Building Resilient Pension Fund Portfolio Against Key Macro Risks

Opportunities in Frontier Markets

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Source of data: Newmarket Asset Management internal estimates; investee companies; Bloomberg LP; FactSet; international organisations, including the IMF
Date of data: **February 2020**– unless otherwise stated.

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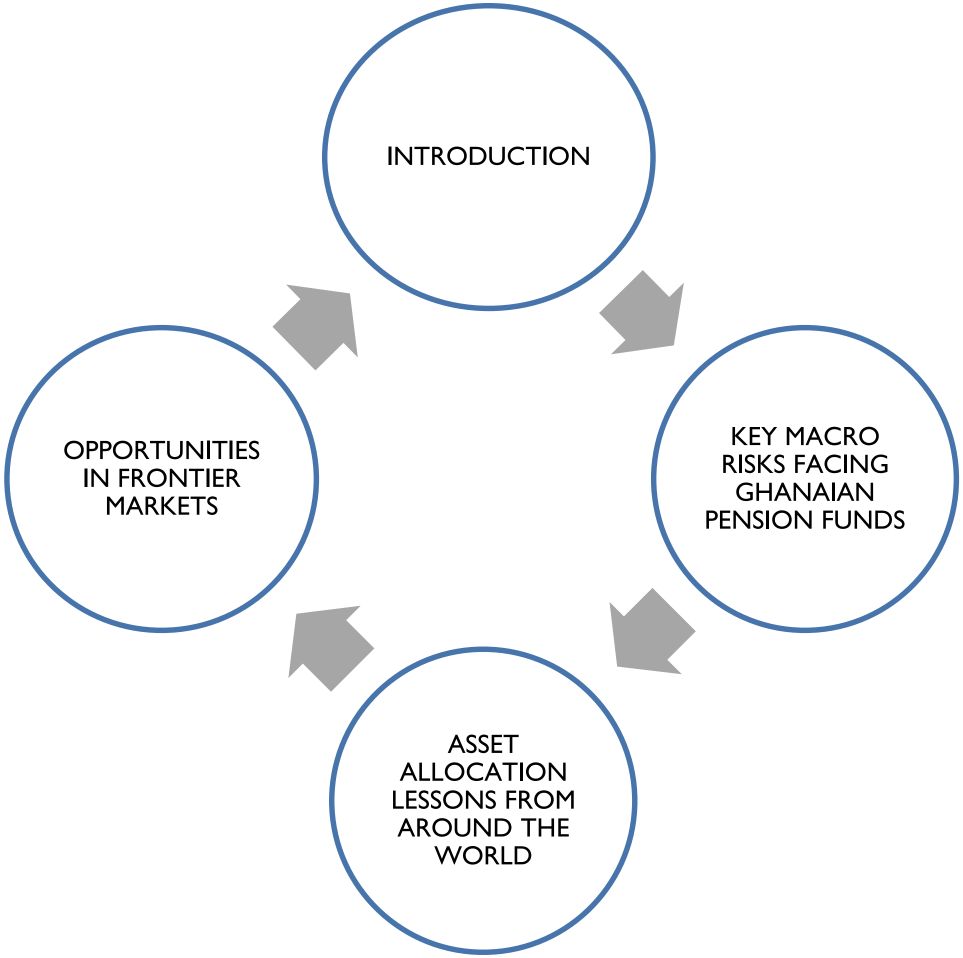
Structure of the Presentation

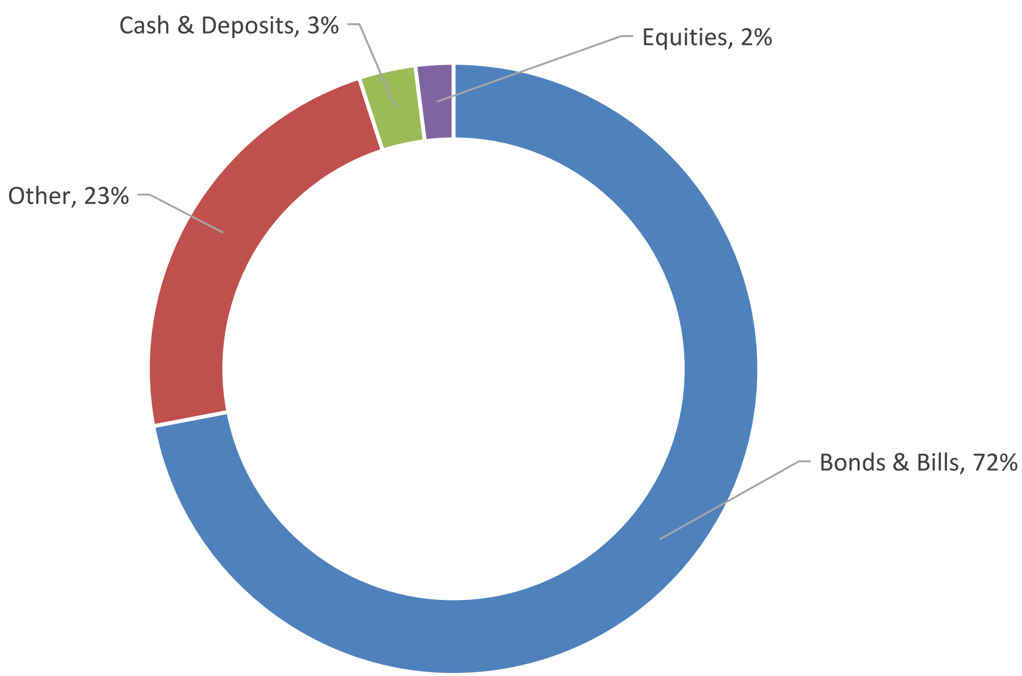


Introduction

- Ghanaian pension funds have over 70% asset allocation to government debt. This allocation remains largely unhedged against shocks and is poorly diversified by international standards

- Reasons include;
  - lack of properly regulated alternatives,
  - competition driving fixation on short-term low volatile returns
  - poor local stock market returns and liquidity in recent years
  - limited regulatory driven behavioural change towards better asset allocation
  - capital controls

Asset Allocation of Funded and Private Pension Funds in Ghana, 2018



Source: OECD

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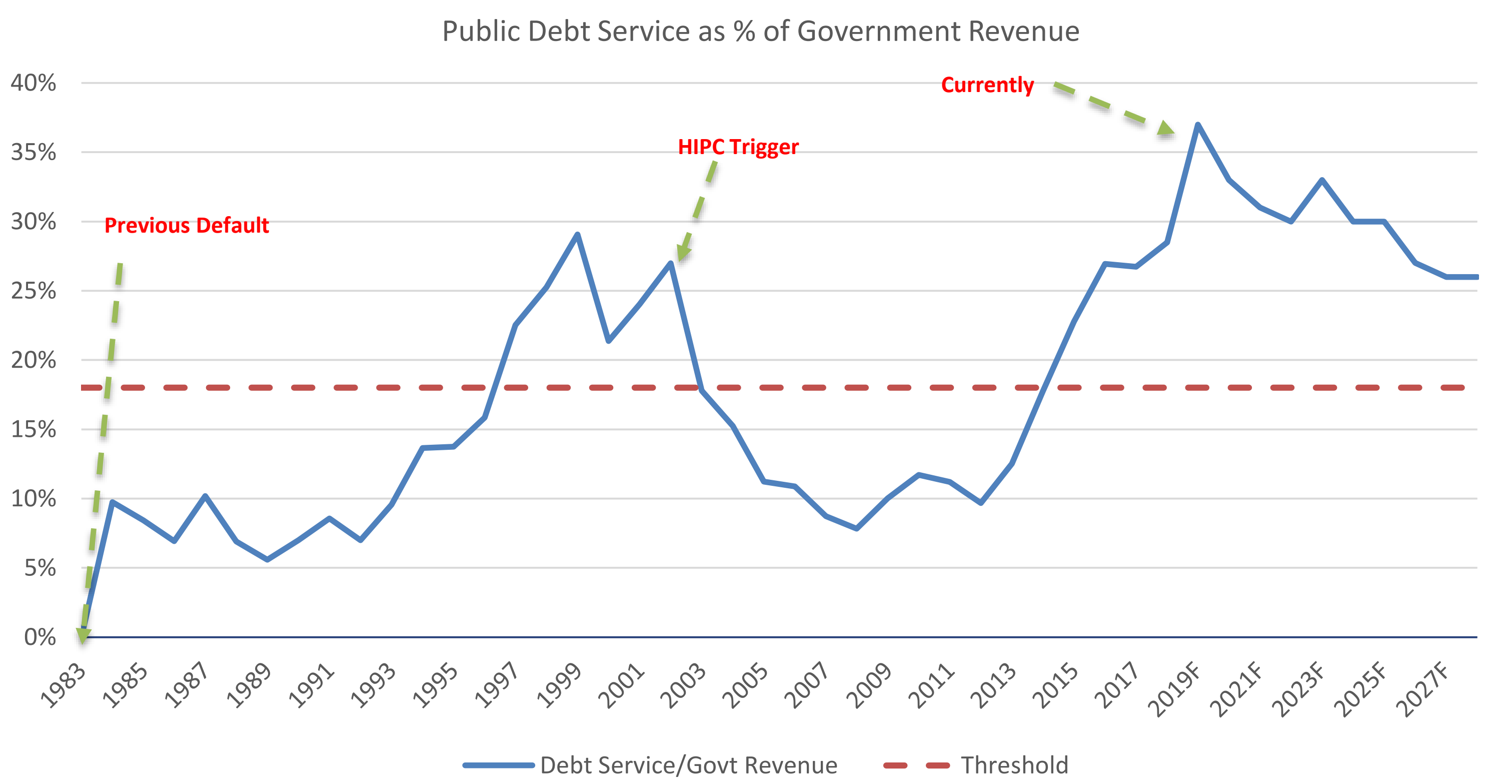
Government Debt is Not Risk-Free

