Bracing for a Different Future

Meristem Annual Outlook (2021)

Meristem Research | January 2021

| WEALTH MANAGERS | FINANCIAL ADVISORS
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Content Highlights

Scarred by Corona… the Future will be Different

Many months since the pandemic began, its adverse effects on the global economy are still very evident. The pandemic triggered an economic fallout of levels not seen since the turn of the century however, most economies are now navigating their way back to recovery. While new vaccines have been discovered and are now being deployed in some countries, we argue that more uncertainty lies on the path to recovery and systemic changes triggered by the pandemic will persist for longer.

Tough Times for Domestic Output

The domestic economy slipped back into recession, barely four years after the last one as structural vulnerabilities of Nigeria's economy were exposed severely. Macroeconomic fundamentals weakened considerably as a result, triggering exchange rate shocks and elevated level of inflation. While these vulnerabilities are expected to persist in 2021, we expect the economy to exit the recession this year.

Nigerian Equities Ends 2020 as the Best Performing Equities Market

Financial system liquidity and unattractive yields on fixed income assets have helped to propel the equities market from its bearish trend to its status as the best performing equities in 2020. This is expected to sustain the positive momentum of the market, at least through the first half of the year. There are however downside risks, especially a surprise from the policy environment and overpriced bellwether stocks.

Abundant System Liquidity, the Song for 2020

Double-digit interest rates now seem like a distant memory in the fixed income space, as the full impact of CBN's OMO policy took hold. The policy unleashed a significant volume of liquidity which were rerouted to other segments of the market, subsequently leading to a crash in rates. Corporates have been taking an advantage to raise funds at cheap rates and we expect we expect this trend to continue.

Chase Yields on Equities and Stay Short in the Fixed Income Market

Considering the pricey status of equities currently, we do not rule out the possibility of a market correction. This is however less likely in the first half of the year. Thus, we advise investors to rotate into dividend paying counters with defensive qualities. In the fixed income market, given our expectations for a sustained low yield environment in the first half, investors will need to be assume more risk to generate above average returns.

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Overview

Global and Domestic Macros

The outbreak of the Coronavirus pandemic had far-reaching impacts for the global economy. Most economies across the world plunged into recession with unemployment hitting record numbers. Its impact on capital flows was almost devastating in the emerging markets as it triggered exchange rate depreciation and declines in capital markets. The crude oil market was hit severely by the sharp drop in demand, following the imposition of lockdowns and the restrictions in the aviation industry. The breakout of a price war by the two largest producers could not have been more ill-timed, as it sent prices down with oil futures briefly trading in the negative.

Fiscal and monetary responses have been very supportive, with most advanced economies expanding their quantitative easing programs to support the growth of their respective economies. Interest rates have dropped near zero while record amounts are being spent as intervention for individuals and households. While these liquidity injections helped the recovery witnessed across markets, global growth is still expected to decline by 4.4% in 2020.

The global economy should however recover in 2021, with real GDP projected to expand by 5.2% by the IMF. The optimism for global growth derives from the current vaccination efforts across the world and the public health measures put in place to ensure a safe resumption of economic activities in 2021. The outlook for commodity prices is also improved by expectations of stronger demand and as economic activities gradually kick back into gear.

However, even though several other vaccines are in development, we have mapped the current vaccine manufacturing landscape and note that available manufacturing capacity falls short of the required demand needed for the world to achieve herd immunity in the near term. As such, uncertainties still abound with regards to the global economic outlook in 2021, particularly as the number of daily infections continue to grow. Elsewhere, the global geo-political landscape witnessed major shifts in 2020, which will have major bearings on the economy in 2021. Key highlights include the election of former Vice President, Joe Biden, as the new President of the U.S, the final severing of ties between the European Union and the United Kingdom, as well as the operationalization of the Africa Continental Free Trade Agreement (AfCFTA).

Like the global economy, the Nigerian economy also fell in line, slipping back into recession in the third quarter of 2020. While the oil sector contracted due to the crash in the price of crude oil, the non-oil sector was affected by the lockdowns in place in some of the most economically active States of the country. It is safe to say that the pandemic amplified the vulnerabilities of the domestic economy. In the absence of crude oil earnings, the fiscal deficit widened to record levels. In addition, the CBN had to devalue the currency thrice, in recognition of the pressure on external reserves. Unemployment rose higher, while the shutdown of the borders and supply side challenges drove the inflation rate higher. We urge for fiscal prudence through the review of the cost of governance and more importantly, the use of public-private partnerships to finance critical infrastructure. The deregulation of the downstream sector is laudable but will require a strong will to follow through on its implementation.

Growth is however expected to return in 2021, at 2.33%, as we expect the economy to gradually recover from the shocks caused by the pandemic. However, we acknowledge that risks to the growth forecasts loom large due to the rising number of COVID-19 cases in the country would threaten full recovery of some of the worst-hit sectors.

Equities

The equities market recovered from deep selloffs to finish as the best performing equities market last year. Unattractive yields in the fixed income market, excess liquidity and relatively resilient corporate performance in the middle of a pandemic were the major factors which drove the market. We expect this to continue, thereby sustaining the positive momentum of the market through the better part of the year. We see a correction on the horizon given the overbought status of the market, especially for major bellwethers. Nevertheless, the first half is expected to be dominated by attractive dividend yields and the low yield in the fixed income market, which we expect to persist through the first half of the year at the very least. Our models forecast a weighted return of -6.09%.

Fixed Income

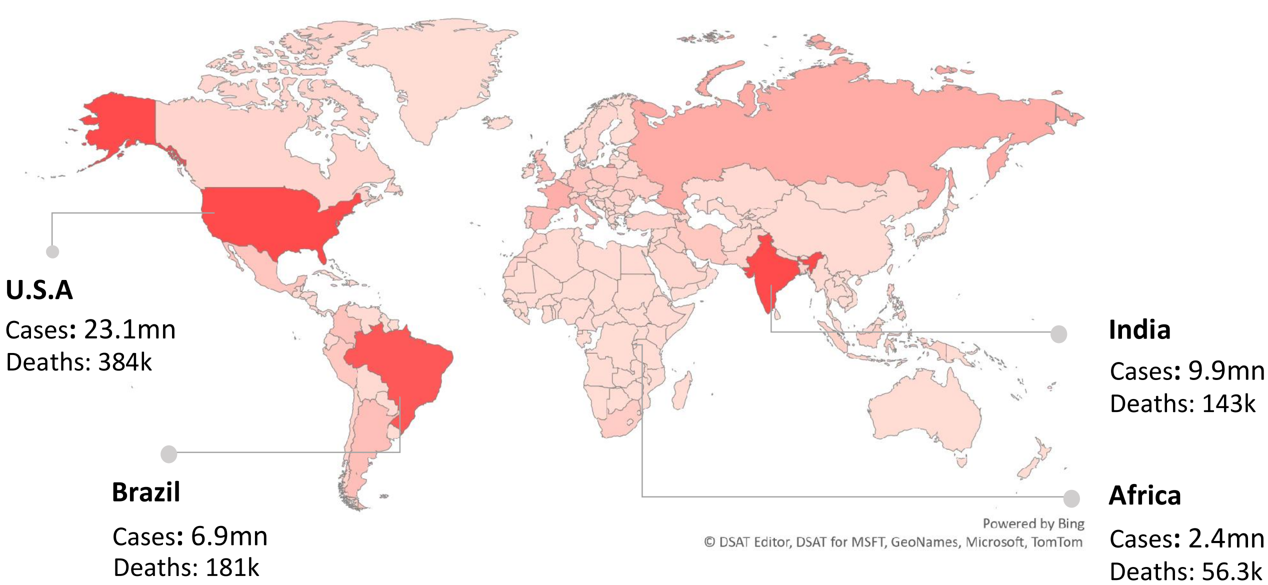
The policy of the CBN to keep local investors from the OMO market precipitated excess liquidity in the fixed income market, compressing yields. Both publicly listed and private corporates have taken advantage to raise cheap funds in the market. We expect this to continue in 2021 given the loose stance of monetary policy.

Global Economy

Scarred by Corona, A Year Like No Other

The global economy has changed drastically since the first cases of COVID-19 (SARS-CoV-2) were reported in Wuhan, China, in December 2019. Early genetic assessments, according to the World Health Organization (WHO), revealed that the virus had an ecological origin from bats which, scientists believe, was transmitted into humans from a zoonotic source. The novelty of the virus and the speed at which it spread prompted unprecedented levels of nationwide lockdown in virtually all countries across the world. In addition, the pandemic exposed fragilities in the global healthcare system which was ill-equipped to cope with the surging number of infections. By March, the WHO had declared the virus a pandemic as over 100 countries had recorded cases of the virus, causing widespread shutdown of international travels, and a halting of all non-essential services.

Chart 1: Global COVID-19 Situation Report



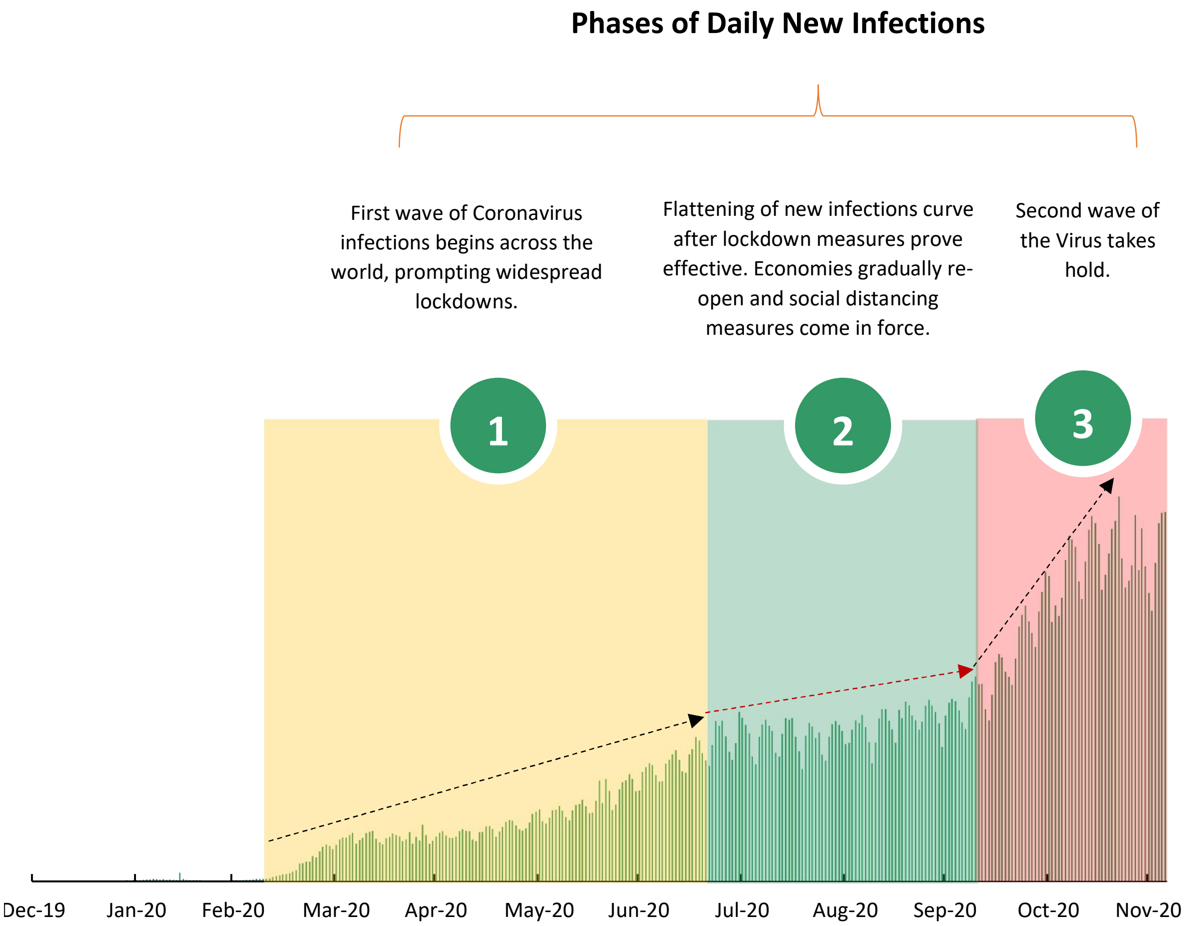
71,503,614	1,612,833	214
Total Cases	Total Deaths	Countries Affected

**Data Correct as of January 14, 2021*

Source: European Centre for Disease Prevention and Control (ECDC), Meristem Research

The containment measures proved effective, particularly in China, whose aggressive contact tracing and decontamination approach was able to significantly reduce the number of new cases by over 80% after its Joint mission with the WHO. These, alongside an improvement of the healthcare system, introduction of face masks, and enforcement of social distancing protocols, provided a framework for the gradual reopening of economies across the world by the second quarter of the year. Although the total number of cases continued to rise, the curve of daily new infections began to flatten between July and early October, reflecting the effectiveness of this approach. Eventually, the average number of new cases reported daily over the period steadied at about 258,000 globally.

