inching beyond its fundamental value threshold, we are also assured that, barring a dysfunctional foreign exchange market, equities are possibly set for appropriately timed entry and exit opportunities in 2018. Fundamentally backed sentiments will conceivably propel the equities market on a volatile but upward trending trajectory which informs our Equity Strategy that is skewed towards five (5) major portfolios. Contrariwise, Long Term play defines our overall strategy in the fixed income market for 2018. We expect the easing of the crowding out effect of the federal government in the domestic debt market to create incentives for sub-national and corporate debt issuances as rates on sovereign instruments moderate towards long term average levels. Importantly, our four (4) portfolios for smart fixed income investing in 2018 is themed: "Active "and "Liquid".

The Virtuous Cycle… Again!

To investors familiar with frontier markets, the almost 360-degree turnaround in Nigeria's economic fundamentals and investor sentiment is not surprising, given the strong correlation of the business cycle and capital market with foreign currency earnings for commodity exporting countries. In our 2017 outlook titled "*Reform or Be Relegated*", we had reflected that;

"*A return to 2015 level of crude oil production (2.1mb/d) would comfortably lift oil sector GDP (which accounts for c.9.0% of aggregate real GDP) by an estimated 15.0% Y-o-Y in 2017 and may pull the economy out of recession… On this basis, Nigeria's business cycle would be highly dependent on the ability of policy makers to deliver incremental oil output in 2017, restore macroeconomic stability by rebuilding confidence in monetary policy and the administrative side of the FX market structure as well as showing commitments to structural reforms.*

We expect the easing of the crowding out effect of the federal government in the domestic debt market to create incentives for sub-national and corporate debt issuances as rates on sovereign instruments moderate towards long term average levels.

These would be necessary to stabilize external account, rebuild external reserves, improve liquidity in the FX market and achieve lower inflation as well as lower long term interest rates."

Events in the last 12 months have justified our prognoses as policymakers were able to deliver on:

1. Increase in domestic crude oil production from a low of 1.6mb/d in Q3:2016 to 2.0mb/d in Q3:2017.
2. Restoration of FX market stability following the increased volume of FX interventions, particularly to BDCs, and eventual opening of a market-oriented FX segment (the I&E FX window), which allowed for flexibility in pricing of FX as well as efficiency and transparency in allocation. The CBN spent US$15.4bn in the first nine months of 2017 intervening in the FX market via Spot and Forward Interbank FX auctions and spot sales to BDCs, relative to US$9.6bn spent in the same period of 2016, while the I&E window recorded US$27.8bn in turnover in 2017.
3. Release of the Economic Recovery and Growth Plan (ERGP) in Feb-2017 - arguably the most ambitious development plan by the FGN since the National Economic Empowerment and Development Strategy (NEEDS) document published in 2004. The ERGP is a medium-term plan (2017-2020) which focuses on five key priority areas: 1) Stabilizing the macroeconomic environment, 2) Ensuring energy sufficiency (power & petroleum products), 3) Achieving agriculture and food security, 4) Improving transportation, and 5) Driving industrialization by focusing on small and medium scale enterprises. An implementation and performance measurement management process was set up to drive execution of the plan.
4. Tackling some of Nigeria's deep-seated structural constraints by surpassing Ease of Doing Business reform target of moving up 20 places in World Bank's Ease of Doing Business ranking in 2018. Nigeria moved up 24 places to 145th and ranked in the top 10 most improved countries.

Fate also smiled on Nigeria as faster than expected rebalancing in the oil market buoyed oil prices and complemented the reform by policymakers to restore macroeconomic stability. Due to the high level of compliance of OPEC/Non-OPEC countries to the deal reached in November 2016 (extended for six months in December 2017) to cut oil production by 1.8mb/d and supply disruptions in the US, UK, Nigeria and Libya, Brent Crude averaged US$54.74/b in 2017 compared to US$45.13/b in 2016.

These reinforcing factors, some due to happy accidents or providence and others, a result of deliberate government efforts, have aided Nigeria's exit from the "**vicious cycle**" of macroeconomic instability and weak capital market returns and ushered in, once again, a "**virtuous cycle**" of stability in external sector indicators and fiscal balance, declining inflationary pressures, improving growth profile, increasingly accommodative monetary policy and strong capital market returns.

Yet, despite the oil price tailwind driving asset prices and short-term growth outlook, Nigeria's recurrent energy crisis, high unemployment rate, fiscal insolvency of sub-national governments, high dependence on oil earnings for fiscal revenue & current account stability as well as several unforced administrative errors by the ruling political class are constant reminders of

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unresolved structural fault lines. Thus, even as we are positive on short term growth prospect as revealed in our report title **"The Virtuous Cycle… Again!"**, we continue to emphasize on our 2-year long theme calling for structural reforms from policymakers to build long term macroeconomic resilience. As the country nears two decades of uninterrupted democracy, by far its longest run post-independence in 1960, we believe issues to top the reform agenda over the next year should include: the liberalisation of the downstream petroleum sector, total deregulation of the power sector to enthrone a more cost reflective electricity tariff, Governance Reforms echoing some of the major themes of much talked about restructuring, Infrastructure Investing, Economic Restructuring to aid Fiscal Viability of Sub-Nationals and Creation of Job Opportunities for the galloping population.

Section Two

Global Economic and Financial Markets Review and Outlook

Synchronised Global Growth Expansion to Continue Despite Policy Stability Risks

Despite heightened geopolitical and policy uncertainties at the start of the year, ranging from the rise of political populism in advanced economies to fears of hard landing in China and policy normalization by the US Fed, the global economy recorded strong and synchronised growth across regions in 2017. The broad-based expansion in economic activities was supported by sustained momentum in Advanced Economies (AEs) – brought about by favourable financial conditions and cyclical recovery in the Euro Area – resilient growth in China and rebound in frontier markets, propped by increase in commodity prices. As a result, the IMF's initial global growth forecast of 3.5% for 2017 was revised northwards to 3.6% – the fastest pace of growth since 2011 – in its October World Economic Outlook report.

Notwithstanding downside risks associated with anticipated monetary policy normalization in AEs – against the backdrop of rising inflation expectation and tighter labour market – fears of slower growth in China, US policy uncertainties and geopolitical tensions, the strong and synchronised global growth upswing is expected to continue into 2018, with the IMF revising 2018 forecast upwards by 0.1% to 3.7% in October 2017 and 0.2% to 3.9% in January 2018.

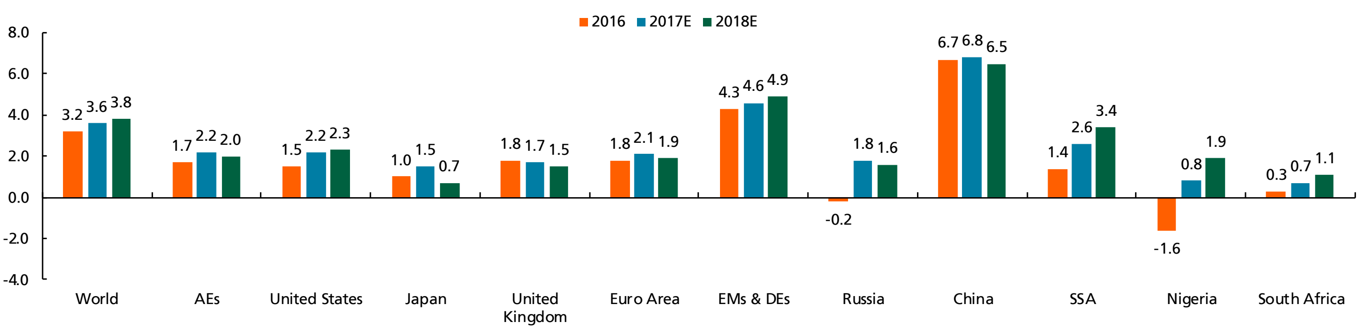
Although growth for AEs is expected to slow to 2.0% in 2018 from estimated 2.2% in 2017, due to shrinking excess capacity and demographic trend, the IMF projects the US economy to expand 2.3%, anchored by strong consumer and business confidence combined with supportive financial conditions and positive knock-on impact of the recently signed Tax cut bill. The Tax Bill was signed into law in Dec-2017 and encompasses a tax overhaul – a slash in corporate, household and small business tax. Meanwhile, UK's economy is expected to grow 1.5% in 2018, lesser than estimated 1.7% in 2017, against the backdrop of disappointing quarterly growth figures in 2017 as well as the effect of currency depreciation on consumer spending. Since the Brexit referendum in June-2016, concerns have continued to weigh heavily on economic activities with impact seen to affect near-term growth outlook.

Buoyed by an accommodative monetary policy and supply side reforms, the Chinese economy is projected as the major driver of growth in Emerging and Developing economies (EMs & DEs). The IMF projects a 6.8% expansion in 2017 (from an initial forecast of 6.6%) but however expects growth to slow 6.5% by 2018. Notwithstanding, growth for EMs & DCs is expected to rise from 4.6% in 2017 to 4.9% in 2018, supported by improved growth outlook for India (7.4% in 2018 from 6.7% in 2017) as well as commodity-dependent MENA (3.5% vs. 2.6% in 2017) and SSA (3.4% in 2018 vs. 2.6% in 2017) regions.

Driven by expansions in its 3 largest economies - Nigeria, South Africa and Angola, growth in the Sub-Saharan region is estimated to rise from 1.4% in 2016 to 2.6% in 2017, and forecast to accelerate further to 3.4% by 2018. Nigeria is expected to exit recession in 2017 (+0.8%) and sustain growth pattern in 2018 (+1.9%), buoyed by increased oil production volume and improvements in external and fiscal balance. Likewise, the Angolan economy is expected to exit recession and grow 1.5% and 1.6% in 2017 and 2018 respectively. Near term growth outlook for South Africa remains weak despite improvements in commodity prices and agricultural produces, with the economy projected to grow 0.7% in 2017 and 1.1% in 2018. This modest projection is on the back of heightened political uncertainties which have weighed on investment spending.

While near term global growth prospect remains broadly positive, increasing geopolitical risk, trade protectionism and policy normalization by systemic central banks are downside risks to forecasts.

Chart 1: Global and Regional Growth Estimates and Forecasts (2016 – 2018F)



Source: IMF, Afrinvest Research

Policy Normalization by Systemic Central Banks Remains Downside Risk to EMs & DEs Growth

As the move towards normalization strengthens in 2018, supported by favourable labour market conditions and a synchronisation in global growth, systemic central banks in developed markets would be more willing to begin monetary policy tightening cycle despite sticky inflation. The US Fed is ahead of other major developed market central banks, expectedly raising its benchmark interest rate three times in 2017, taking it to 1.25% -1.50% despite inflation persistently below the Fed's 2.0% target. With impending impact of the tax cut bill expected to further boost growth and tighten the labour market, the "continuity candidate" – Jerome Powell, selected to succeed current Fed Chair Janet Yellen, is expected to support further hikes in interest rate and plans to begin winding down the Fed's Balance sheet. The market is already pricing in expectation of further monetary policy tightening, with the 1-Year LIBOR currently at a 7-Year high, although bond yields remain surprisingly low.

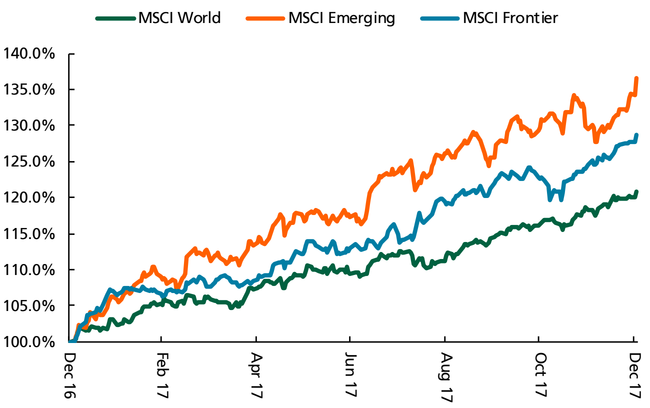
Meanwhile, after mulling over its base rate, the Bank of England (BoE), raised its Benchmark interest rate (from 0.25% to 0.5%) for the first time in a decade in Dec-2017, and is expected to tighten further in 2018 in order to support its dwindling currency. In the interim, strong growth in the Euro zone continues to validate a cut back on the European Central Bank's (ECB) quantitative easing scheme from € 60.0m of monthly bond purchase to € 30.0m.

As Central Banks gradually normalize monetary policy from the extraordinary measures taken at the peak of the global economic and financial crisis, associated downside risks of tightening global liquidity and capital flow reversals from emerging and frontier markets and currency volatility will become more prominent headwinds to near term growth and financial market stability.

Global Markets: Consensus Opinion Points to Further Gains against Strong Macro Backdrop

Against the strong macro backdrop, improvement in corporate earnings and slow pace of policy tightening by the US Fed, equity markets globally outperformed in 2017, with MSCI World, Emerging and Frontier markets indices recording double-digit growths after shrugging off a modest start to the year. For the second year running, Emerging Markets came out top as the MSCI Emerging Markets Index (MSCI EM) outperformed both the MSCI Frontier (MSCI FM) and MSCI World (MSCI WO) indices. The MSCI EM returned 34.3% in 2017, driven by strong economic growth, supportive global financial condition and higher commodity prices. Likewise, Frontier markets recovered from a 1.3% loss in 2016 as the MSCI FM index gained 27.7%, driven by stellar performance of equity markets in Argentina and Nigeria which benefitted from pro-market reforms and commodity price upswing. MSCI WO – which tracks stocks in developed markets – also sustained its multi-year expansion as it gained 20.1% in 2017, buoyed by continued bullish sentiment in US markets - fueled by anticipated tax cuts, strong earnings and economic growth – as well as rebound in European markets.

Chart 2: MSCI Indices Performance (Dec-2016 – Dec-2017)



Source: Bloomberg, Afrinvest Research

After a remarkable 2017, consensus opinion points to further gains in equity markets in 2018 on the back of expectation of sustained global growth and bullish outlook for commodities key to several EMs & DEs. Yet, downside risks relating to a move towards monetary policy normalisation in advanced economies, geopolitical tensions and developments in China could spur correction in risk asset markets globally, particularly in Emerging and Frontier markets highly dependent on portfolio flows.

Section Three

Domestic Macroeconomic Review and Outlook

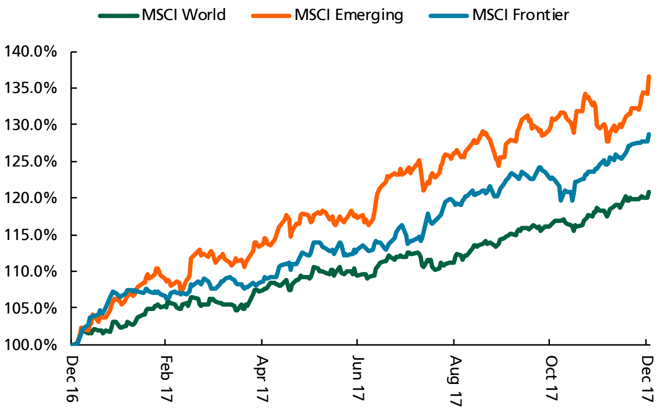
The Recession and its Aftermath

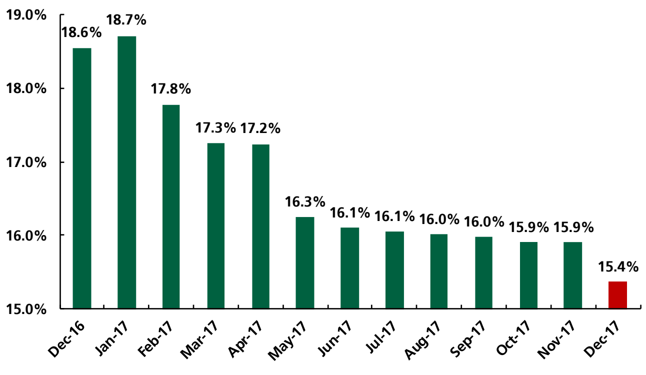
The year 2017, in many respects, was a year of recovery for the Nigerian economy and financial market compared to the sharp business cycle contraction witnessed in 2016 alongside weak market returns. Consequent on the upturn in commodity prices, cessation of attacks on oil & gas infrastructure in the Niger Delta region (which had a positive knock-on impact on domestic crude oil production volume) and adoption of pro-market FX reforms by the Central Bank of Nigeria (CBN), economic activity rebounded while investor & consumer confidence as well as business sentiment strengthened.

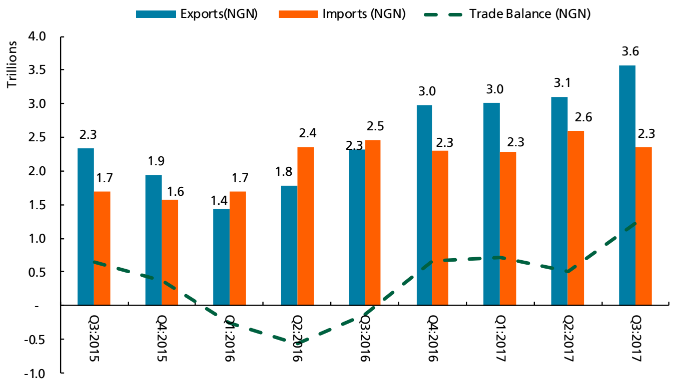
The Nigerian economy returned to growth in Q2:2017, exiting a 4-Quarter long recession - its first in 25 years – which lasted between Q2:2016 and Q1:2017. Propped by higher oil exports and administrative flexibility in FX management structure, reflected in increased CBN FX Interventions and opening of the Investors' and Exporters' (I&E) FX Window in April 2017, external sector indicators also turned positive with Current Account Balance rising from a surplus of US$2.5bn in 2016 to US$9.5bn in 2017 while cumulative Capital Importation as of 9M:2017 rose 91.5% Y-o-Y to a 2-year high of US$6.8bn. The favourable Balance of Payment dynamics led to accumulation in External Reserves which climbed to a 3-year high of US$38.7bn (29/12/2017) and stabilized the Naira at the official window with multiplier impact on the parallel market – gaining 35.0% Y-o-Y against the greenback to close at N363.00/US$1.00 by year-end. Supported by improved growth prospect and FX liquidity, business sentiment, gauged by the CBN's Manufacturing and Non-Manufacturing Purchasing Managers' Indices (PMI), has indicated expansion in activity from April 2017 till date. Consumer Confidence has also been on the rise, with NOI (Ngozi Okonjo Iweala) Polls survey showing a 4.8 points increase in its Consumer Confidence Index from 62.7 points in Q1:2017 to 67.5 points in Q3:2017.

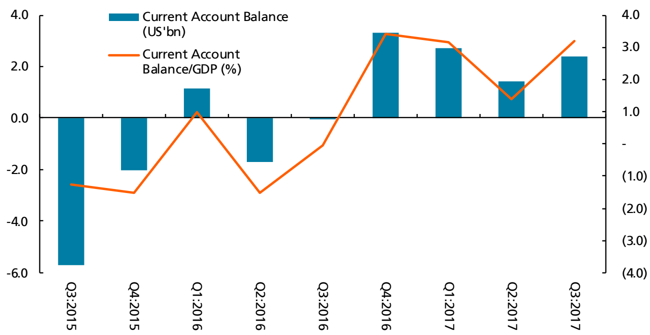
Although price level growth disappointed for much of the year, persistently falling below Analysts' estimates, due to pressures on food prices, Headline Inflation measured Year-on-Year (Y-o-Y), moderated 318bps to 15.4% in December 2017 while the Core measure of prices fell 596bps within the same period to 12.1%. Labour market slack was the only blot on the overwhelming improvement in core macro variables as the economy struggled to create enough jobs for the expanding labour force; thus Unemployment and Underemployment rates rose 4.6ppts and 0.2ppts to 18.8% and 21.2% respectively in Q3:2017.

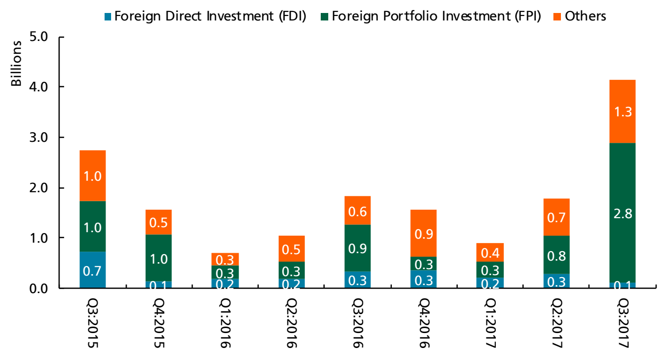
Chart 3: Nigeria's Macroeconomic Fundamentals - Activity, Prices and External Sector Balance

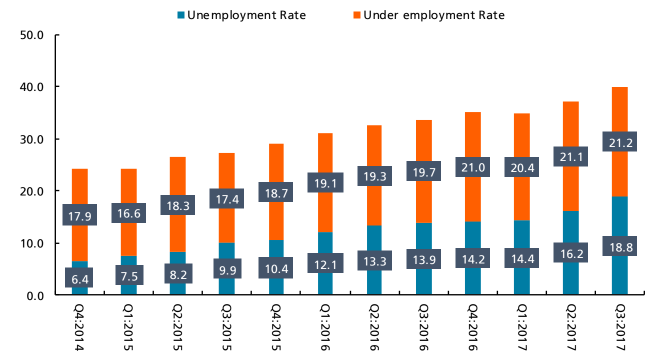












Source: CBN, NBS, Afrinvest Research

Against the improved macro backdrop, corporate profits have also rebounded while all major asset classes recorded expansion in valuation as foreign investors increased holding of Nigerian assets. 12-month trailing Earnings Per Share (EPS) of the NSE All Share Index rose 81.0% Y-o-Y as of Q3:2017, eclipsing previous earnings record set in 2014 according to data compiled from Bloomberg. The index also posted its first positive annual return in four years (+42.3%) in 2017, ranking as the 11th best performer in the world and 2nd in Africa. The CBN, encouraged by moderating external sector pressures and the need to boost domestic growth and lower government borrowing cost, also guided short term market rates downward in the fixed income market, leading to price appreciations in the bond market especially in the last quarter of 2017.