- In theory government debt is considered 'risk-free'. This is possibly one reason behind the skewed asset allocation to this asset class
- In practice, 'risk-free' assets don't exist. Even the value of cash is affected by inflation
- Governments can become bankrupt and default on their debt . Debt defaults are often preceded by excessive hard currency borrowing in times of strong economic growth
- Some examples of sovereign debt defaults include;
    - Argentina, 1982, 1989-90, 2002-2005
    - Ghana, 1979 & 1982
    - Cameroon, 2004
    - Gabon 1999-2005
    - Rwanda, 1995
    - Russia, 1998-99
    - Paraguay, 2003
    - Mexico, 1982
    - USA, 1971 i.e. The Nixon Shock
    - Brazil, 1983

Ghana is classified as 'At High Risk of Distress'

- The IMF's most recent debt sustainability analysis places Ghana at a high risk of debt distress and likely to remain so over the next decade
- Public debt service costs as a proportion of government revenues have been rising since 2008 and are now well above Pre-HIPC levels and the minimum threshold recommended by the IMF for low income countries. This ratio is at a 36 year high.
- Ghana's debt sustainability is at the risk of commodity and other external shocks



Data Source: Bank of Ghana Website, IMF Debt Sustainability Report

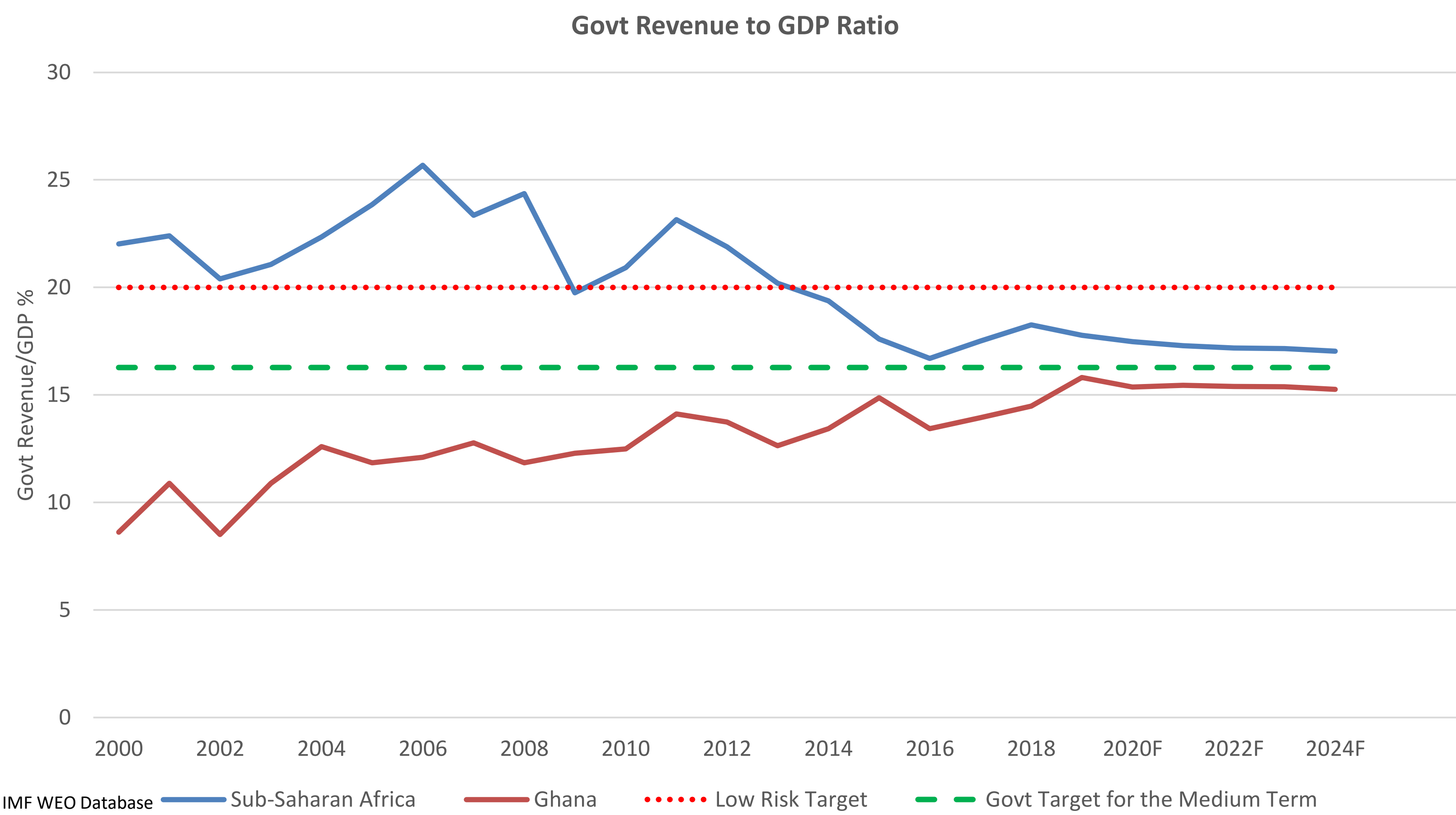
External Debt Sustainability is Also Under Stress

- External debt has grown at around 16% per annum since 2015 with sustainability vulnerable to external shocks
- External Debt Service Costs are now well above the minimum threshold recommended for low income countries

Data Source: Bank of Ghana, Ministry of Finance

Structural Shift to Higher Revenue Collection Key to Debt Sustainability

- Ghana's debt sustainability in the medium to long-term is significantly dependent on the government's ability to improve revenue collection and raise revenue to GDP ratio to around 20% from the current 15%
- The government's revenue intensity has systematically been well below the rest of Africa but the resolve to correct this has political ramifications



Data Source: IMF WEO Database

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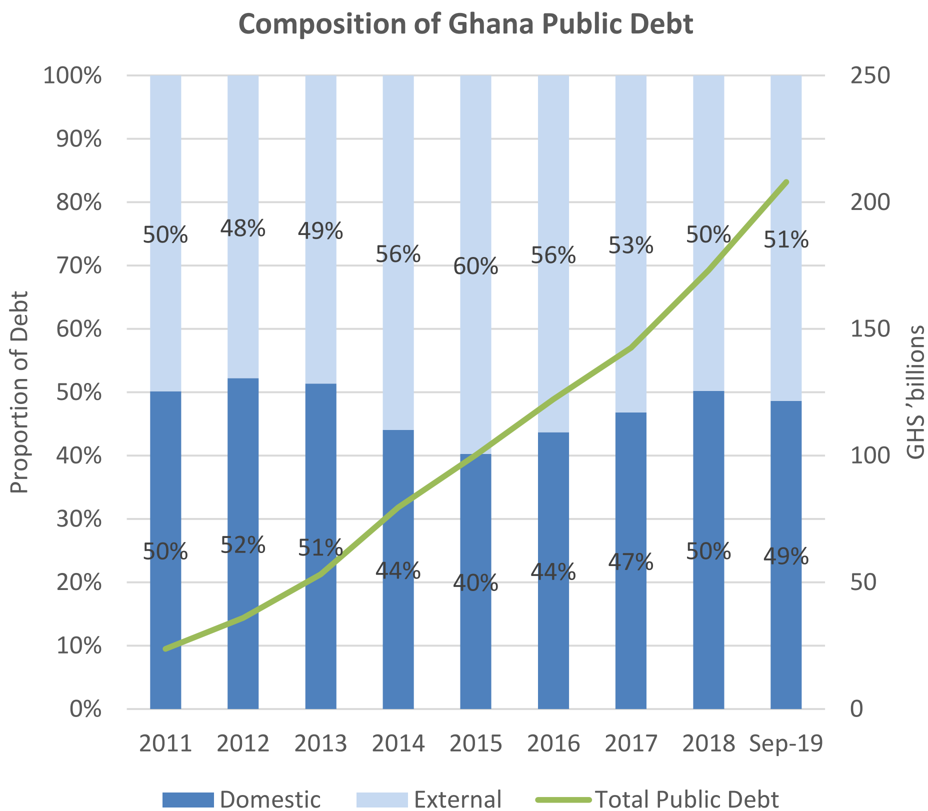
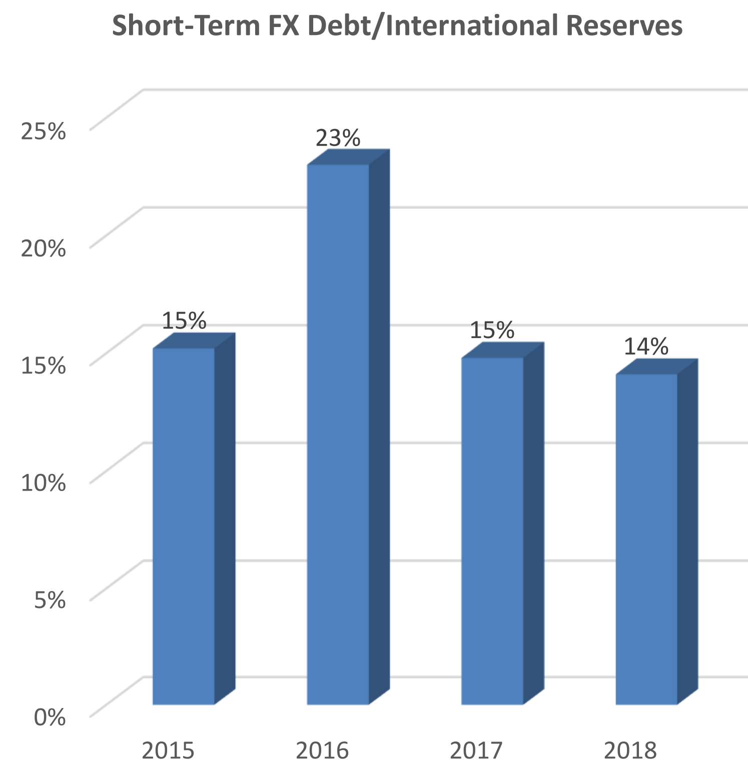
Key Macro Risks Facing Ghanaian Pension Funds