Chart 2: Daily Coronavirus Cases Across the World



**Data Correct as of December 14, 2020*

Source: European Centre for Disease Prevention and Control (ECDC), Meristem Research

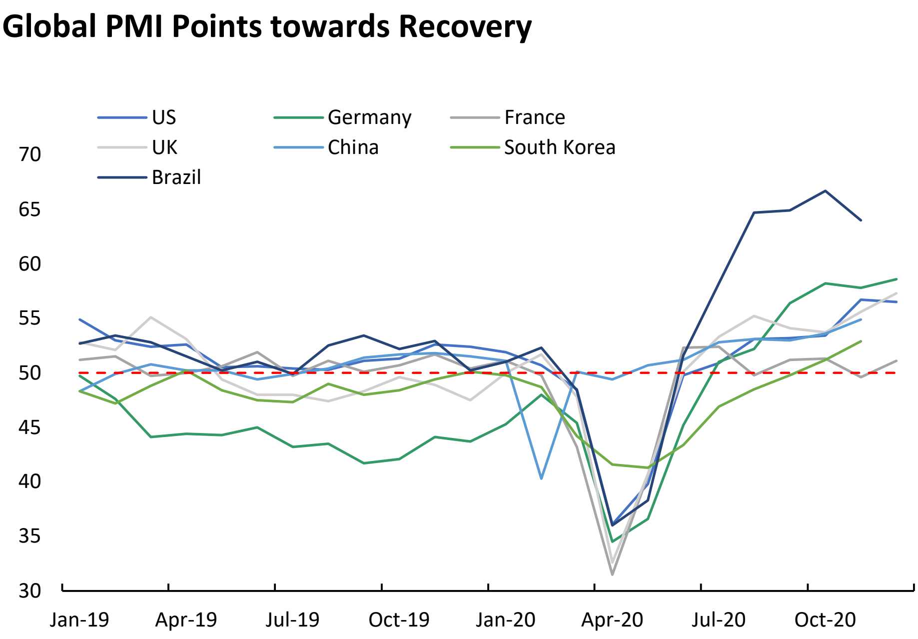
The economic effect of these unprecedented levels of lockdown measures were already well documented in our H2:2020 outlook; where we highlighted its impact on global GDP, per capita income, capital flows and financial markets. We indicated that the pandemic was set to trigger a global output decline much deeper than the Global Financial Crisis (GFC). It dragged global PMI levels to levels not seen since the GFC, while unemployment levels across major economies spiked to their sharpest levels in decades. We also indicated that Global GDP per Capita was projected to contract by 6.2% (more than two times the contraction during the GFC), according to the World Bank, while at its peak in late March, the spread of the pandemic triggered capital flight from

Emerging Markets which were approximately four times the outflows suffered during the Global Financial Crisis.

However, quite positively, the gradual re-opening of economies in the second half, along with sustained policy support from monetary and fiscal authorities, allowed for a sharp upturn in economic activity.

Manufacturing PMIs across the U.S, China, UK, Brazil, etc. (see chart 3) have largely returned to expansion since July, while third quarter GDP data for the U.S (+33.1%), U.K (+15.5%) and the E.U (11.5%) also point towards this recovery. However, with the exception of China, global GDP is still expected to suffer a synchronous decline in 2020, according to the International Monetary Fund (IMF). Output levels are generally not expected to return to pre-pandemic levels till late 2021.

Chart 3: Manufacturing Indices across Select Countries



**index data below 50pts indicate a contraction*

Source: Bloomberg, Meristem Research

Second Wave Bites Hard

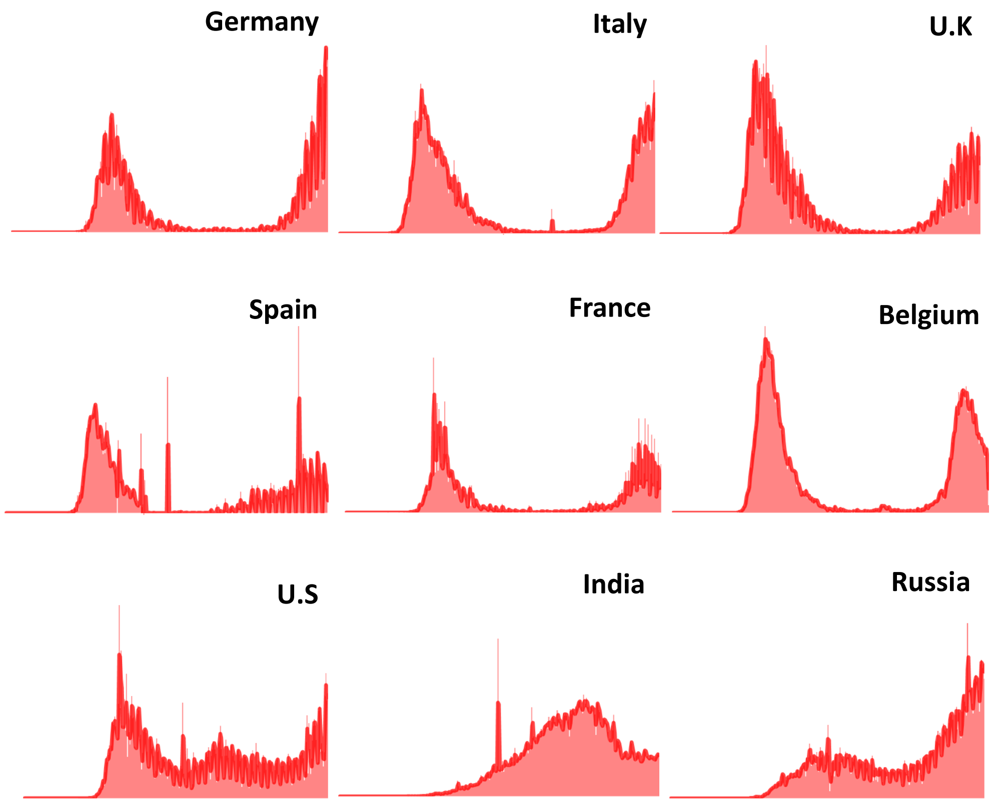
In our H2:2020 Outlook: *Unmasking Value in a Scourge,* we had warned that with the threat of a second wave of new infections very much a possibility, the strength of the post-pandemic recovery will remain fragile until a vaccine is developed. Thus, much would depend on strict compliance with social distancing and healthcare measures as economies gradually re-opened.

Unfortunately, a second wave of new infections began to occur in early October, which has been ascribed to lax post-lockdown control policies and weak compliance with COVID-19 preventive measures. At the moment, cases of COVID-

19 infections have surpassed 65 million globally, with the U.S., Brazil, India, and European nations such as Italy, Spain, France, Germany, Belgium, and the United Kingdom as hotbeds of the pandemic.

Chart 4: Daily Death Toll in Select Economies

Second Wave already Deadlier than the First in Some regions



**Data Correct as of December 14, 2020*

Source: European Centre for Disease Prevention and Control (ECDC), Meristem Research

In Europe, a rush to lift domestic lockdown measures at the onset of the summer season, as well as resumption of cross-border travel with minimal quarantine requirements were some of the factors attributed to the resurgence of the second wave. Approximately 105,000 deaths were recorded in the region during November. In Central and Eastern Europe, the second wave of infections has been more severe than the first, with daily death tolls beginning to climb above the levels experienced during the first wave.

The situation is even more dire in the United States which has recorded over 15 million cases and 280,000 deaths (c.20% of global cases and deaths). Unlike most countries, the U.S never fully recovered from the first wave of the pandemic. After a slight respite in the summer, new cases of infections and deaths began to spiral out of control in the months preceding the Presidential elections in November. With daily death tolls now averaging over 2,000 per day and hospitalization rates at record highs, the spread of the virus across the country is becoming increasingly difficult to control.

In addition, reports about a new strain of the virus recently emerged in mid-December. This new mutation was first reported in the U.K, South Africa, Nigeria and later in at least 13 other countries, and has been discovered to be even more infectious than the original version of the virus. Scientists attribute part of the surge in the growing number of infections to this new strain although it remains unclear whether the strain is more deadly than the original version.

Government authorities were initially hesitant to re-impose complete national lockdowns with the same level of severity as the first wave, to avoid the economic fall-out that would ensue. Nonetheless, curfews and movement restrictions have been re-introduced with varying degrees of severity in most regions where the occurrence of a second wave of infections are high. For instance, second national lockdowns were announced in France, the U.K and Germany, with only schools and essential service providers allowed to operate. Nevertheless, a major concern for health experts has been the low levels of compliance observed in some areas. Given the winter festivities, health experts advocated for significant behavioural changes as a rise in indoor gatherings with minimal observations of social distancing provisions could spur a more severe third wave in the early months of 2021.

Light at the End? What we know about the Vaccines

Effective vaccines against the virus were generally not expected to be available until early or mid-2021 due to the lengthy process required before drug approval. After the exploratory and pre-clinical stages, vaccines will typically need to undergo a three-stage clinical development process before they are sent for regulatory approval. This entire process could take up to 15 years in some instances. However, governments, multi-lateral agencies, regulators, and drug manufacturers across the world have combined to significantly shorten the time required for a COVID-19 vaccine to be developed, whilst seeking to uphold safety standards.

At the moment, over 160 vaccines are reportedly undergoing pre-clinical testing worldwide, while about 52 vaccines are at various stages of clinical human trials. 19 vaccines have reached Phase 3 clinical trials, which typically involves large scale testing of the vaccine's efficacy against the virus. Upon achieving satisfactory Phase 3 results (a minimum of 50% according to the U.S Food and Drug Administration), the vaccine could be granted an Emergency Use Authorization before receiving final approval. Quite positively, 9 of these have received regulatory clearance for use in various countries across the world (as at the time of writing), and these countries have moved swiftly towards deploying for use within their population.

Chart 5: COVID-19 Vaccine Development Tracker

PRE-CLINICAL	PHASE 1	PHASE 2	PHASE 3	APPROVED
162 Vaccines	44 Vaccines	20 Vaccines	19 Vaccines	9 Vaccines
are being explored in lab experiments and animals	are undergoing safety tests in healthy young individuals	are being tested in broader groups of people	are in large international trials to test their impact on COVID-19	have been approved for general or limited use in at least one country

**Data correct as of December 31, 2020*

**Some vaccines are in combined phases (i.e., combining Phase 1 and 2)*

Source: World Health Organization (WHO), New York Times, Gavi, Meristem Research

Approved Vaccines

Manufacturer	Type	Dose	Effectiveness	Storage	Approval Status
AstraZeneca/University of Oxford	Adenovirus	2 doses, 4 Weeks Apart	Up to 90%	Refrigerated	Emergency use in U. K
CanSino	Adenovirus	Single Dose	N/A	Refrigerated	Limited Use in China
Gamaleya (Sputnik V)	Adenovirus	2 doses, 21 days apart	92.0%	Freezer Storage	Emergency Use in Belarus, Argentina, Russia
Moderna	mRNA	2 doses, 4 Weeks Apart	94.5%	-20°C	Approved in Canada Emergency use in U. S
Pfizer-BioNTech	mRNA	2 doses, 21 days apart	95.0%	-75°C	Approved in Canada, Bahrain, Saudi Arabia, Switzerland. Emergency approval in U.K, E.U, U.S, Argentina, Chile and 6 other countries
Sinopharm (Beijing)	Inactivated	2 doses, 3 weeks apart	79.34%	N/A	Approved in U.A.E., Bahrain. Limited use in China.
Sinopharm (Wuhan)	Inactivated	N/A	N/A	N/A	Limited Use in China, UAE
Sinovac	Inactivated	2 doses, 2 weeks apart	>50%	Refrigerated	Limited Use in China
Vector Institute	Protein	2 doses, 3 weeks apart	N/A	Refrigerated	Early Use in Russia

**Data correct as of December 31, 2020*

N/A – Information not publicly available as at time of writing

Source: World Health Organization (WHO), New York Times, Gavi, Meristem Research

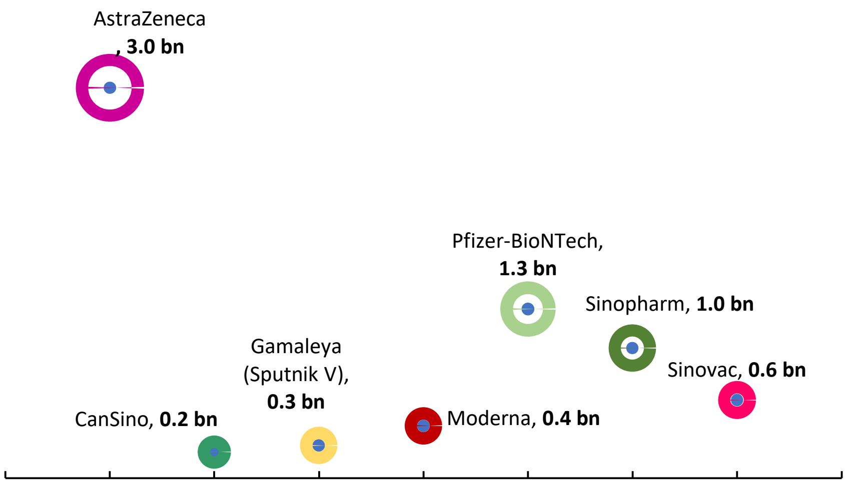
Vaccinating the World, What to Expect

While we view news about the development and approval of these vaccines as a positive, the next milestones of manufacturing and distributing the vaccines across the world present new challenges. The global population is estimated at 7.8 billion in 2020, and health experts postulate that about 70% of this population will need to receive the vaccine to achieve herd immunity. Considering that most of the vaccines developed so far require two doses, projections for the total number of vaccines required to achieve herd immunity stand between 11 to 15 billion doses.

From a manufacturing standpoint, scaling up production capacity to meet the projected demand will be a key priority for vaccine developers. At the moment, the combined manufacturing capacity for the licensed vaccines falls significantly below demand. Pfizer and BioNTech expect to supply about 1.3 billion doses of their vaccine in 2021, the manufacturing capacity for Moderna's vaccine is expected to reach 400 million doses annually in 2021, while AstraZeneca expects to reach a manufacturing capacity of 3 billion doses in 2021. In sum, the combined manufacturing capacity for the currently licensed vaccines is expected to hit 6.8 billion doses annually in 2021, which theoretically speaking, will be sufficient to immunize about 44% of the global population.