Business Cycle Turnaround: Cyclical Oil Earnings Upswing Masks Structural Reform Inertia

To investors familiar with frontier markets, the almost 360-degree turnaround in Nigeria's economic fundamentals and investor sentiment is not surprising, given the strong correlation of the business cycle and capital market with earnings from commodity exports. In our 2017 outlook titled "*Reform or Be Relegated*", we had reflected that;

"A return to 2015 level of crude oil production (2.1mb/d) would comfortably lift oil sector GDP (which accounts for c.9.0% of aggregate real GDP) by an estimated 15.0% Y-o-Y in 2017 and may pull the economy out of recession… On this basis, Nigeria's business cycle would be highly dependent on the ability of policy makers to deliver incremental oil output in 2017, restore macroeconomic stability by rebuilding confidence in monetary policy and the administrative side of the FX market structure as well as showing commitments to structural reforms. These would be necessary to stabilize external account, rebuild external reserves, improve liquidity in the FX market and achieve lower inflation as well as lower long term interest rates."

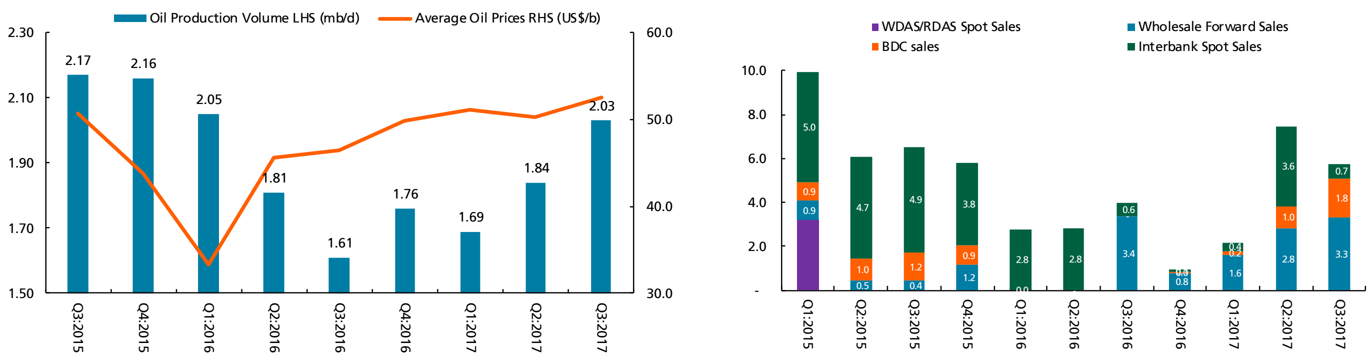
Events in the last 12 months have justified our prognoses as policymakers were able to deliver on:

1. Increase in domestic crude oil production from a low of 1.6mb/d in Q3:2016 to 2.0mb/d in Q3:2017.
2. Restoration of FX market stability following the increased volume of FX interventions, particularly to BDCs, and eventual opening of a market-oriented FX segment (the I&E FX window), which allowed for flexibility in pricing of FX as well as efficiency and transparency in allocation. The CBN spent US$15.4bn in 9M:2017 intervening in the FX market via Spot and Forward Interbank FX auctions and spot sales to BDCs, relative to US$9.6bn spent in the same period of 2016, while the I&E window recorded US$27.8bn in turnover in 2017.
3. Release of the Economic Recovery and Growth Plan (ERGP) in Feb-2017 - arguably the most ambitious development plan by the FGN since the National Economic Empowerment and Development Strategy (NEEDS) document published in 2004. The ERGP is a medium-term plan (2017-2020) which focuses on five key priority areas: 1) Stabilizing the macroeconomic environment, 2) Ensuring energy sufficiency (power & petroleum products), 3) Achieving agriculture and food security, 4) Improving transportation, and 5) Driving industrialization by focusing on small and medium scale enterprises. An implementation and performance measurement management process was set up to drive execution of the plan.

4. Tackling some of Nigeria's deep-seated structural constraints by surpassing Ease of Doing Business reform target of moving up 20 places in World Bank's Ease of Doing Business ranking in 2018. Nigeria moved up 24 places to 145th and ranked in the top 10 most improved countries.

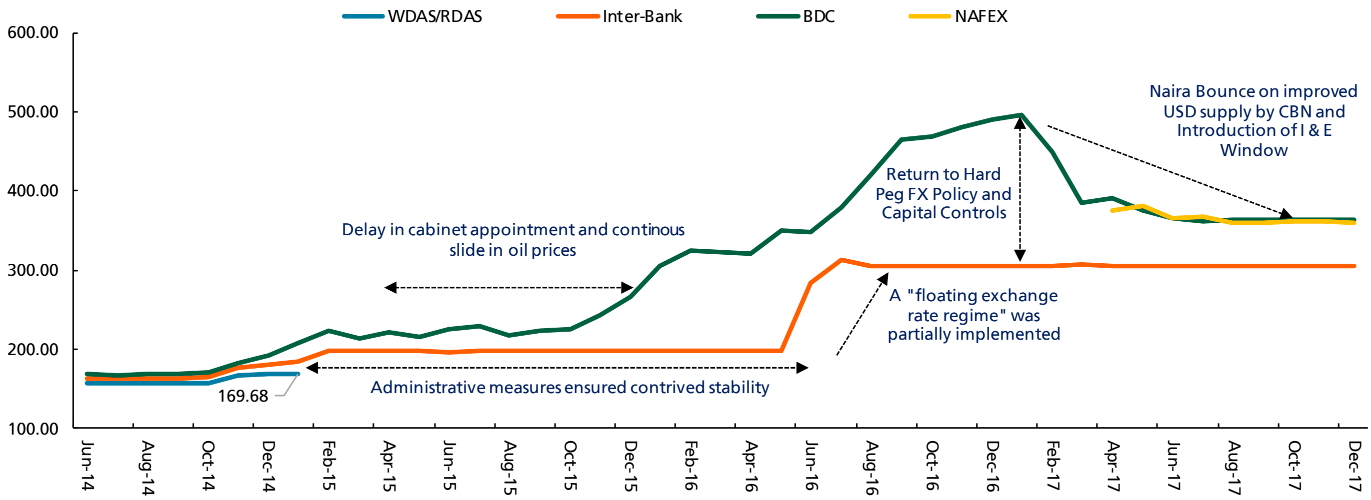
Fate also smiled on Nigeria as faster than expected rebalancing in the Oil market buoyed oil prices and complemented the reform by policymakers to restore macroeconomic stability. Due to high level of compliance of OPEC/Non-OPEC countries to the deal reached in November 2016 (extended for six months in December 2017) to cut oil production by 1.8mb/d and supply disruptions in the US, UK, Nigeria and Libya, Brent Crude averaged US$54.74/b in 2017 compared to US$45.13/b in 2016.

Chart 4: Oil Price vs Oil Production (Q3;2015 -Q3:2017) and CBN FX Interventions US$'bn (Q3:2015 - Q3:2017)



Source: NBS, CBN, Afrinvest Research

Chart 5: Nigeria's Foreign Exchange Market Development



Source: CBN, FMDQ, Afrinvest Research

Yet, despite the oil price tailwind driving asset prices and short-term growth outlook, Nigeria's recurrent energy crisis, high unemployment rate, fiscal insolvency of sub-national governments, high dependence on oil earnings for fiscal revenue & current account stability as well as several unforced administrative errors by the ruling political class are constant reminders of unresolved structural fault lines. Thus, even as we are positive on short term growth prospect as revealed in our prognoses outlined in the next section, we continue to emphasize on our 2-year long theme calling for structural reforms from policymakers to build long term macroeconomic resilience. As the country nears 2 decades of uninterrupted democracy, by far its longest post-independence in 1960, we believe issues itemised below should top reform agenda over the next decade.

Table 1: Ease of Doing Business Ranking

	2018 Rank	2017 Rank	Change in Rank
Overall	145	169	24.0
Starting a business	130	138	8.0
Dealing with Construction Permits	147	174	27.0
Getting Electricity	172	180	8.0
Registering Property	179	182	3.0
Getting Credit	6	44	38.0
Protecting Minority Investors	33	32	1.0
Paying Taxes	171	182	11.0
Trading across Borders	183	181	2.0
Enforcing Contracts	96	139	43.0
Resolving Insolvency	145	140	5.0

Source: World Bank Ease of Doing Business Report, Afrinvest Research

Table 2: Four Key Reform Agenda

Energy Sector Deregulation

- Energy demand was estimated at 31,240mw in 2015 by the Energy Commission of Nigeria, 6x peak supply of 5000mw
- Frequent supply shortage of petrol

Reform Objective

- Making power tariff more cost-reflective to incentive private sector investment in the sector
- Increase investment in transmission grid and distribution infrastructure
- Deregulating the downstream sector and/or transparently allocating subsidy cost.

Reforming Institutions and Investing in Infrastructure

- Nigeria ranks 145 out of 190 countries on ease of doing business according to World Bank,
- 132 out of 137 countries for infrastructural adequacy under the Global Competitiveness report of the WEF

Reform Objectives

- Sustain Ease of Doing business reforms
- Public-Private sector partnership on development of critical infrastructure
- Embarking on land administration reform to unlock productivity.
- Improve Tax administration to increase compliance and curb abuse.

Fiscal Viability of Sub-Nationals

- Debt to IGR of sub-nationals rose from 2.4x in 2013 to 5.0x in 2016
- Except for Kano, Katsina, Lagos and Rivers, every other state's average monthly revenue was less than average monthly recurrent expenditure in 2017 (BUDGIT)

Reform Objectives

- Engender transparency and accountability at sub-national level
- Build internal generated revenue capacity.
- Creation of an incentive based FAAC Allocation system to reward states with good IGR levels.

Creating Economic Opportunities for expanding labour force

- Nigeria's Unemployment rate is 18.8% while underemployment rate is 21.2%
- Youth unemployment + underemployment rate (between ages 14-35) estimated at 47.4% by the NBS.

Reform Objectives

- Build industrial parks and export processing zones linked to global supply chain to jumpstart growth and job creation
- Invest in Education, Research and Science to develop human capacity and create new business lines.

Source: ECN, FMPWH, World Bank, WEF, BUDGIT, Afrinvest Research

2018 Macroeconomic Prognoses… Consolidating the Recovery

Price Level… Benign Outlook as Policy Makers Hold -off on Supply Side Reforms

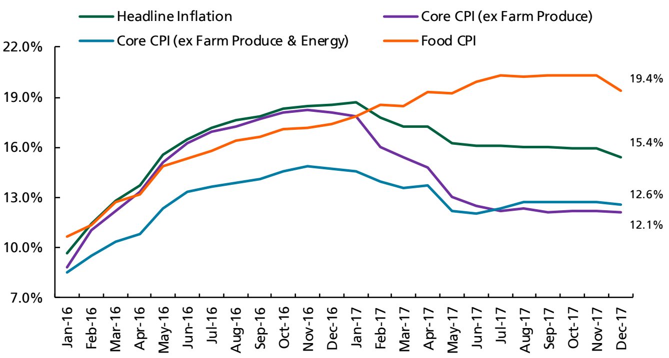
Against the backdrop of high base effect on Core CPI, Headline Inflation consistently decelerated from 18.7% in January to 15.4% in December despite pressures on Fuel and Transport prices which can be attributed to PMS supply crisis witnessed in Q4:2017. However, prior to the observed pressures on energy prices in December, the pace of moderation of the Headline Index had been underwhelming relative to consensus forecasts on the back of pressures on food prices and gradual wearing off of high-base effect in H2:2017. Food Inflation rose 203bps Y-o-Y to 19.4% in December 2017 to partially offset moderation in Core Inflation from 17.9% in January to 12.1% in December.

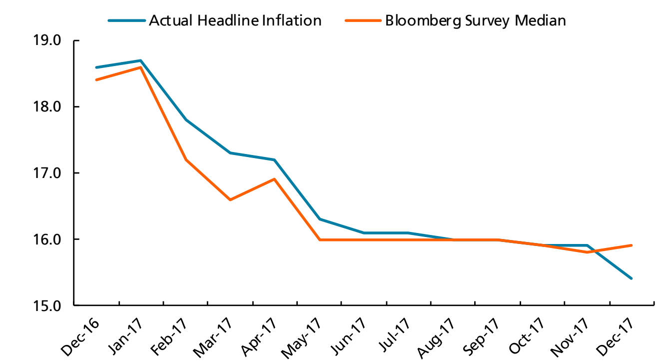
Several theories, ranging from higher demand for domestic farm produce from neighbouring countries following steep Naira depreciation to CBN's FX restrictions on imported food items, have been attributed to the unprecedented Food price pressure. Regardless, some respite has been gained in recent months as M-o-M Food CPI growth fell below 1.0% in September – the first time in 9 months – attributable to seasonal factors. According to Famine Early Warning Systems Network (FEWSNET), the USAID funded provider of early warning and analysis on food insecurity, favourable main season harvest which is underway has improved food access and led to decline in some staple food prices, though higher relative to previous year.

We expect the positive-knock-on impact of harvest to continue to subdue Food Inflation in Q1:2018 while improved FX access, combined with already high-base of the Food Index, should place near term downward pressure on Y-o-Y Food Inflation. However, the major risk -factor for Consumer Prices in 2018 will be coming from the Core Index where delayed supply-side reforms in regulated markets for Power and Fuel could destabilize prices.

The Power sector is currently facing a liquidity crunch due to non-cost reflective tariff and lack of investment in the value chain to ebb high Aggregate Technical, Commercial and Collection (ATC&C) losses. ATC&C losses averaged 57.4% across the 11 Discos in December 2016 with none close to achieving set performance target. Multi-Year Tariff Order 2 (MYTO 2) assumptions implemented in February 2016 have been rendered ineffective as a result of macroeconomic instability in the last two years, resulting in demand for increase in tariff by value chain operators. The MYTO 2 tariff is due to be reviewed in December 2018 but we anticipate implementation would likely be delayed till after 2019 elections.

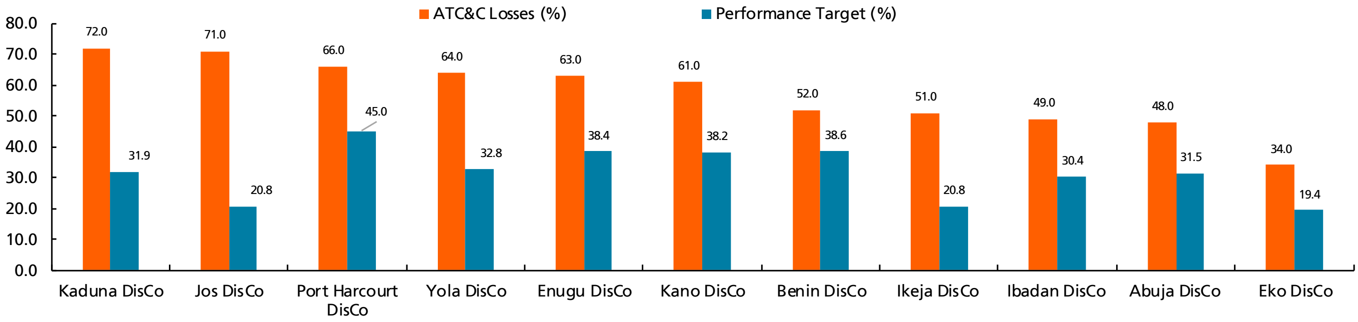
Chart 6: Inflation Indices Development (2016 – 2017)





Source: NBS, Bloomberg, Afrinvest Research

Chart 7: ATC&C Losses vs. Performance Target (Dec-2016) and MYTO 2.1 Tariff Assumptions vs. Current Realities



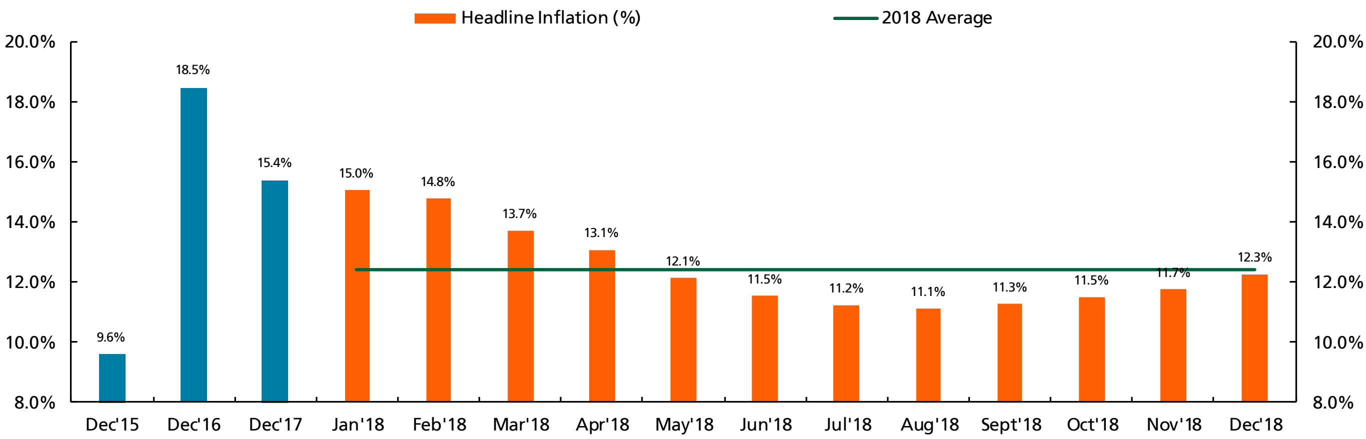
Parameters	MYTO 2 Assumption (2015 - Dec. 2018)	Prior Review in March 2014	Actual (2017 Average)
Inflation (%)	13.0	7.8	16.7
Exchange Rate (US$/NGN)	178.0	158.0	305.7
Gas Price/mmBtu (US$)	2.3	1.8	3.0
Generation Capacity (MW)	5556.0	3424.0	7000.0

Source: NERC, Afrinvest Research

Furthermore, the "Price-Modulation" template for pricing of PMS introduced by the PPPRA in May 2016, in retrospect, is akin to putting a Band-Aid on fiscal bleeding rather than a landmark reform to liberalise the downstream industry as earlier guided. Already, assumptions included in the template are due for upward review on the back of increase in landing cost of PMS – following rally in oil prices and June-2016 naira devaluation.

Despite the aforementioned considerations, our near-term inflation outlook remains benign due to limited political will to implement supply side reforms ahead of the elections. Supportive oil earnings tailwind will also buy regulators more time in implementing the reforms. Hence, our base-case scenario projects Headline Inflation moderating further to 12.3% by yearend 2018.

Chart 8: 2018 Headline Inflation Forecast



Source: NBS, Afrinvest Research

Near Term Growth Outlook … Oil Sector Low Base Will Remain Key Driver

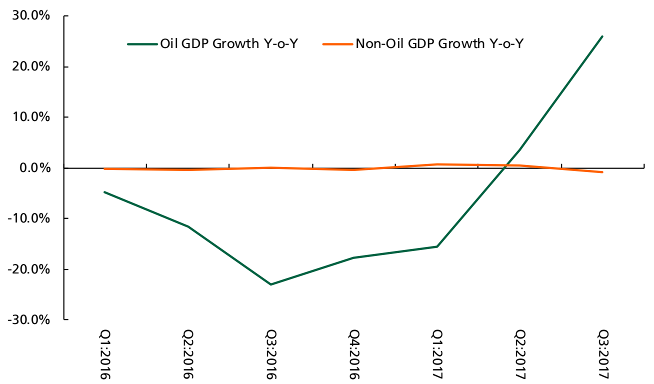
The economy's return to growth in Q2:2017 and acceleration in momentum in Q3 were largely driven by Oil sector GDP which grew 3.5% and 25.9% Y-o-Y in Q2:2017 and Q3:2017 respectively. The sizeable expansion in Oil sector, particularly in Q3:2017, was due to low base effect of oil sector production which reached a 6-Quarter high of 2.0mb/d in the quarter. Non-Oil sector however remains a pressure point, as it relapsed to negative growth in Q3 after showing positive signs in Q1 and Q2. The disappointing performance of the Non-Oil sector - which was unexpected given positive readings from leading variables such as the PMI - is evident in virtually all the main Non-Oil categories including Services and Manufacturing which contracted 2.7% and 2.9% Y-o-Y respectively in Q3:2017.

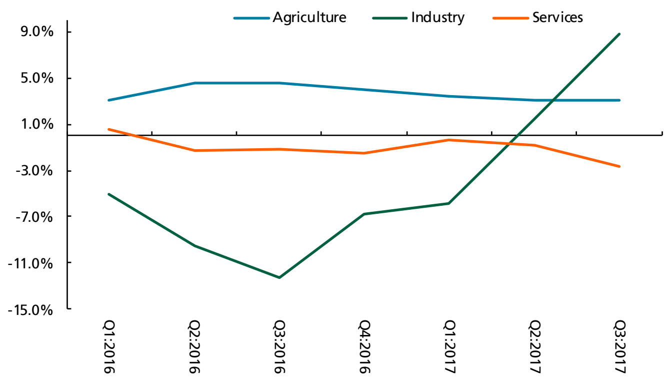
The slow recovery of the Non-Oil sector has both cyclical and structural explanations. Cyclical factors include tight monetary policy, subsisting weak fiscal spending – particularly at sub-national level - low real household consumption growth (due to high inflation rate) and benign corporate investment spending consequent on the damaging impact of large FX rate movements in the last 3 years on corporates' balance sheet. Our analyses of leverage ratios of listed companies show debt/equity of NSE ASI constituents jumped 37.1ppt to 121.6% in 2016 while companies used a significant chunk of capital raised in 2017 to restructure their balance sheet, rather than expand capacity, leading to a 12.0ppt decline to 109.6% in 2017. Hence, Capital Expenditure per share of NSE ASI constituents fell 3.9% Y-o-Y in 2017 and currently at a 4-year low.

