Is Equity Market Rally Sustainable?

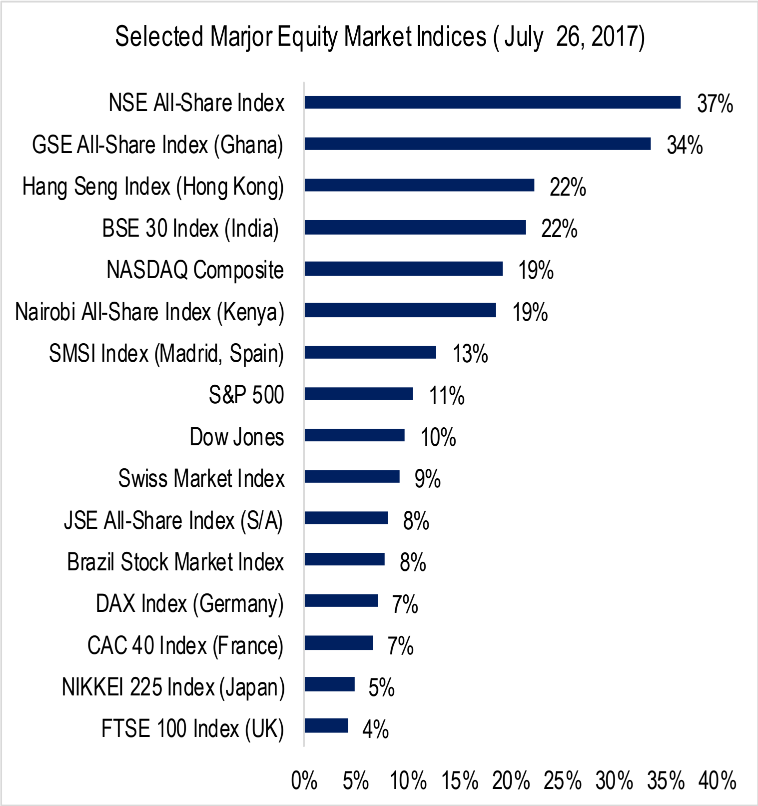
The IMF in its WEO Update July 2017 edition, states that equity prices in advanced economies remain strong, and are showing continued market confidence about company earnings.

The performance of the Nigerian equity market as measured by The Nigerian Stock Exchange All Share Index (NSE ASI) has been impressive since the beginning of the year 2017. As at the close of trading on July 27, 2017, the NSE ASI had appreciated by 38.59% Year-to-Date (YTD). A review of the performance of 15 major equity market indices in other countries shows that the NSE ASI recorded the best performance of 37% as at July 26, 2017, closely followed by GSE All Share Index (Ghana) at 34%. The International Monetary Fund (IMF) in its World Economic Outlook (WEO) Update July 2017 edition, states that equity prices in advanced economies remain strong, and are showing continued market confidence about company earnings. It notes that markets are also optimistic about emerging market prospects as reflected in strengthening equity markets and some further compression of interest rate spreads. It however cautions that oil exporters provide an exception to this pattern, because of the dwindling oil prices since March 2017. The big question in the minds of investors and equity market analysts is if the strong growth in the equity market since April 2017 is sustainable or if there is a bubble waiting to burst.

The average P/E multiple for the top ten most capitalised stocks increased from 11.46x in July 2015 to 12.25x in July 2016 and to 27.06x July 27, 2017.

The fortune of the market changed in March 2017 with a month on month appreciation of 0.74%, April 0.95%, May 15%, June 12%, and 12% as at July 27, 2017.

Our review of the Price to Earnings (P/E) multiples of the top ten most capitalised stocks on The Nigerian Stock Exchange (NSE) as at July 27, 2017 shows that the companies traded at higher P/E multiples in July 2017 than in July 2016 and in July 2015. The average P/E multiple for the companies increased from 11.46x in July 2015 to 12.25x in July 2016 and to 27.06x July 27, 2017. Nestle recorded the highest P/E multiple of 78.87x in July 2017 and 34.91x in July 2015 while Nigerian Breweries recorded the highest P/E multiple in 2016 at 30.7x.