Chart 6: Projected Manufacturing Capacity for Vaccine Developers in 2021

Combined manufacturing capacity of approved vaccines to reach 6.8bn doses annually in 2021



Source: Pfizer, Bloomberg, AstraZeneca, Global Times, New York Times, Sputnik Vaccine, Meristem Research

The cold temperature requirements for vaccine storage also pose major logistics concern particularly in Sub-Saharan Africa and other low-income countries. The WHO estimates that about 50% of vaccines are wasted every year, largely due to a lack of temperature control. Invariably, distributing vaccines which requires extremely cold storage, like Pfizer/BioNTech's vaccine (-75°C) in SSA will prove particularly challenging due to infrastructural challenges and poor levels of electricity in the rural areas of most countries. Therefore, without key investments to address these deficits, most of these countries could face delays before they are able to immunize a sizeable amount of their population, which would negatively impact the pace of their post-pandemic recovery.

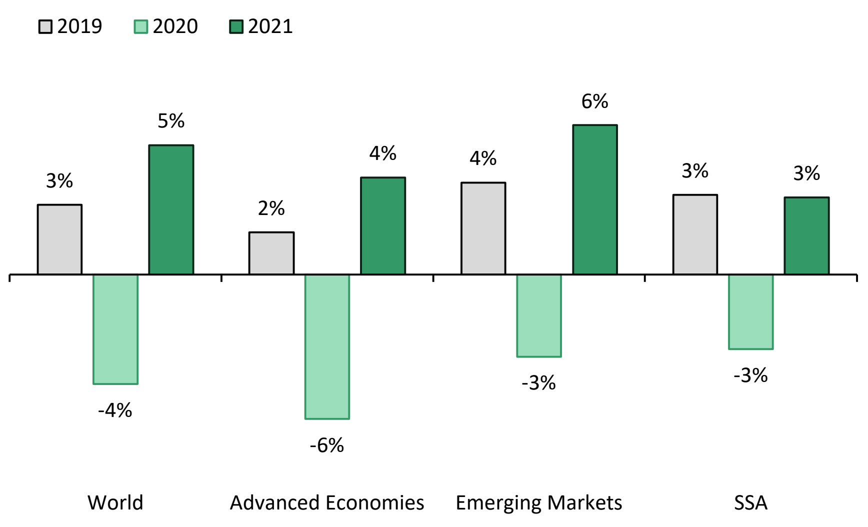
In a best-case scenario which assumes 100% vaccine production capacity utilization in 2021 and neither production nor distribution losses, the global herd immunity benchmark of 70% will not be attained until mid or late 2022. Given the low likelihood of this scenario, a much more realistic timeframe to attaining the herd immunity benchmark, in our opinion, is sometime around mid-2023

Navigating the Path Towards Recovery

Global economy to rebound but the future will be different

According to its October 2020 World Economic Outlook, the IMF sees slightly better prospects for the global economy in 2020, with its contraction forecasts lowered to 4.4% from 4.9% in June. Recovery projections for 2021 are relatively stable at 5.2% (compared to 5.4% in June), which is premised on slightly positive GDP results for Q2:2020 expected to be sustained till the end of the year, along with the persistence of social distancing measures and safety standards required to support the prolonged re-opening of the economy.

Chart 7: Economic Growth Projections



Source: IMF, Meristem Research

While we align with the IMF's position of a recovery in 2021, we highlight that the rising number of daily infections, particularly in countries suffering from the second wave of infections, along with the re-introduction of partial lockdowns in these countries, pose added risks to these forecasts. Already, Q4:2020 forecasts are less optimistic than initially expected for some of these regions.

News about the approval of more vaccines have generally spurred optimism, albeit we do not expect this to be an immediate panacea due to the significant time lag required to upscale production capacity to meet demand. In addition, it is unclear how much long-term protection is offered by the vaccines and whether the immunized population could still transmit the virus. These, alongside the discovery of a more infectious strain of the virus mean that government authorities will need to prioritize emphasis on public health safety over total economic recovery pending when vaccines become generally available.

We posit that some form of restrictions on economic activity will be maintained in 2021 to prevent further strain on the health care systems. Countries generally tend to enforce international travel controls, school closures, public event cancellations, gathering and movement restrictions (curfews) when daily infections begin to spiral out of control. **As a result, we can expect that international travel, tourism, hospitality, and other non-essential people intensive sectors will remain below pre-pandemic levels in 2021, which should keep global unemployment levels elevated in the near term. We also posit that behavioural changes enabled by technology and the adoption of the work from home culture will persist even after the pandemic, with long lasting changes to business travel, e-commerce, real estate, hospitality, and global oil demand.**

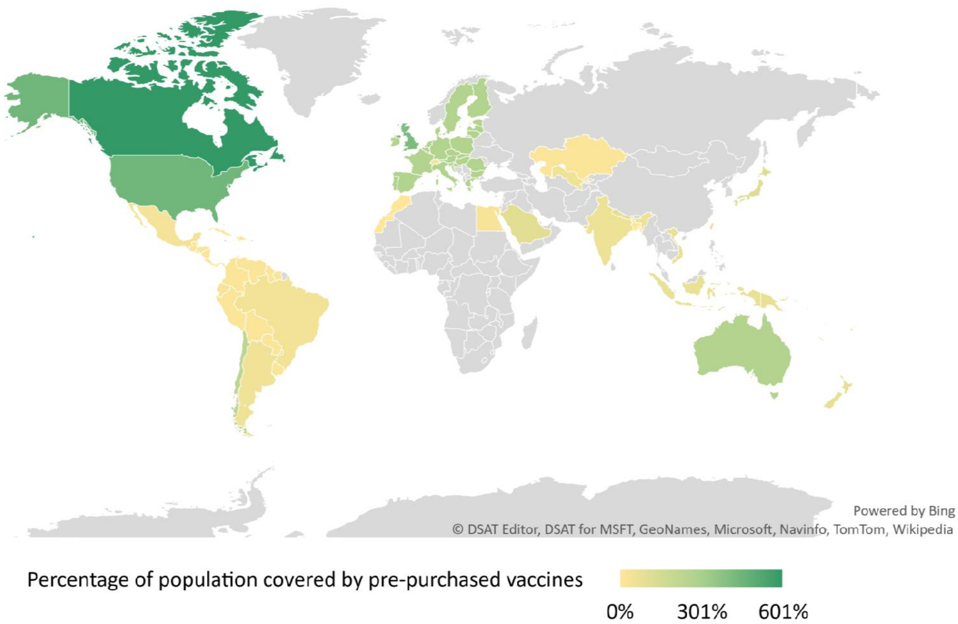
Vaccine Distribution will need to be equitable

Given that we do not expect general availability of vaccines till 2023, the near-term dynamics of economic recovery will be impacted by the ability of countries to secure vaccines to immunize at least 70% of their citizens. Countries who are able to secure enough doses for their population can expect to enjoy steeper economic recovery in the near-term while the reverse is the case for countries who are unable to. Data reveals that higher income nations like the U.S, U.K, E.U and Canada have already moved to secure vaccines capable of immunizing their citizens many times over, crowding out near term vaccine availability for many low and middle-income countries.

The Duke Global Health Institute reports that 8.6 billion doses of vaccines have been pre-purchased, with an additional 3.5 billion doses under negotiation or reserved as options on existing deals. Of these confirmed purchases, 4.12bn doses (60.59% of manufacturing capacity) have been reserved for a handful of high-income countries such as the U.S, U.K, E.U, Canada, Australia, South Korea and Japan, which collectively account for about 15% of global population. Thus, we can expect near-term economic recovery to be faster in these regions as vaccine rollouts become widespread, albeit at the detriment of lower income countries.

Emerging market/middle income economies have employed a host of strategies to secure vaccine stockpiles for themselves. Countries such as Russia and China, with vaccine development capabilities will be sure to secure enough vaccine doses from domestic developers as part of funding agreements. Elsewhere, countries like India and Brazil with large manufacturing infrastructure have already negotiated rights for vaccine doses needed to cover about 50% of their population, according to the Duke Global Health Institute. Others such as U.A.E and Peru, are using their position as the site of COVID-19 trials to secure stockpiles for their population.

Chart 8: Countries Covered by Vaccine Pre-Purchases



**Data correct as of December 31, 2020*

***Grey coloured countries have not disclosed information on vaccine pre-purchases. With the exception of China, India and Russia, they represent low and middle countries who have been unable to clinch pre-purchase agreements.*

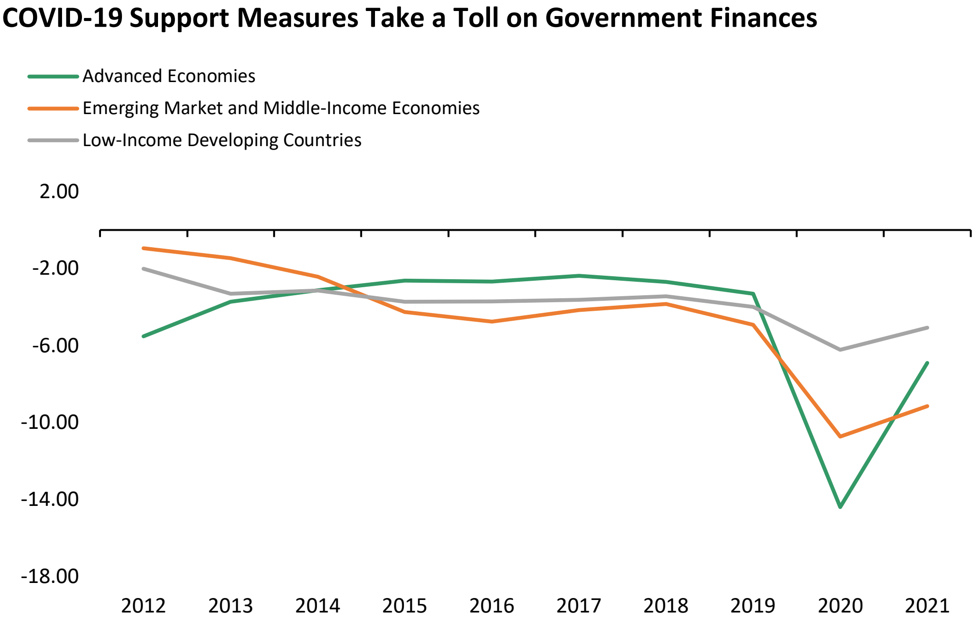
Source: Duke Global Health Innovation Centre, Paul Domjan, Meristem Research

As a result, many low-income countries without drug manufacturing capabilities or clinical testing capacity are largely unable to secure doses for their population in advance, pushing them further behind in the queue for vaccine doses. Invariably, this would mean that the full post-pandemic recovery of these countries would be prolonged, while the possibility of another spike in cases could overwhelm their weak health care systems. As shown in Chart 8 above, many countries in Africa fall within this group and would require added support from multilateral organizations such as the COVAX (a global initiative coordinated by Gavi, the Coalition for Epidemic Preparedness Innovations (CEPI) and the WHO) for equitable allocation. Unfortunately, the COVAX initiative was set-up to provide member countries with enough vaccine doses to cover 20% of their population, as such, more support would be required to cover the remaining 50% needed for these countries to achieve herd immunity.

Fiscal Policy Support Required to Weather the Storm

Timely fiscal policy responses delivered by government authorities across the world provided crucial lifelines for their respective economies, as the pandemic dealt significant blows to incomes and livelihoods. The IMF estimates the size of the global fiscal support since the pandemic at USD11.7trn (*c.*12% of global GDP), mainly in form of direct transfers, foregone revenue, tax reliefs and various forms of liquidity support for critically impacted sectors. Expectedly, this has come at a cost for public finances, resulting in wider fiscal deficits and higher public debt levels. Global government debt is set to reach a record high of *c.*100% of GDP in 2020, which has brought into the fore concerns about public debt sustainability given the impact of the pandemic on government revenue, particularly for developing countries.

Chart 9: Government Fiscal Balances (% of GDP)



Source: IMF, Meristem Research

However, much uncertainty still lies ahead the path towards global economic recovery as highlighted above, which necessitates additional fiscal policy support measures till the vaccines are widely available and economic activity begins to improve. This, according to the IMF, would help limit the number of people set to fall into extreme poverty to 80-90 million, as opposed to the 100-110 million that would fall into extreme poverty if policy support lifelines were withdrawn.

Thus, we see the current supportive fiscal policy measures by governments across the world to persist. We expect government authorities with ample fiscal policy headroom, particularly those in advanced Economies and large emerging markets, to continue deploying policy measures as required to support their economies. Debt affordability concerns in these economies should be mitigated by low interest rates, while the gradual return of business activities should boost tax incomes. However, other emerging and low-income economies with limited fiscal headroom and at risk of debt default would need to exercise a lot more prudence with managing public finances. Multilateral support, debt concessions and targeted economic reforms would also be required to help these economies navigate the terrain.

Advanced Economies

Monetary Stance to Remain Largely Dovish

Earlier in the year, inflation in most advanced economies (AEs) nosedived following lockdown measures which placed restrictions on travels and restaurants and as well saw energy prices plummet. A fallout of this has been the accommodative posture seen across central banks in a bid to reflate their respective economies. The US Fed responded to the shock in March by cutting policy rates by 150bps to near zero levels and deployed a quantitative easing program worth over USD2.3trn. Similarly, the Bank of England reduced interest rates to an historical low of 0.1% while also injecting over GBP700bn into the economy under its asset purchase program. The European Central Bank (ECB) with its EUR750bn Pandemic Emergency Purchase Programme (PEPP) was not different. The spate of asset purchase programs and monetary easing, as we highlighted in our H2:2020 outlook, elevated global liquidity and stretched balance sheets of monetary authorities.