Whilst the structural issues remain headwinds, we note that the cyclical challenges will start to abate from 2018 and buoy Non-Oil growth against the backdrop of 1) anticipated expansion in fiscal spending as fiscal balance stabilizes and political parties spend ahead of the election, 2) further deceleration of inflation rate which will directly affect GDP price deflator and support real growth, and 3) Increase in private investments due to favourable aggregate demand outlook and stable FX rate. Similar to 2017, we also expect oil sector low-base push to remain a key driver of growth till Q2:2018 before the effect wears off as base normalizes. The expected take-off of oil production from Total's offshore Egina field project in Q4:2018 will possibly add c.0.2mb to daily crude production, but with oil production capped by OPEC at 1.8mb/d (ex- condensate), we do not foresee aggregate oil production (including condensate) breaking its peak of 2.2mb/d.

Thus, against the backdrop of expected rebound in Non-Oil sector and Oil sector low base push, we forecast GDP growth to accelerate to 2.1% in 2018 from estimated 0.7% in 2017. Major downside risks to our forecast include OPEC/Non-OPEC decision on Nigeria's production cap, development in the oil market and stability in the Niger-Delta.

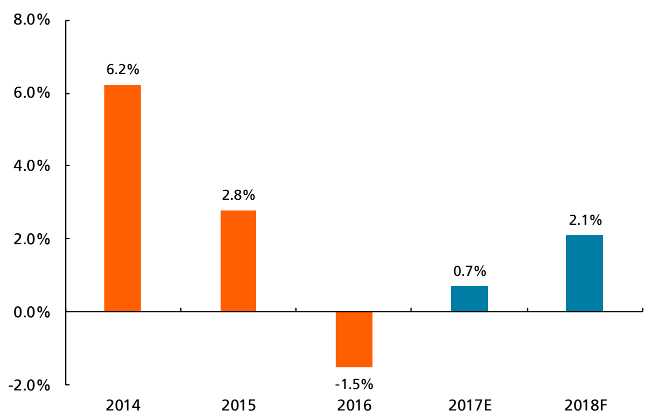
Chart 9: GDP Performance by Sector (Q2:2016-Q3:2017)





Source: CBN, Afrinvest Research

Chart 10: GDP Growth Outlook



Source: NBS, Afrinvest Research

Monetary Policy Outlook… Easing Cycle to Enter Full Gear despite Stable Benchmark Rate

As we projected in our 2017 Outlook, the CBN successfully guided short and long-term rates downward in the fixed income market despite retaining benchmark policy rate at 14.0%. Although price level growth disappointed in 2017, with Inflation rate still above MPR, the CBN began an easing cycle with the use of clearing rates at OMO auctions and frequency of auctions as policy instruments to achieve its easing objective. The CBN temporarily suspended OMO auctions for two weeks in December, resulting in a build-up in financial liquidity as well as a further moderation in short term rates and outperformance of long duration bond - signified in 294bps Y-o-Y decline in MAR 2036 20-year benchmark bond compared to 148bps Y-o-Y decline of the FEB 2020 2-year benchmark.

Slowing inflation rate, albeit at an underwhelming pace, favourable balance of payment dynamics, fiscal strategy to reduce borrowing cost and the need to boost non-oil sector growth were major factors we believe contributed to the CBN's decision to begin easing cycle. Typically, what should follow the moderation in market rates and signify the full take-off of the easing cycle is a benchmark interest rate cut. However, we believe the CBN would stick to utilizing its recently favoured OMO strategy – which is more flexible - to achieve the same easing objective without tweaking the MPR. Despite our conviction, we do not rule out the possibility of a politically induced benchmark rate reduction in the second half of 2018, in order to make credit available to the real sector. If economic conditions improve further, this could potentially be done in order to score political points with the populace ahead of the 2019 election. Our forecast is based on three considerations:

1. Anticipated fiscal spending in the run up to the general elections and expected volatility in domestic assets market in H2:2018 will pose a threat to price and exchange rate stability;
2. Expected Monetary policy tightening by systemic central banks in Europe and North America, against the backdrop of strong synchronised global growth expansion and improving inflation expectation, could spur capital outflows from emerging and frontier markets and pose a risk to domestic exchange rate stability;
3. Benign but double-digit inflation rate which may not necessarily go below MPR may support a hold on rate as the CBN tries to consolidate gains on price level although core inflation continues to moderate.

Hence, our monetary policy outlook favours continued downward repricing of fixed income yields, albeit with stable MPR.

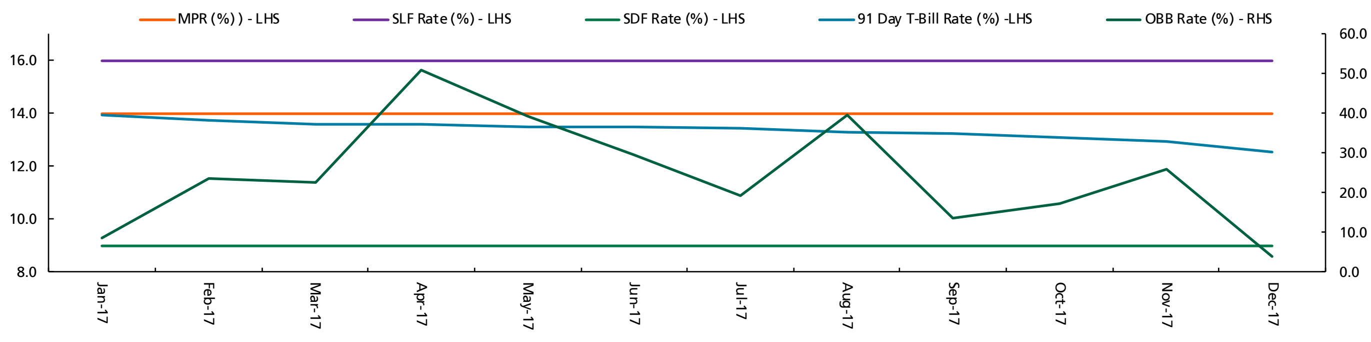
Fiscal Policy Outlook… Focus on Reducing Debt Service Obligations amidst Rising Expenditure

Nigeria's increasing debt burden and rising servicing cost have come under focus in recent times for justifiable reason. Since the onset of the oil shock in Q3:2014, public debt stock has almost doubled to N20.4tn as at Q3:2017. The surge in public debt was partly driven by the effect of large FX rate depreciation on external debt as well as an increase in deficit financed expenditure by Sovereign and Sub-national entities due to revenue shortages associated with oil production and price shocks experienced in the last three years. Whilst the equivalent 18.2% debt to GDP ratio appears non-threatening, rising servicing cost relative to revenue (47.0% in FY:2016) and slow growth of non-oil revenue post-crisis have increased debt sustainability risk – a key consideration of Moody's Rating Agency in recent Sovereign Downgrade.

The FGN has responded by changing its 10-year long conservative debt strategy of relying more on domestic market for debt to tilting towards cheaper external sources in the global market to reduce servicing cost. Thus, the FGN returned to the Eurobond market after a 4 -year hiatus in 2017, raising US$1.5bn in Q1:2017 and US$3.0bn out of a US$5.5bn approved Medium Term Note Project in Q4:2017. Another US$300.0m was raised in Q3:2017 via a debut Diaspora bond issuance, taking total external debt issuance to US$4.8bn. US$650.0m of the US$3.0bn bond raised in December was used to redeem domestic maturing T-bills worth N198.0bn, leading to further decline in fixed income yields. Despite the steep decline in domestic market rates, we expect the

FGN to stick to the new strategy in the near term due to favourable global market environment and ambitious expenditure plan.

Chart 11: Policy and Market Interest Rates in 2017



Source: CBN, FMDQ, Afrinvest Research

As with prior years, the 2018 Budget projects a reflationary spending of N8.6tn (16.2% increase relative to N7.4tn in 2017) with a focus on consolidating on gains recorded in the previous year whilst also prioritizing the need to bridge the investment deficits in Infrastructure, Agriculture and Health sectors amongst others. On the basis of the revenue projection, FGN's share of oil & gas revenue is estimated at N2.4tn while non-oil revenue - including Company Income Tax (CIT), VAT, Customs & Excise Receipts, Independent Revenues and income from other sources as well as proceeds from the restructuring of FGN's equity in JVs – is projected to account for N4.2tn. On the expenditure side, recurrent debt and non-debt are proposed to make up N5.5tn (63.9%) of the total spending while capital expenditure is planned to contribute N2.4tn (28.2%) and statutory transfer N451.5bn (5.3%). Fiscal deficit is also expected at N2.0tn implying a 1.8% debt to GDP although debt service to revenue ratio is estimated at 30.5%.

While the budget's macroeconomic variables assumptions are not far off from current realities, perhaps even prudent with regards to crude oil prices, we are of the view that achieving >70.0% implementation of capital component will be difficult due to overstretched non-oil and independent revenue assumptions. As of 9M:2017, performance of the "Budget of Recovery and Growth" has been rather underwhelming with fiscal authorities falling short of revenue target, especially Non-oil revenue (N0.7tn actual vs. N1.0tn projection) and Independent Revenue (N155.1bn vs. N605.9bn projected in the period), despite recent drive to increase tax revenue via reforms such as the Voluntary Assets and Income Declaration Scheme (VAIDS). Thus, Non-core revenue lines which are non-recurring such as Exchange Rate difference and Paris Club over-deduction refund were leveraged to finance the budget. While the Presidency hopes to improve on existing tax reforms to boost income from the Non-oil sector as well as enhance activities in other sectors of the economy, the odds of a significant increase in tax revenue in the short term remains low as Non-oil sector growth remains below long-term trend.

Table 3: Current and previous Sovereign Credit Rating

Rating Agency	Current Rating	Previous Rating (2014)
S&P	B (Stable)	BB- (Negative)
Fitch Ratings	B+ (Negative)	BB- (Stable)
Moody's	B2 (Stable)	Ba3 (Stable)

Source: Bloomberg, Afrinvest Research

Table 4: External Debt Issuances

Description	FGN US$1.5bn Eurobond Tranch 1	FGN US1.5$bn Eurobond Tranch 2	Diaspora Bond	FGN 10 Year Eurobond	FGN 30 Year Eurobond
Pricing Date	9-Feb-17	29-Mar-17	19-Jun-17	20-Nov-17	20-Nov-17
Maturity Date	16-Feb-32	16-Feb-32	27-Jun-22	28-Nov-27	28-Nov-47
Tenor	15 Years	15 Years	5 Years	10 Year	30 Year
Offer (US$'bn)	1.00	0.50	0.30	1.50	1.50
Total Subscription (US$'bn)	7.8	3.0	0.39	11.4	
Coupon	7.875%	7.875%	5.625%	6.500%	7.625%
Yield at Issue	7.875%	7.500%	5.625%	6.500%	7.625%
Current Yield to Maturity	6.6%	6.6%	4.7%	6.1%	7.3%

Source: Bloomberg, Afrinvest Research

Table 5: 2018 Budget

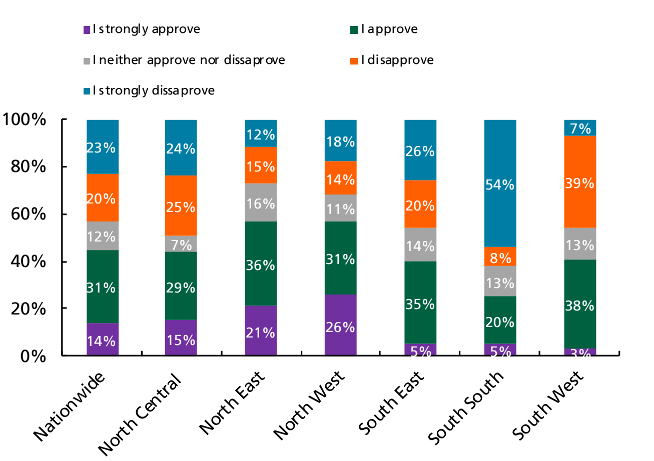
	Items	2016 Budget	FY: 2016 Actual	2017 Budget	Pro-Rated 9M:2017 Budget	FY:2017 Actual (9M:2017)	Variance from Actual	FY: 2018 Budget
Assumptions	GDP Growth (%)	4.4%	-1.6%	1.5%	1.5%	0.4%		3.5%
	Oil Production Volume (m/bpd)	2.20	1.82	2.20	2.20	1.85		2.30
	Average Budget price per Barrel (US $)	38.00	42.09	44.50	44.50	51.30		45.00
	Average Exchange Rate (N/US$)	197.00	305.00	305.00	305.00	305.70		305.00
Revenue	Oil & Gas Revenue	717.6	697.8	2,122.2	1,591.6	749.9	-52.9%	2,441.6
	Non-oil revenue	1,567.9	818.5	1,379.8	1,034.9	710.1	-31.4%	1,385.3
	Independent revenue	1,505.9	237.9	807.8	605.9	155.1	-74.4%	847.9
	Others	64.8	1,193.3	774.6	580.9	990.0	70.4%	1,932.2
	Total FGN Retained revenue	**3,856.2**	**2,947.5**	**5,084.4**	**3,813.3**	**2,605.2**	**-31.7%**	**6,607.0**
Expenditure	Statutory Transfer	351.4	344.0	434.4	325.8	288.4	-11.5%	456.5
	Debt Service	1,475.3	1,384.9	1,663.9	1,247.9	1,541.0	23.5%	2,014.0
	Sinking Fund	113.4	71.4	177.5	133.1	N/A	N/A	220.0
	Recurrent (Non-debt)	2,646.4	2,411.6	2,990.9	2,243.2	1,939.2	-13.6%	3,494.0
	Capital Expenditure	1,587.4	1,219.5	2,174.5	1,630.9	377.0	-76.9%	2,652.0
	Total Expenditure	6,173.9	5,431.4	7,441.2	5,580.9	4,145.5	-25.7%	8,612.0
	Fiscal Deficit (N'tn)	**2317.7**	**2483.9**	**2356.8**	**1767.6**	**1540.3**	**-12.9%**	**2005.0**
Fiscal Deficit	Domestic Borrowing	984.0	N/A	1,254.3	940.7	1,180.0	25.4%	N/A
	Foreign Borrowing	900.0	N/A	1,067.5	800.6	722.0	-9.8%	N/A
	Others	433.7	N/A	35.0	26.3	9.9	-62.3%	N/A
	Debt Service/Revenue Ratio	**38.3%**	**47.0%**	**32.7%**	**32.7%**	**59.1%**		**30.5%**
	Deficit/GDP Ratio	-2.1%	-2.3%	-2.2%	-2.2%	N/A		-1.8%

Source: CBN, Afrinvest Research

Polity Stability: Security Concerns and Ethnic Divide Setting Stage for Volatile Election Cycle

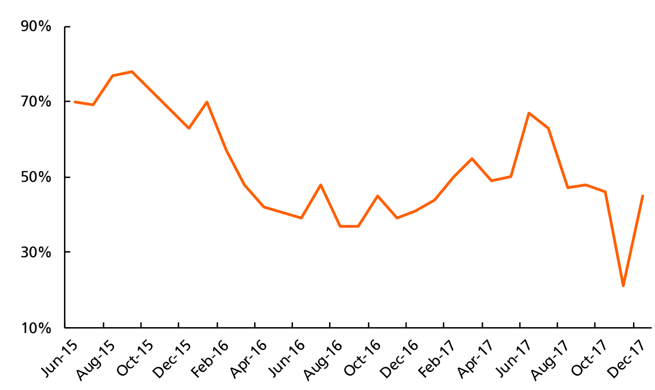
One of the major downside risks to asset markets and polity stability in 2018 is politicking ahead of the General Elections holding in February 2019. President Muhammadu Buhari of the All Progressives Congress (APC) is widely expected to seek re-election in what would potentially be a keenly contested poll due to waning popularity of the incumbent in Southern Nigeria (see NOI polls) and divisions in the ruling party which has already led to the defection of Former Vice-President Atiku Abubabar to the opposition People's Democratic Party (PDP).

Chart 12: President Buhari's Approval Rating by Regions



Source: NOIPolls, Afrinvest Research

Chart 13: President Buhari's Approval Rating Trend



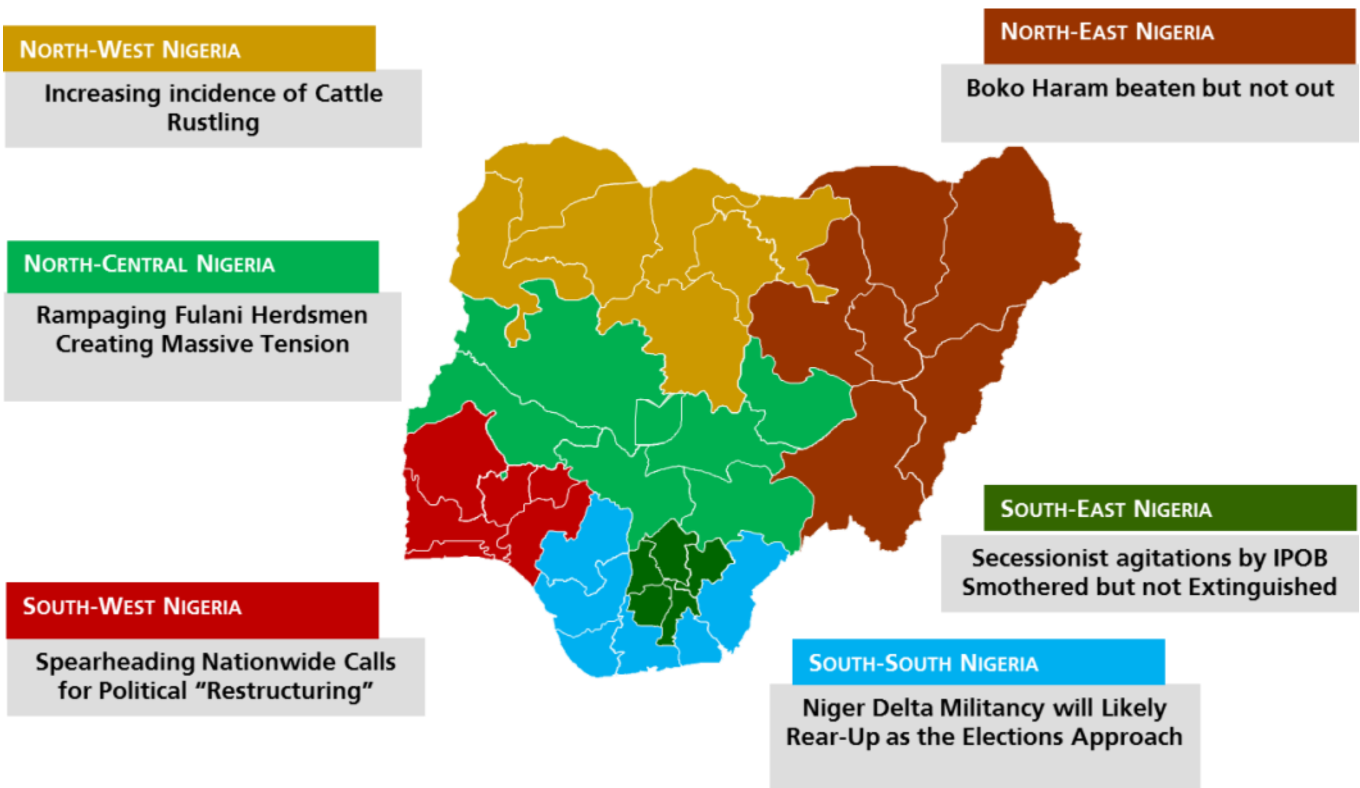
Source: NOIPolls, Afrinvest Research

Former Vice President Atiku, who has contested for the Presidency in the past, will likely be vying for the fourth time on the platform of the PDP. Having consolidated his leadership of the APC in Northern Nigeria and enjoying backing of the South-East and South-South caucuses, President Buhari looks set to blitz through his party's presidential primaries. Yet, securing the backing of the South West coalition will be key to his success at the general elections.

Typical of election cycles in frontier markets, we expect to see some volatility in assets market in the period leading up to the polls whilst policymaking will take a shorter-term perspective, leaving urgent long term structural reforms to take the back seat. Key issues we expect to dominate debates include Job Creation, Security and Political restructuring.

Slacking labour force despite improving growth profile has led to an increase in Unemployment and Underemployment rate with 34.0m labour force population either without jobs or underemployed. On security, although the military has consolidated on gains fighting insurgency in the North East region, militants' uprising in the Niger Delta and secessionist agitations in the South East, led by the Indigenous People of Biafra (IPOB), destabilized the polity in 2016 and 2017. Whilst the secession agitation appears to have lost momentum and government's efforts to placate militants have borne fruits, the impact of climate change – which has ravaged grazing fields in Northern Nigeria – has increased incidences of trespassing in farmlands in North Central and Southern Nigeria by nomadic cattle herdsmen searching for greener pasture. This has heightened ethnic tension and driven up incidences of violent clashes between host communities and pastoralists in North Central region with 371 deaths recorded in 2017 according to data compiled from ACLED (Armed Conflict

Figure 1: Nigerian Polity Heat map



Source: Afrinvest Research

Section Four

Equities Market Review and Outlook

Equites Market Performance and Outlook – A possible Game of Two Halves?

The performance of the Nigerian equities market in 2017 was mixed as the weak sentiment which had persisted since H2:2014 lingered into Q1:2017 before reforms in the FX market upturned the bearish sentiment to fuel a year-long bull run in the market.