- Rising debt servicing costs is driven by increased borrowing with total public debt up 108% since 2015 well ahead of growth in government revenues
- External debt now accounts for 51% of total debt vs 60% in 2015 partly due to increasing foreign investor participation in the domestic debt market
- A decline in short maturity FX loans from 23% of international reserves in 2016 to 14% in 2018 is a positive development

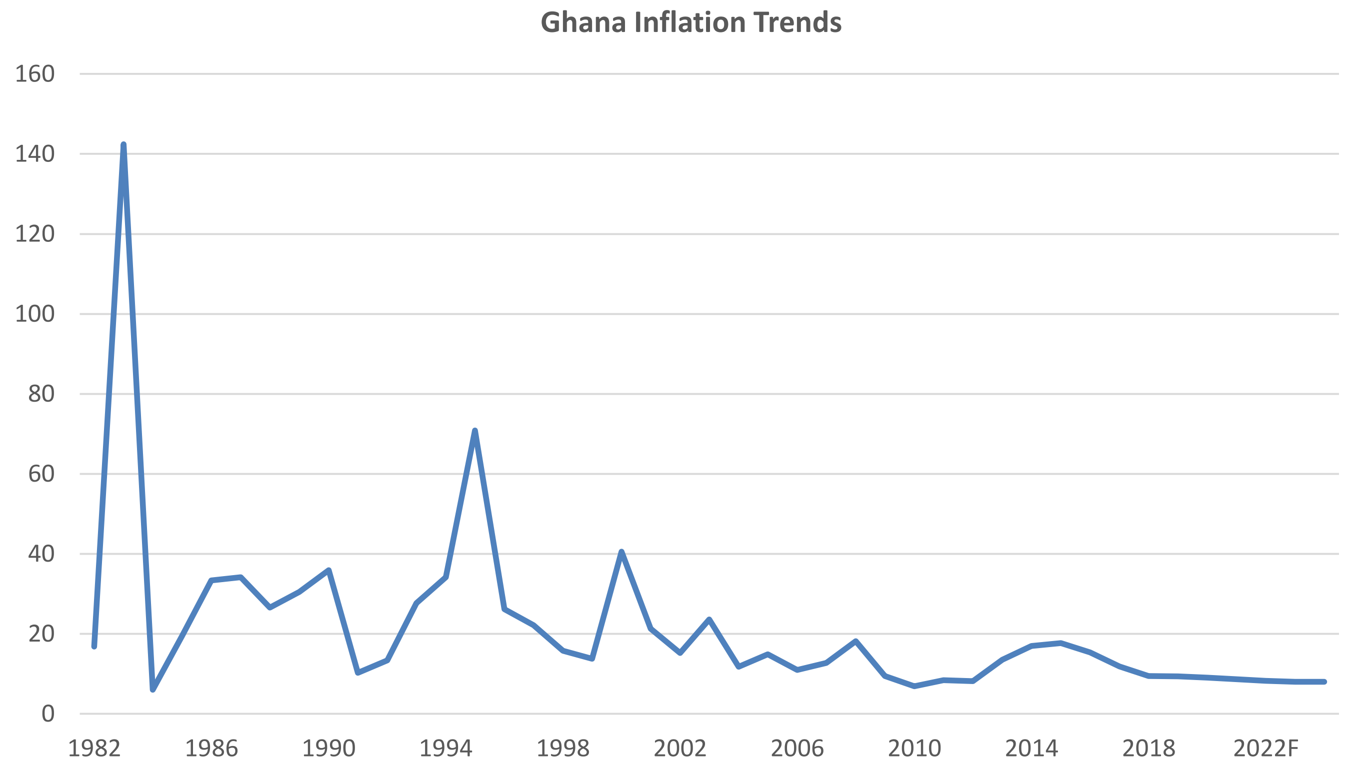




Data Source: Bank of Ghana, Ministry of Finance

Inflation Management Has Improved but is Vulnerable to External Shocks

- Inflation trends can significantly impact real returns on pension assets
- Improved policy management and external environment has significantly reduced inflationary pressures in recent years
- Inflation expectations are susceptible to commodity shocks, weather patterns, fiscal discipline, external shocks and other structural factors



Data Source: IMF WEO Database

Managing Ghana Country Risk

- Harry Markowitz called diversification "the only free lunch in finance

- Investors can transform country level systematic risk into diversifiable non-systematic risk through international diversification

- The extent to which investors can reduce country risk depends on;

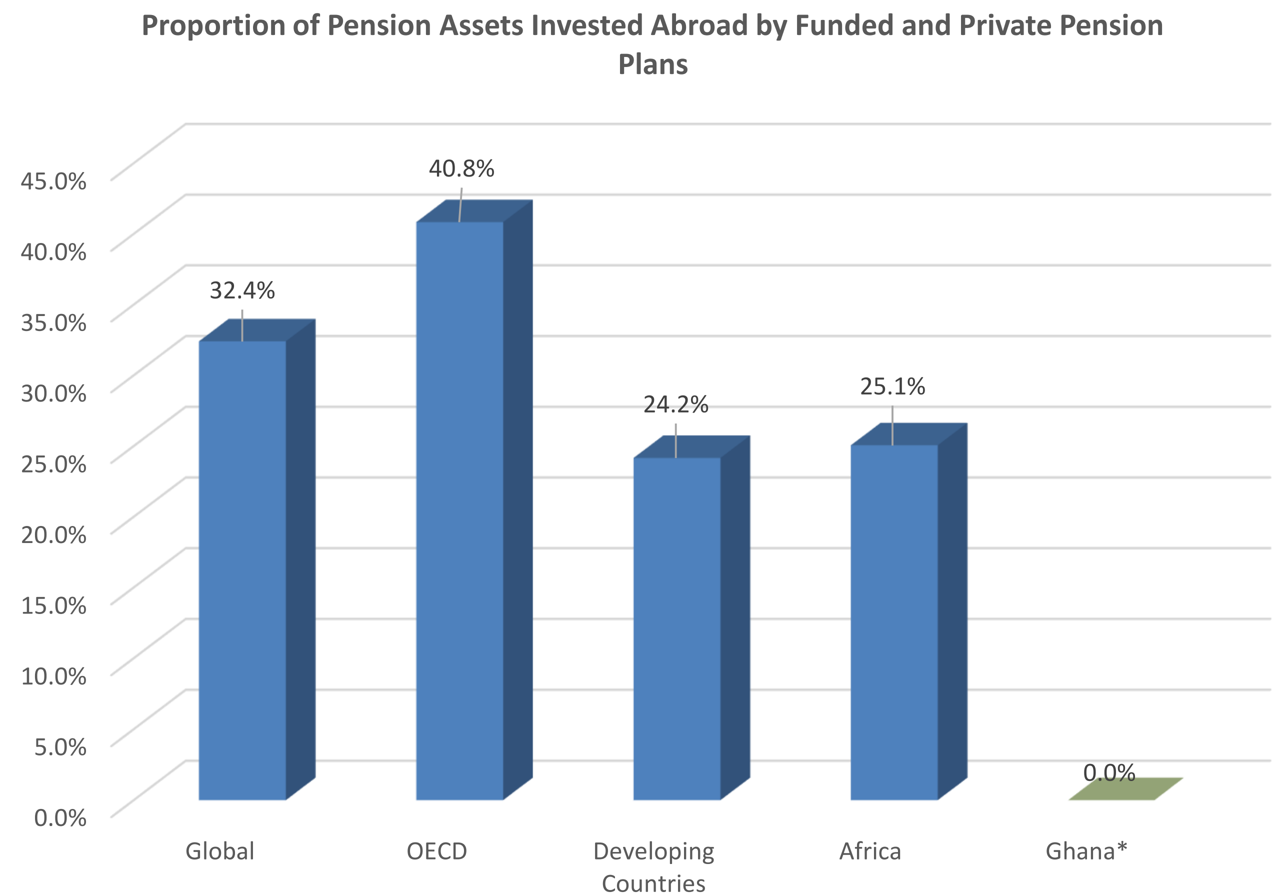
    - Regulatory & Capital Controls
    - Quality of asset allocation across positions, geographies, sectors and investment strategies in international markets

- Regulations in Ghana allow Pension funds to invest up to 10% of their assets abroad but this is yet to be taken advantage of in any meaningful way for bureaucratic reasons

- Pension funds are therefore entirely exposed to Ghana Country Risk- structural FX weakness, structural high inflation, financial sector cyclical risks, sovereign debt default risk etc.