Chart 10: Inflation Rate Across AEs

Inflation Rate Below 2% Target Range in AEs

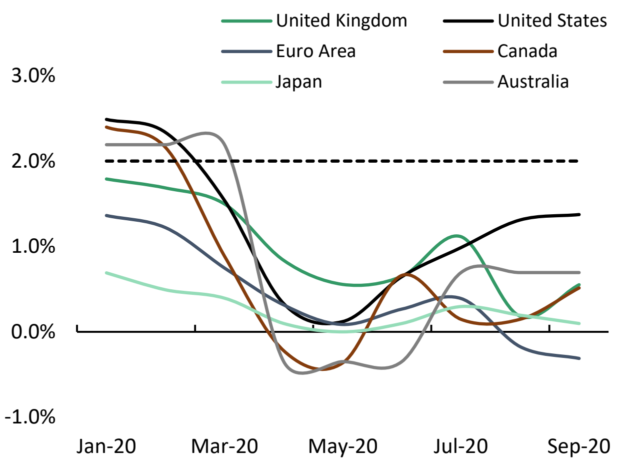
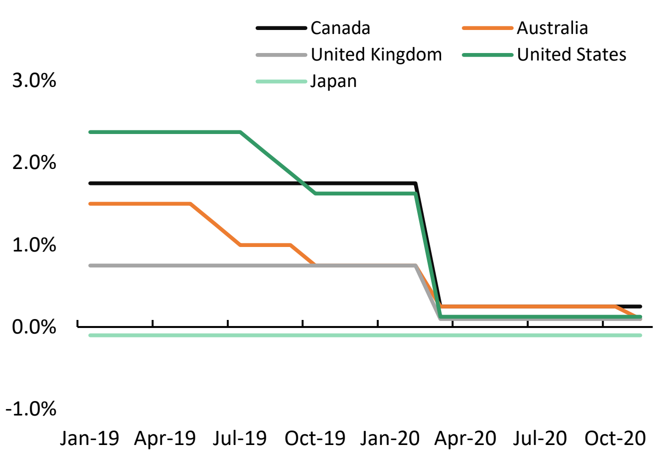


Chart 11: Monetary Policy Rate in AEs

Policy Rate Expected to Remain at Zero Levels

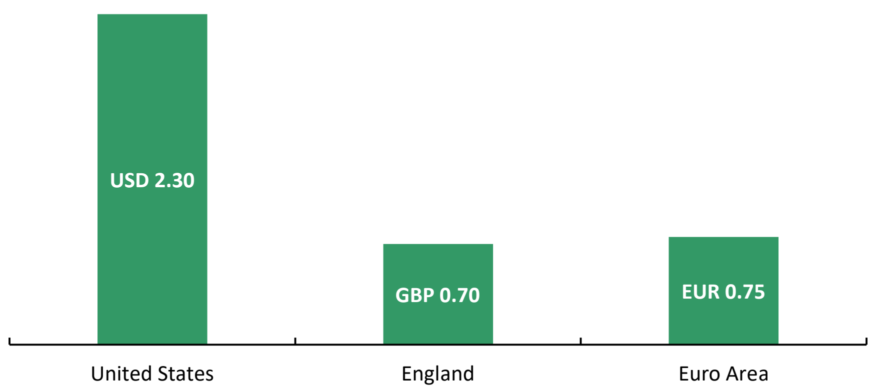


Source: BIS, Meristem Research

Nonetheless, inflation across developed markets remain largely below the 2% target as economic activity still looks to recover from the pandemic shock (see Chart 10). The IMF forecasts developed economies to contract by 5.80% in 2020, only to rebound by 3.9% in 2021. However, while a vaccine-induced recovery and higher energy prices could spur some inflationary pressure in the coming months, Bloomberg consensus forecasts expect the dovish stance of monetary authorities in the US to be maintained up to the second quarter of 2021 where there could be a possible hike. In our opinion, we think the stance could be maintained for longer given the extent of disruption in economic activities. The US Open Market Desk's Survey of Primary Dealers and Survey of Market Participants show that the market expects an increase in the federal funds rate to come in only around 2024 given the anticipated timeline for the fed's objective on employment and price-stability to materialize.

Recently, the Federal Reserve Board extended its lending facilities which were set to expire in December to March 2021. This gives us the sense that the monetary authority will aim for policy harmony and thus keep the federal funds rate at current levels. However, possible factors to trigger a "premature" hike include; spike in energy prices, fast recovery in the labour market, earlier than anticipated circulation of a COVID-19 vaccine and a fat stimulus package by the US Senate. The same scenario plays out in the European union where the ECB has provided guidance on keeping the interest rate on the main refinancing operations, the marginal lending facility and the deposit facility unchanged at 0.00 per cent, 0.25 per cent and -0.50 per cent respectively, while also expanding the pandemic emergency purchase programme (PEPP) by EUR500.00bn.

Chart 12: Asset Purchase Size in Selected Advanced Economies



* Euro area and England figures plotted in Dollar equivalent

Source: FED, ECB, BOE, Meristem Research

Generally, our expectation for monetary policy in developed economies in 2021 is largely dovish. In our view, we consider a sustained dovish stance to be desirable for a faster economic recovery in the hope that vaccination efforts gain traction.

United States

Charting a New Course

The 2020 US presidential election ushered in a change of guard at the White house as President-elect Joe Biden and his running mate Kamala Harris edged out the incumbent Donald Trump and Mike Pence. Having secured 306 electoral college votes, exceeding the 270 needed to win, Biden is set to be sworn in on January 20, 2021.

The emergence of Joe Biden is expected to be accompanied by major economic and foreign policy changes cutting across migration, trade, and taxes. However, more pressing is the direction the incumbent President would take in tackling the COVID-19 health crisis, reflating the economy and the future of the United States' Bi-lateral relationship with its partners (particularly China). Biden has hinted on re-establishing and expanding the Democrats healthcare plan (Obama Care) and in combating the health crisis, utilize the Defence Production Act to produce more personal protective equipment (PPE) for essential workers. Like Donald Trump's "America first" mantra, Biden fronts his "Buy American" plan where he proposes his administration will support American producers. Donald Trump's "America first" approach has led critics to describe his foreign policy stance as protectionist. Notable foreign policy changes during the Trump administration were revision of the North American Free Trade Agreement (NAFTA), leaving the Paris Agreement in 2017, reinstation of trade and travel restriction on Cuba and the US-China trade war.

In gauging the impact of Donald Trump policies, we note that average GDP growth between 2016 and 2019 at 2.30% slipped slightly when compared to 2.40% between 2012 and 2015. However, expectations are that a Biden presidency will restore the US trans-Atlantic alliance with Europe- a tie which many perceive as severed, improve relations with the North Atlantic Treaty Organization (NATO) and advocate for cleaner energy. On US-China trade relations, we do not expect significant changes under a Biden-led White-house. Overall, the IMF projects the United States economy to expand by 3.10% by 2021FY

United Kingdom

Till Brexit Do us Part

Four years after the referendum in which the U.K voted to leave the E.U, the almost 50-year long membership of the U.K in the European Union finally came to an end. Both parties narrowly escaped having to deal with the economic consequences of a hard-Brexit by agreeing to a last-minute deal which would govern trade relations going forward. This was pertinent considering that the E.U remains the U. K's largest trading partner, with the bloc accounting for 43% of its exports and 52% of imports. Failure to agree a trade deal would have been detrimental to both parties; a no-deal scenario was estimated to shave off about 1.5% - 2% of GDP in the long run, an untenable position worsened by the effect of the pandemic on their respective economies.

The final agreement addresses key contentious issues such as fishing rights, concerns about state aid and level playing field for businesses, the role of the European Court of Justice in dispute resolution, and most importantly, it offers zero tariffs and quotas for goods traded between both sides, despite the U.K losing access to the E.U's single market. While this ensures that manufacturers in both countries will continue to enjoy zero tariffs on their products, a host of regulatory non-tariff barriers such as the new customs rules, differing product standard requirements and additional border checks, is set to impede the free flow of trade between both parties and ultimately raise trade costs for businesses on both sides. In addition, the new arrangement introduces restrictions on the free movement of people between both regions, making recruitment much harder for both sides.

While the deal effectively puts to bed much of the uncertainty regarding the nature of trade with the E.U going forward, new concerns have emerged. The deal offers little clarity on terms of trade for services between both sides and could potentially spell trouble for the U. K's financial services sector, which accounts for about 80% of its GDP and *c.*40% of its exports to the E.U. As such, we expect negotiations around this to come to the fore in coming periods. Also, the U.K would need to renegotiate trade agreements with other crucial trade partners such as the U.S, China, and Canada, considering that it no longer enjoys the benefits provided by being a member of the E.U. These could prove difficult considering that such deals involve major trade-offs.

In sum, the U.K economy is widely projected to return to growth in 2021, estimated at 5.9% by the IMF. Nonetheless, this still puts the country well below pre-pandemic levels, with the threat posed by spiralling COVID-19 cases as lingering downside risks.

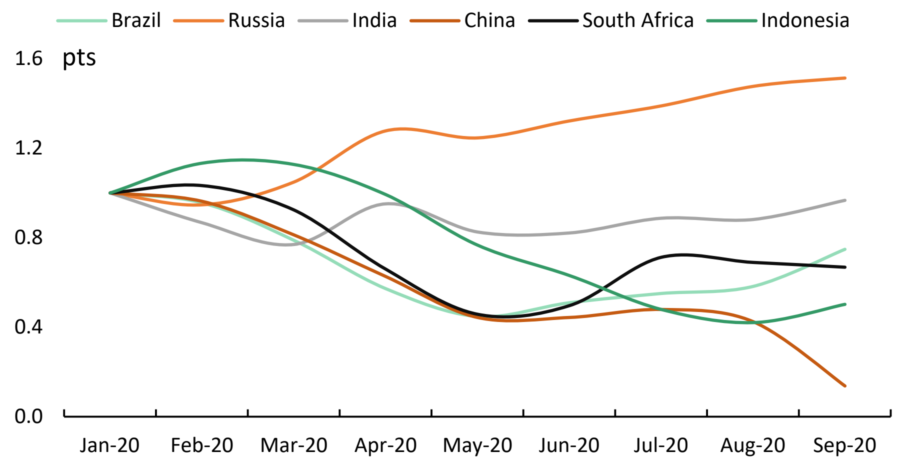
Emerging Markets

Monetary Authorities to Focus on Economic Recovery

2020 was an unusual year especially for Emerging Markets and Developed Economies (EMDEs), one in which Central banks had to maintain a dovish monetary stance despite depreciating currencies and a constricted fiscal space. Across EMDEs, yields on fixed income instruments toppled to historic lows while capital sought havens in more developed markets. However, a combination of extensive monetary easing in developed markets and a more structurally determined inflation gave monetary authorities the leeway to stick to the path of easing. Meanwhile, in most emerging economies (except China), inflation has increased steadily.

In China, a hike in rates could be in the offing as economic output looks to have beaten the Coronavirus and inflation trends a downward path. Looking ahead, while attraction of foreign capital makes a good case for tightening in emerging markets, we expect that monetary authorities would prioritize a rebound of the domestic economy and thus maintain its expansionary stance. In our view, a lot would depend on how swiftly economies rebound, along with recoveries in the commodities market.

Chart 13: Trend of Inflation in Selected Emerging Economies in 2020



*Rebased from January

Source: BIS, Meristem Research

We expect improvements in domestic demand, driven by improved private consumption and investments. However, barring inflow from external donors and development finance institutions, we consider the closing fiscal space in many EMDEs as downside risk to sustained fiscal intervention. This, in our opinion, could cap the growth potential in these countries. The IMF forecasts EMDEs to contract by -3.30% in 2020 but swing back by 6.0% in 2021.

Chart 14: BRICS Exchange rate Trend

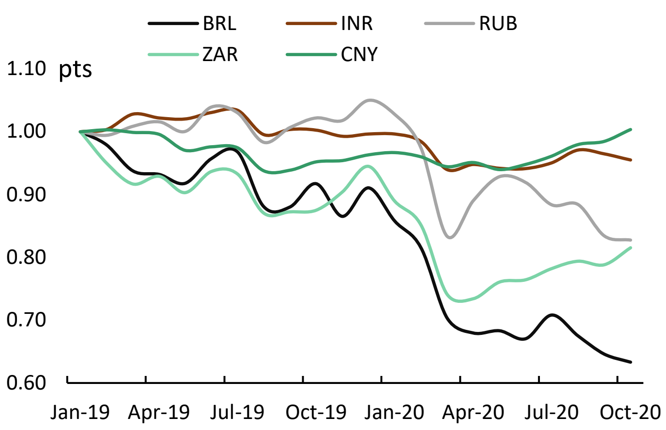
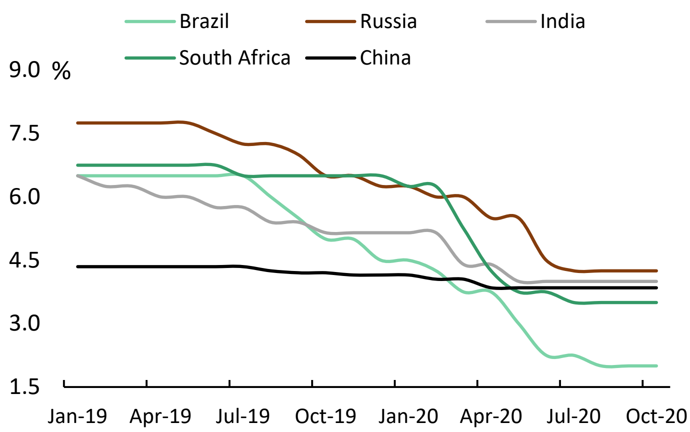


Chart 15: BRICS Monetary Policy Rate



*Rebased from January

*BRL- Brazilian Real, *INR- Indian Rupee, *RUB- Russian Ruble,

*ZAR- South African Rand, *CNY – Chinese Yuan

Source: BIS, Meristem Research

Sub-Saharan Africa

No Hike in Sight

For Sub-Saharan African (SSA) countries, the tale is largely the same with the rest of emerging markets; having to grapple with depreciating currencies, constrained fiscal space amid a strong need for fiscal support and concerns on debt sustainability. Also, in many SSA countries, inflation has been on the rise, led by increases in the price of food. However, reasons for the inflationary pressures are found to be specific to regions – from the desert locust invasion in East Africa to the effect of climate change and border closure in west Africa. Like most of the world, monetary authorities in SSA countries have toed the line of easing, prioritizing economic recovery from the pandemic.