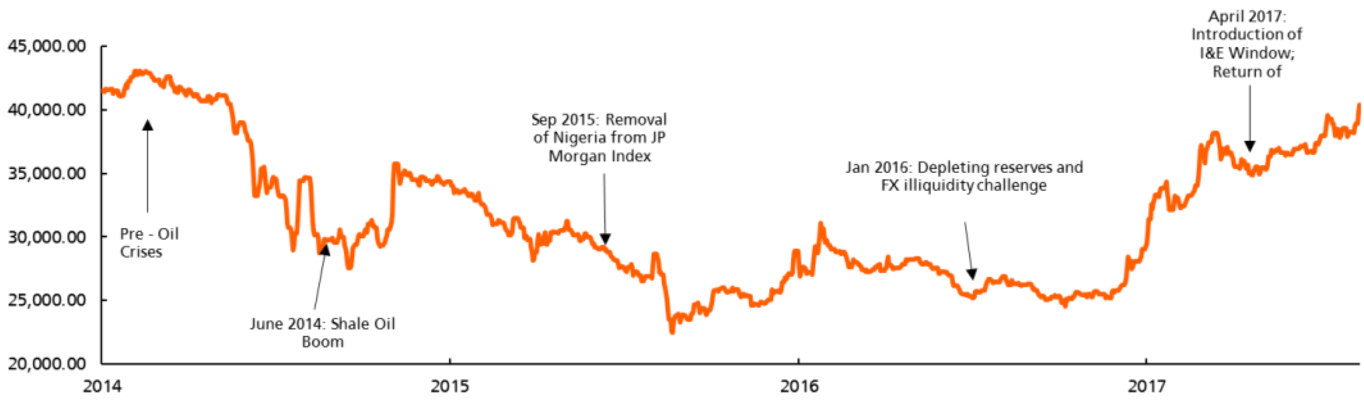
The crash in oil prices which began in H2:2014, falling to as low as US$27.00/b in January 2016, depressed the performance of the broader economy, as pressures on the domestic currency mounted while external reserves declined with the Apex bank adopting unorthodox measures to tackle speculative pressures against the naira which eventually dragged the economy into recession in 2016 (first time in 25 years). All these factors culminated in the weak sentiment noticed in the first quarter of 2017. In clear understanding of the issues and the required solutions, our Nigerian Economic and Financial Market Outlook Report for 2017 titled, "*Reform or Be Relegated*" detailed the need for policy makers to reform if the desired positive changes in the economy and market sentiment should be achieved. We highlighted that reforms targeted at the FX market structure needed to be taken urgently. Following the launch of the Investors' and Exporters' (I&E) FX window in April-2017, sentiment began to change and buoyed positive performance of the equities market.

The impact of the improved FX liquidity was reflected in sentiment in the manufacturing sector as PMI readings from April till the end of the year showed sustained expansions in the sector - although actual GDP performance remained below trend. Likewise, headline inflation rate moderated from as high as 18.7% in January to 15.4% by November. To consolidate on these improvements, the economy finally came out of recession in Q2:2017 recording a growth of 0.7% and this was sustained in Q3:2017 (+1.4%).

Consequent on the weak investor sentiment at the start of the year, investors sold off on stocks without much regard for fundamental analysis. As a result, Nigerian stocks were greatly undervalued in relation to peers. In the first quarter, the only positive indicator for investors was the resilient performance from the banks, especially top Tier-1 Banks GUARANTY, ZENITH, ACCESS and UBA. Hence minimal buy interest was recorded in these counters while sell offs persisted across other sectors. The NSE All Share Index had declined 6.2% as at April 20th, 2017 prior to the launch of the I&E FX window. However, following the launch of the window, massive buy interest returned to the domestic equities market to take advantage of cheap valuation of assets.

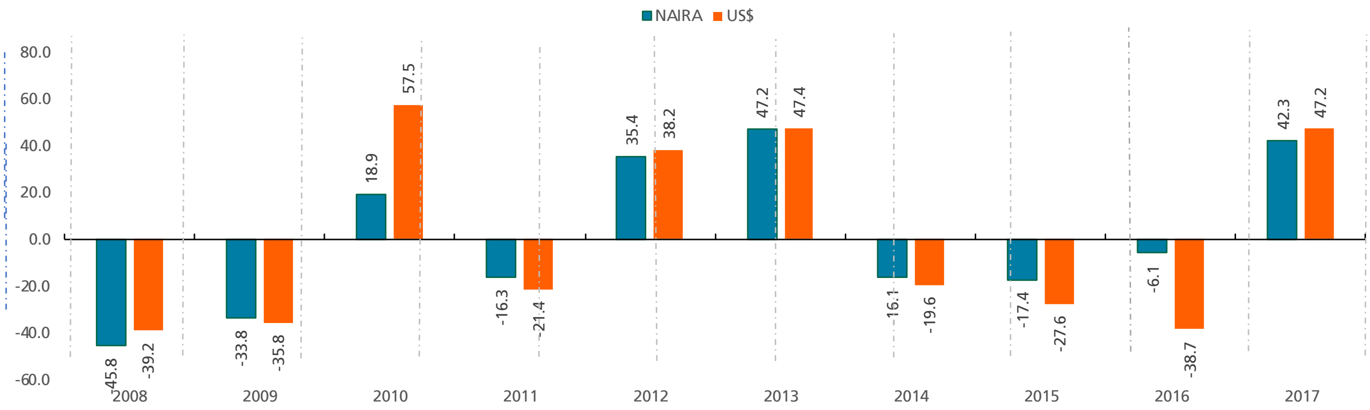
Corporate releases for the rest of the year were reflective of the improving conditions in the broader economy hence the rally was sustained all year. The NSE ASI gained 42.3% in 2017, the second highest Y-o-Y index return in 10 years.

Chart 14: Nigerian Equites Market Performance in 2017



Source: NSE, Afrinvest Research

Chart 15: 10-Year YTD performance of the NSE ASI



Source: NSE, Afrinvest Research

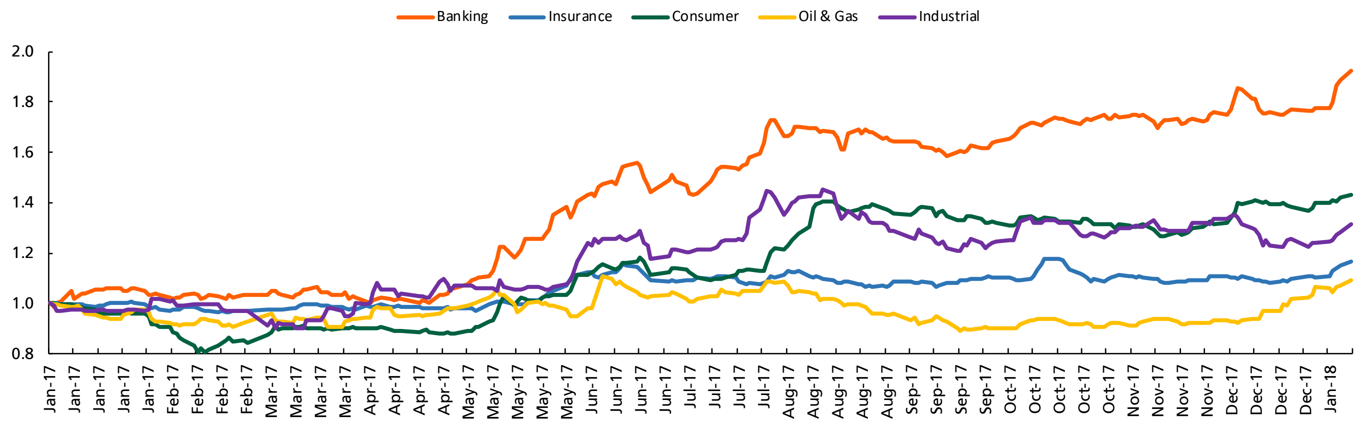
Sector Performance …Broad Based Rally Recorded across Sectors

As a result of the improved sentiment in the market, a broad-based rally was recorded which drove all sectors to close in the green for 2017. Given the resilience demonstrated by the banks amidst tougher operating conditions, the banking index was unsurprisingly the best performing sector in 2017, up 73.3%. Performance of the banks remained driven by resilient earnings, supported by interest income (due to higher interest rate environment). **FIDELITY** (+196.4%) received the most buying interest. In addition, significant interest in Tier-1 banks - **GUARANTY** (+64.9%), **ZENITH** (+73.8%), **ACCESS** (+78.0%) and **UBA** (+128.9%) was recorded.

The Consumer Goods index followed, gaining 37.0% as increase in product prices and improvement in access to FX as well as the relative peace in the North Eastern part of the country, positively impacted earnings of companies in the index. **DANGSUGAR** (+229.8%) was the best performer, followed by **INTBREW** (+191.9%) as investors cheered the decision of its parent company - AB Inbev - to merge operations of all its subsidiaries in Nigeria. In the same vein, the Industrial Goods index increased 23.8% on the back of gains in **BETAGLASS** (+69.2%) and **DANGCEM** (+32.1%) while the Insurance index grew 10.4% as **LINKASSURE** (+32.0%) and **MANSARD** (+20.9%) appreciated.

The Oil & Gas index gained 5.8% for the year, majorly due to performance of Upstream players – **SEPLAT** (+56.9%) and **OANDO** (+27.4%) - which was bolstered by the cessation of attacks on oil installations in the Niger Delta as well as improved global oil prices. Sentiment towards the downstream players remained soft during the year, due to absence of reforms needed to revitalize the sector.

Chart 16: Nigerian Equities Market Sector Performance in 2017



Source: NSE, Afrinvest Research

Table 6: Performance of NSE Sector Indices in 2017

Sectors	YTD Retrun
NSE ASI	42.3%
Banking	73.3%
Consumer Goods	37.0%
Industrial Goods	23.8%
Insurance	10.4%
Oil & Gas	5.8%

Source: NSE, Afrinvest Research

Is the Equities Market Overvalued?

Given the challenges faced between H2:2014 and Q1:2017, investors constantly punished Nigerian equities, with sell-offs recorded across various sectors of the market. Consequently, Nigerian equities were undervalued, in comparison to peers, presenting ample opportunities for investors to take advantage of some of the companies, which turned out impressive results despite the economic challenges.

Following the reforms in the FX market which resulted in increased FX liquidity and a restoration of investor confidence, massive gains were recorded in the market in 2017 and this has been sustained into 2018, up 12.2% (12/01/2018). With the market now at an all-time high in terms of market capitalisation and the NSE All Share Index at a 9-year high, there are justifiable fears of overvaluation of the market which raises concerns with regards to a near term correction. Our approach is to diagnose and probe into the fundamentals as well as technical merit of the overvaluation hypothesis.

From our analysis, average Trailing P/E and P/BV for the Nigerian equities market in the last one month as at at 17/08/2018 stood at 13.1x and 1.7x, which are lower than 15.1x and 2.0x respectively for the MSCI Frontier markets index. Looking back to the last 2-year bull market run Nigeria experienced between 2012 and 2013, the Nigerian equities market was priced at a premium to frontier markets peers in the late cycle of the run, as shown in the average P/E and P/BV multiples of the MSCI Frontier Markets index of 12.5x and 1.6x in 2013 relative to 13.5x and 2.2x of the Nigerian market in the same period. This implies that despite the rally in the market in 2017 and early trading in 2018, current undervaluation of the Nigerian market by valuation multiples and the proven historical valuation premium Nigerian market enjoys in period of boom suggest there are more miles to clock in the market rally. Hence, against the backdrop of improving macroeconomic conditions as well as positive outlook for corporate earnings, we believe there is a compelling case for investors to sustain interest in the Nigerian equities market as already noticed in the YTD return of 17.4% (17/01/2018).

Our Scenario Analysis in 2018

A review of our market forecast for 2017, shows that actual performance outperformed our bull case scenario, in which we projected that a contraction in the spread between the official and parallel market rates, an increase in oil production to about 2.2mb/d, oil prices between US$55.00/b to US$60.00/b and MPR at 14.0% will result in a 15.6% appreciation in the benchmark index. Actual performance for 2017 (+42.3%) surpassed our forecast as investor confidence was reinvigorated following the reforms in the FX market and resilient earnings.

In 2018, we envisage that market performance will be largely determined by the following factors:

1. Earnings fundamental of Corporates;
2. Stability in the FX market and other macro indicators; and
3. Funds flow dynamics to emerging and frontier markets.

Our analysis of market trend over the past 10 years, makes a case for a possible repetition of history. As noticed in 2012 and 2013, the periods following the global economic crisis, sentiment in the local bourse strengthened which drove the ASI 35.4% and 47.2% northwards in the respective years. In a similar situation, as the economy rebounded from the slump - 2014 to 2016 - in 2017, we expect market sentiment to wax stronger in 2018. In our scenario analysis for the market performance in 2018, we employed a blend of relative valuation in which we benchmarked our market valuation against multiples for peers in the MSCI Frontier market index and absolute valuation based on price forecasts for our coverage universe which is about 86.0% of the entire market.

From our analysis, the Nigerian market has outperformed the MSCI index on the basis of EPS, growing at a CAGR of 12.2% between 2010 and 2017 vs. a 2.1% decline for the MSCI index in the same period. Similarly, on a P/E basis, the Nigerian market has commanded higher pricing over the MSCI index in 6 of the 8 years under review. Against this backdrop, we carried out scenario analysis for the performance of the All Share Index in 2018.

Our forecast for the performance of the benchmark index in 2018 is largely positive as our scenarios (bear, base, bull) all signal appreciation in the benchmark index.

On a relative valuation basis, we noted earlier that our expectations for corporate earnings in 2018 is largely optimistic on the back of improving conditions in the operating environment; hence, we assumed an EPS of N3,377.4 as our base case scenario which implies a 13.0% increase from a trailing EPS of N2,988.8 in the prior year. Our EPS projection was based on the 7-year EPS CAGR for the All Share Index to arrive at the forecast. For our P/E projection, we compared current pricing in the Nigerian markets against peers for which the MSCI Frontier Markets index was employed. In order to arrive at our p/e forecast of 14.1x in the base case scenario, we analysed historical P/E multiple of the ASI relative to the MSCI Frontier Index P/E and assumed a 1.0x premium in line with historical valuation spread. This methodology yielded an All Share Index projection of 47,620.71 points in our base case scenario, which suggests a 24.5% appreciation in the year.

On an absolute valuation basis, we have a more conservative forecast for market performance, albeit still positive. Based on our 12-month target prices from our coverage universe of stocks – about 86.0% of market cap - relative to 2017 yearend prices, we forecast a 5.6% jump in market capitalisation, implying ASI projection of 40,384.81 points.

Finally, to make a call on market performance for 2018, we adopted a blend of both valuation methodologies. Based on the foregoing, we arrived at an ASI projection of 45,811.73 points for 2018 which is a 19.8% appreciation from 38,243.19 points in 2017. Our bear case (+7.7% to 41,189.9 points) and bull case (+32.7% to 50,749.10 points) also follow the same trend and further buttress the consensus view of positive market performance in 2018.

Whilst we note that developments in the macro space will also determine overall market performance, we opine that barring any major shocks in the FX market, corporate fundamentals will be a key determinant of overall performance as shown below.

Table 7: Market Return Assumptions and Projection

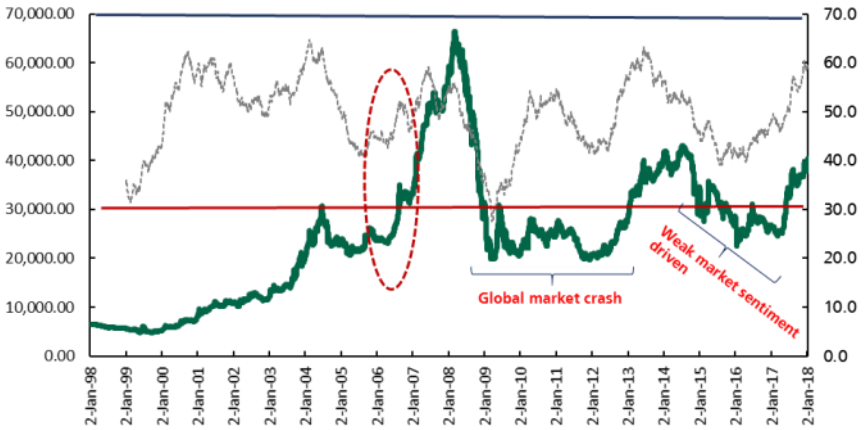
		Bear Case	Base Case	Bull Case
Relative Valuation	EPS (N)	3287.7	3377.4	3437.1
	P/E (x)	13.1	14.1	15.1
	ASI	43,068.75	47,620.71	51,900.69
Absolute Valuation	ASI	40,384.809	40,384.809	40,384.809
Weighting	Relative	30.0%	75.0%	90.0%
	Absolute	70.0%	25.0%	10.0%
Projection	2017 ASI	38,243.19	38,243.19	38,243.19
	All Share Index Forecast	41,189.99	45,811.73	50,749.10
	Overall Return	7.7%	19.8%	32.7%

Source: Afrinvest Research

What does Technical Analysis Show?

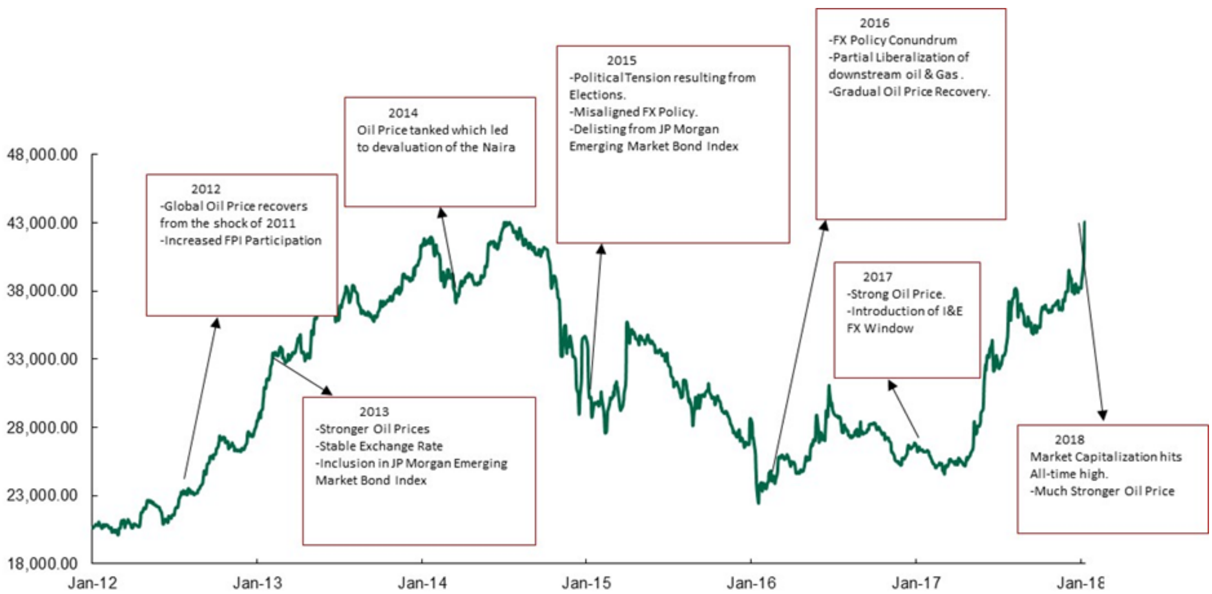
Historical analysis of the equities market shows that the benchmark index still remains in the ascendancy despite the rally recorded in 2017, as RSI has moved in tandem with the benchmark index. Our analysis shows a 250-Day RSI trend of the ASI from 1999 to 2017. In the years, prior to 2006, market activities were minimal hence our trend analysis is focused on 2006 to 2017. A reversal in RSI trend can be noticed every two years save for the periods between 2014 and 2016 given the peculiarity of the situation. Following a reversal, RSI hovers around the 60 points mark for a 2-year period, hence we expect to see the RSI around the same level in 2018 which implies sustained buy interest and further buttresses our positive outlook on the market.

Chart 17 : Historical RSI Trend of the Nigerian Equities Market



Source: NSE, Afrinvest Research

Chart 18 : Historical performance of the NSE ASI



Source: NSE, Afrinvest Research

Equities Market Prognoses for 2018… The Era of "Happy-go-lucky Trading" to Fizzle Out

Notwithstanding the superlative market performance in 2017, we are largely optimistic on 2018 as another bullish year. Our conviction is hinged on the fact that fiscal and current account balances have improved against the backdrop of sustained increase in oil prices which has had a positive knock-on impact on FX market stability. Given that activities in the Nigerian economy still remain heavily dependent on foreign participation, developments in the FX market, will be a key determinant. On the flipside, we note that a potential downside risk is largely hinged on the general elections slated for 2019, which could weigh on polity stability as well as investor sentiment. We highlight potential drivers as well as drags for 2018 below.

Figure 2: NSEASI vs. External reserves

Source: Afrinvest Research

1. **Corporate Earnings to Drive Sentiment**
   Following the improvement in investor sentiment in 2017, valuation of Nigerian equities has significantly improved and as such we believe investors decisions in 2018 will be largely driven by fundamental analysis. As witnessed in 2017, given the improved macroeconomic conditions, earnings performance of corporates was largely impressive and this informs our positive outlook on earnings for 2018. Hence, we believe investment decisions will be largely swayed by corporate scorecards during the year.

   Across the sectors, we expect the banks to sustain the current impressive trend, especially tier-1 banks, as growth prospects could spur credit extension and reduce credit impairment charges to offset the impact of decline in yields on government securities on earnings. Furthermore, the banks have taken steps to adjust to the tougher operating environment over the past year by taking cost cutting measures to boost profitability. We forecast a positive performance from companies in the Industrial Goods space, against the backdrop of widening margins and increased spending on capital expenditure. Similarly, we expect the Consumer Goods as well as Agricultural sector companies to turn out positive results due to high product prices and reducing cost pressures. For the Oil & Gas sector, we are more optimistic on performance of the upstream players, given the rally in oil prices as well as improved oil production volumes whilst we note that complete liberalization is what we envisage will unlock value for investors in the downstream oil and gas sector.

2. **Sustenance of Flexibility at the FX Market**
   As historical analysis has shown, performance of the Nigerian equities market is largely dependent on activities in the FX market, given the dominance of foreign participants over domestic investors. Hence, investors will be keeping a keen eye on management of the FX market during the year.