Diversification: Lessons from Around the World

- Pension Funds in developing countries are increasingly allocating capital abroad. The average foreign allocation of developing countries for which data is available is 24%. For Africa it is 25%



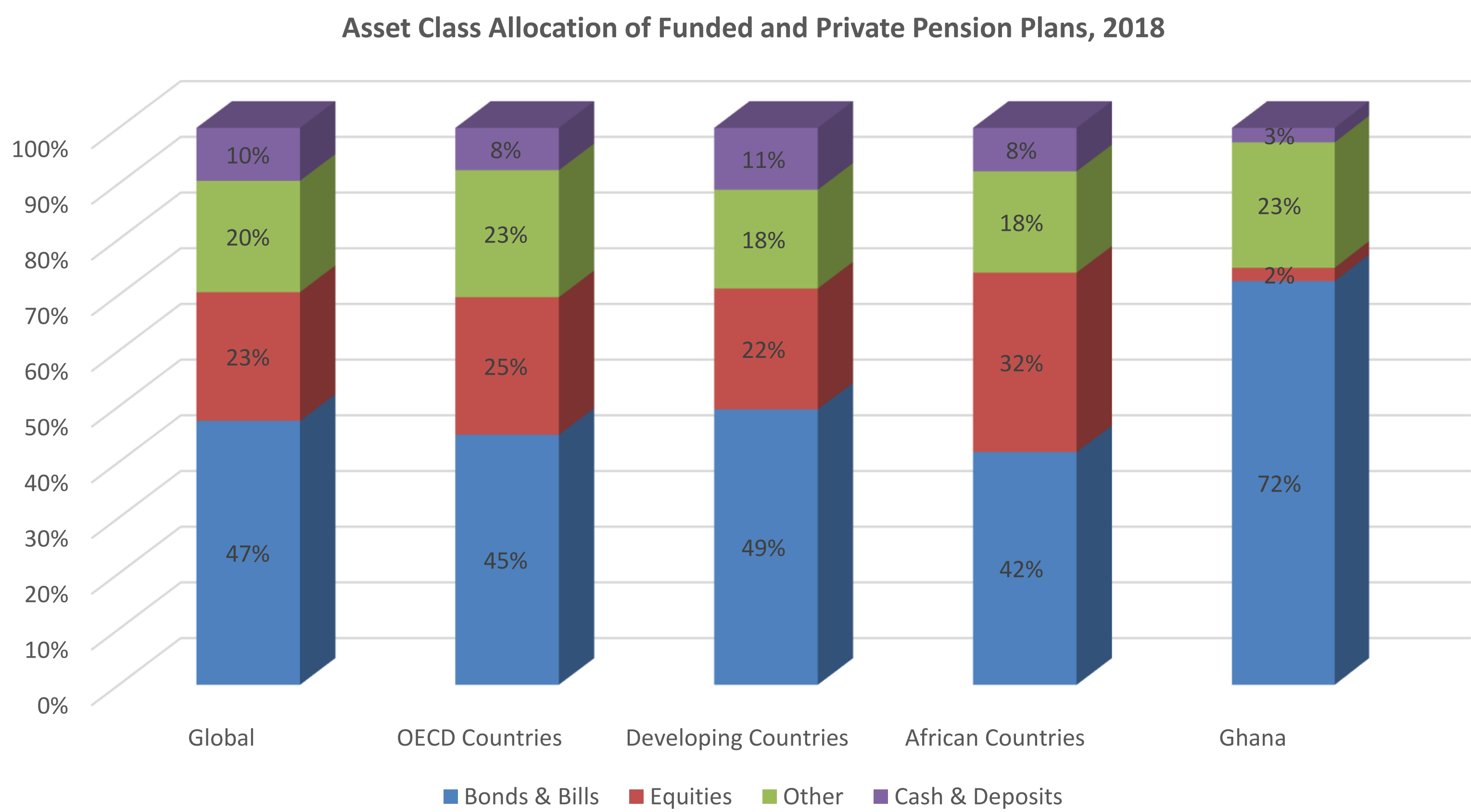
Data Source: OECD Pension Markets in Focus Database. *Anecdotal evidence

Diversification: Lessons from Around the World

Data Source: OECD Pension Markets in Focus Database

Diversification: Lessons from Around the World

- Asset Class Allocation tends to reflect the long maturity nature of pension plans, demographics and are typically biased towards long term bonds and equities
- Exceptionally low allocation to the equity asset class in Ghana due partly to a shallow public equity market and high interest rates

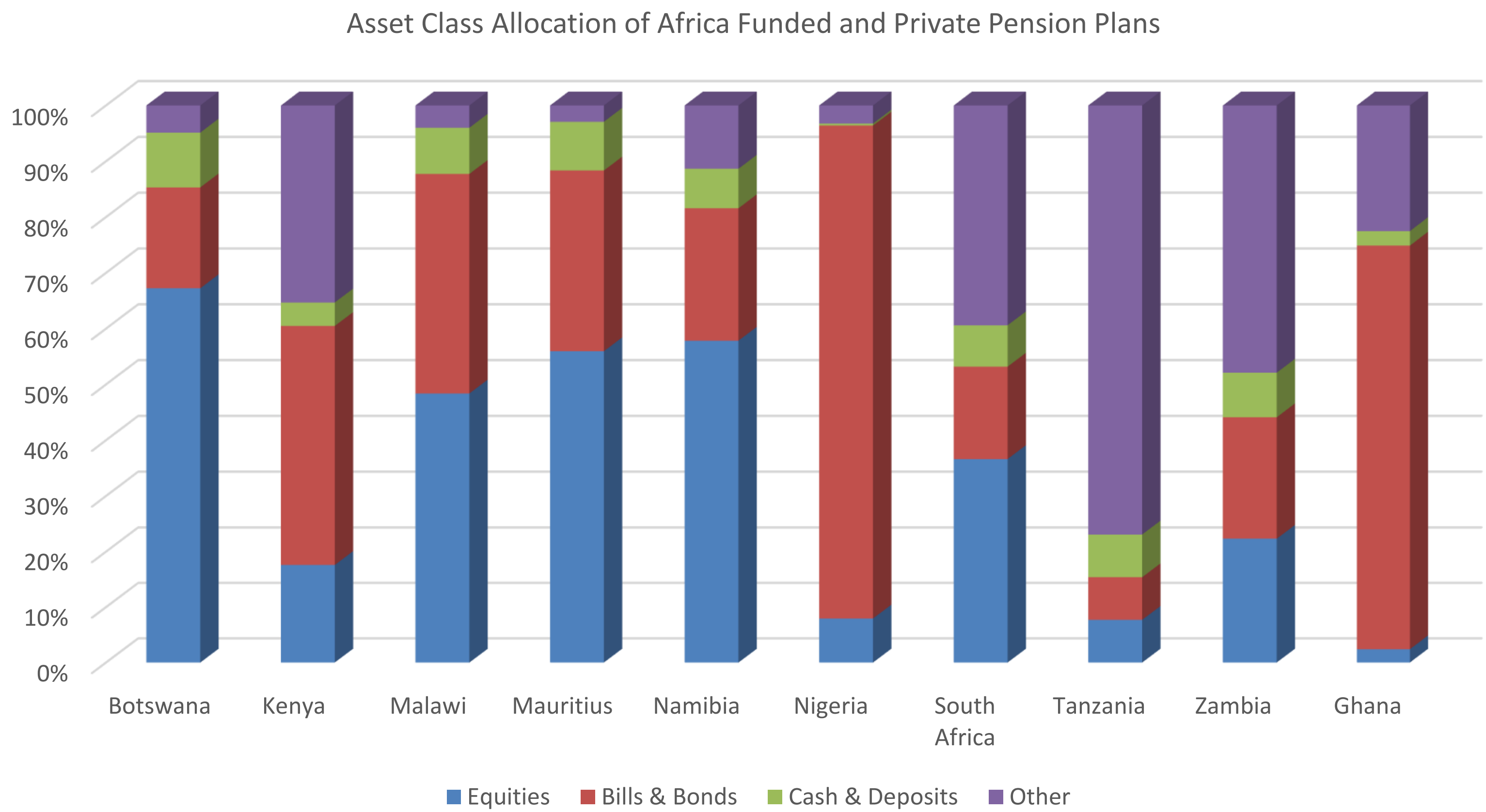


Data Source: OECD Pension Markets in Focus Database

Diversification: Lessons from Around the World

- Relative to other African countries, the allocation of Ghanaian Pension Plans to the Equities asset class is low

- Equities as an asset class in theory provides the best hedge against inflation in the long-term



Data Source: OECD Pension Markets in Focus Database

Why Frontier Markets

Good Relative Track Record

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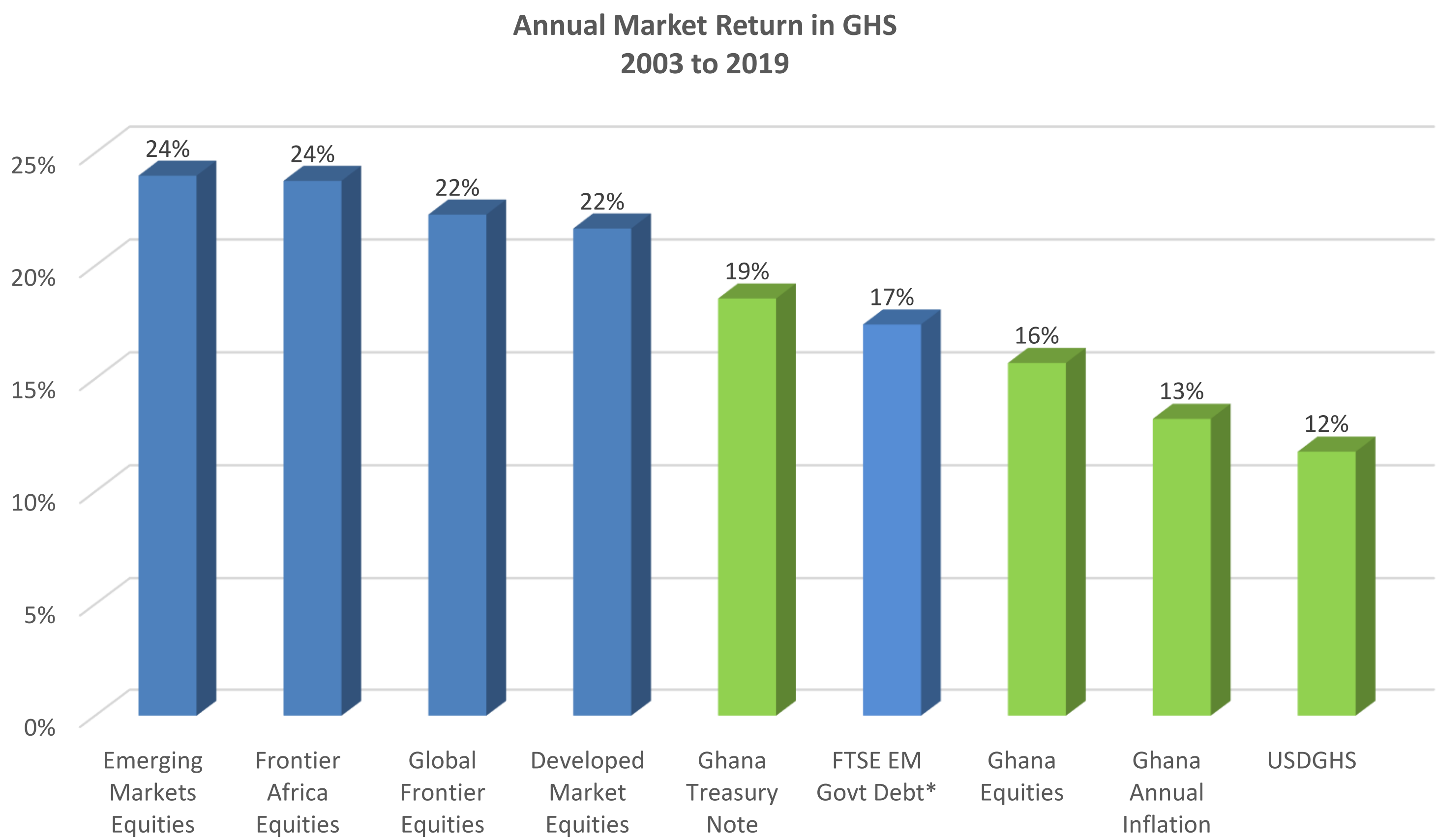
- Over long periods, frontier equity and emerging markets tend to outperform but also carry higher risks
- Diversification to frontier markets have the potential to enhance returns