The IMF forecasts the SSA region to grow by 3.10% in 2021 and to return to pre-crisis level in 2022. For us, we put the spotlight on tourism-reliant countries like Cape Verde, Comoros, The Gambia, Mauritius, São Tomé and Príncipe and Seychelles, who were heavily impacted by reduced tourist inflow due to travel restrictions. In our view, although the World Tourism Organization anticipates world tourism to begin its recovery process (premised on swift vaccination) in 2021, we expect the accommodative monetary stance to be maintained well into 2022.

For many SSA countries, the eased lockdown measures give room for optimism on economic performance in the coming quarters. Nonetheless, as many are commodity-reliant, improvement in world trade and recovery in commodity prices are key performance determinants. Our outlook on world trade and the commodities market is however positive. For countries like Nigeria and Angola, a lot would depend on international oil market conditions while in South Africa, a recovery of the external sector. In essence, we expect improved domestic demand fuelled largely by improved government expenditure and private consumption in the region

African Continental Free Trade Agreement (AfCFTA)

…. In Furtherance of an Economic Bloc

The African Continental Free Trade Agreement is a part of the African Union's grand plan of *Agenda 2063*, where the Union seeks to transform Africa into a global powerhouse by the year 2063. The AfCFTA agreement covers issues around Trade in Goods and Services, Investment, Intellectual Property Rights and Competition Policy to be governed by five operational instruments; Rules of Origin; the Online Negotiating Forum; the Monitoring and Elimination of non-tariff barriers; a digital payments system and the African Trade Observatory.

While trade in goods and services only constitute the first phase of the negotiation, the second phase comprises of Investment, Competition Policy, and Intellectual Property Rights. So far, 54 out of 55 countries have signed the AfCFTA, while 28 out of 54 countries have ratified the agreement (exceeding the 22 required for operationalization). Following the launch of the operational phase of the agreement in July 2019, the first phase of the agreement was scheduled to commence in July 2020, but subsequently moved to January 2021.

The AfCFTA is expected to deliver cost reduction for African producers and consumers conducting intra-African trade, as the agreement seeks to ease Tariff and Non-tariff barriers to trade, provided the rules of origin standards are upheld. Under the agreement establishing the AfCFTA, member countries are committed to phasing out 90% of tariffs within the next five to ten years. Also, expectations are that tariff reduction schedules by member countries and key rules of origin will be finalized by July 2021.

Given the commitment to expedite tariff roll back and eradication, we see positive prospects for local enterprises and manufacturers in the near term. In addition, the World bank notes that Non-tariff barriers, such as differences in product standards and regulations across countries, lead to high compliance costs and overall trade costs. We also expect improved external sector performance from member countries arising from increased intra-Africa trade volumes. In terms of impact on government finances, the World Bank expects that for most countries, tariff revenue would decline by less than 1.5%, as imports from African neighbours account for only a small percentage of tariff revenue.

Policy Coverage Under Different African Regional Arrangements

	EAC	COMESA	SADC	ECOWAS	AfCFTA
Tariffs on manufactured goods	✓	✓	✓	✓	✓
Tariffs on agricultural goods	✓	✓	✓	✓	✓
Export taxes	×	✓	✓	×	✓
Customs	✓	✓	✓	✓	✓
Competition policy	✓	✓	✓	×	✓
State aid	✓	✓	✓	×	×
Antidumping	×	✓	✓	✓	✓
Countervailing measures	×	✓	✓	×	✓
STEs	×	×	×	×	✓
TBTs	✓	✓	✓	×	✓
GATS	✓	✓	✓	✓	✓
SPS measures	✓	✓	✓	×	✓
Movement of capital	✓	✓	×	✓	✓
Public procurement	✓	×	×	×	×
IPRs	✓	×	×	×	✓
Investment	✓	✓	✓	×	✓
Environmental laws	✓	✓	×	✓	×
Labour market regulations	✓	✓	×	×	×

*Note: ✓= policy area covered; × = policy area not covered; **AfCFTA** = African Continental Free Trade Area; **EAC**= East African Community; **COMESA** = Common Market for East and South Africa; **SADC**=South African Development Community ; **ECOWAS** =Economic Community of West African States; **GATS** = General Agreement on Trade in Services; **IPRs** = intellectual property rights; **PTAs** = preferential trade agreements; **SPS** = sanitary and phytosanitary; **STEs** = state trading enterprises; **TBTs** = technical barriers to trade*

Source: The World Bank, Meristem Research

Commodities: Oil and Gas

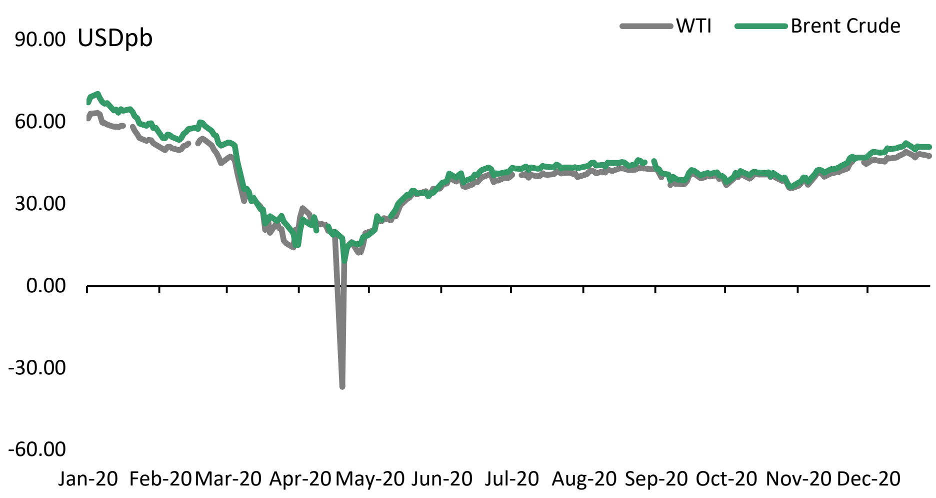
Demand Losses Bring Market to its Knees

It has been a tumultuous year in the global oil and gas industry. This came off the back of weaknesses in the market in the last half of 2019 where the OPEC+ alliance has been managing prices by controlling output. The outbreak of COVID-19 sent further fissures through the market, with demand for aviation fuels disappearing due to curbs in air travel while reduced economic activities across the world negatively impacted the demand for other fuel types. To put it in context, the demand for crude oil is estimated to have dropped by 8.8mbpd in 2020 with the drop in aviation fuel projected to account for c. 80% of the shortfall.

The decline in demand drove prices to historic lows, compounded by the price war between the two leading actors in the OPEC+ alliance, whose output cuts have helped to stabilise the market since January 2017. Saudi Arabia was pushing for a deepening of existing output cuts to 1.5mbpd, a measure that Russia rejected since the latter needed prices around USD51pb to balance its budget (as opposed to Saudi's much higher level of USD80pb).

With the oil price war, Saudi Arabia offered crude for as low as USD5pb in March and April as unsold cargoes *littered* the sea in the face of dwindled demand. It must however be said that the price war was not without its use, if anything, it helped to curb the boom of the US shale industry (a major adversary to the OPEC+). Until now, the OPEC+ alliance was making the output sacrifices while the U.S shale industry benefited from the price support.

Chart 16: Crude Oil Price Trend



Source: Bloomberg, Meristem Research

Shale Producers Take the Fall

The shale industry which has been bingeing on credit from Wall Street would struggle if prices dropped below its breakeven price range of USD48pb to USD68Ppb. With the price war, Brent crude dropped to about USD9pb about the same time that futures on WTI crude (US crude) turned negative to c.-USD37pb. It was therefore not too surprising that as of October 2020, there have been about 43 recorded cases of bankruptcies of exploration and production companies in the industry. Also, the number of E&P firms searching for oil in the Permian Basin has dropped massively as investors shy away from providing credit to the sector.

The extent of the struggle could not be better illustrated than with the intervention of President Trump in brokering an end to the price war as the shale industry was unravelling. His intervention inadvertently culminated in the agreement to cut an unprecedented 9.7MMbpd in May. This is to taper to 7.6MMbpd from June till the end of the year and 5.6MMbpd in 2021 to 2022.

Although demand losses (due to restrictions put in place to fight COVID-19) continue to pressure prices as the resulting supply glut strained the industry's storage capacity, the historic OPEC+ agreement, along with recovery in Chinese demand for crude, and the easing of lockdowns in many countries helped to prop prices above USD40pb.

The greatest reason for optimism in the market would however only show up in the fourth quarter with the announcement of effective vaccines against COVID-19.

Crude Oil Outlook

Asian Markets to Bolster Oil Demand

The outlook for the crude oil market is very much dependent on the effectiveness of the global fight against the Coronavirus disease and its consequent impact on demand recovery. Already, a second wave and new strains of the COVID-19 threaten the progress of ongoing vaccination efforts in major economies that already have access to the vaccines. New rounds of lockdowns have therefore been imposed in the U.K and are projected to last till February as infection rates spike. Nevertheless, there is broad optimism in the market with December 2021 contracts on Brent crude trading at USD53.3pb as at Dec 31.

Much of the improvements in demand is expected from Asian markets especially India and China where major segments of the economy have been re-opened. However, in most of Europe, we still expect pressured demand in the short term in the wake of the new strain of the Corona virus pending a widespread vaccination. However, taking a holistic view, we are optimistic on demand recovery in the road transportation and aviation sectors. Recall that in 2020, oil demand from the aviation sector declined by c.50% while road transportation lost c.4mbpd (compared to 2019) due to the lockdown measures.

In 2021, we expect a pick-up in demand from these sectors, however still below 2019 levels. The OPEC expects strong demand from the petrochemical sector (which accounts for c.12% of global oil demand) over the medium to long term. We align with this thought as the rekindling of global manufacturing would spur higher demand from petrol-based manufacturers. For 2021, the OPEC estimates a total world oil demand to rise to 97.7mbpd (vs. 90.7mbpd in 2020).

Oil Price Recovery Will Be Slow but Steady

In 2021, key downside risks to oil prices include unrelenting Libyan supply, possibilities of Iranian supply following the emergence of President-elect Joe Biden (It portends that the US could return to the Iran nuclear deal and previous sanctions lifted) and supply from persistently uncompliant member countries.

Overall, our outlook on the oil market is a slow and steady recovery process. While cuts implemented by OPEC and its allies have continued to gradually scale back oil inventory levels, inventory stockpile would require some time to return to adequate levels, as an estimate of 830MMb was accrued in 2020. **We expect the continued demand recovery in Asia, hopes for a more collaborative stance on global trade (due to the outcome of the U.S elections), and the attainment of a critical mass in the population of vaccinated persons to support prices. This is in view of the continued efforts of OPEC+ in stabilising the market. Given these expectations, we expect Brent crude to average about USD49pb to USD53pb in 2021.**

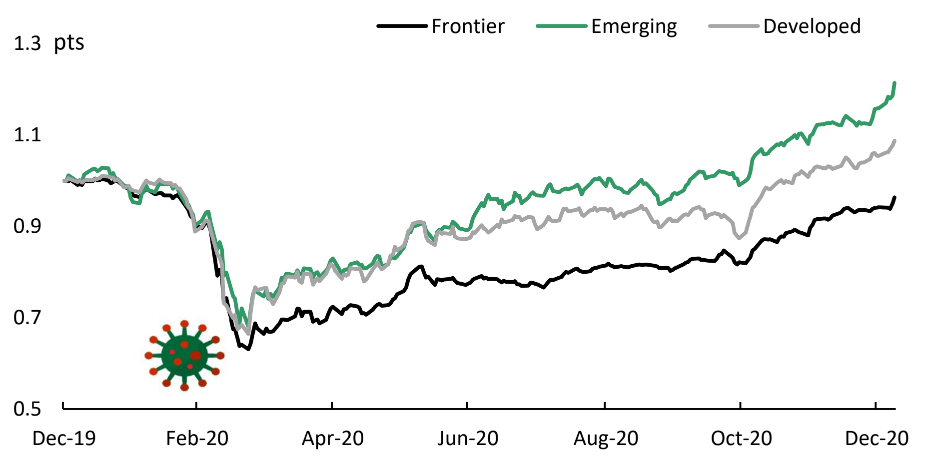
Global Equities

Markets Rally Despite Early Scare

The outbreak of the Coronavirus pandemic at the start of 2020 proved to be the single most relevant global headwind in 2020 – infecting everything from people to markets. In this section, we traced the impact of the virus and how investors' reaction shaped performance across key equity markets in the US, Europe and Asia.