   Movement in oil prices which remain the largest source of foreign receipts into the domestic economy will be a key determinant of the CBN's ability to sustain the current pace of intervention in order to maintain stability and ensure adequate liquidity. In 2017, oil prices rallied from as low as US$44.82/b in June to above the US$60.00/b mark; a period in which a sustained rally was recorded in the equities market as well. In addition to this, during this period, production volumes also increased which resulted in higher FX receipts following the cessation of attacks on oil installations in the Niger Delta region, enabling Nigeria to benefit from the rally in oil prices and higher production volumes. As a result, significant accretion to the external reserves was recorded, rising from US$26.1bn in Jan-2017 to US$38.8bn by the end of the year.

   Historical analysis shows there is a positive relationship between the trifecta of oil prices, external reserves as well as FX market stability and the performance of the domestic equities market as shown in the chart below. Hence we note that maintaining the current peace in the Niger Delta region as well as stable oil prices is paramount to keeping investor sentiment upbeat.

3. **Policy Uncertainty Typically Characteristic of a Pre-Election Year**
A possible downside to market performance in 2018 is political risk. In the second half of the year, we believe a determining factor in performance of the market will be stability in the polity as investors gauge the potential impact of the general elections slated for 2019. The uncertainty surrounding the outcome of the elections could potentially drag market performance as the elections draw closer.

4. **New Market Listings through Rights, Introduction or IPO**
In line with the drive of operators and regulators to increase product offerings in the market, we could potentially see more issuances of rights, IPOs from large unlisted corporates as well as new products all together in the market. We believe the improved sentiment presents an opportunity for these instruments to be launched. With regards to rights issues, in 2017, GUINNESS, FLOURMILLS, UNION BANK, UNILEVER as well as UACN approached the market to issue rights which were largely successful. With regards to IPOs, there has been a lot of speculation as to a possible listing of MTN Nigeria's shares, which is one of the largest companies in Nigeria, on the exchange. In the same vein, the NSE has guided on launching derivative instruments on the exchange which will also deepen product offerings as well as increase interest in the market. We opine that all these factors could lead to more inflows in to the market which will also drive performance.

5. **2018 Budget Implementation as a Catalyst for Growth in the Industrial sector**
In anticipation of increased government spending on capital expenditure (N2.4tn) as proposed in the 2018 budget, we believe performance of companies in the industrial sector will be boosted. In addition to this, effective implementation of the budget should lead to increased spending which will stimulate business activity in the economy via job creation and increased funds flow.

6. **Development in Unconventional Asset Classes – Cryptocurrency**
The rise of unconventional asset classes especially Cryptocurrency, could potentially weigh on activity level in the more conventional investment securities. However, we do not believe this poses any immediate threat due to the high institutional client dominance of the Nigerian market as opposed to retail client base of crypto assets.

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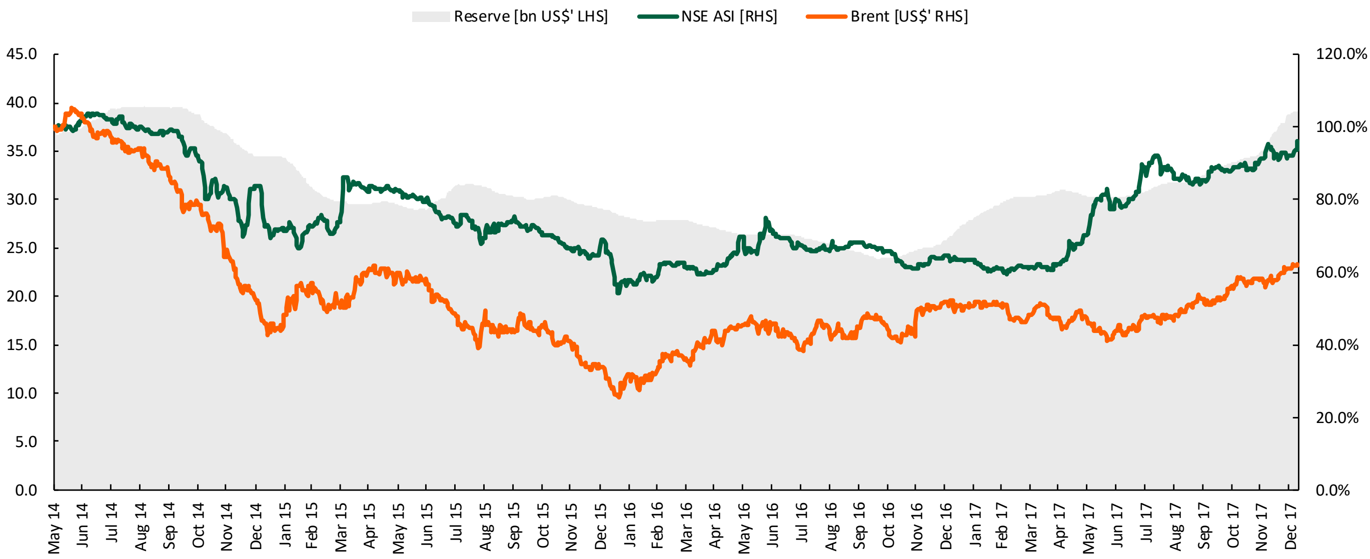
Chart 19: NSEASI vs. External reserves and Oil Prices



Source: NSE, Afrinvest Research

Section Five

Fixed Income Market Review and Outlook

Sustained Tight Monetary Policy Bolstered Activity in Fixed Income Market

Sustained hawkish monetary policy stance, pressure on general price level, improved investor appetite for safety and the weak start of domestic equities market amongst others shaped the direction of yields in 2017 as well as the overall level of activities in the fixed income market. Investors displayed overriding interest for shorter term fixed income securities compared to bonds as the influx of T-bills and OMO (Open Market Operations) supplies from the Central Bank of Nigeria (CBN) propped the level of activities. Whilst the activity dominance of most institutional investors – PFAs, DMBs and Insurance companies - remained noticeable in the year, attractive interest rate environment, strengthened by the CBN's tight monetary policy stance, also attracted retail and HNI investors to the market. Average T-bills yield on 91-day, 182-day and 364-day benchmarks settled at 17.3%, 18.7% and 20.3% in 2017 relative to 12.5%, 14.3% and 15.0% respectively in 2016. At the end of 2017, total OMO and T -bills issuance settled higher at N6.5tn and N4.4tn compared to N4.4tn and N4.0tn respectively in 2016. Similarly, despite the expensive short-term rates, a handful of Corporates - including ACCESS (N88.4bn, 20.8%), FSDH (N14.4bn, 21.2%), STERLING (N2.2bn, 21.5%) and WEMA (N17.0bn, 21.9%) - successfully issued Commercial Papers at average issue yield of 21.0%.

On the medium to long term end of the market, the dominance of the Federal Government of Nigeria as the largest supplier became entrenched in 2017 with a total Sovereign bond value of N1.5tn (compared to N1.3tn in 2016) issued at the monthly auctions conducted. In addition, the FGN explored alternative long term borrowing windows within the domestic market including the launch of the Quarterly Coupon Paying Savings Bonds (N7.0bn, 13.5%), N100.0bn Sukuk bond issued at 16.5% rental yield and the Green Bond worth N10.7bn issued in December 2017 at 13.5% yield. Also, the Debt Management Office (DMO) successfully raised a total of US$4.5bn (in four tranches) through the Eurobond market at average marginal coupon rate of 7.3% while also successfully raising US$300.0m Diaspora bond at 5.6%.

At the Corporate end, UBA successfully raised US$500.0m in its debut Eurobond issuance at a coupon of 7.8% while Zenith and Fidelity re-issued US$500.0m and US$400.0m at coupon rates of 7.4% and 10.5% respectively. Sub-National end of the market in terms of supply had minimal issuance levels with Lagos state successfully issuing N85.1bn in two tranches in Aug-2017 at coupon rates of 16.8% (N46.4bn) and 17.3% (N38.8bn). Also, backed by the full faith of Lagos State Government, Municipality Waste Management Contractors Limited (MWMCL), at estimated 74.0% success rate, issued N20.0bn as part of its N50.0bn bond programme. Similarly, Bayelsa State restructured its N50.0bn 2019 bond while Ondo state extended its N27.0bn 2019 bond for the next 3 years.

Table 8: Treasury Bills, OMO and Bond Auction Summary for 2017

	Treasury Bills (91D,182D AND 364D				Open Market Operations (OMO)				Sovereign BONDS Auctions (JUL-2021, JAN-2026, MAR-2036)			
	Amount Offered (N'bn)	Subscription (N'bn)	Amount Allotted (N'bn)	Average Marginal Rate	Amount Offered (N'bn)	Subscription (N'bn)	Amount Allotted (N'bn)	Average Marginal Rate	Amount Offered (N'bn)	Subscription (N'bn)	Amount Allotted (N'bn)	Average Marginal Rate
Jan-17	441.8	636.4	441.8	16.6%	250.0	507.1	477.1	18.3%	130.0	235.1	215.0	16.96%
Feb-17	384.8	1011.7	504.8	16.5%	90.0	391.7	391.7	18.3%	110.0	337.0	160.0	16.64%
Mar-17	698.9	764.5	698.9	16.4%	400.0	342.7	342.6	18.4%	130.0	216.4	160.0	16.27%
Apr-17	402.4	417.1	324.5	16.6%	470.0	373.5	316.1	18.3%	135.0	129.4	105.3	16.16%
May-17	458.7	671.6	458.7	16.5%	420.0	256.1	250.3	18.3%	140.0	161.9	110.0	16.29%
June-17	369.9	419.4	369.9	16.5%	320.2	419.6	337.6	18.3%	140.0	158.1	99.3	16.19%
July-17	381.9	526.7	381.9	16.5%	1065.0	892.2	885.1	18.3%	135.0	129.2	106.0	16.25%
Aug-17	484.7	612	484.7	16.2%	890.00	888.5	830.8	18.2%	135.0	63.7	56.1	16.83%
Sept-17	174.1	387.2	174.1	16.1%	970.1	657.3	612.4	17.2%	135.0	394.9	243.8	15.93%
Oct-17	264.2	722.7	264.2	14.7%	1080.0	1,016.7	1012.9	16.8%	100.0	166.3	100.0	10.00%
Nov-17	322.3	438.9	337.9	14.6%	1,785.0	1, 182.2	1,055.7	16.9%	100.0	105.4	87.8	9.86%
Dec-17					2,150.0	1,432.4	1431.8	13.9%	100.0	280.1	77.6	8.80%
Sum	**4,383.7**	**6,608.2**	**4,441.4**	**16.1%**	**7,740.3**	**5,745.4**	**6,512.3**	**17.9%**	**1,490.0**	**2,377.4**	**1,520.8**	**14.7%**

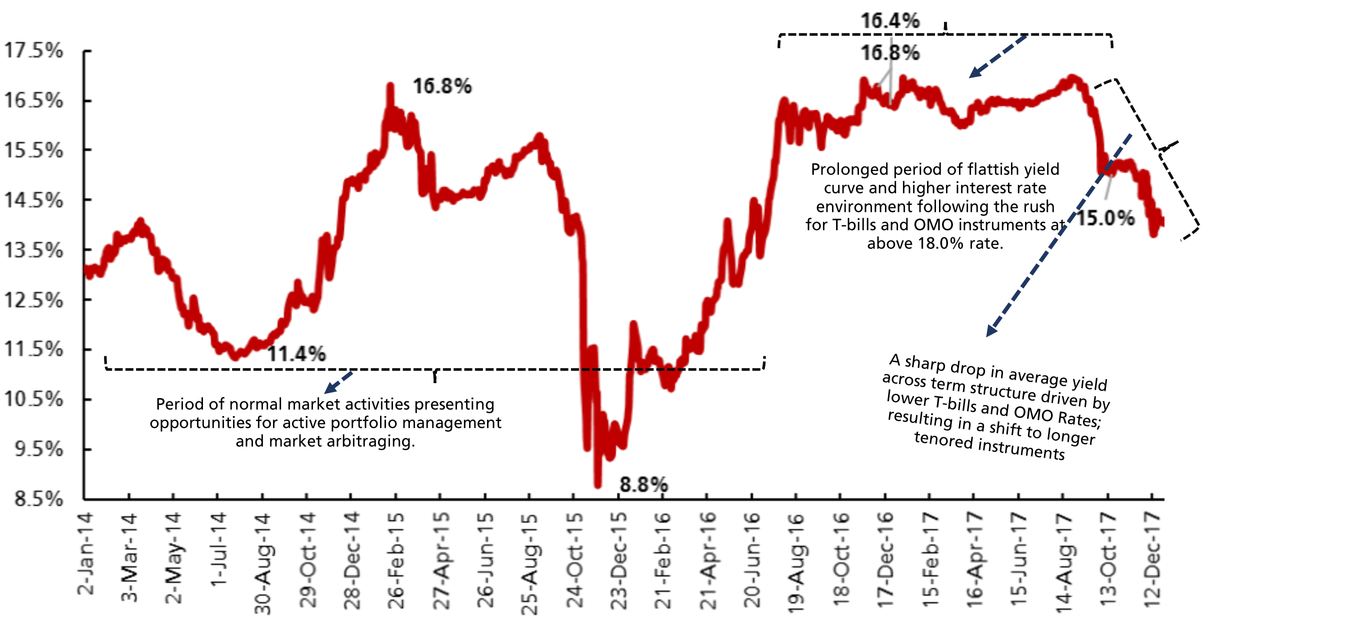
Source: CBN, Afrinvest Research

In the secondary market however, the domestic bond market stayed largely calm with minimal trading activities for the most part of the year although activity picked up towards the end of the last quarter. Average yield closed at 14.1% in 2017, relative to the level of 16.4% in 2016, as short and long term yield moderation buoyed bonds market performance in Q4:2017. Active bond market traders thus had minimal opportunities of riding the curve before the last quarter as most secondary market activities were concentrated at the T-bills end of the fixed income market. Pension Fund assets deployed to T-bills investment according to National Pension Commission (PENCOM) rose 60.7% as at Oct-2017 to N1.3tn from N779.1bn in Dec-2016 compared to 9.2% increase in bonds assets (up from N3.7tn to N4.0tn) despite the 1.2% yield moderation recorded in the same period. Domestic Corporate bond market performance remained largely illiquid in 2017 save for the OTC trades on Lagos State Bond series. As at Oct-2017, pension funds hold 90.6% and 43.2% of Corporate and State Government bonds respectively.

Tighter monetary policy environment coupled with the sustained attraction of most investors towards long dated T-bills and OMO securities, made long term bond instruments somewhat less attractive for active fund managers until the later part of the year but more comfortable for "Held to Maturity" portfolios at average coupon rate of 13.1%. The initial Dec-2015 spike in yield which continued up until Jun-2016 resulted in a somewhat flattish curve between Jun-2015 and Sept-2017, driven by higher T-bills and OMO Rates, with yields on medium and long-term bonds stabilizing at an average of 15.7% in 2017.

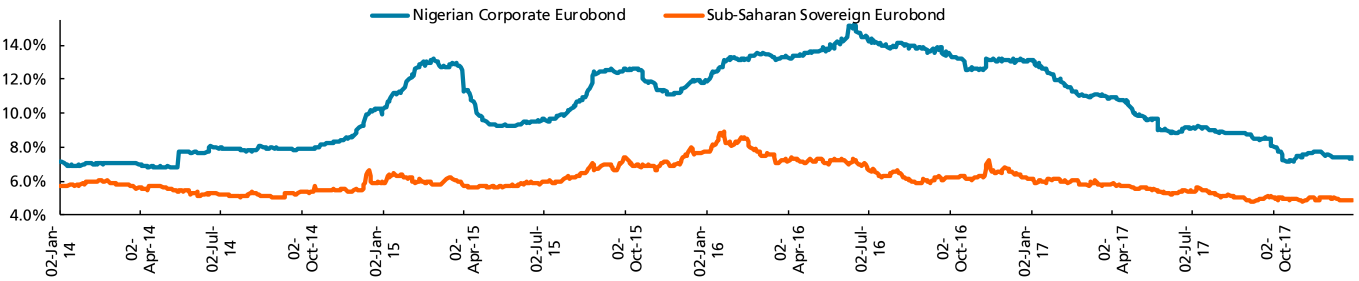
The Corporate and Sovereign Eurobonds market was however very active throughout the year and presented massive opportunities for riding the yield curve especially at the corporate end of the market. Average Nigerian Corporate Eurobond yield moderated by 5.9% Y-o-Y in 2017 to 7.3% from 13.2% while yield on selected Sovereign Eurobonds closed bullish at 4.8% in 2017 from 7.3% in 2016.

Chart 20: 3-Year Average Historical Nigerian Sovereign Bond Yield



Source: Bloomberg, Afrinvest Research

Chart 21: Historical Average Sub-Saharan Sovereign and Corporate Eurobond Yield



Source: Bloomberg, Afrinvest Research

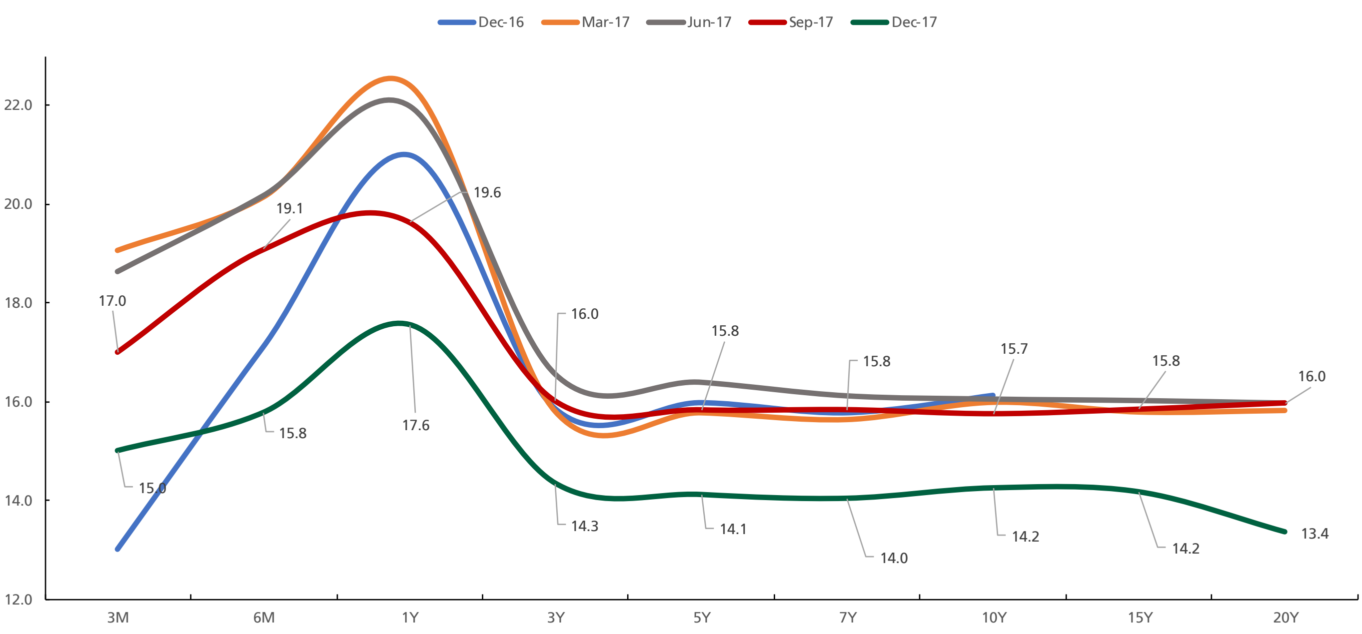
The Sovereign Eurobonds in the Sub-Saharan African basket recorded a very bullish performance in 2017 as the recovery in commodity prices, in addition to interest rate normalization in the US and other Systemically Important Economies (SIE), supported the demand for most high yielding instruments from Emerging Markets. Average Sovereign Eurobond yield in SSA moderated to 4.8% in 2017 relative to 6.1% in 2016. Similarly, Nigerian Corporate Eurobonds presented the most opportunities in 2017 as average yield crashed from 13.2% in 2016 to a 3-year low of 7.3% as the positive sentiment towards FGN securities, following the successful issuance of the US$4.5bn Eurobond, improved sentiment on Corporate Eurobonds space.

Humped Sovereign Yield Curve…Optimizing Portfolio Yield towards Going Long

The Nigerian Sovereign Yield Curve has maintained a Humped or Bell-Shaped slope since Dec-2016. A "Humped or Bell-Shaped" Yield Curve is the slope of the curve achieved when the intermediate yields are higher than the short term and long-term yields. Although a Humped yield curve merely signifies a transactional state and not necessarily backed by economic theories, it signifies a slowdown in Nigeria's economic growth momentum as revealed by the recent recovery from the recession of 2016.

Our outlook on bond yields movement in 2018 hints of the possible opportunities the curvature of the Sovereign yield curve presents. Whilst we anticipate a gradual moderation in bond yields, purely based on improved market activities as demand for longer term fixed income instruments softens yields to an average of 12.5% by yearend, the transitioning path to a flattish and later a normal yield curve is anticipated to be a downward "Butterfly Shift" (a yield curve shift that changes the curvedness to either a flattish, normal or inverted yield curve) to normality. The recent moderation in market yields hints towards a possible gradual normalization of the yield curve than an inversion given that the economy is on a recovery path. Hence, a shift towards a normal yield curve is more plausible in 2018 from the current Bell -Shaped yield curve. Intermediate term bonds may present short term opportunities as yields normalize and prices increase. Notwithstanding, the long-term bonds with longer modified duration portends the most attractive price appreciation opportunities for active investors in 2018.