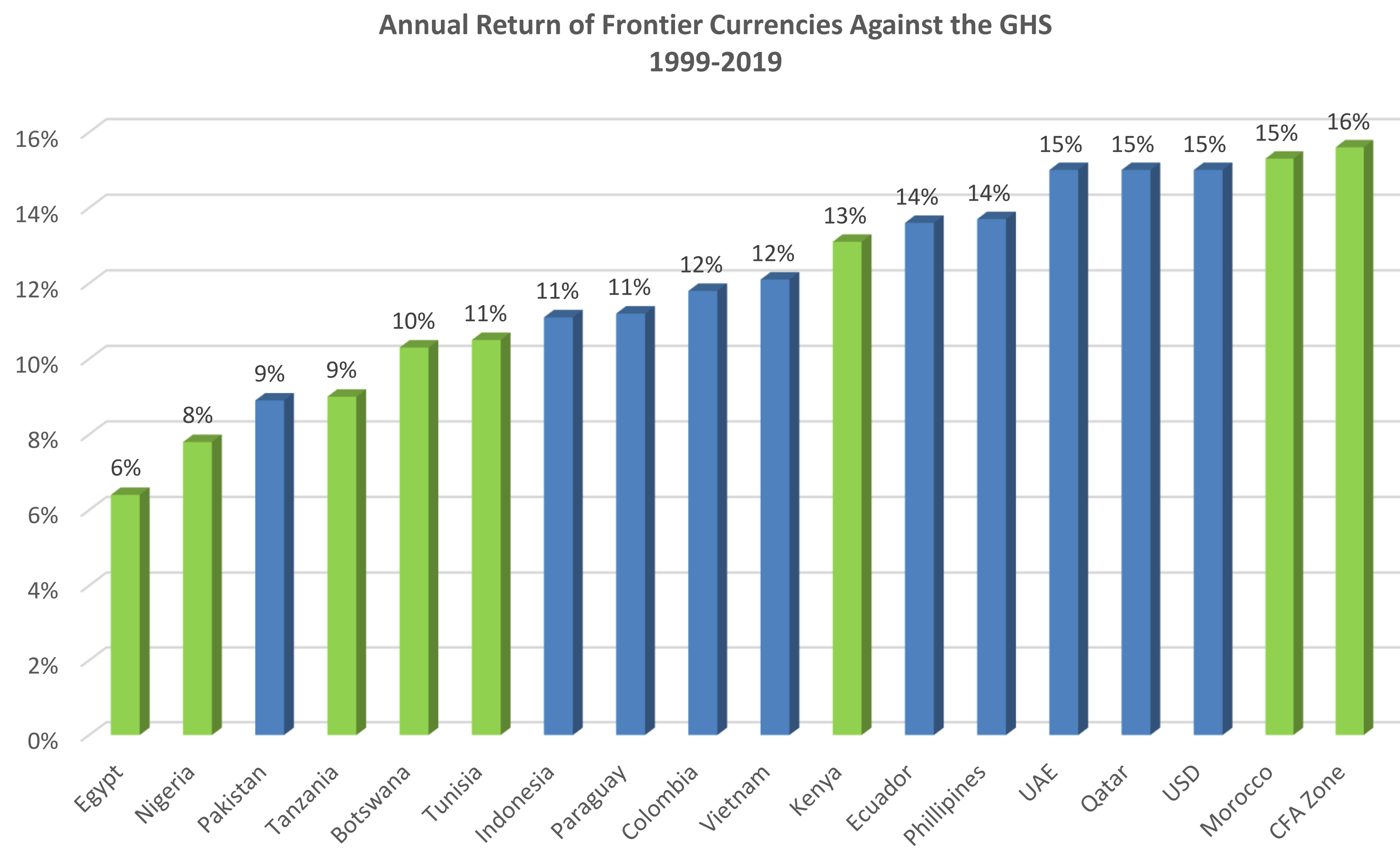


Sources: Factset, MSCI, Databank, Factset. 2003 is used as the base year as this is the year where all the indices shown have a common base on basis of data availability, MSCI data on frontier markets exists from mid 2002. *Last 10 years annual due to data availability

Structural GHS Weakness A Major Factor

- Frontier markets have outperformed Ghanaian asset classes over long periods partly due to the structural weakness of the GHS against key frontier market currencies

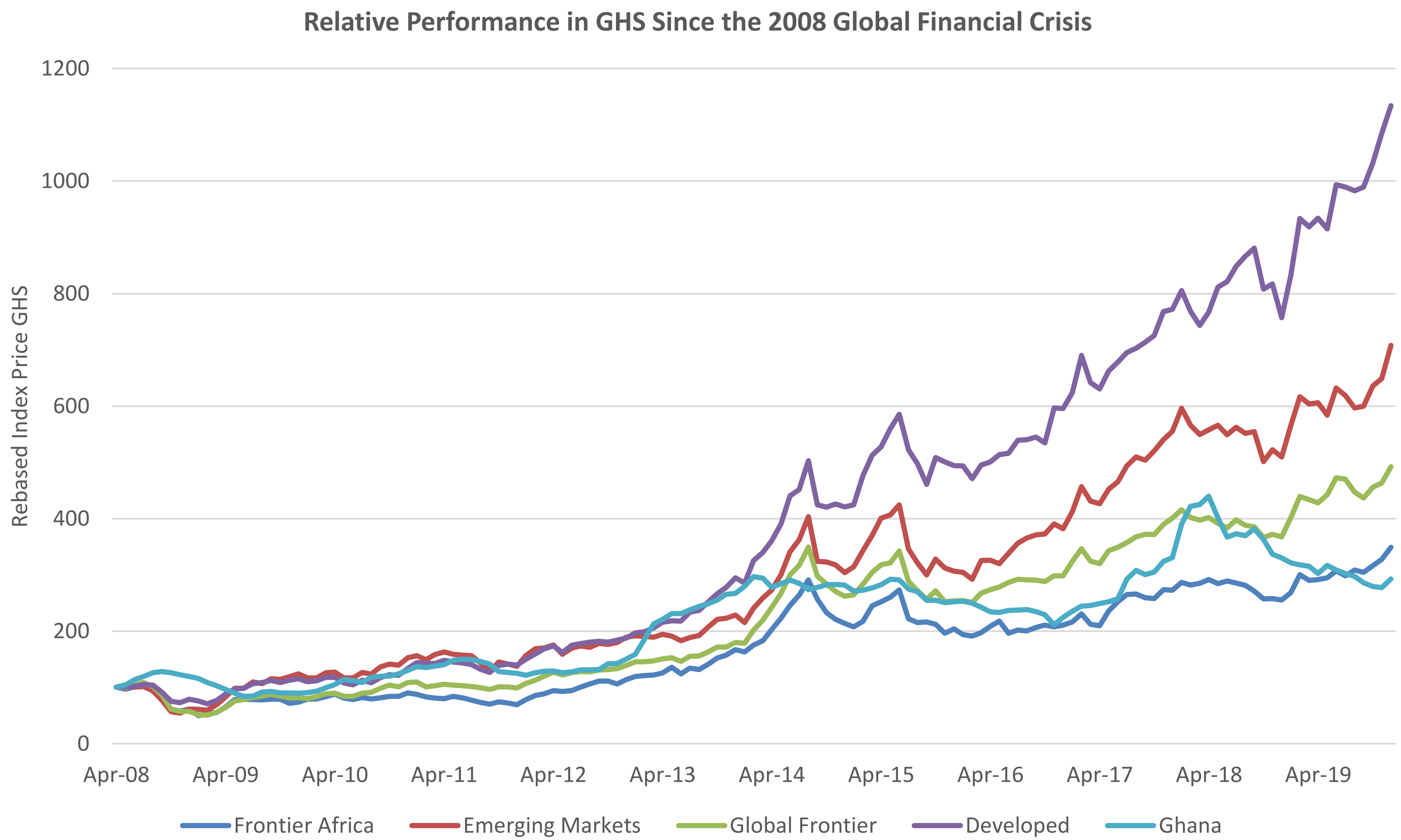
- Perennial weakness of the GHS against other frontier currencies suggest local currency frontier debt exposure has the potential to add value to Ghanaian pension assets