The year started on a strong footing, manifested in the bull run that swept across markets in early January; the Emerging, Developed and Frontier Market Indices were up by +2.89%, +1.02% and +0.47% respectively. The excitement was, however, interrupted by the Coronavirus pandemic. Virtually, all equity indices suffered steep declines (see chart below) as heightened risk aversion and market volatility (the like of which has not been seen since the global financial crisis) surfaced. Investors instead rotated their funds from equities into safer assets – chiefly government bonds and commodities like gold. Thus, as at the end of Q1, equities and commodity prices (particularly oil) had tumbled.

Chart 17: MSCI Frontier, Emerging and Developed Market Indices



Source: Bloomberg, Meristem Research

Prospering in a Pandemic or Not

By December 2020 however, equity indices had recorded a broad-based recovery – some rising to pre-pandemic levels, and others to new highs. A number of factors have contributed to these positive outcomes across markets. Broadly, we classify them under accommodative responses by both monetary and fiscal authorities, optimism around finding a Coronavirus vaccine and investors betting on stocks expected to be resilient to the impact of the pandemic such as healthcare and technology stocks.

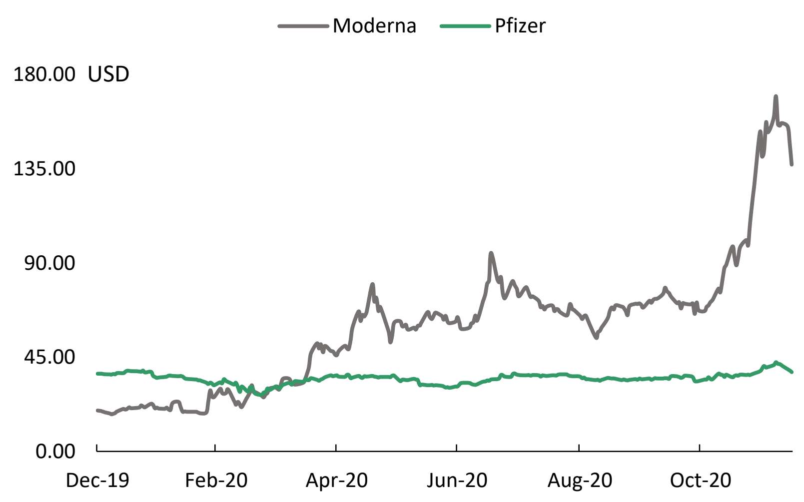
US Equities

In the US, the equity market has largely recouped its losses from the pandemic shock in March. This performance has been driven by an interplay of monetary and fiscal factors within the economy. These include the Fed's prompt response to douse the impact of the pandemic by keeping interest rates low (0 – 0.25%) and launching sizable asset purchase programmes (between mid-March and early December). In addition, the distribution of fiscal stimulus packages saw to increased interest in retail-related equities, and most notably an accelerated technology adoption that heralded a surge in technology stocks. At the end of 2020, the major NYSE indices posted positive performances- the S&P 500 (+16.26%), DJIA (+7.25%) and NASDAQ (+43.64%).

The global health pandemic presented opportunities for dozens of healthcare, big pharma and biotechnology companies. Even smaller companies involved in the manufacture of diagnostic test kits, hand sanitizers and face masks ramped up production to meet the unprecedented demand. Moderna, Pfizer and a number of other pharmaceutical and biotech companies have been very instrumental in the race towards vaccine development.

In November, after announcing phase 3 trial results, both reporting above 90% efficiency (*FDA requires a minimum of 50%*), their stock price rose sharply – gaining 126.38% and 13.98% respectively through the month. Moderna shines as the bright spot, up by c. 600.56% while Pfizer gained a marginal 1.94%.

Chart 18: Movement in Moderna and Pfizer Share Prices



Source: Bloomberg, Meristem Research

Technology giants on the other hand were buoyed by the increasing adoption of working from home by many organizations across the world, while retailers (*mainly consumer non-discretionary*) with online channels benefitted from a surge in demand. On the flipside, energy stocks were hit hard, with the addition of the oil price war in the first quarter weighing heavily on performance. Aviation, hospitality and industrial sectors were also stifled by widespread restrictions.

Despite the headwinds, over four hundred IPOs were recorded in 2020, the highest in about ten years. A notable rebound of IPO activities was seen in the second half of the year (including those of ZoomInfo, McAfee, DoorDash and Airbnb) after the Covid-induced slowdown in H1:2020.

Chart 19: Year to Date Return Across Key Markets

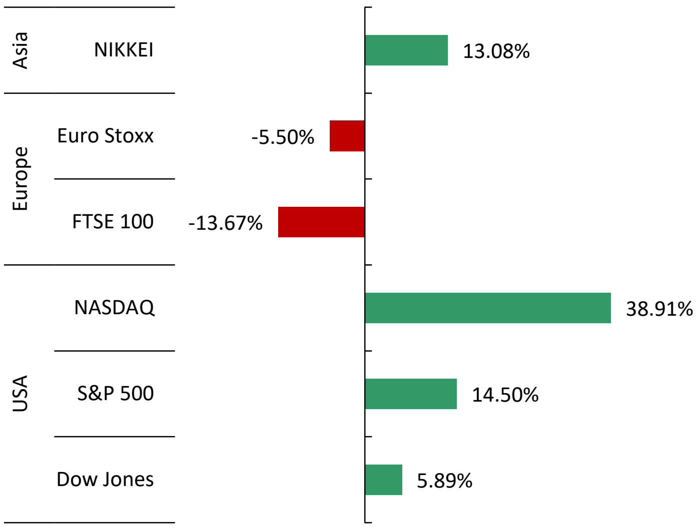
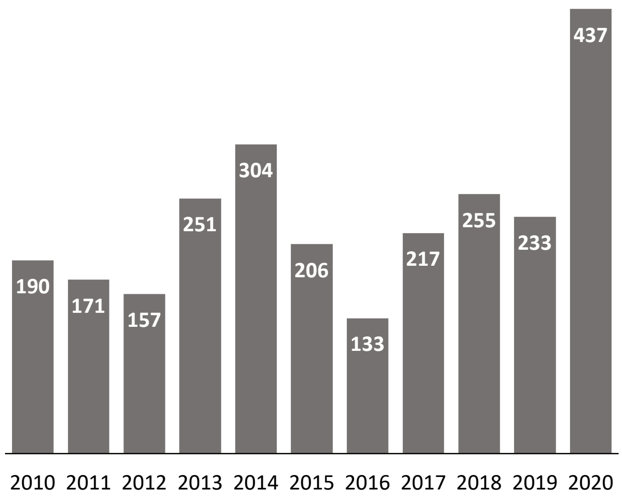


Chart 20: Number of IPOs (2010 – 2020YTD)



Source: Bloomberg, Meristem Research

The Eurozone and United Kingdom

Similar to other developed markets, Eurozone equities experienced a sharp dip in Q1 due to the impact of the virus. Some of the countries in the region (Spain and Italy) were the hardest hit, necessitating widespread restrictions to curb the spread of the virus. Although European stocks had clawed back some losses, the broad market index (STOXX600) was down 4.64% by year end.

UK equities lagged behind other regions – emerging as the worst performer in 2020 (down 14.34% as of 31st December 2020). For the UK, the risks have been heightened as investors remain wary of Brexit, the implications of a second wave of COVID-19 infections and ensuing lockdowns on the region.

Asia

In Asia, Japan's Nikkei 225 index closed up 16.01%- 27,444.20pts its highest point in three decades. Interestingly, the bulk of this growth occurred in November (+15.04%) as investors responded positively to the development of effective vaccines against the Coronavirus.

Chinese investors shrugged off escalating tensions with the US with the SZSE Index, China's major stock market index, closing in positive territory, up by 32.29%.

Domestic Economy

Tough Times for Domestic Output

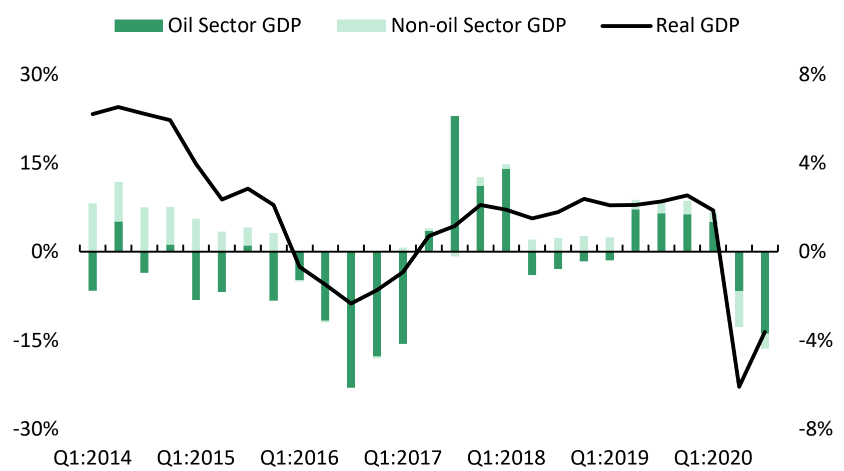
Nigeria's domestic output was on a painfully slow growth path before 2020 and at the start of the year, we had good reasons to believe that real output growth would remain sluggish at 2.47% YoY in 2020. Our expectation was hinged on a slower oil sector growth outlook, as well as a sluggish manufacturing and trade performance. We however reckoned that the closure of the border and the interventionist policies of the CBN would strengthen agricultural output.

By midyear, we revised our 2020 GDP projection downwards (to -3.03% YoY) to reflect the prevailing realities and heightened uncertainties caused by the pandemic. The pandemic was a random unforeseen factor in our earlier forecast and turned out to be the most significant headwind in 2020 – impacting the movement of people, goods, and capital. As already explained earlier, the pandemic brought the crude oil market to its knees and when combined with the pronouncement of nationwide lockdowns in April and May, the perfect storm was created for Nigeria to slump into its steepest quarterly GDP contraction since the 1980s.

Pandemic Sparks Second Recession in 4 Years

In Q2:2020, real GDP contracted by 6.10% YoY, as both the oil (-6.63% YoY) and non-oil (-6.05% YoY) sectors suffered significant declines. The oil sector suffered from a double whammy of weak global oil prices and lower oil production figures. Production volumes suffered due to the oil price war between Russia and Saudi Arabia, while the subsequent deepening of oil production cuts by OPEC placed a cap on the country's oil production volumes for the year. In the third quarter, daily oil volumes averaged 1.51Mbpd - the lowest levels since Q3:2016 when it produced 1.49MMbpd

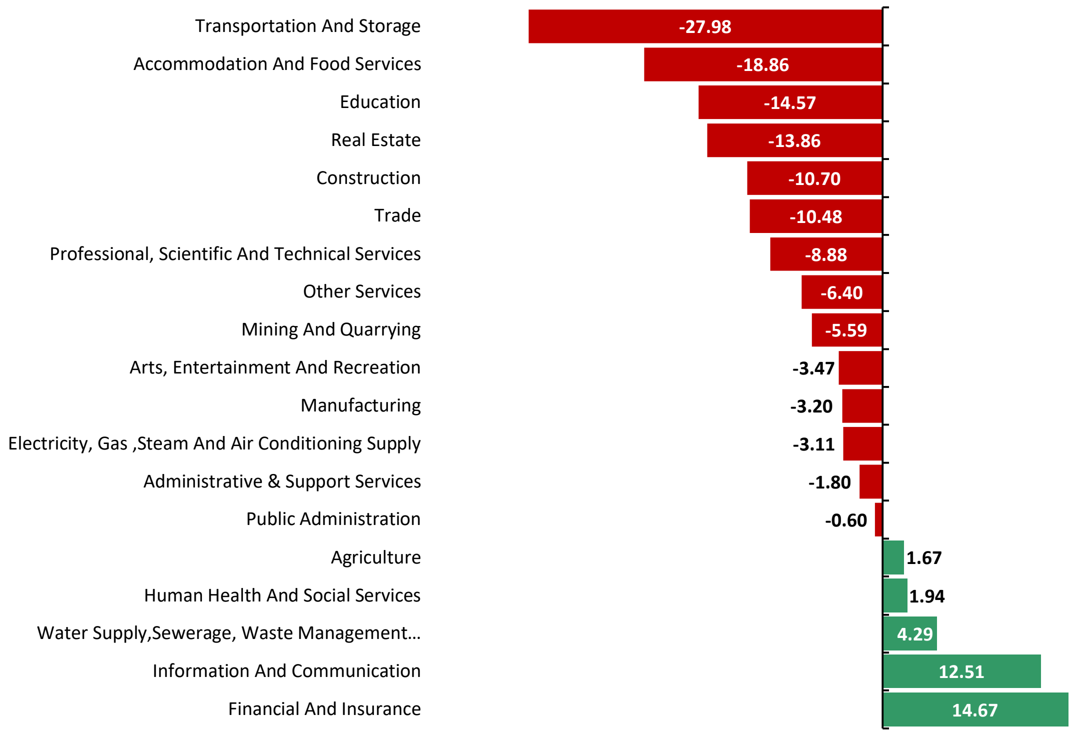
Chart 21: Real GDP Suffers Deepest Contraction in Decade



Source: CBN, Meristem Research

We ascribe the fallout suffered in the non-oil sector to the impact of the lockdown measures on the economic nerve centres of the country, as the authorities sought to curb the spread of the pandemic. This was particularly damaging on key non-oil sectors such as transportation and storage, construction, education, trade, real estate, and manufacturing. In contrast, the Financial and insurance, Information and Communications (ICT), and agriculture sectors were the only major sectors that recorded growth (See chart 16).