Chart 22: Nigerian Sovereign Yield Curve across Quarters (%)



Source: FMDQ, Bloomberg, Afrinvest Research

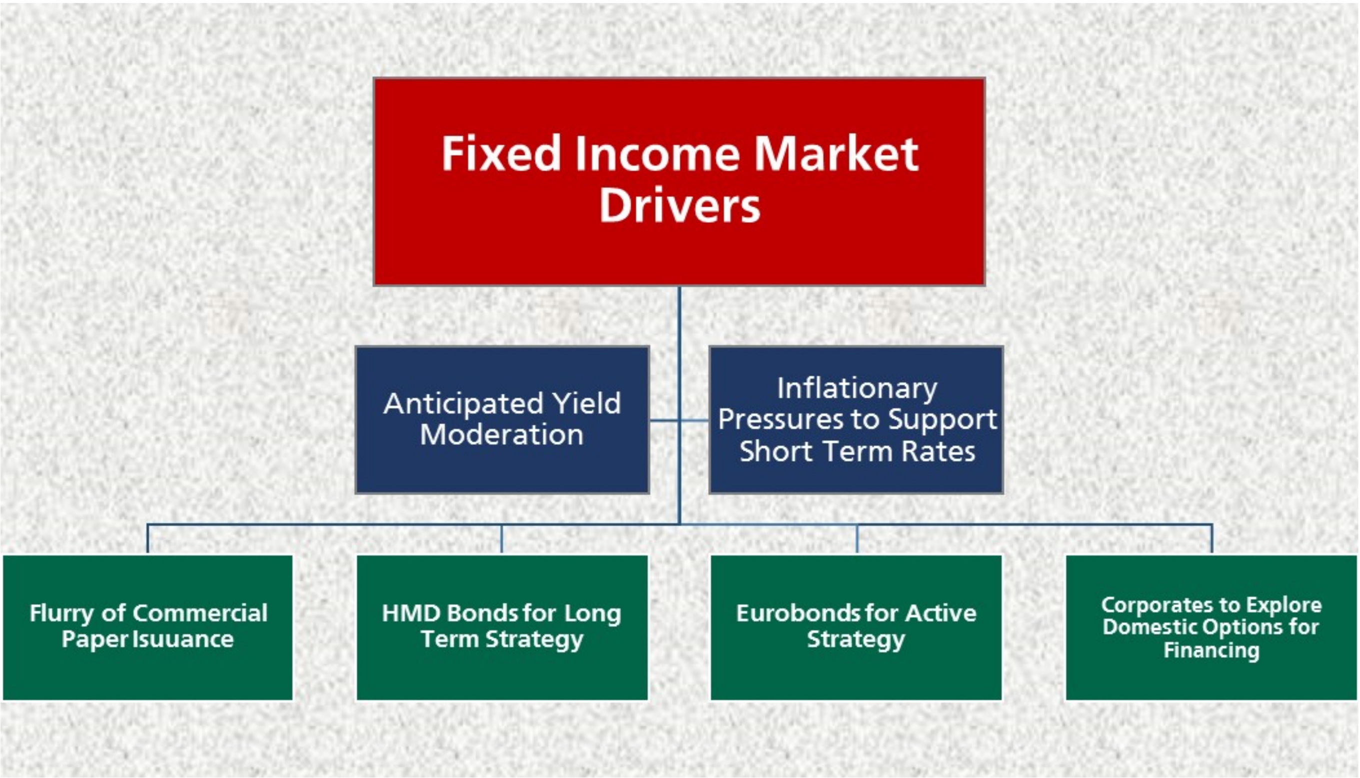
Fixed Income Market Prognoses for 2018… Overall Activity Should Favour Optimal Return

On the back of domestic economic recovery and more accommodative monetary policy, we anticipate investors are likely to structure their fixed income portfolios towards bonds rather than short term treasury instruments. Overall market yield is anticipated to moderate 1.6% to 12.5% in 2018 as the yield curve is also forecast to transition to normality.

We believe the yield environment in 2018 will be largely determined by market activities as already being noticed since the last quarter of 2017. Nevertheless, we do not discountenance the possibility of a benchmark rate reduction in H2:2018 to align with market movement. We are of the view that the demand for safer sovereign instruments by Institutional Fund Managers (notably PFAs, Insurance Companies, Discount Houses etc.) and DMBs as well as HNIs will propel market activities towards yield moderation. We highlight some of the revelations from our crystal ball below.

1. **Anticipated Yield Moderation on Long Term Instruments:**
   In line with the moderating yield environment from 2017, we anticipate that yields on long term instruments would further decline given the Federal Government's plans to reduce pressures on domestic borrowing. In Nov-2017, the issuance of a US$3.0bn Eurobond indicated the Government's interest to shift its borrowing focus to the international market, hence lowering its participation in the domestic market. Resultantly, average yields on Government issued long term instruments are expected to moderate further in 2018 as investors are likely to find hitherto unattractive longer dated bonds as safer havens; we believe this will drive stronger market activities.

Figure 3: Potential Fixed Income Market Drivers for 2018



Source: Afrinvest Research

2. **Undissipated Inflationary Pressures May Keep Short Term Rates Upbeat:**
   Pressures on domestic price levels continue to mount on the back of unabated elevations on food prices throughout 2017 despite the anticipated base effect moderation. Recent developments in the energy market have worsened the outlook on inflationary pressures; yet, we forecast moderation in inflation rate to as low as 11.1% in 2018 due to high base effect and delay in price hike in electricity tariffs and pump price of petrol - events that could conceivably weigh on inflationary trend. Although recent gradual normalization of the yield curve has become noticeable, subsisting double-digit inflation rate may yet be reflected on the performance of short term rates in 2018, thus stabilizing rates around the Monetary Policy Rate (MPR).

3. **Flurry of Commercial Paper Issuance as Government Participation Reduces:**
   Following the plans by the Federal Government to ease borrowing pressures on the domestic market, we anticipate the private sector would take advantage of the lower interest rate environment to raise short term financing via Commercial Papers. With probable moderation in the crowding out of treasury short term instruments, Corporates are likely to find the Commercial Paper window cheaper than approaching DMBs for working capital funding at commercial rates. We envisage that the expectation of flurry of issuances will make the secondary market for Commercial Papers more active for traders to explore in 2018.

4. **Higher Modified Duration Bonds Will Support Long Term Fixed Income Strategy:**
   Activities in the local bonds market in 2017 remained soft as investors concentrated on shorter term money market securities (OMO and T-Bills). Yield curve normalization and the overall expectation of yield decline will anticipatorily be most optimal for long duration bonds in 2018. Our view is that most institutional fund managers, notably Pension Fund Managers, will stick to their long-term horizon and "Hold to Maturity" strategy. Hence, we foresee improved activities in the long-dated bond instruments in 2018.

5. **Eurobonds Market Will Favour Active Fixed Income Strategy:**
   The Sub-Saharan Sovereign and Corporate Eurobonds market was very active throughout 2017 given the stability in global commodity prices; average yield on SSA and Nigerian corporate Eurobonds moderated 4.8% and 7.3% Y-o-Y respectively. Although the market appears fairly valued with most sovereign and corporate instruments trading at premium to par values, we are of the view that active market players in the Eurobonds market will have opportunities to profit from market volatility in 2018. For Nigerian Sovereign and Corporate Eurobonds especially, given the political risk uncertainties that have always defined periods preceding an election year, we expect yields to rise sharply in H2:2018, presenting entry opportunities for later trading in 2019 post-election cycle.

6. **Corporates will Explore Domestic Market Options for Long Term Financing:**
   Government borrowings in Nigeria until recently have continued to suppress credit to the private sector while also crowding out corporates and Sub-Nationals from the domestic bonds market. As a result, corporate issuance of debt securities has continued to indicate unsustainably high yields for most corporates with some opting for alternative financing options - raising capital (via rights) in the equities market. Hence, with less reliance on domestic borrowing by the Federal government and forecast yield moderation in 2018, we expect a resurgence of corporate issuances in the domestic bond market.

Section Six

Alternative Asset Classes

Real Estate Market Review and Outlook

Real Estate Sector Remains in Recession on the back of High Vacancy Rate & Induced Cost Pressures

Despite the rebound in global oil prices and an improved macroeconomic environment in 2017, the Nigerian real estate sector remained in a recession as it contracted 5.0% Y-o-Y annualized in Q3:2017, a subtle improvement from 6.9% Y-o-Y contraction in FY:2016. The negative performance of the sector could be attributed to sustained cost pressures in construction materials which have steadily increased since Q1:2015 along with high residential and commercial vacancy rates amongst others.

Table 9: Change in Prices of Construction Materials

Cost of Construction Materials			
Item	H1-2016	H1-2017	% Change
Cement (50kg)	1,500	2,800	86.7%
Distribution Board	40,000	45,000	12.5%
Sandcrete Block (9 inch)	200	220	10.0%
13A socket	950	1,200	26.3%
Aluminium Roofing Sheet (0.55mm)	1,550	2,500	61.3%
Ariston water heater (Small)	28,000	28,000	0.0%
Cables (6mm / Coil)	16,000	38,000	137.5%
Tyford complete set WC	14,500	14,000	-3.4%
Coloured Emulsion Paint	8,500	12,000	41.2%
Paving stone 60mm (Local)	1,750	2,100	20.0%
White Emulsion (Dulux)	26,000	28,000	7.7%
Harvey roof tiles	5,700	11,000	93.0%

Source: Northcourt, Afrinvest Research

An analysis by Northcourt real estate – a premier real estate investment company in Nigeria – suggested that despite the improvement in macroeconomic indicators, residential vacancy rate in select locations, mostly high-brow, have remained pressured whilst land prices have soared on the back of anticipated strong demand. This could be attributed to several factors such as house types as well as pricing; hence, mid-market areas recorded lower vacancy rates. FDC's Vacancy Factor index corroborated this narratives as it rose 7 points Y-o-Y to 172 points in January 2018 from 165 Points in January 2017.

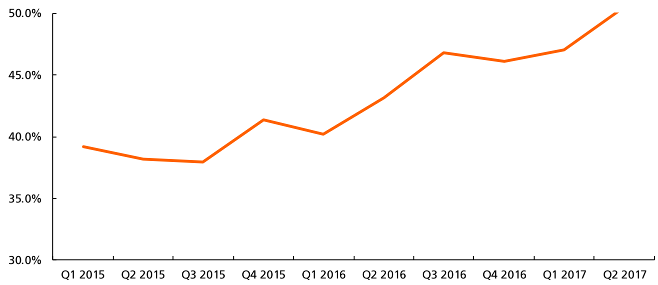
Property Listing Technology Space Records First Major M&A Consolidation

Tech participation in the real estate space in Nigeria has continued to disrupt traditional methods of home ownership, rent payments and even apartment sharing. Sustaining the momentum from 2016, technology start-ups in the real estate space have continued to expand and consolidate operations with the largest area of tech adoption in the sector being Property listing. In 2017, several deals were sealed by tech start-ups, the most significant of which was the purchase of Jumia Homes for an undisclosed sum by "Tolet.com.ng"- an online real estate portal which then rebranded to "propertypro.ng". This positioned it as a market leader in the Nigerian online real estate market reportedly with approximately 66.0% market share. 2017 also saw the entrance of new participants such as "muster.ng", "instantapartment.com" – an online luxury apartment rental portal – "estatedesk.com" and "moovedin.com" amongst others into the market.

Primary Mortgage Institutions Sustain Loan Growth despite Slow Real Estate Activity

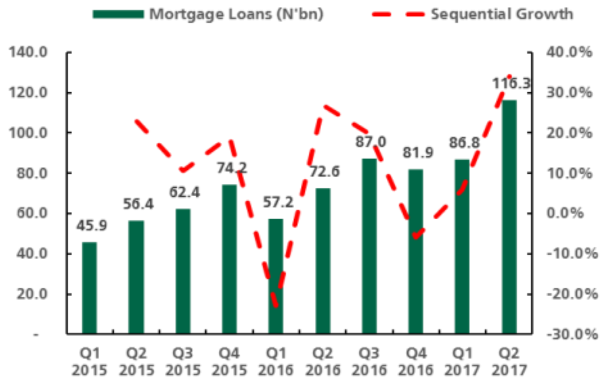
Despite the negative performance of the real estate sector in 2017, Primary Mortgage Institutions (PMIs) have recorded steady growth in Mortgage Loans over the past 3 years. In Q2:2017, loans increased 33.9% Q-o-Q to N116.3bn (from N86.8bn in Q1:2017), while also rising 60.1% Y-o-Y. Similarly, mortgage loans as a percentage of PMIs interest earning assets has also sustained an upward trend from Q1:2015. In Q2:2017, mortgage loans accounted for 50.6% of interest earning assets, up from 39.2% in Q1:2015. Considering the sizeable National Housing deficit estimated at 17.5m, increasing population and low home ownership levels in urban areas, there are opportunities for mortgage lenders to tap into in order to maximize profitability. In our view, the risk to creating mortgages in a peculiar environment like Nigeria, where assets hardly depreciate in value, is not as pronounced as the risk to commercial bankers especially given that the underlying assets will serve as the basis for securitizing the loan. We believe the burgeoning middle class which is characteristically typified in the proportion of labour force earnings in excess of N2.0m per annum supports the hypothesis for opportunities PMIs can tap into.

Chart 23: Mortgage Loans as % of Income Assets (2015 – 2017)



Source: CBN, Afrinvest Research

Chart 24: Mortgage Loans Performance (2015-2017)



Source: CBN, Afrinvest Research

Nigerian Mortgage Refinancing Company (NMRC) Launches Strategic Partnerships to Boost Performance

The Nigerian Mortgage Refinancing Company (NMRC) was established in 2013 as a vehicle to bridge the existing gap between the capital market and mortgage lenders by refinancing mortgage loans, as well as providing affordability of quality housing through the provision of increased liquidity in the mortgage market. The company in its 2016 Annual Report cited it had refinanced mortgage loans up to N8.1bn (up from N1.9bn in 2015) representing 19.9% of its total assets - N40.8bn, whilst staying heavily invested in Government securities. However, in its bid to position as the top refinancing company in the country, NMRC launched the Mortgage Warehouse Funding Limited (MWFL) in October 2017. MWFL is a Special Purpose Vehicle (SPV) company created with the objective of providing short-term viable funding to listed member mortgage banks using a market

Table 10: NMRC Financial Statement Summary in FY:2016

NIGERIAN MORTGAGE REFINANCING COMPANY (NMRC) FY 2016 Result - Financial Highlights (NGN Billion)				
Statement of Comprehensive Income	**FY:2016**	**FY:2015**	**Y-o-Y Growth**	
Gross Earnings	6.0	4.1	49.0%	
Interest Income	5.2	3.1	65.2%	
Interest Expense	(2.2)	(1.1)	95.0%	
Net Interest income	3.0	2.0	49.1%	
Credit impairment charges	(0.04)	(0.04)	-9.5%	
Investment and Other Operating Income	0.00	0.00	-107.8%	
OPEX	(1.7)	(1.5)	13.1%	
Profit/Loss Before Tax	1.3	0.5	164.6%	
Taxation	(0.0)	(0.0)	164.6%	
Profit/Loss After Tax	1.3	0.5	164.6%	
Per share data	**NMRC**		**Corporate Actions**	
Current Price	N/A		Proposed Dividend	N/A
Earnings Per Share	0.72			
Price multiples/Ratios			Payment Date	N/A
RoAE (Annualised)	15.6%			
RoAA (Annualised)	3.2%		AGM Venue	N/A
Net Interest Margin (Annualised)	7.7%			
Cost of Funds (Annualised)	9.1%		*nm	Not Meaningful
Cost to Income	56.1%	73.9%		
Cost of Risk	0.4%	0.3%		
Net Margin	21.1%	11.9%		
Statement of Financial Position	**FY 2016**	**FY 2015**	**Y-o-Y Growth**	
Cash and Bank Balances	1.3	7.4	-82.9%	
Total Loans and advances	9.5	16.0	-40.4%	
Financial Assets	29.4	15.3	91.8%	
Total Assets	40.8	39.1	4.4%	
Total Equity	8.6	7.8	10.9%	
Total Borrowings	24.3	23.3	4.1%	
Total Liabilities	32.2	31.3	2.8%	

Source: NMRC, Afrinvest Research

intervention mechanism to support and improve mortgage pre-financing on a short-term basis. The company would provide short term financing through the issuance of high quality investment grade and rated Asset Backed Commercial Papers (ABCP), using the proceeds to fund member mortgage banks' pipeline of prequalified NMRC conforming mortgage loans.

NMRC also developed strategic partnerships with real estate developers such as the Ogun State Property and Investment Corporation (OPIC) aimed at boosting capacity of OPIC by giving more long-term mortgage loans to potential home owners in Ogun and Lagos environs. Similarly, in July 2017, a Memorandum of Understanding (MoU) was signed with Echostone to finance and deliver about 750,000 housing units over a 10 -year period.

Real Estate Investment Trusts (REITs) Activity Remains Weak in Line with Trend

The performance of Real Estate Investment Trusts (REIT) in 2017 was largely underwhelming as the three REITs listed on the Nigerian Stock Exchange - **Union Homes REIT** (N45.20), **UPDC REIT** (N10.00) and **Sky Shelter Fund** (N100.00) – with a combined market capitalization of about N40.0bn recorded no activity over eight consecutive quarters. Whilst performance remained at seemingly insignificant levels, there have been efforts by the Nigerian Stock Exchange to shore up investor confidence in the sector, one of which was the mandate given to REITs operators to submit quarterly and audited annual reports as well as frequent submission of performance metrics.

Outlook: Government Spending to Drive Sector Performance in 2018?

The Federal government in its proposed 2018 Appropriation Bill ramped up infrastructural spending by about 11.7%, a move which could strengthen activity levels in the construction and housing sectors as well as participation of the private sector. As part of its plan to tackle the current housing deficit, the Ministry of Power, Works and Housing has earmarked N35.4bn for the National Housing Program as well as setting aside N100.0bn for the Social Housing Program. Following the recovery in the economy and stability in the Foreign Exchange Market, our near-term outlook for the sector is positive while also remaining cautiously optimistic on the vacancy rates in highbrow areas.

Derivatives Market Review and Outlook

Regulators step up Efforts to Deepen Product Offerings
The awareness of investment opportunities in the derivatives market in Nigeria, remains sub-optimal, hence activity level in that space in comparison to other asset classes, remains low. Given the continuous expansion of the Nigerian capital market product offerings as well as the inherent macroeconomic risks, opportunities for investors to take advantage of derivative instruments with the aim of hedging their exposures or taking speculative actions against price movement have arisen. The FMDQ in partnership with the CBN has, in the past few years, introduced several FX-based derivative products to deepen FX market liquidity while the Nigerian Stock Exchange (NSE) also announced plans in 2017 to introduce equity based derivative products on the exchange. Currently, most derivative products in Nigeria are tied to the foreign exchange market especially on Forward, Futures and Swaps. To this end, the NSE has organized series of trainings and seminars in a bid to improve awareness and technical knowledge of derivative products. We review the performance of the Nigerian derivatives market as well as our outlook below in light of Forward, Futures, Swaps and Options.

Forward Contract Market…Integral Tool to Maintaining FX Stability

A forward contract is an agreement between two parties in which one agrees to purchase an asset at a given price and future date while the counterparty sells under the same conditions. A tool often used by investors and manufacturers to hedge volatility risk, forward contract sales have been majorly utilised by Nigerian FMCGs and Industrial manufacturers to lock in prices of raw materials needed for production. The prominence of forward contract sales has however grown over the past year, especially FX forward contracts, due to increased Naira volatility in the last 2 years and CBN FX reserves management strategy.

In 2017, given the higher FX receipts, the CBN increased its spate of intervention in the forex market, via weekly Special Wholesale Intervention sales for spot and forwards of a maximum of 60 days, in a bid to improve liquidity within the market while also ensuring stability of external reserves. According to data from the CBN statistical database, total volume of FX forward sales by the CBN as of September 2017 was US$7.7bn, an 85.7% increase from US$4.2bn recorded in FY:2016. The jump in forward contract sales is unsurprising, given the drive of the Apex Bank to clear backlog of FX obligations as well as maintain FX rate stability. However, forward pricing of the tenors which reflects expectation of future pricing of the spot exchange rate suggests a possible depreciation of the domestic currency. For instance, at the start of 2017, while the spot rate stood at N305.00/US$1.00, the 1 -year forward quote was at N378.00/US$1.00 which was close to the prevailing NAFEX rate at the end of 2017. Nevertheless, we note that these quotes are not necessarily trade backed, but indicative rates quoted by participants. In 2018, we expect the CBN to sustain its pace of forward FX sales, hence an opportunity is presented for individuals or corporates who have FX obligations to fulfil.

Futures Contract Market… Declining Subscription Level on Narrowing Arbitrage Opportunity

The adoption of a “flexible exchange rate regime” by the CBN in June 2016 was followed by the introduction of 12 different Naira settled Non-deliverable OTC FX Futures Contracts. This was targeted at boosting FX liquidity while also allowing for effective pricing of the domestic currency against the dollar as well as serve as a hedge for foreign investors exposed to exchange rate volatility. The introduction of these contracts was initially greeted with a lot of optimism, as importers, especially in the agricultural sector as well as the consumer goods sector took advantage of this, given the massive spread between contract prices and prevailing exchange rates at maturity. Despite the interest, none of the 12 contracts was totally subscribed as value of open contracts never touched the US$12.0bn on offer. The underlying constraint was the reduced arbitrage opportunity as the rates on the contract were tied to the upward review of contract prices as well as change in settlement rate from NIFEX to NAFEX.

Hence, total value of Open Contracts fell US$336.3m Y-o-Y, declining from US$3.7bn in Dec-2016 to US$3.3bn in Dec-2017. The April 2018 contract was the most subscribed contract with a total subscription of US$656.9m as at Dec 2017 at a rate of US$361.64.

Table 11: OTC Futures Contract as at December 2017

Contract Tenor (Month)	Contract	Settlement Date	Value of Open Contracts (US$'m)	Current Rate ($/N)
1	NGUS JAN 31 2018	31-Jan-18	321.60	361.19
2	NGUS FEB 28 2018	28-Feb-18	288.27	361.34
3	NGUS MAR 28 2018	28-Mar-18	431.52	361.49
4	NGUS APR 25 2018	25-Apr-18	656.90	361.64
5	NGUS MAY 30 2018	30-May-18	161.77	361.79
6	NGUS JUN 27 2018	27-Jun-18	236.89	361.94
7	NGUS JUL 25 2018	25-Jul-18	395.57	362.09
8	NGUS AUG 29 2018	29-Aug-18	220.81	362.24
9	NGUS SEP 26 2018	26-Sep-18	325.27	362.39
10	NGUS OCT 31 2018	31-Oct-18	107.19	362.54
11	NGUS NOV 28 2018	28-Nov-18	163.08	362.69
12	NGUS DEC 26 2018	26-Dec-18	10.00	362.84
Total			3,318.87	

Source: FMDQ, Afrinvest Research

In 2018, we expect interest in the futures contracts to remain sub-optimal, based on three factors:

1. Stable FX rate outlook - on the back of rising oil prices and current account balance - which would reduce demand for hedging products;
2. Narrowing spread between NAFEX settlement rate and contract prices, and
3. The Naira-settled quality of the contracts which make them less desirable for hedging than a conventional FCY settled contracts.