Data Sources: Factset

Underperformance since 2008 Rendering them Cheap

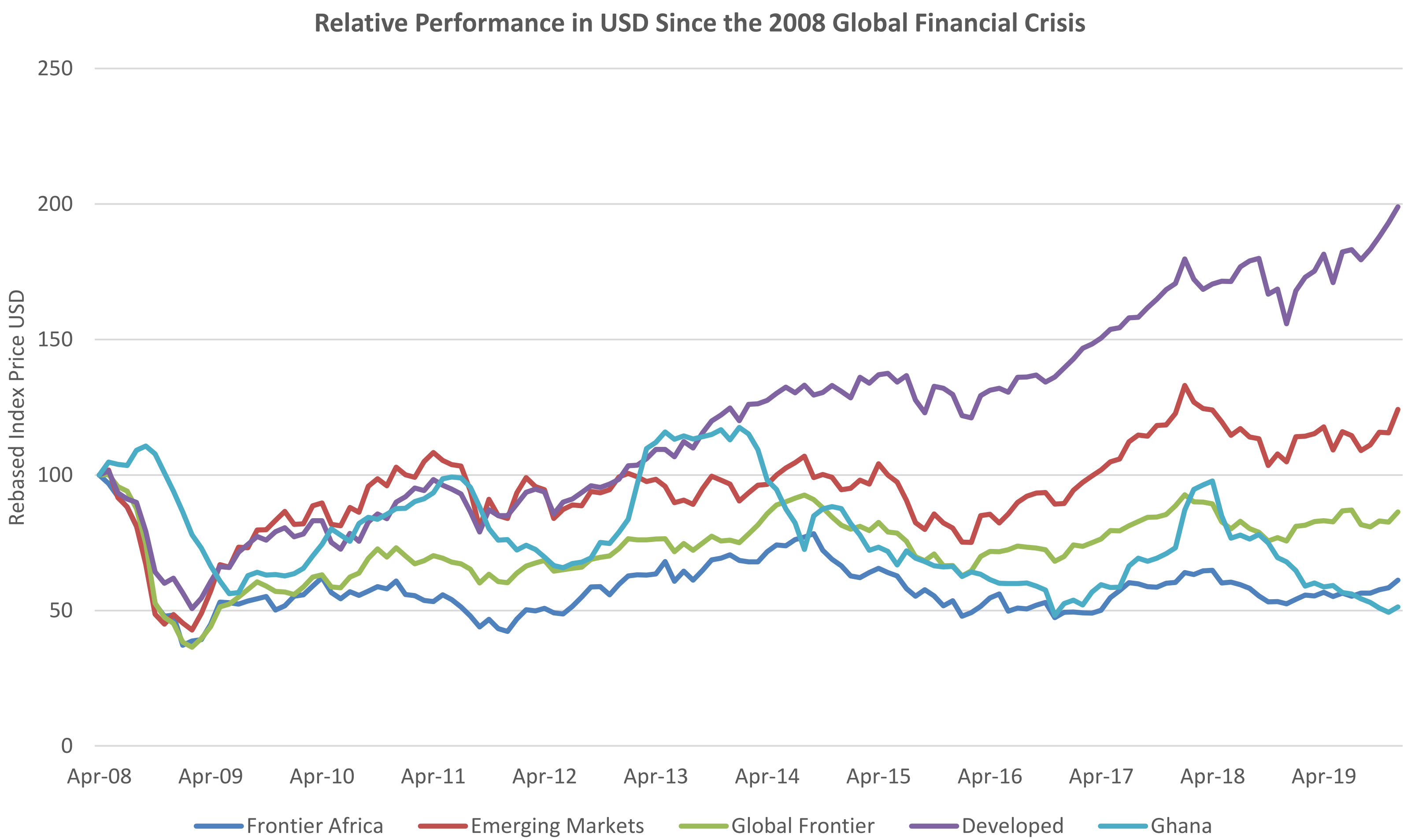
- Frontier Equity Markets have underperformed since the global financial crisis despite stronger economic growth and have consequently become relatively cheap and attractive



Sources: Factset, Databank Research

In US$, Frontier Markets Are Below 2008 Levels

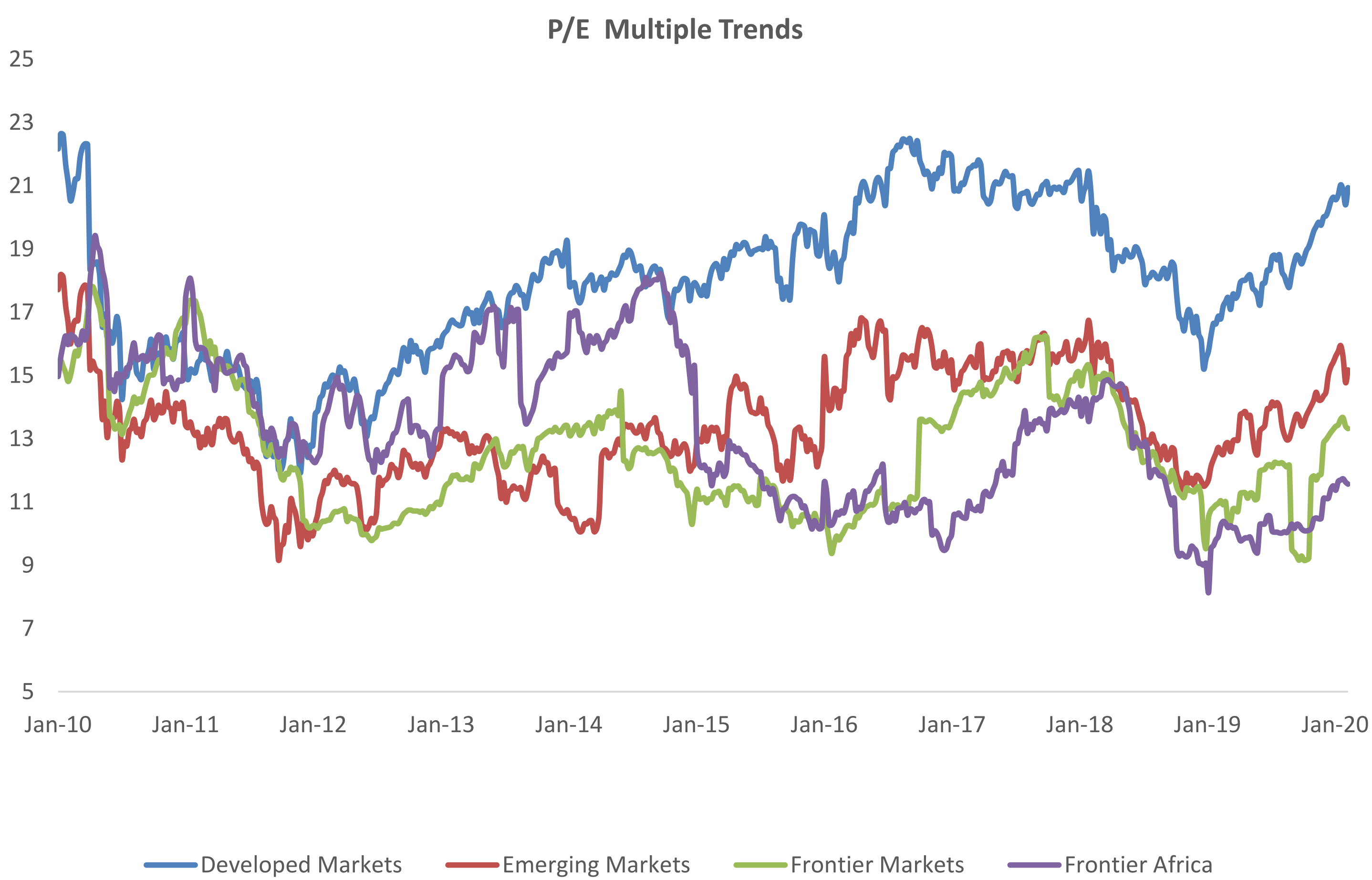
- In hard currency, frontier markets are still trading well below 2008 levels in contrast to over 100% increase in developed markets.