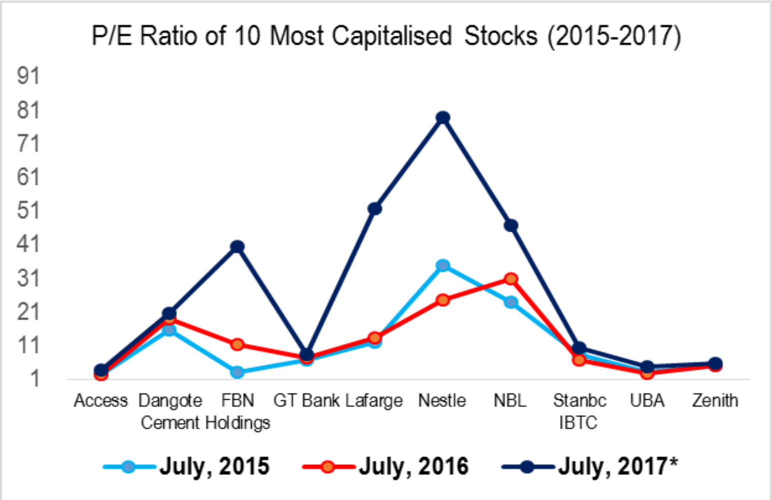
Source: Bloomberg

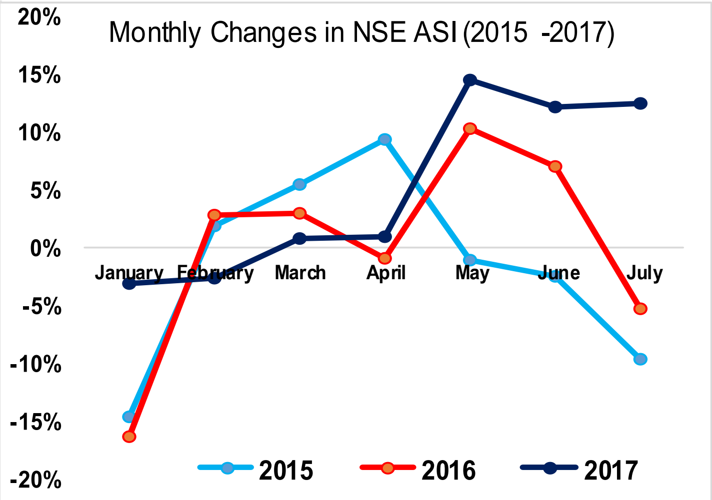
We think profit taking is imminent on a few stocks that have recorded strong appreciation in their share prices.

Although a high P/E multiple may indicate that investors believe in the future earnings growth of the company, the current trend in the market shows that stocks are trading far higher than the historical level and a possible correction may be imminent.

The monthly analysis of the NSE ASI shows that the equity market rally started in April 2017. The equity market appreciated between April and July 27, 2017 by 45% while it depreciated by 4.15% between December 2016 and April 2017. The equity market followed similar trend between April and June in 2016 and 2017. The equity market recorded negative performance both in January and February 2017 at 3.12% and 2.72% respectively, with investors' outlook that 2017 might be another bad year for equity market investment. However, the fortune of the market changed in March 2017 with a month on month appreciation of 0.74%, April 0.95%, May 15%, June 12%, and 12% as at July 27, 2017. YTD, the top gainers in the equity market as at July 27, 2017 are: May & Baker 245.74%; Fidson Healthcare 172.66%; Stanbic IBTC Holdings 150.00%; UBA 124.44%; Beta Glass 99.01%; Cement Company of Northern Nigeria 94%; Airline Services 91.20%; Okomu Oil 85.24%; FBN Holdings 78.21%; and Presco 77.06%.

Some notable factors that are responsible for the market rally are: improved business and consumers confidence in the economy, consistent improvement in the Purchasing Managers' Index (PMI), stability in the foreign exchange market leading to the inflow of foreign investors, particularly with the establishment of the Investors and Exporters' Foreign Exchange Window and the prospect of improvement in corporate earnings. While we note that the improvement in the macroeconomic environment in the last few months has sustained the rally in the equity market, we think profit taking is imminent on a few stocks that have recorded strong appreciation in their share prices.





Sources: The Nigerian Stock Exchange (NSE), and FSDH Research Analysis

For enquiries please contact us at our offices:

Lagos Office: 5th-8th floors UAC House, 1/5 Odunlami Street, Lagos. Tel: 234-1-2702880-2; 234-1-2702887

Port Harcourt Office: 2nd Floor, Skye Bank Building (Former Mainstreet Bank Building) 5 Trans Amadi Road, Port Harcourt. Tel: 234-8024081331

Abuja Office: Leadway House (First Floor), Plot 1061 Herbert Macaulay way, Central Business District, Abuja-Nigeria. Tel.: 234-9-2918821

Website: www.fsdhgroup.com **email: research@fsdhgroup.com**

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