Chart 22: Cumulative Sectoral GDP Performance in 2020 (%)



Source: NBS, Meristem Research

PMI readings also reflected the impact of the pandemic on the domestic economy, as both the manufacturing and non-manufacturing PMI slumped to their lowest levels since the data became available, during the second quarter (see chart 19). Although lockdown measures were eased in the third quarter, the scarring was deep and the country officially slumped into its second recession in 5 years, as real GDP fell by 3.62% YoY at the end of the period.

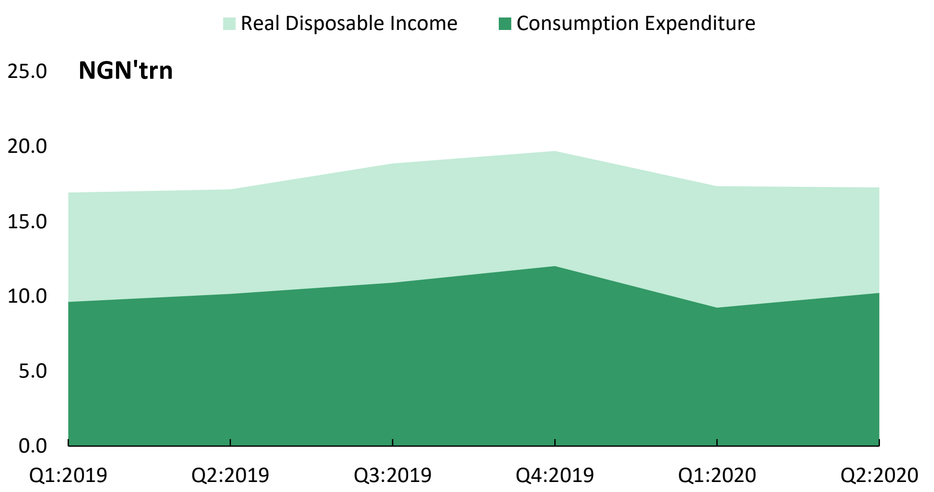
National Consumption Supported by Reliefs and Transfers

In 2020, real disposable income was constrained mainly by fast rising prices of commodities and unemployment. Official unemployment figures as at Q2:2020 revealed that despite population growth, the labour force declined by 2.79% from 82.59mn persons as at Q3:2018 to 80.29mn persons in Q2:2020, while the number of people classified as unemployed climbed by 82.49% over the same period. It goes without saying that the higher the level of unemployment in a country, the less its national disposable income.

The other factor responsible for lower real consumer disposable income is the rapid increase in prices of commodities driven chiefly by the border closure, exchange rate devaluation & FX illiquidity, liberalization of petrol prices and the upward review of electricity tariffs. We note that the COVID-19 pandemic had a significant impact on these variables in 2020. Unemployment in Q2:2020 was exaggerated by the pandemic while exchange rate devaluation became necessary following the decline in FX earnings due to the drop in crude oil price and output.

The decline in real consumption expenditure was however marginal (1.61% YoY as at H1:2020) as disposable income was boosted by Government transfers and other private sector relief packages such as the Coalition Against COVID-19 (CACOVID) which raised up to NGN25bn during the early stage of the pandemic in Nigeria. Nevertheless, **we are of the position that high unemployment and inflation will persist in 2021, and thus continue to constrain national disposable income, consumption spending and ultimately GDP growth. Upsides to this outlook stem from the reopening of the land borders which will encourage the influx of goods and services thereby minimizing inflationary pressure; sustained Government and private sector support to individuals; and improved FX earnings which would translate to exchange rate stability and lower pressure on price level.**

Chart 23: Strong Correlation Between Consumption and Real Disposable Income



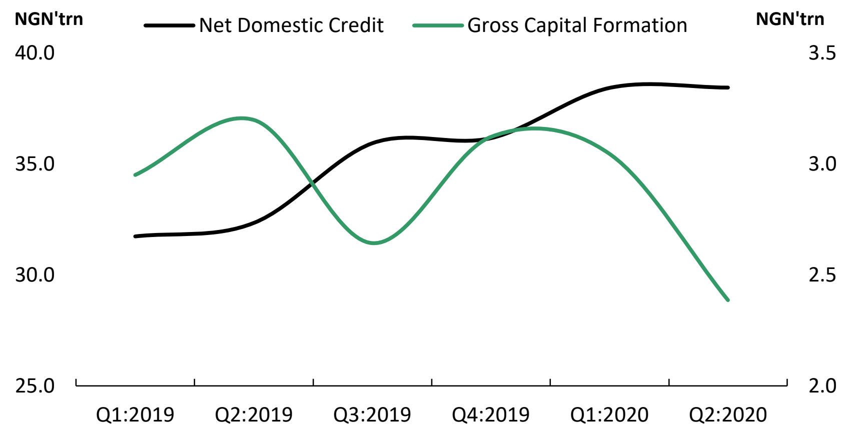
Source: NBS, Meristem Research

Investment Apathy Persists Despite Improved Credit Access

Investment spending is essentially gross capital formation, which refers to expenditure aimed at increasing the stock of real capital in the economy. In Nigeria, investment spending accounts for c.16% of real GDP. Theoretically, investment is a direct function of the real rate of return. However, the relationship is much more complex in reality.

The wide differential among interest rates in Nigeria especially with reference to the benchmark rate (Monetary Policy Rate) further complicates the relationship. Meanwhile, Nigeria’s low gross capital formation-to-GDP ratio is due to inhibitive factors such as exchange rate volatility, poor infrastructure, limited access to finance and insecurity. Although access to finance has improved in recent times, due to interventions by the CBN, the impact on investment spending however remains largely to be seen. While Net Domestic Credit has continued on an upward trend in 2020, the reverse has been the case for investment spending.

Chart 24: Net Domestic Credit Growth Fails to Reflect on Capital Formation



Source: NBS, Meristem Research

We acknowledge the role of the COVID-19 pandemic on declining investment spending in 2020 and hence we expect an improvement upon the resumption of economic activities. However, we do not expect a significant recovery over the short-to-medium term as the inhibitive factors earlier cited are expected to remain dominant.

Socio-Political Unrests Add Another Layer of Risk to Growth

While the outbreak and responses to combat the Coronavirus pandemic tested the resilience of Nigeria's economy, her security apparatus also came under considerable strain in 2020. Being a year with relatively few governorship elections, not many had anticipated the level of unrest witnessed almost throughout the year. In addition to the farmer-herder clashes that has plagued the country's agricultural belt, insurgency in the North-East and widespread reports of violence, kidnapping and banditry on major highways, Nigeria's security forces faced a new kind of challenge – an eruption of nationwide protests.

Consistent with widespread movements demanding justice across the world – including the #BLM movement in the US, the #EndSARS protests in Nigeria took off in October and quickly commanded international attention. The protests sought the ban of the Special Anti-Robbery Squad (SARS) – which many accused of abusing its power, extortion and extra-judicial killing. The protests which dragged on for more than two weeks across several States of the Federation before turning violent, prompted the Federal Government to scrap the rogue police unit and encourage States to set up panels of inquiry to properly administer justice to petitioners.

Notwithstanding, the protests also had an impact on economic activity. The imposed curfews, which were an offshoot from the protest was estimated to cost the economy c.USD1.8bn by the Lagos Chamber of Commerce and Industry (LCCI), while the Lagos State Government indicated that the vandalization of public infrastructure by hoodlums was set to cost NGN1trn.

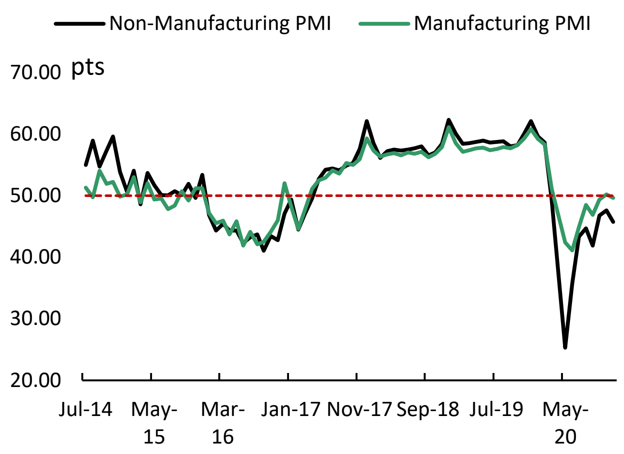
Growth to Return in 2021 but the Risks Loom Large

While we expect the economy to return to growth in 2021, the nature of the recovery remains very uncertain and the risks are quite large. We posit that the low-base effect from 2020, coupled with an absence of a loss of productivity triggered by lockdowns are strong positives for a swift return to growth in 2021. This is supported by removal of lockdown measures and the gradual return of business activity across the country from the fourth quarter of 2020.

Albeit we acknowledge that the impact of the protests early in the fourth quarter might dampen the expected level of economic growth in Q4:2020. In addition, the recent surge in domestic COVID-19 cases add another layer of uncertainty to the forecasts. which could threaten the full recovery of some of the worst-hit sectors.

Chart 25: CBN PMI Readings

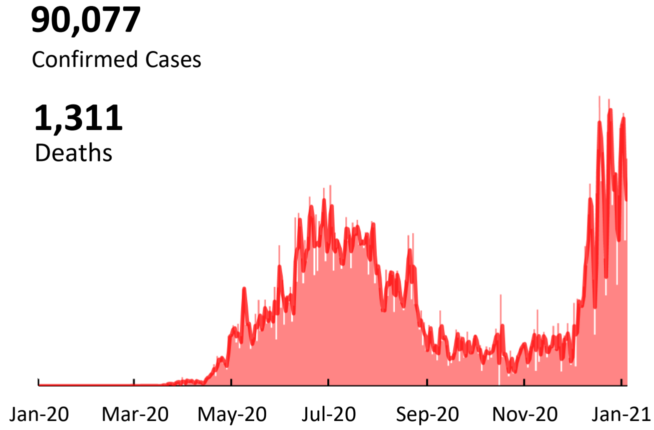
PMI Yet to Return to Recovery



**Figures above 50pts indicate expansion*

Chart 26: Daily New COVID-19 Cases in Nigeria

Second Wave of Infections are Brewing



**Data correct as of Jan 3, 2021*

Source: CBN, NCDC, ECDC, Meristem Research

Our position is also supported by recent PMI readings from the CBN which indicate that the economy is yet to fully shrug off the effects of the pandemic as well as the protests. On a sectoral basis, we expect to see real growth from the telecommunications and information services and agricultural sectors – although insecurity and logistical challenges could taper the performance of the agricultural sector. Modest recovery is also anticipated for the manufacturing and trade segments even though FX shortages and weak supply chains continue to adversely impact activities. We also expect to see growth return to the oil sector in 2021 as the gradual recovery in the global oil environment bodes well for oil prices and domestic oil volumes.

Based on our analysis therefore, we project a 2.95% decline in real GDP in 2020FY but a 2.33% growth in 2021FY. We expect Q4:2020 GDP results to be pressured by a higher base from last year, although under our base scenario, we expect to see improvements in the growth trajectory from Q1 through till Q2:2021. We have included a worst-case scenario in our analysis which considers a scenario where the second wave of COVID-19 significantly disrupts economic activities during the first quarter of the year. In that case, a recovery from recession could be delayed until Q3:2021.

Outlook for Key Sectors (c.70% of GDP)

Sector	% of GDP	Drivers	Drags	Outlook
Agriculture	25	Institutional support (pioneer status for small-to-medium sized agricultural firms, reduction of import duties on tractors from 35% to 5%, hire or lease of agricultural equipment exempted from VAT) and improved credit access by farmers	Worsening insecurity in major production zones, Low yielding crops, high cost of inputs (fertilizer, feed etc.), poor logistics and storage facilities, Climate change (flooding, irregular rainfall etc.)	Modest
Telecommunications and Information Services	11	High youthful population, increased access to the internet and digital devices, rapidly developing tech ecosystem	Services eligible for excise duties under the 2020 Finance Act.	Bullish
Manufacturing	9	Improved access to credit, Operationalization of AfCFTA	FX shortages, high cost of logistics and energy, infrastructure deficits, inflationary pressure.	Modest
Trade	15	Border reopening, Operationalization of AfCFTA	Limited re-opening of borders, weak consumer spending	Modest
Crude Petroleum and Natural Gas	9	Vaccination efforts to boost demand recovery, Modular refineries to support local refining capacity, Government focus on gas utilization, petroleum industry reforms through the Petroleum Industry Bill.	Weaker than expected global demand for crude oil due to COVID-19	Modest

Financial Services	3	Increased demand and access to credit facilities, new BOFIA 2020 Act to help minimize credit losses by banks.	Over-regulation of the banking sector	Modest
Total	**72**			

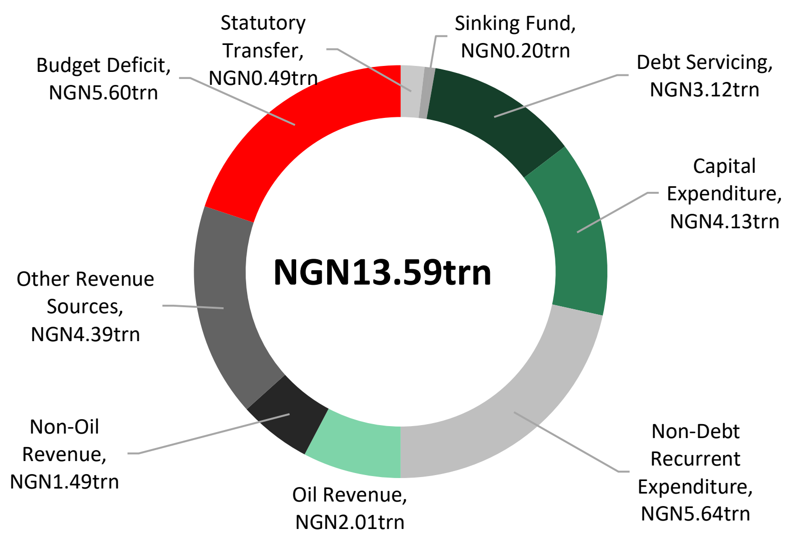
Fiscal Policy

The Budget of Recovery and Resilience

Nigeria's NGN13.59trn spending plan for 2021 was aptly named "The Budget of Recovery and Resilience" to reflect the ravaging effect that the Coronavirus pandemic had on the economy last year. While it was refreshing to see the President sign the budget into law on 31st December 2020, maintaining the January to December budgetary cycle, not much else about Nigeria's fiscal planning has changed.