Data Sources: MSCI, Databank Research

Relative Valuation

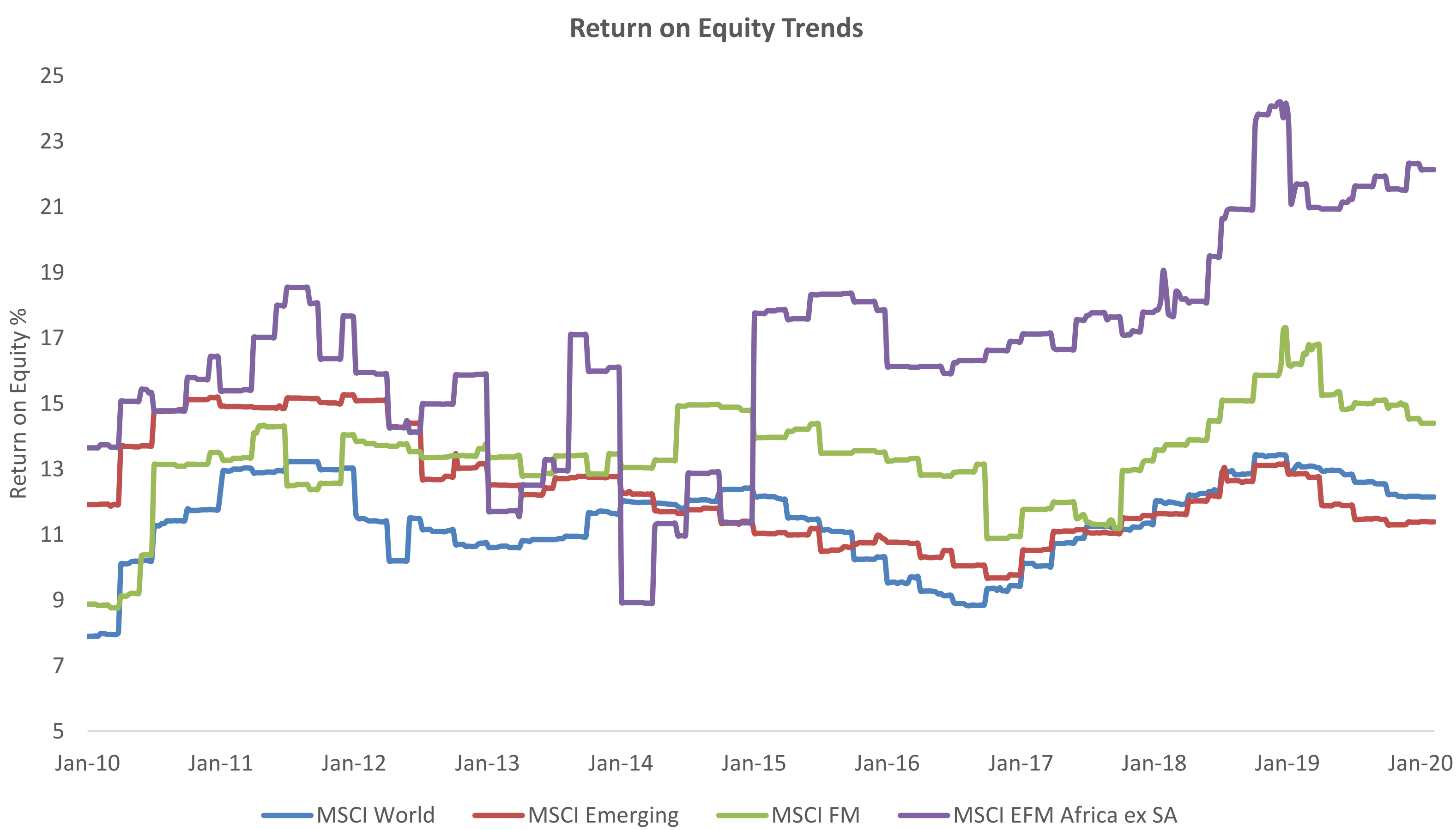
- Frontier equity markets have become relatively cheap due to underperformance in the last decade
- This is also to some extent a reflection of the perception of risk in the context of a strong US dollar



Sources: Bloomberg

Attractive Relative Return on Capital

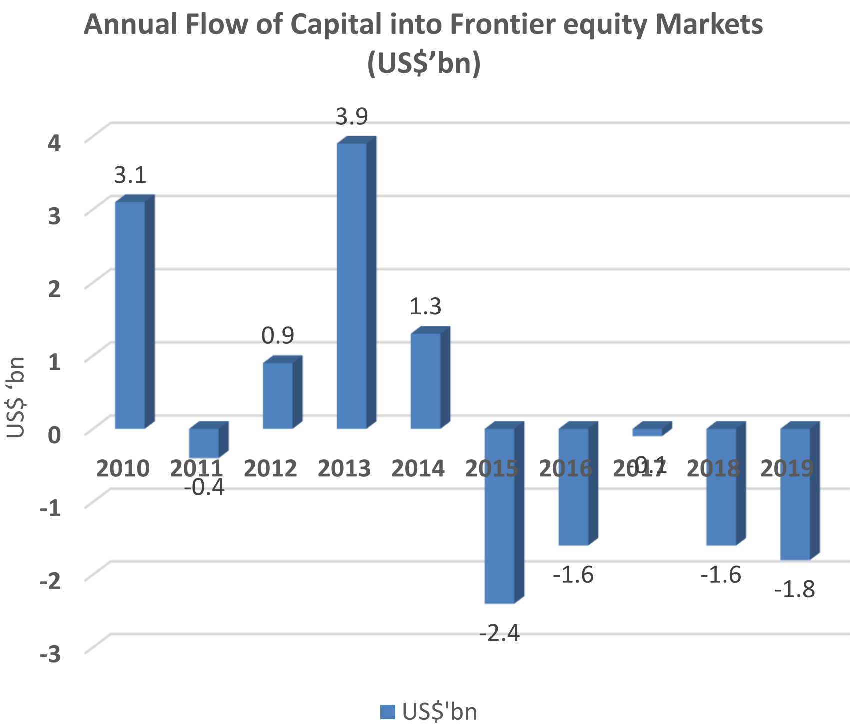
- Frontier Markets have the capacity to produce higher returns on invested capital to compensate for the perception that they are risky markets



Sources: Bloomberg

Why Frontier Has Underperformed Recently

- Strengthening dollar and bullish mature equity markets since 2015 have attracted flows out of frontier markets for the past 5 consecutive years
- Several frontier countries (Ghana, Egypt, Nigeria, Pakistan, Sri Lanka, Argentina) were hit by bearish commodity markets and had to request assistance from the IMF



Sources: EFPR, Aberdeen Asset Management

Cyclical Attractiveness

- Capital outflows may reverse in the years to come as developed markets face the prospects of interest rate declines, weaker stock markets and possibly a weaker dollar

- Frontier markets are attractively valued relative to historical levels. Several markets are trading at 20- year low earnings multiples

- Frontier markets have young, growing populations that are becoming, urbanized, wealthier and able to increasingly participate in consumer markets

- Frontier market economies are growing above 5% in real terms on average annually

Sources: EFPR, Aberdeen Asset Management

Strong Diversification Potential

- Low correlation of returns among frontier countries offer strong opportunities for effective diversification

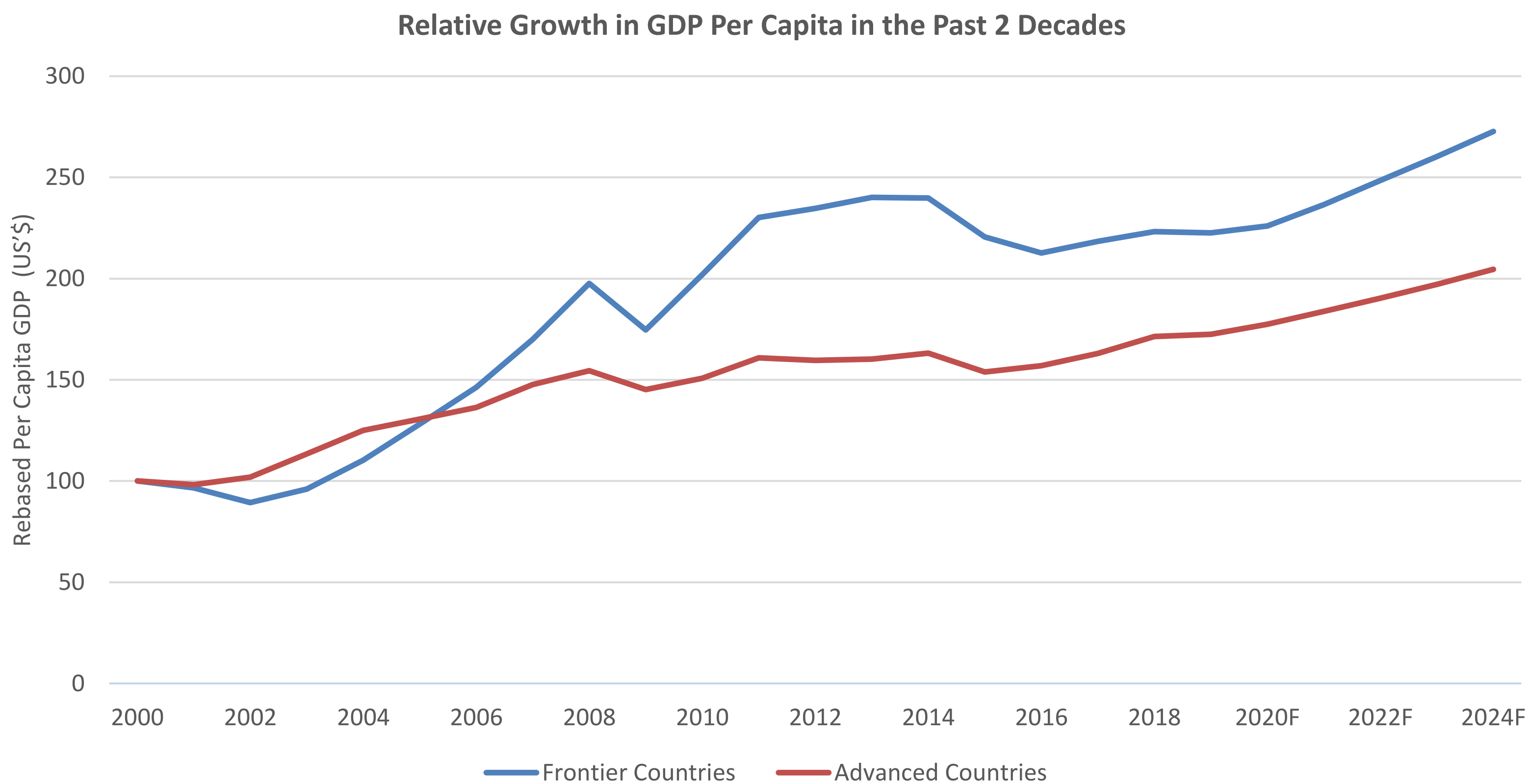
Correlation Matrix of Selected Frontier Equity Markets
(US$ Monthly Returns, Dec 2010 –Dec 2019)