Swaps… Increased FCY Borrowing by DMBs Boosts CBN Swap Inflows

A swap agreement involves two counterparties who agree to exchange a series of future cash flows with a present duration, settlement date and mode of payment as stipulated in the contract. Commodities, interest rates, currencies, equities, fixed income instruments etc. usually serve as underlying assets in swap agreements. In Nigeria, currency swaps have risen to prominence, especially from 2014 to 2016, as the Apex Bank sought to shore up the external reserves given the lingering FX liquidity crisis at the time. Inflows from swap contracts between the CBN and Deposit Money Banks accounted for 16.1% (US$4.2bn) of the external reserves (US$25.8bn) as at 30/12/2016.

In 2017, DMBs appetite for swaps remained upbeat as total inflows stood at US$2.7bn in 9M:2017 as against US$2.8bn in 9M:2016. Furthermore, the improved FX liquidity situation which trailed the launch of the I&E FX window increased banks' ability to secure FCY debt and we believe this could also have contributed to the relatively high interest in swap agreements with the CBN. On the informal side, 2018 appears to be a seller's market for interest rate swaps given our overall outlook on moderating interest rate environment. DMBs are likely able to take advantage of short term opportunities in underwriting contracts on interest rate swaps. Nevertheless, because the transactions in this market are largely unorganized, we expect that activities will stay calm.

Options… Fixed Income Instruments Dominate

Options, in contrast to the other derivative instruments described earlier, offer the holder the right, but not necessarily the obligation to execute a transaction at a pre-stated volume of an underlying asset at a given date as well as an established rate. Similar to forwards, asset classes including equities, bonds, interest rates, commodities, currencies etc. often serve as underlying assets for option contracts. In the Nigerian option contracts market, fixed income issuances dominate as some corporate and sub-national bonds have embedded options, as shown below.

On the equities side, the NSE is targeting to launch its option trading platform in 2018 after having missed the Q3:2017 deadline earlier set. We expect this to monumentally shift the dynamics of derivatives in the Nigerian financial market as it helps to further deepen the market.

Table 12: Selected Bonds with Options

Issuer	Maturity Date	Coupon (%)	Tenor (Years)	Option Type	Currency
United Bank for Africa	30-Sep-18	14.00	7	Callable	Naira
United Bank for Africa	30-Dec-21	16.45	7	Callable	Naira
Fidelity Bank Plc	13-May-22	16.48	7	Callable	Naira
First Bank Limited	07-Aug-20	8.25	7	Callable	USD

Source: FMDQ, Afrinvest Research

Global Commodities Review and Outlook

Energy Commodity Prices to Outstrip Others for the Third Year

The global commodity market was mildly bullish for most part of 2017 with Energy commodities outperforming Agricultural commodities, similar to the trend observed in 2016. According to the World Bank Commodity Markets Outlook (Oct 2017), Energy commodity index gained 11.5% in 2017 after a marked increase of 42.9% in 2016 while the non-Energy index only gained 2.4% in 2017 compared to 9.7% rise in 2016. Prices of Agricultural commodities were flattish throughout 2017 with the index shedding 2.1% Y-o-Y on the back of declines recorded in Beverages (-6.4%), Food (-1.3%) and Oils & Mills (-5.3%) indices. Grains index was the only component of the broader food index that appreciated Y -o-Y in 2017. Falling inventories in the oil market - against the backdrop of OPEC production restraints - and strong global demand despite stabilizing US shale production, strengthened oil prices above US$54.7/b for most part of 2017. Sufficient supplies as well as stable stocks-to-use ratios (measure of abundance of supply relative to demand) supported stability in Agricultural commodities.

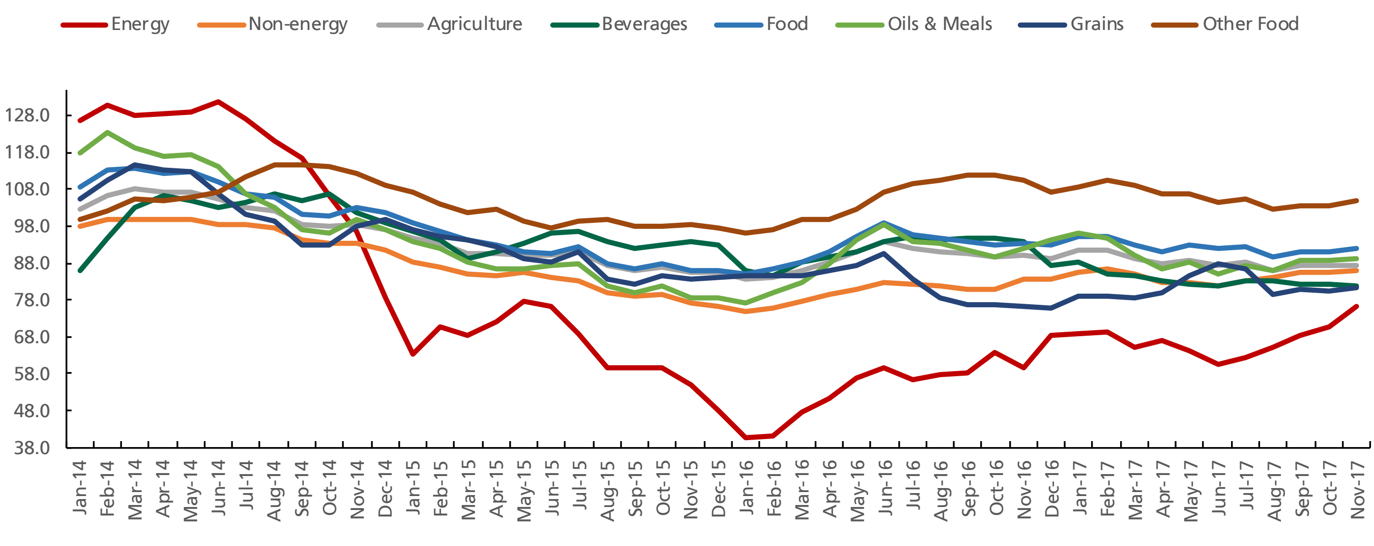
Outlook on global commodities appears favourable as energy prices are projected to rise 4.0% in 2018 while non-energy prices are forecast to increase by a modest 1.0% in the same period. Stable crude oil prices are anticipated to support the increase in energy prices as oil prices are expected to increase to US$56.00/b in 2018 by the World Bank on strong demand as well as restraint in OPEC and non-OPEC production offsetting anticipated increase in shale oil outputs. Agricultural prices are forecast to drive the performance of non-energy prices in 2018 with the World Bank forecasting the prices of Beverages, Food and Grains to stabilize with Y-o-Y marginal increases.

Our profiles of major global commodities focus on Energy (Crude Oil) and Agricultural commodities (Wheat, Sugar, Barley, Sorghum, Cocoa and Crude Palm Oil).

Crude Oil: Supply Freeze Agreement Buoyed Prices; Stable Outlook For 2018

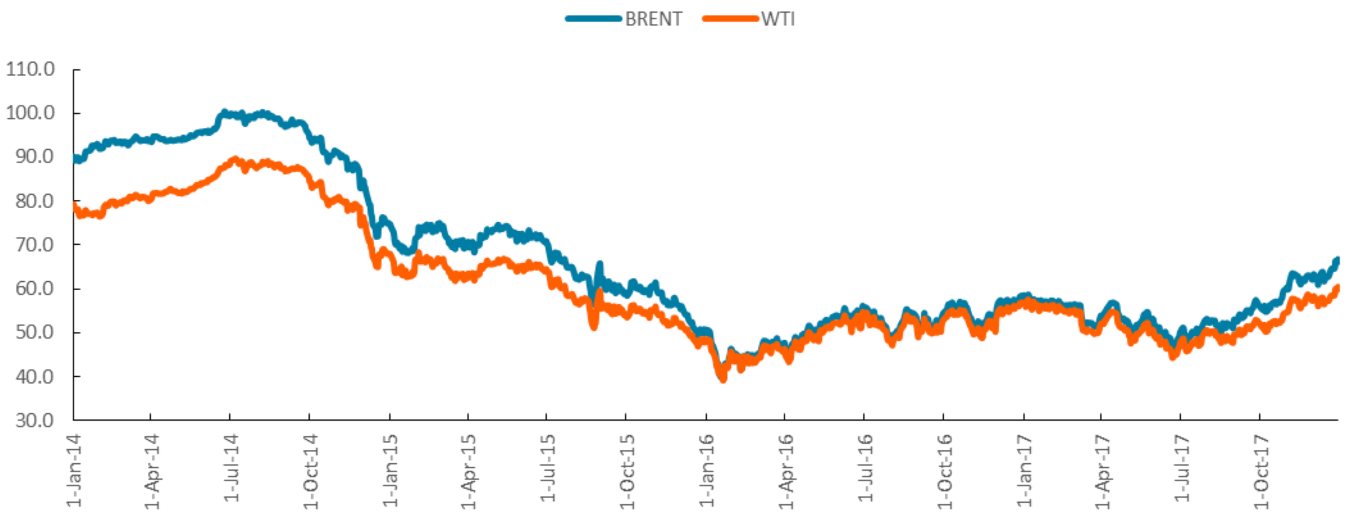
Crude oil prices had a positive year on the back of high degree of compliance by OPEC and Non-OPEC countries with the oil supply freeze agreement which was reached in December 2016 and extended in November 2017 for 6 months. As at September 2017, the degree of compliance to the deal was estimated by OPEC in its Monthly Oil Market Report (MOMR) at 88.0%. The strong performance in 2017 was also aided by natural disasters (Hurricane Harvey and Irma) which hit US Shale oil production in the gulf coast - notably reducing production by 1.65mb/d in September according to data from OPEC's MOMR, falling production volumes in Venezuela, declining oil inventories and increase in global oil demand. OPEC in its MOMR estimated global supply at an average of 97.44mb/d with 0.35mb/d increase Y-o-Y while global aggregate demand rose by an estimated 1.53mb/d or 1.6% Y-o-Y to 96.94mb/d; hence,

Chart 25: World Bank Monthly Energy and Non-Energy Commodity Price Indices (2014-2017)



Source: World Bank, Afrinvest Research

Chart 26: Brent and WTI Crude March 2018 Futures Prices from 2014-2017



Source: Bloomberg, Afrinvest Research

Brent Crude price closed 2017 at US$66.90/b or 14.2% higher. Among the countries leading the unexpected surge in oil demand was China due to increased demand for transportation. According to World Bank, United States and Europe also contributed to demand growth among the OECD countries which was put at 0.9mb/d (1.9%) as at half year 2017 on the back of increased demand for gasoil (diesel and heating oil).

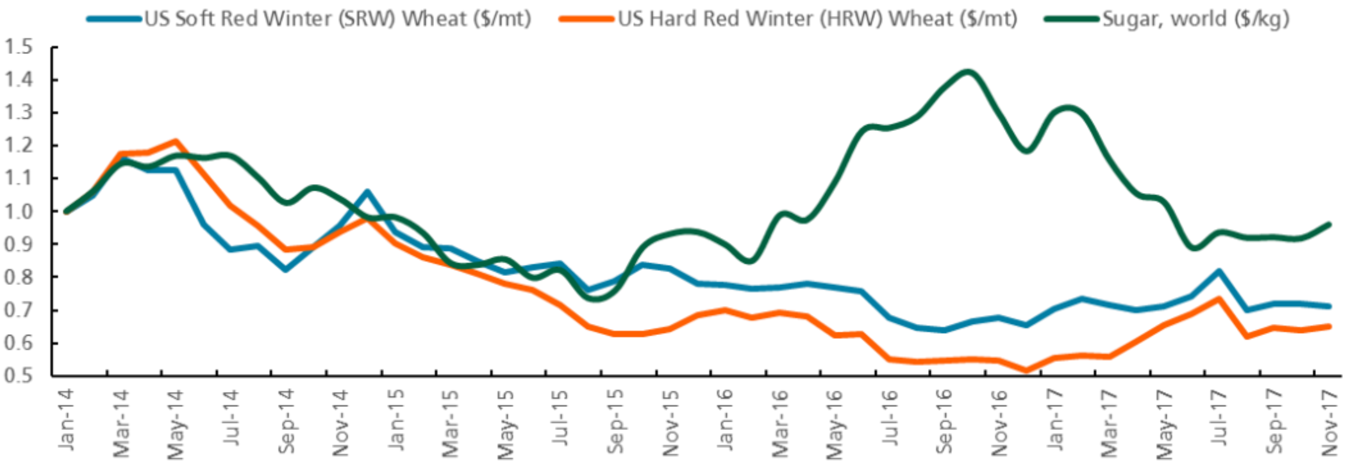
After hitting a 29-month high towards the end of 2017, the supply/demand dynamics in the global oil markets in 2018 is expected to support above US$60.0/b oil prices. US Shale oil production is forecast to recover due to the high crude oil price environment and projected recovery of US drilling facilities, justifying the estimated 1.29mb/d increase in aggregate global supply level despite expected strong compliance of OPEC members to production cut agreement. Yet, the oil market is expected to continue rebalancing as demand is projected by the OPEC to increase by 1.51mb/d or 1.56% in 2018 and 1.3mb/d according to IEA estimate. Goldman Sachs in its research report raised price outlook for Brent and WTI Crude to US$62.00/b and US$57.50/b respectively. March 2018 Futures Brent crude closed at US$67.84/b while the WTI Crude futures for March 2018 closed at US$61.63/b (05/01/2018), reflecting the possible stability of prices in 2018.

Wheat and Sugar: Improved Stocks-to-use Ratios to Steady Prices

Global wheat prices trended higher for most part of 2017, surging between May and July before moderating in August. The US Soft Red Winter (SRW) and Hard Red Winter (HRW) wheat increased 9.0% and 26.7% after falling 16.1% and 25.0% in 2016 respectively . Outlook on Wheat prices according to the United States Department of Agriculture (USDA) is positive as conditions for the global wheat crop are favourable. Whilst the wheat crop production for North America, Australia and Argentina continue to proceed as expected, favourable weather conditions in Kazakhstan, Russia and Ukraine will buoy global supplies estimated by USDA to stabilize at 751.2MMT by the end of 2017/18 harvest season. More importantly, stocks-to-use ratio is forecast at 3-decade high of >36.0%, implying commendable supply overweight on demand; hence, wheat prices will stabilize around current levels in 2018.

The World sugar market in recent years continues to record build-up in inventories having transitioned from prolonged years of scarce supplies. Global sugar prices declined significantly by 18.9% in 2017, reversing the bullish trend of 2016 (sugar prices were up 26.3%). According to the USDA, global sugar consumption is forecast to increase by 1.5% in 2017/18 to 176.8MMT. Similarly, global production is estimated to increase 4.6% to 184.9MMT in 2017/18, creating another year of global surplus in excess of 8.1MMT or 27.2% stocks-to-use ratio given the estimated 40.0MMT ending stock. If the USDA forecast for consumption is compared with the World Bank sugar output projection – estimated lower for 2017/18 at 179.6MMT to be driven by the output in Brazil (39.7MMT), India (25.8MMT) and the European Union (18.6MMT) – then the stocks-to-use ratio will come in slightly lower at 24.2%. On the back of the forecast demand and supply conditions, World Sugar prices in 2018 are more tilted towards a bearish outlook but are expected to be largely stable.

Chart 27: Historical Trajectory of US SRW and HRW Wheat and World Sugar Prices (Rebased)



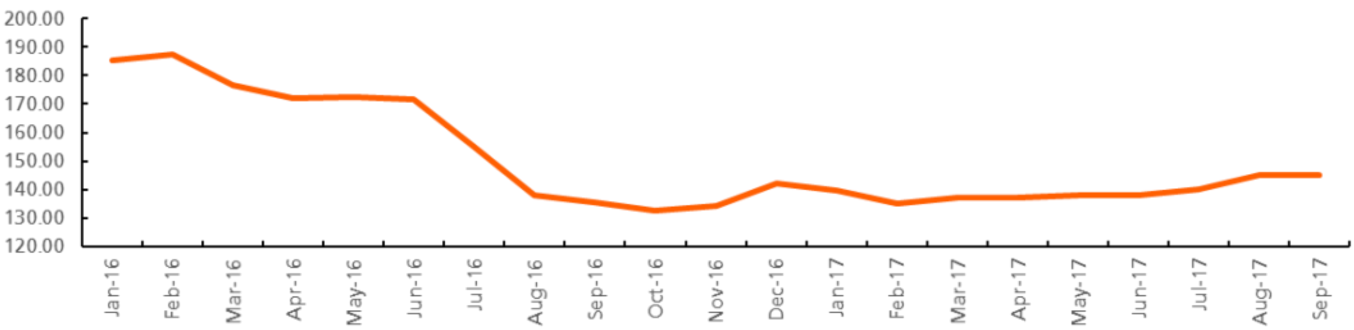
Source: World Bank, Afrinvest Research

Barley and Sorghum: Price Improvements of 2017 to be Reversed in 2018

The downtrend in Barley prices which persisted in H2:2016 came to a halt in Mar-2017 as average price for the month improved to US$137.00/MT from US$135.00/MT in Feb-2017. As a result, average price for Q1:2017 marginally improved 0.7% Q-o-Q to US$137.21/MT from US$136.19/MT in Q4:2016. The uptrend in barley prices was sustained all through the year to eventually settle at US$145.00/MT in Sep-2017, up 7.0% Y-o-Y. Similarly, average Sorghum prices improved in 2017, rising 6.5% from US$139.00/MT in Q4:2016 to US$148.00/MT in Q2:2017 on the back of increased global demand, especially from China.

From the USDA's Grain: World Markets and Trade report for December 2017, Barley output for 2017/18 is projected to reduce to 141.9MMT from 147.2MMT in 2016/2017 due to lower production across major exporters, save for Belarus, China, Ethiopia, Iran, Morocco and Russia. The EU remains the largest producer, accounting for 40.7% of world output, followed by Russia (11.9%) and Australia (9.1%). Similarly, Sorghum production is projected to decline to 59.2MMT from 63.2MMT. In terms of consumption level, Barley and Sorghum are expected to reduce from 149.2MMT and 63.4MMT to 147.4MMT and 59.8MMT respectively in 2017/2018. Consequently, Barley is expected to pare gains in 2018 as the World Bank forecasts average Barley prices to settle at US$144.00/MT while pricing of Sorghum will be majorly dependent on production from Nigeria.

Chart 28: Barley Price Movement (Jan-16 – Sep-17)



Source: World Bank Commodity Outlook Report, Afrinvest Research

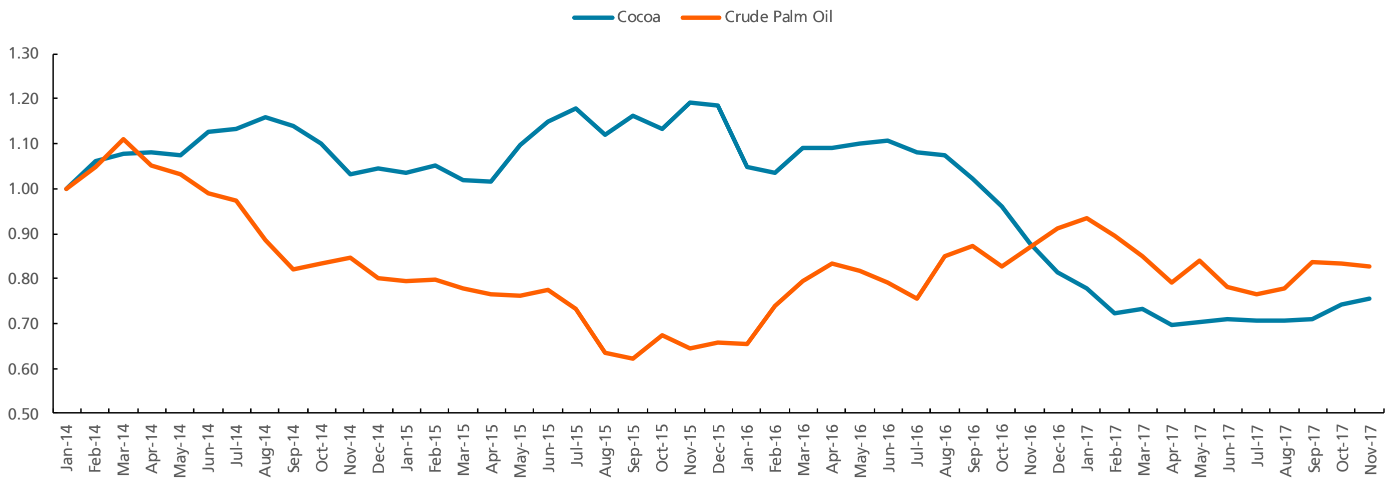
Crude Palm Oil (CPO): Prices to Remain Stable on the back of Steady Demand

As the El-Nino effect fizzled out in 2017, average palm oil prices moderated 4.7% Y-o-Y to US$716.00/MMT in Nov-2017 from US$722.00/MMT in Nov-2016 which was largely expected as weather conditions improved, and production volumes increased 5.9% from 58.8MMT in 2015/16 to 62.3MT in the 2016/17 farming season. Despite the increasing global output, Nigeria's output has remained at 0.97MMT till date, far below its potential, given the long gestation period for oil palm trees. According to the World Bank's Commodity Outlook for 2018, World outputs are projected to rise, buoyed by favourable weather conditions and plans by Indonesia to increase its total production to 42.0MMT by 2020. In line with the World Bank's projection, we expect the price of CPO in 2018 to remain largely stable - inching slightly higher by 2.0% on the back of steady demand for palm oil.

