MERCHANT BANK LTD

Equity Market Ready for a Recovery

We believe the equity market is ready for a recovery in 2017.

There are indications that the Nigerian equity market is ready for a recovery in the year 2017 after three consecutive years of decline. The equity market, as measured by The Nigerian Stock Exchange All Share Index (NSEASI), depreciated by 16.14%, 17.36% and 6.17% in 2014, 2015 and 2016 respectively. As at April 28, 2017 the NSEASI had lost 4.15% of its value. **The major factors responsible for the poor performance of the equity market in the last three years are: weak macroeconomic performance, inconsistent policies, weak corporate earnings and portfolio realignment from equities to fixed income securities.** However, looking at the strong growth in the unaudited results that quoted companies released for the period January – March 2017 and the improvement in the macroeconomic environment, we believe the equity market is ready for a recovery in 2017.

The increase in the supply of foreign exchange to meet the input requirements of manufacturing companies should increase their production activities and revenue in the current financial year.

As at April 27, 2017, 62 quoted companies had released their unaudited quarterly results for the period January – March 2017. The total turnover of these companies increased by 41% from N1,450billion in 2016 to N2,042bilion in 2017. The Profit Before Tax (PBT) increased by 45% from N257billion in 2016 to N373billion in 2017 while the Profit After Tax increased by 29% from N240billion in 2016 to N310billion in 2017. **The recent increase in the crude oil price and production and subsequent increase in the external reserves have helped to stabilise the foreign exchange market – a major concern of the foreign investors.** The increase in the supply of foreign exchange to meet the input requirements of manufacturing companies should increase their production activities and revenue in the current financial year. The fiscal and the monetary authorities are implementing policies that should inspire investors' confidence in the Nigerian economy and market.

There is room for pension fund assets to allocate more funds to equities.

Our survey shows that most investors did a lot of portfolio realignment - moving from equities to fixed income securities. The main reason for this was the lacklustre performance of equities in the face of attractive yields on fixed income securities. The data from the National Pension Commission (PenCom) on the allocation of the Pension Fund Assets as at February 2017 shows that the weight of the pension fund assets on domestic equity dropped consistently from 2014 to 2017.

The weight stood at 13.7%, 10.4%, 8.6% and 7.5% in February 2014, 2015, 2016 and 2017 respectively. These figures are lower than PenCom's approved pension fund assets allocation weight to equities, an indication that there is room for pension fund assets to allocate more funds to equities.

PenCom stipulates the maximum weights of equities in the investment portfolio of pension assets as follows: Fund I: 30%; Fund II: 25%, Fund III: 10% and Fund IV: 5%.

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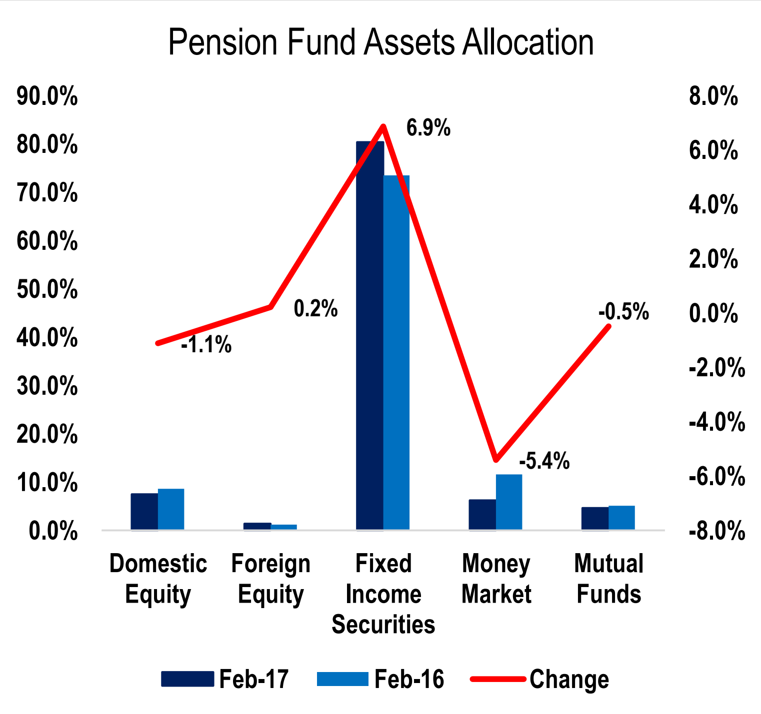
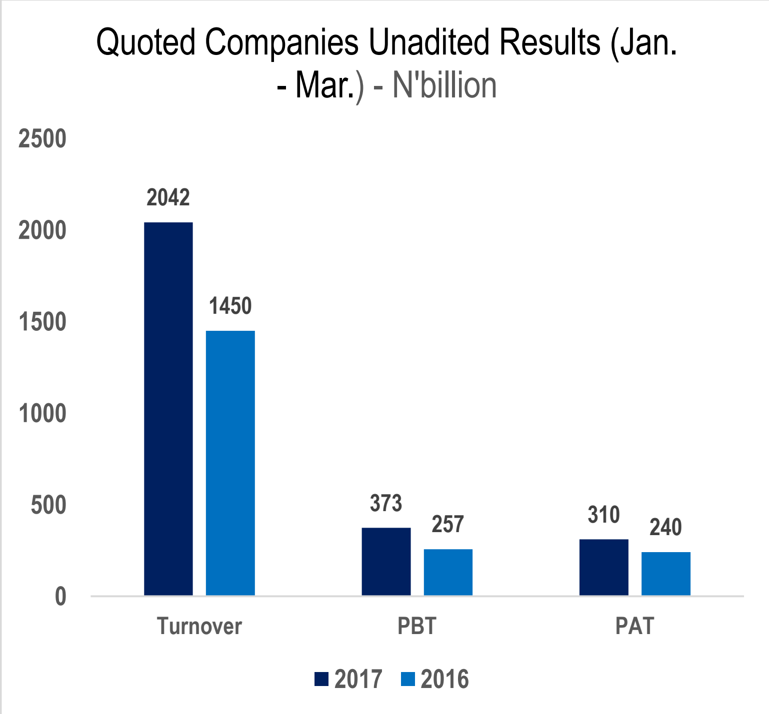
The analysis of the equity transactions on the NSE in the last three years shows investors' apathy for equity investment. According to the NSE, the value of equity transactions from foreign and domestic investors declined between 2014 and 2016. Foreign transactions were N1.54trillion, N1.03trillion and N0.52trillion in 2014, 2015 and 2016 respectively while Domestic transactions were N1.14trillion, N0.88trillion and N0.63trillion in 2014, 2015 and 2016 respectively.

The stability in the macroeconomic environment and the strong earnings of quoted companies should attract the needed liquidity into the market.

Although the relative size of foreign investors' participation in the equity market declined between 2014 and 2016 (58%, 54% and 45% in 2014, 2015 and 2016 respectively), the share of foreign investors' participation was higher than domestic investors' participation between 2014 (Foreign: 58% and Domestic: 42%) and 2015 (Foreign: 54% and Domestic: 46%). The foreign investors' participation in 2016 at 46% was lower than domestic investors' participation at 54%. The uncertainties surrounding the foreign exchange policies and the difficulties to access foreign exchange to repatriate capital and profit led to the withdrawal of foreign investors from the market. **The stability in the macroeconomic environment and the strong earnings of quoted companies should attract the needed liquidity into the market. Consequently, the equity market should record a strong recovery in the year 2017.**





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