	Nigeria	Ghana	Kenya	Morocco	Tunisia	Ivory Coast	Pakistan	UAE	Indone sia	Chile	Colombia	Egypt	Vietnam	Sri Lanka	Qatar
Nigeria	1.00														
Ghana	0.26	1.00													
Kenya	0.33	0.18	1.00												
Morocco	0.05	0.25	0.18	1.00											
Tunisia	0.02	0.10	0.15	0.20	1.00										
Ivory Coast	0.28	0.21	0.31	0.21	0.12	1.00									
Pakistan	0.18	0.17	0.13	0.11	0.06	0.32	1.00								
UAE	0.21	0.20	0.22	0.26	0.20	0.38	0.37	1.00							
Indonesia	-0.03	0.22	0.25	0.27	0.16	0.18	0.13	0.27	1.00						
Chile	0.04	0.21	0.29	0.36	0.29	0.31	0.06	0.29	0.56	1.00					
Colombia	0.24	0.08	0.26	0.38	0.22	0.35	0.25	0.33	0.39	0.59	1.00				
Egypt	0.15	0.13	0.25	0.35	0.17	0.24	0.17	0.43	0.30	0.31	0.36	1.00			
Vietnam	0.23	0.22	0.23	0.24	0.37	0.40	0.39	0.41	0.23	0.25	0.36	0.32	1.00		
Sri Lanka	0.24	0.16	0.08	0.20	-0.11	0.21	0.20	0.20	0.18	-0.03	0.06	0.16	0.18	1.00	
Qatar	0.12	0.14	0.08	0.17	0.19	0.18	0.32	0.66	0.22	0.25	0.26	0.30	0.27	0.12	1.00

Sources: Factset,

Relatively Faster Growth in Income Per Head

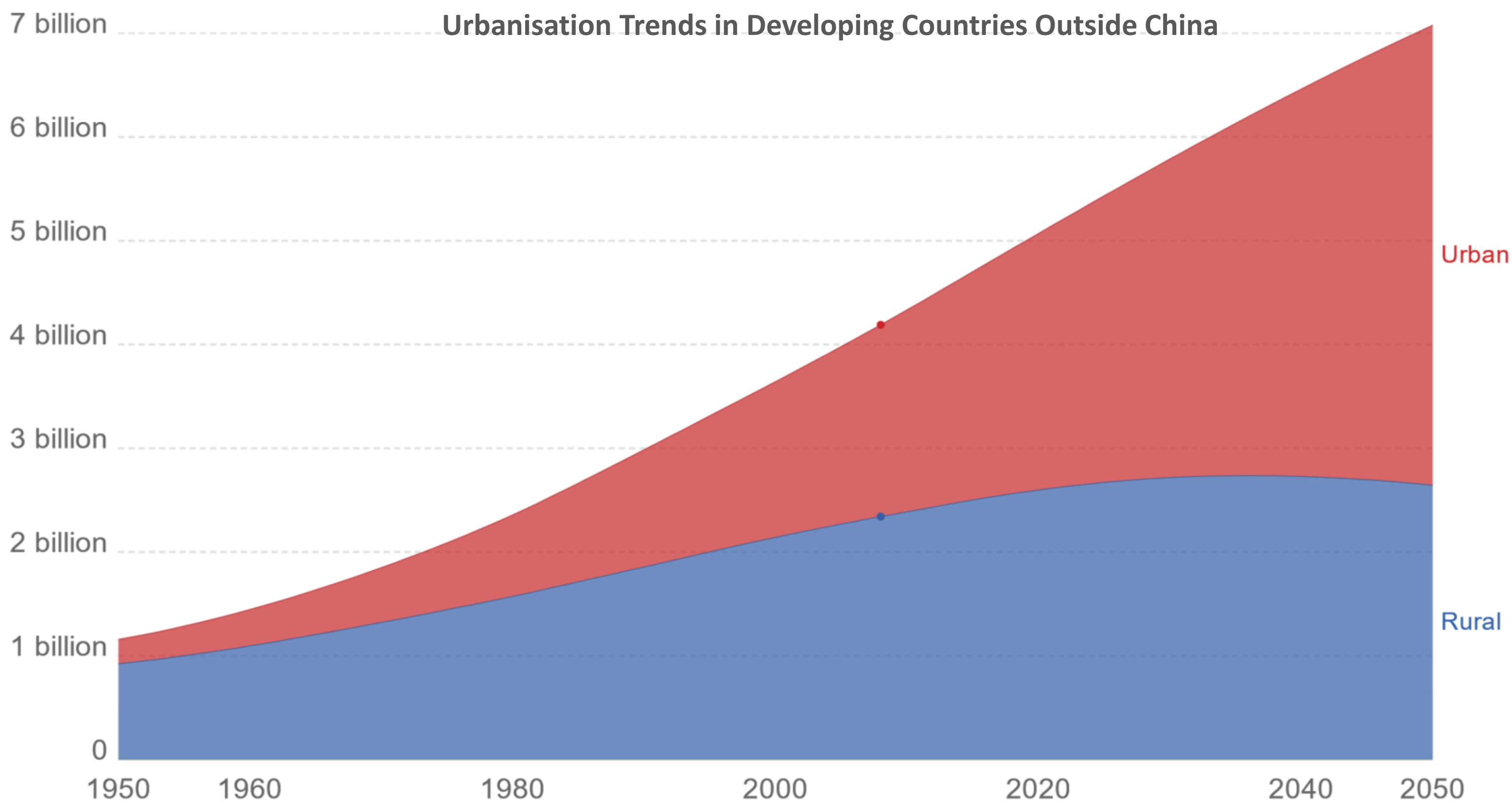
- The past two decades has seen an unprecedented growth in incomes in frontier countries relative to advanced economies
- Rising incomes combined with faster population growth has seen greater participation of people in the consumer economy in frontier countries



Data Sources: IMF WEO Database

Potential Demographic Dividends

- Urbanisation is accelerating and is a key factor driving changes in consumer behavior and access to markets
- Over half of the population of frontier countries will be urbanized within the next 3 decades



Data Source: Our World in Data

Opportunities in Frontier Debt Markets

- Post HIPC, frontier markets have increasingly tapped the eurobond debt market to finance expenditure
- Consequently the number of capital market debt issues has increased substantially, and the maturity curves are being increasingly lengthened over time
- Notwithstanding the fact that frontier markets have broadly lower Debt/GDP ratios compared to Emerging and Developed Countries, debt intensity has been rising
- Frontier countries also have low levels of capital stock compared to Emerging and Developed markets to finance the growing debt intensity. Lower Debt/GDP for a country where capital stock is very low as in many frontier countries is often a recipe for a crisis.
- Investors in my view should allocate their debt exposures on a global rather than regional basis driven by risk-return assessment of specific issues. For example, asset allocators often perceive Sub-Saharan African sovereigns as junk and it may be worth it for an investor to compare those to US corporate junk and on the basis of bottom-up risk-return assessment allocate accordingly.

Data Source: Our World in Data

Newmarket Asset Management

- Specialist frontier markets investment firm
- Independent, London based and FCA regulated
- Combined 35 years frontier markets investment experience

Investment Team

Senyo Dewotor

Managing Partner

Senyo was an Investment Director at Fulcrum Asset Management LLP, UK responsible for Pan-African Strategies. Previously he worked for UBA Capital UK as a Portfolio Manager. Senyo joined UBA from Databank Financial Services Group, where he spent 10 years in various roles at Databank Asset Management and as Regional Manager for Databank's West African subsidiaries. He holds a BSc (Hons) degree in Administration (Accounting Option) from the University of Ghana and a Masters in Finance from the University of Glasgow where he studied as a DFID Commonwealth Scholar.

Alexander Trotter

Managing Partner

Alexander was previously a portfolio manager at Fulcrum Asset Management LLP. Prior to that, he was Head of United Bank for Africa's Global Asset Management business and a portfolio manager. He has considerable African investment and corporate finance experience, particularly within the financial services sector and held senior positions at the United Bank for Africa Plc. He began his career at Linklaters as a corporate lawyer, working in cross border mergers and acquisitions, followed by banking and asset management positions at UBS, Global Asset Management and Firecrest Hambro. Alexander holds degrees from Oxford University (BA) and Imperial College (MBA).

Support Team

Colin Tricker CFA

Operations Manager

Colin is responsible for all operational aspects of Newmarket's investment process. Colin has previously held positions at Jupiter Asset Management and JP Morgan Asset Management in London, where his roles included oversight of third party administration, fund accounting and custodians for the SICAVs in Luxembourg, hedge funds and feeder funds, providing broad-based exposure to fund valuation and NAV oversight, administration and custody. Most recently, he worked with Citco Fund Services (Australia), where responsibilities related to fund administration. He holds the UK Investment Management Certificate, Unit 1- Investment Environment & Unit 2 – Investment Practice and the Investment Administration Qualification (IAQ). He holds a BA (Hons) in Business Studies from the University of the West of England.

Richard Rothwell

Managing Partner Stoneware Capital LLP

Richard Rothwell, ASIP, FSIP is the Managing Partner of Stoneware Capital LLP. Richard is a Fellow of the CFA Society of the UK ("CFA UK") and served as the Society's Chairman. In 1995, Richard was awarded the Wincott Foundation prize by Institute of Investment Management & Research (predecessor of CFA UK). He qualified with the Institute of Chartered Accountants in England and Wales in after graduating in 1985 in Natural Sciences from St John's College, Cambridge University. Prior to establishing Stoneware in 2006, he was a senior fund manager for Northern Trust, where he was responsible for the EAFE equities product, as well as being a member of the firm's Investment Policy Committee. Previously he was a portfolio manager and on the Investment Policy Committee of Deutsche Asset Management and prior to that at Hermes Investment Management investing in North American, global emerging markets and pacific basin equities.