Cocoa: Rising Demand in Asia to Support Market

In 2017, total Cocoa production increased as farmlands across West Africa and Latin America enjoyed favourable weather conditions. Although positive for output, the resultant effect was an oversupply in the market and a subsequent decline in prices. As a result, average Cocoa prices fell 7.3% to US$2,127.90/MT in Nov-2017 from US$2,295.30/MT in Dec-2016, leaving the two largest exporters - Cote d'Ivoire and Ghana - grappling with revenue challenges. As consumers' health consciousness increases, the demand for Cocoa is expected to decrease in the long term; however, it is believed this effect will be tapered by rising demand from Asian consumers in the near term.

Chart 29 : 3 – Year Monthly Historical Price Movement



Source: World Bank Commodity Price Data

Section Seven

Investment Strategy for 2018

Recovery Driven Fundamentals to Shape Investment Strategy

Sequel to the rebound in global oil prices and increased flexibility of FX policy, the domestic economy and financial markets kick started a bullish jolly ride in 2017. The economy continues to show signs of recovery with prospects inclined towards a slow but steady growth. Whilst the traditional investment asset classes, most especially equities and fixed income, had their boom and bust in the year, one key theme continues to define the domestic investment landscape: "Sound Fundamentals".

Having survived the policy misalignment that enveloped and weakened equities market return in 2016, we are of the view that the recent recovery momentum will be sustained in the near term. On the back of a 42.3% return in 2017, the NSE All Share Index is set for another bullish year, in what looks like a repeat of 2013 history, having gained 12.2% as at 12/01/2018. Similarly, the bullish run in the fixed income market in Q4:2017 resulted in a 10.5% return on the Access Bank Bond index in 2017 relative to 4.5% loss in 2016; yet, expectation of lower yields in 2018 will shape performance on fixed income securities. Consequently, we reason that for the investment strategy in 2018 to be optimal, it will necessarily have to hinge on fundamentals of investible asset classes.

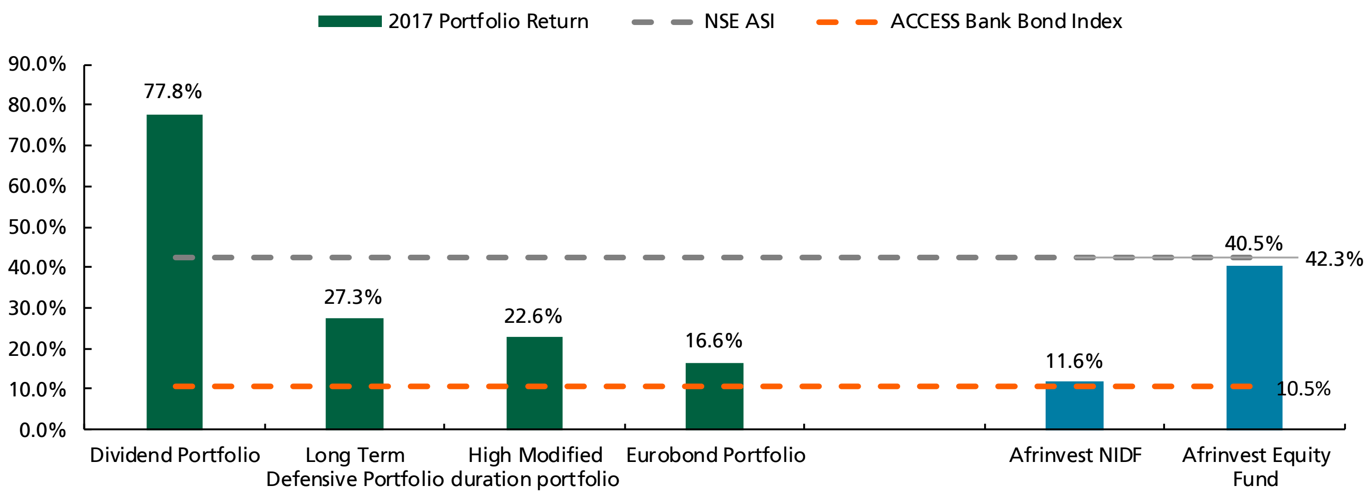
Our outlook on the market for 2018 remains largely positive as we expect investor sentiment to remain strong as already demonstrated in early trades. Furthermore, barring any major negative shocks in the FX market, fundamentals will be a key determinant of overall performance for the year. Hence, investors will have to adopt an active investment strategy, especially for equities, in order to take advantage of opportunities in the market.

Review of 2017 Strategy: "Recession Investing amidst Policy Deficit Calls for a Cautious Strategy"

On the back of the prevailing macroeconomic realities at the start of 2017 – contraction in GDP, high inflation level, low oil prices as well as FX illiquidity - the view on the equities market was a more pessimistic outlook given weak sentiment towards the broader economy. Against this backdrop, we advised investors to remain cautious and adopt a strategy that is more focused on capital preservation whilst recommending investors stay overweight on fixed income securities over equities with an advised mix of 80:20 allocation.

However, following the reforms implemented in the FX market, as well as the improvement in macroeconomic indicators, sentiment strengthened, driving the benchmark index 42.3% northwards in 2017. Despite our recommendation to overweight on fixed income instruments, investors who also took advantage of our equity recommendations recorded substantial gains as FX policy reforms favoured equities.

Chart 30: Afrinvest Strategy Portfolio Returns and Fund Performance



Source: Afrinvest Research

…Recovery Investing amid Moderating Yields Supports a Fundamental Strategy

Our optimism for the Nigerian markets in 2018 hinges on the slow but steady recovery in the general macroeconomic conditions following the upturn in global oil prices. Stable oil price outlook puts less strains on monetary and fiscal policies given the significant dependence of government's revenue on proceeds from exports as well as the reliance of the CBN on foreign exchange earnings in optimizing FX allocation. As the economy gradually regains its growth momentum, we are confident that improved fundamentals, coupled with enriched investor sentiment – currently at recent time high, will continue to drive equity asset prices. Correspondingly, our prognosis on interest rate proposes a market driven moderation in 2018 as the government shifts its focus from short term domestic borrowing to long term foreign debt while investors explore alternative high yielding domestic short/long term securities.

Equity Market Strategy in 2018…Long Bull Ride on "Custom Street"

Interestingly, contrary to our 2016 and 2017 investment strategy that suggested overweight on fixed income securities over equities, we believe 2018 will be more skewed towards a balance of play between the two traditional asset classes. Whilst we are more cautious about equity market valuation inching towards its fundamental threshold, we are also assured that, barring a dysfunctional foreign exchange market, equities are possibly set for appropriately timed entry and exit opportunities in 2018. Fundamentally backed sentiments will conceivably propel the equities market on a "Jolly Roller Coaster". Our Equity Strategy is thus skewed towards five major portfolios:

1. Consumer Goods Portfolio
2. Banking Quality Portfolio
3. Short Term Dividend Portfolio
4. Long Term Dividend Portfolio
5. Strategic Sentiment Portfolio

Consumer Goods Portfolio

As the Nigerian economy is on a gradual recovery, we reason that sectors with essential products will record decent revenue and earnings growth as consumer spending continues to recover. Resultantly, we screened stocks that operate in the segments with products that are essential to the average individual - majorly companies in the Consumer Goods and Agriculture sectors. Stocks that fall within these category have recorded revenue growth – despite weak economic cycle – although margins have not been as strong due to high cost. With price level growth now moderating, we should expect margins to expand and earnings to accelerate thereby justifying our pick.

Given our generally optimistic outlook on the economy for 2018, we forecast that overall performance of the stocks in the portfolio will be largely positive.

In order to select optimal stocks for the portfolio, we selected Consumer Goods stocks that had a positive 5-year revenue and net income CAGR as well as positive 5-year average ROE and Net Margin in a bid to identify fundamentally sound stocks that have delivered alpha over the years. Given the peculiarity of the sector, Nestle, Nigerian Breweries and Guinness were selected despite falling short of minimum selection criteria on the back of the generally positive market sentiment towards the counters. Accordingly, these stocks enjoy premium pricing relative to peers and we expect this to be sustained in 2018. Backtesting the portfolio, performance of 2017 was 37.0% relative to 42.3% of the NSE ASI.

Table 13: Selected Stocks for the Essential Products Investment Strategy

Stocks	5-Year Average Net Margin (%)	5-Year Revenue CAGR (%)	5-Year Net Income CAGR (%)	5-Year Average ROE (%)	5-Year Average Financial Leverage
PRESCO	112.0	13.0	64.6	22.1	1.7
OKOMU	28.5	5.2	4.6	17.0	1.4
NASCON	16.1	12.1	2.1	35.4	2.0
DANGSUGAR	12.8	9.6	14.2	23.1	1.9
PZ	5.0	2.0	6.6	9.2	1.7
HONEYFLOUR	3.3	6.9	9.8	6.9	3.2
FLOURMILLS	1.7	15.2	2.0	1.3	3.8
NESTLE	10.3	13.2	-13.6	56.0	3.1
NIGERIAN BREWERIES	7.5	8.2	-5.7	31.0	2.3
GUINNESS	-1.2	1.6	-33.0	13.2	2.9

Source: NSE, Bloomberg, Afrinvest Research

Banking Quality Portfolio

The banking sector has remained one of the resilient sectors, outperforming the broader market in 2016 and 2017 in terms of earnings and returns. The sector remains the most liquid across the Nigerian equity market and presents substantial upside potential for discerning investors. Given our generally positive outlook for the market and the broader economy in 2018, we structured an investment strategy that focuses on Quality banking stocks based on earnings fundamental. Our screening criteria present the banks that have historically demonstrated impressive performance and present upside opportunity for investors in both dividend and capital appreciation.

Return on Equity (ROE) remains the most valuable fundamental measure and the stocks with relatively high ROE have historically outperformed. Hence, from the universe of banks, we selected stocks with ROE higher than industry average in at least 8 of the last 16 quarters. In the same vein, stocks which simultaneously meet our measurement of market value criteria (Earnings Yield, Dividend Yield and Book Value to Price Yield) of higher than industry averages in at least 4 of the last 8 quarters, qualify for this portfolio. We also screened the stocks for liquidity using the tradable float while also capping exposure to a single stock at 30.0% using the free float market capitalization. Back-testing these criteria against banking stocks in Nigeria, the portfolio has outperformed the NSE banking index in 3 of the last 5 years – portfolio gained 88.2% in 2017 relative to NSE banking return of 73.3%.

Short Term Dividend Income Portfolio

Our short-term dividend income portfolio is recommended for investors with a short term investment horizon, especially the first three months of the year, prior to the payment of dividend for the FY:2017 period. Our portfolio tracks a list of fundamentally sound stocks in our coverage universe that are expected to pay attractive dividend for FY: 2017 relative to market price. We selected stocks with a minimum of expected 5.0% implied yield based on closing price as at 8/01/2018. The stocks that qualified fall within the Insurance, Banking, Consumer and Industrial Goods sectors. The portfolio is structured for entry in January and should be actively tracked in order to determine best exit time after the rally on the stocks post dividend declaration. Nevertheless, investors can still hold the stocks for a 12-month holding period given the portfolio constituents also pass our fundamental criteria. Our dividend portfolio held throughout 2017 returned 77.8%.

Table 14: Selected Stocks for the Banking Value Strategy

Stocks	ROE Count	BVP/P Count	Earnings Yield Count	Dividend Yield Count	Liquidity	Weighting
GUARANTY	16	-	-	-	10.4%	30.0%
ZENITH	16	-	7	3	17.8%	30.0%
ACCESS	14	7	8	5	17.7%	10.4%
UBA	16	5	8	4	14.4%	10.1%
STANBIC	16	8	8	-	5.9%	6.7%
FBNH	8	8	-	-	13.5%	12.8%

Source: NSE, Bloomberg, Afrinvest Research

Table 15: Selected Stocks for the Long run Dividend Portfolio

	2017 DPS	Price	Trailing P/E	Trailing ROE	Implied Yield
CONTINSURE	0.16	1.40	8.85	9.65	11.4%
WAPCO	4.41	44.89	4.88	47.14	9.8%
MANSARD	0.17	1.93	12.90	11.86	8.8%
UBA	0.90	10.30	5.33	17.18	8.7%
ZENITHBA	2.19	25.64	6.52	21.70	8.5%
DANGSUGA	1.57	20.00	8.39	23.75	7.9%
CUSTODIAN	0.29	3.89	4.18	18.86	7.5%
ACCESS	0.75	10.45	4.90	15.08	7.2%
FCMB	0.10	1.48	7.31	3.81	6.8%
GUARANTY	2.49	40.75	10.32	25.96	6.1%
FIDELITY	0.15	2.46	2.79	8.00	6.1%
FLOURMIL	1.53	29.00	9.07	10.40	5.3%
DANGCEM	11.96	230.00	17.40	30.41	5.2%

Source: NSE, Bloomberg, Afrinvest Research

Long-Term Dividend Portfolio

Dividend payment is a major determinant of investment decisions for Nigerian investors given the generally risk adverse nature of the average investor. In this portfolio, we screen stocks with a consistent dividend payment history in at least 4 of the last 5 years and also have positive earnings growth for the same period. These criteria ensured that the selected stocks have historically demonstrable sufficient level of earnings stability. In the same vein, dividend yield for the selected stocks must have surpassed average market dividend yield in at least 4 of the past 6 years, which will enable us determine stocks that have consistently outperformed the market based on dividend yield.

We also placed emphasis on liquidity, using Annualised Traded Value Ratio (ATVR) to screen out illiquid stocks while free-float market capitalisation methodology was used to weigh constituents but capped exposure to a given sector and stock at 50.0% and 20.0% respectively. Back testing the portfolio with historical data, it has consistently outperformed the market in the last 5 years, returning 68.5% in 2017 relative to market return of 42.3%.

STANBIC) and Consumer Goods (NESTLE, NIGERIAN BREWERIES, GUINNESS, PZ and UNILEVER) stocks constitute our sentiment portfolio. Whilst we note that this portfolio is sentiment based, selected stocks also parenthetically passed our basic tests of sound fundamentals. The Portfolio returned 56.8% in 2017.

Fixed Income Strategy in 2018…More than Meets the Eye

Long term play defines our overall strategy in the fixed income market for 2018. We expect the easing of the crowding out effect of federal government in the domestic debt market to create incentive for Sub-National and Corporate debt issuances as rates on Sovereign instruments moderate towards long term average level. Importantly, our theme for smart fixed income investing in 2018 is: “Active “and “Liquid”.

1. Smart Eurobond Portfolio
2. Low Risk Aggressive Portfolio
3. High Return Long-Bond Portfolio
4. Passive Bond Portfolio

Table 16: Selected Stocks for the Long-Term Dividend Portfolio

Stocks	Dividend Payment Count	Net Income Growth Count	Dividend Yield Count	Liquidity	Weighting
GUARANTY	5	6	5	10.4%	20.0%
CAP	4	5	6	4.0%	20.0%
UACN	5	4	4	6.4%	20.0%
ZENITH	5	5	6	17.8%	15.4%
AIRSERVICE	4	4	5	17.7%	10.0%
ACCESS	5	5	6	16.1%	5.3%
UBA	5	4	5	14.4%	5.2%
STANBIC	5	4	4	5.9%	3.4%
FCMB	4	4	6	14.1%	0.6%

Source: NSE, Bloomberg, Afrinvest Research

Sentiment Portfolio

Due to the fact that the Nigerian equities market is majorly dominated by foreign portfolio investors, we also adopted a “purely sentiment based” strategy for playing equities in 2018. Following the return of foreign players into the Nigerian markets in 2017, against the backdrop of improving macroeconomic conditions – especially reforms implemented in the FX market - we forecast that significant interest could be recorded in stocks that have historically been the toast of FPIs either because of the foreign parent affiliation or their inclusion in the MSCI frontier market index. Banking (GUARANTY and

Smart Eurobond Portfolio

We are of the view that despite the normalization of monetary policy in most systemically important economies, emerging and frontier markets will still present optimal return in 2018. This assumption informs our “Smart Eurobond Portfolio” designed to be active all year-round. The portfolio comprises of SSA Sovereign and Corporate Eurobonds intended to take advantage of Yield volatility across emerging and Frontier markets. Although interest rates are normalizing across developed markets, investors would seek more optimal returns in emerging markets.

Table 17: Smart Eurobond Portfolio

CREDIT RATING	ISSUER	ISSUE DATE	MATURITY DATE	TTM	COUPON (%)	YIELD (%)	ASK PRICE
B	REPUBLIC OF ZAMBIA	4/14/2014	9/20/2022	4.8	5.4	5.8	98.3
BB+	REPUBLIC OF SOUTH AFRICA	1/17/2012	1/17/2024	6.1	4.7	4.2	102.6
			CORPORATE EUROBONDS				
B-	DIAMOND BANK PLC	5/21/2014	5/21/2019	1.4	8.8	11.4	96.7
CCC	FIRST BNK NIGERIA (FBN F	8/7/2013	8/7/2020	2.6	8.3	9.1	99.4
CCC	FIRST BNK NIGERIA (FBN F	7/23/2014	7/23/2021	3.6	8.0	9.4	96.8
NR	EBN FINANCE CO BV	8/14/2014	8/14/2021	3.6	8.8	9.9	97.5
B	ZENITH BANK PLC	4/22/2014	4/22/2019	1.3	6.3	4.0	102.8

Source: Bloomberg, Afrinvest Research

Whilst we design the portfolio to be active all year round in order to take advantage of market movements, we recommend Eurobond securities trading at a minimum yield to maturity of 4.0% and at discount or slightly above par value with investment grade or junk rating but not exceeding 3.6 years term to maturity. The portfolio screening comprises of two Sub-Saharan Sovereign Eurobonds and five Nigerian Corporate Eurobonds all with Yields to Maturity of 4.0% and above. The portfolio is opened to rebalancing to include other Sovereign or Corporate Eurobonds in the course of the year as opportunities surface.

Low Risk Aggressive Portfolio

On the back of our overall outlook on interest rate, yields on short term LCY sovereign instruments, particularly T-bills, are expected to moderate considerably in 2018. This presents an opportunity for Corporates with Prime borrowing status to explore capital raising from the domestic market through Commercial Paper issuances for funding working capital needs. Furthermore, we anticipate a moderation in issuance yield of CPs to a range of 15.0% - 17.0% in 2018 (compared to expected 17.5% average prime lending rate) relative to the average issue yield of 21.0% in 2017. Consequently, investors with short term funds can ride on the wave of this recent market repricing to buy into attractive investment-grade rated Commercial Papers in 2018. We recommend maximum of 6-month tenor for any commercial paper to be considered in this portfolio. Similarly, the portfolio favours investment in the monthly savings bond of the Federal Government as well as other specialized debt issuances of the Federal Government such as an infrastructure bond.

High Return Long-Bond Portfolio

Our High Return Aggressive Portfolio is designed to leverage on interest rate movement during the year as we expect the yield environment to moderate. This technically implies that bond prices are anticipated to rise given the inverse relationship between the two. For portfolio optimization, we recommend long dated bonds with >8 years term to maturity which in turn corresponds to bond securities with minimum of 4.5 years modified duration.

Table 18: Movement in Bond Price Given a 2.0% change in Yield

Instrument	Issue Date	Coupon %	Maturity	TTM (Years)	Modified Duration	Offer Yield %	Offer Price (N)	Price CHG with 2.0% Drop in Yield	Price Return Plus Coupon
^12.50 22-JAN-2026	22-Jan-16	12.5	22-Jan-26	8.1	4.5	14.2	91.8	100.8	113.3
^12.49 22-MAY-2029	22-May-09	12.5	22-May-29	11.4	5.6	14.2	90.6	101.8	114.2
^8.50 20-NOV-2029	20-Nov-09	8.5	20-Nov-29	11.9	6.2	14.2	67.8	80.2	88.7
^10.00 23-JUL-2030	23-Jul-10	10.0	23-Jul-30	12.6	5.8	14.2	75.9	87.5	97.5
^12.1493 18-JUL-2034	18-Jul-14	12.1	18-Jul-34	16.6	6.1	14.1	87.7	99.8	112.0
^12.40 18-MAR-2036	18-Mar-16	12.4	18-Mar-36	18.2	6.6	13.4	93.5	106.7	119.1
							507.2	576.8	644.8
				Expected Overall Portfolio Return			27.1%		

Source: FMDQ, Bloomberg, Afrinvest Research

Empirically, a 1.0% moderation in yield increases the value of the bond by the size of the modified duration. Hence, we expect market conditions to result in at least 2.0% drop in yield; implying total return of 27.1% (coupon plus capital appreciation) for our modelled High Return Long-Bond portfolio. This portfolio is designed to be active given the medium term to long term maturity of most instruments screened; thus, holding to maturity may give less annualized return on the portfolio.

Passive Bond Portfolio

We are convinced that primary market for Corporate and Sub-national debt securities will resuscitate in 2018 as the Federal Government becomes less aggressive with domestic debt raising and fiscal profile of sub-nationals improve to allow for access to capital market. However, given that most Corporate and State debt instruments are illiquid in Nigeria, we recommend this portfolio for passive investors with long term fund. We recommend a maximum tenor of 5 years for any constituent of the portfolio with an investment grade not less than a BBB.

Section Eight

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Afrinvest (West Africa) Limited

Afrinvest (West Africa) Limited ("Afrinvest" or the "Company") is a leading independent investment banking firm with a focus on West Africa and active in four principal areas: investment banking, securities trading, asset management, and investment research. The Company was originally founded in 1995 as Securities Transaction and Trust Company Limited ('SecTrust') which grew to become a respected research, brokerage and asset management firm. Afrinvest (West Africa) Limited is licensed by the Nigerian Securities and Exchange Commission ('SEC') as an issuing house and underwriter. We provide financial advisory services as well as innovative capital raising solutions to High Net-worth Individuals ('HNIs'), corporations, and governments. Afrinvest is a leading provider of research content on the Nigerian market as well as a leading adviser to blue chip companies across West Africa on M&A and international capital market transactions. The company maintains three offices in Lagos, Abuja and Port-Harcourt.

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