Chart 27: **Breakdown of the Approved 2021 Budget (NGN'trn)**

The Spending Plan for 2021 is the highest on Record



Source: Budget Office, Meristem Research

The chart above features, quite understandably, a widening budget deficit (projected at NGN5.60trn – an estimated 3.88% of GDP, higher than is recommended by the Fiscal Responsibility Act, 2007); higher recurrent expenditure (representing 41.50% of the total budget), and rising debt service costs (projected at NGN3.12trn), closing in on the NGN4.13trn set aside for capital expenditure for the year. On the budget assumptions, we are quite comfortable with the expectation for oil prices to average USD40pb and daily crude oil production (including condensates) to come in at 1.86mbpd in 2021. However, we think that the assumptions of Exchange Rate at NGN379/USD; GDP growth of 3.00% and inflation rate at 11.95%, are rather optimistic ones.

In 2021, the FG expects to raise c. NGN7.99trn in revenues (split across oil revenue: 25.48%, non-oil revenue: 18.76% and others: 55.77%). We believe that the gains from the currency devaluation in 2020 along with the current oil market dynamics make the NGN2trn oil revenue target attainable. Nevertheless, for non-oil revenue (comprising CIT, VAT, PIT, Customs and Excise Duties), we are less optimistic given the current macroeconomic realities and the Federal Government's worrisome history of collection underperformance. According to the Budget Office, as at H1:2020, the Federal Government had failed to meet its projected targets for revenue and VAT by 44% and 40% respectively.

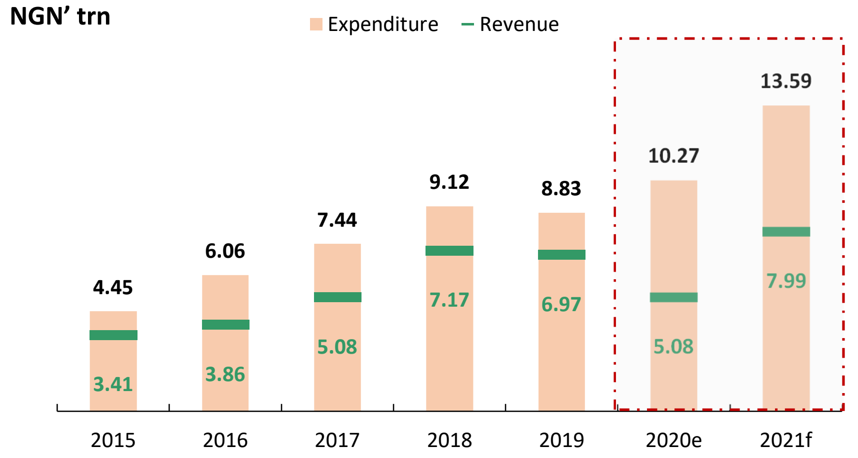
Interestingly, the updated Finance Bill 2020 includes some provisions that will see to reductions in taxes/import duties on tractors, buses, and certain exemptions to SMEs to cushion current socio-economic conditions. This, we expect, would further weigh on FG's revenues in the near-term. Notwithstanding, we generally view the ongoing fiscal reforms as positive steps in the right direction towards supporting the business environment and enhancing the tax collection framework. In addition, we note that ongoing reforms in the oil and power sectors (deregulation/subsidy removal and implementation of service-based tariffs) should help free up much needed cash.

An Unhealthy Dependence on Deficit Financing

As Chart 28 below shows, the budget's expenditure component has historically outstripped revenue, having more than doubled to NGN10.27trn between 2015 and 2020e. Revenue, in contrast, has only grown by 1.5x to NGN5.08trn over the same period. The country's unhealthy dependence on crude oil amidst poor revenue collection and rising cost of governance have continued to drag revenue and expenditure in opposite directions. As a consequence, the deficit has been plugged by borrowings from multilateral and domestic sources – which has seen the debt stock rise to NGN31.00trn (21.50% of GDP) along with debt service costs which gulped c. 99% of Government revenues in Q1:2020.

Chart 28: Trend in Fiscal Revenue and Expenditure between 2015-2021f

The Gap between Revenue and Expenditure continues to widen



Source: *Budget Office, Meristem Research*

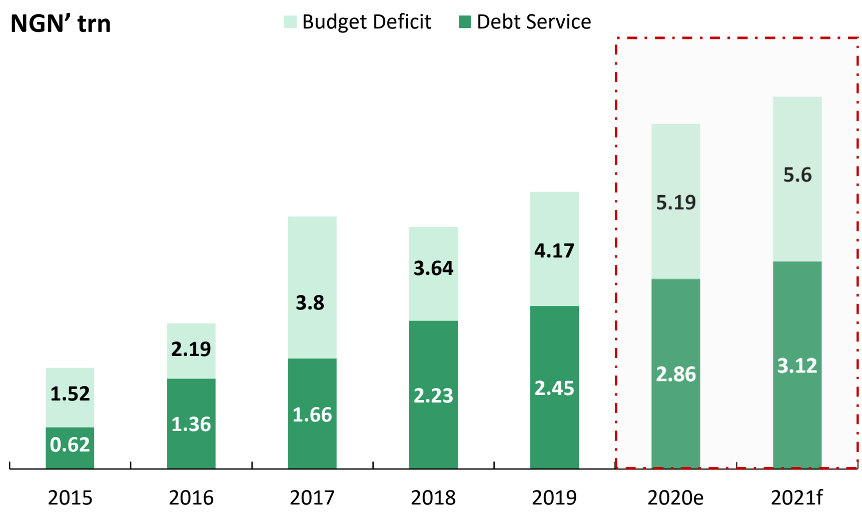
In 2021, the budget deficit is to be funded from even more debt financing (NGN4.69trn), sale of Government assets (NGN0.21trn), and multilateral/bilateral project-tied loans (NGN0.71trn)

For a country grappling with negative output growth (cumulative GDP for 2020: -2.48%), high unemployment levels, widespread poverty, and requiring significant investments in infrastructure, we are concerned with the capital expenditure plans. In addition, the well-known history of capital expenditure underperformance is quite worrisome, a trend which the Government can ill-afford to continue, given the current strain on its finances.

Also, in our opinion, raising recurrent expenditure in the face of revenue weaknesses also does not signify fiscal prudence. While we acknowledge that higher Government expenditure levels will ultimately be necessary in supporting the post-pandemic recovery, we advocate for fiscal reforms to reduce the cost of governance and free up resources for more productive projects in the economy.

Chart 29: Budget Deficit and Debt Service between 2015-2021f

Budget Deficit and Debt Service Costs Have Trod a Similar Trajectory



Source: Budget Office, Meristem Research

Debt Sustainability Analysis

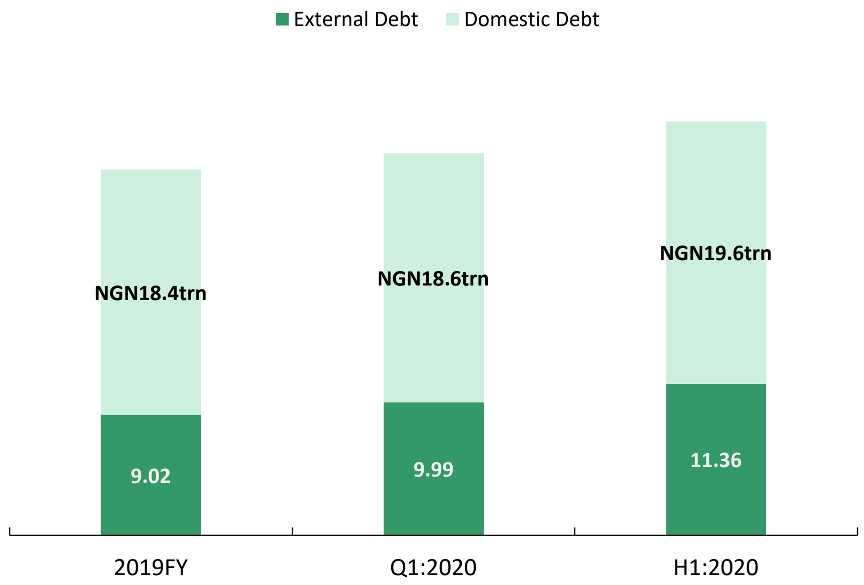
Public Debt Levels on the Rise

As described in the Fiscal Policy section, the pandemic caused a widening of global fiscal deficits and is expected to trigger an increase in public debt levels. Unsurprisingly, Nigeria has not been immune from the trend. The country has received a total of USD3.80bn (being the change in external debt between 2019FY and H1:2020) in aid in 2020 alone, to cope with the effects of the pandemic. Funding sources have varied; from the IMF, to the World Bank, AfDB, among others. Data made available by the Debt Management office (DMO) reveals that Nigeria's total debt stock had risen to NGN31.01trn (representing c. 22% of GDP), from NGN28.63trn in the prior quarter, and from NGN27.40trn as at year end 2019.

The growth in external debt, relative to 2019FY (+25.94%), has outpaced domestic debt (+6.89%) and now accounts for 36.65% of the total debt stock as at H1:2020. Although no insight has been provided on the FG's plan to source its borrowing needs, the situation in the domestic fixed income space (where yields have been depressed for a while) may prove favourable to the Government.

Chart 30: Movement in External and Domestic Debt

External and Domestic Debt Reach New Highs



Source: DMO, Meristem Research

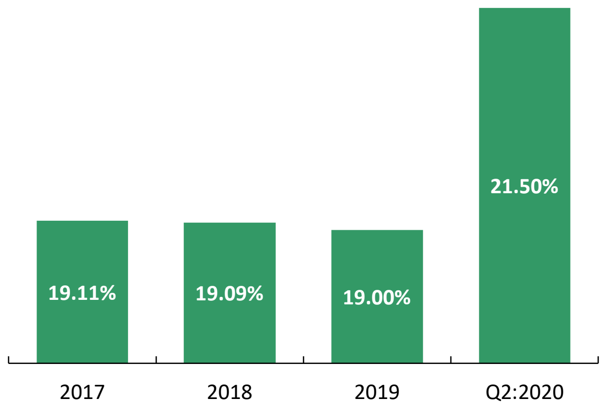
Soaring Debt Service Costs Remain Cause for Concern

Nigeria plans to spend NGN3.12trn (39.05% of the FG's revenue target) on debt servicing in 2021. Although debt service to GDP remains in a relatively comfortable band (H1:2020: 21.50%, 2019: 19.00%, 2018: 19.09%) - within the 25% upper limit provision of the Fiscal Responsibility Act, and below the World Bank - IMF recommended threshold of 56% for her peer countries, Nigeria's debt service to revenue ratio has risen sharply – reaching 99% in Q1:2020 and 94.94% as at H1:2020. This means that for every NGN100 earned in revenue, NGN95 was spent servicing her debts – a trend that is likely to persist as Government revenue remains under pressure.

According to Nigeria's Minister of Finance, the country's total debt stock is expected to rise to NGN38.68trn by year end 2021, as the FG plans to borrow an additional NGN6.17trn next year to fund the proposed budget deficit.

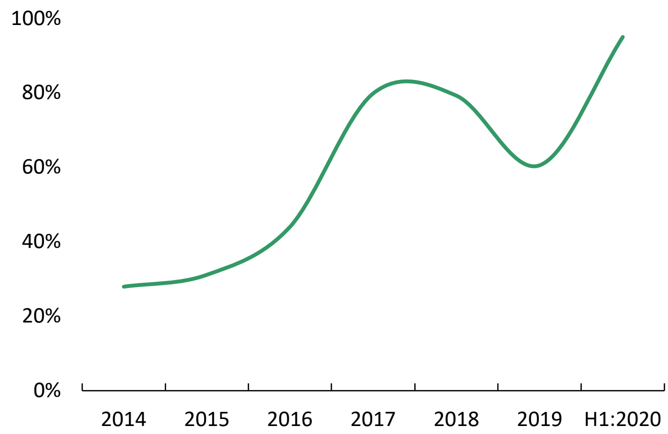
We expect that these loans would add further pressure to the country's already mounting debt service costs. We however advocate that the Federal Government begins to explore revenue bonds and encourage widespread fiscal prudence to rein in the rising debt and associated costs.

Chart 31: **Historical Debt to GDP ratio**



Source: Budget Office, Meristem Research

Chart 32: **Historical Debt service to Revenue**



Source: DMO, Meristem Research

Inflation

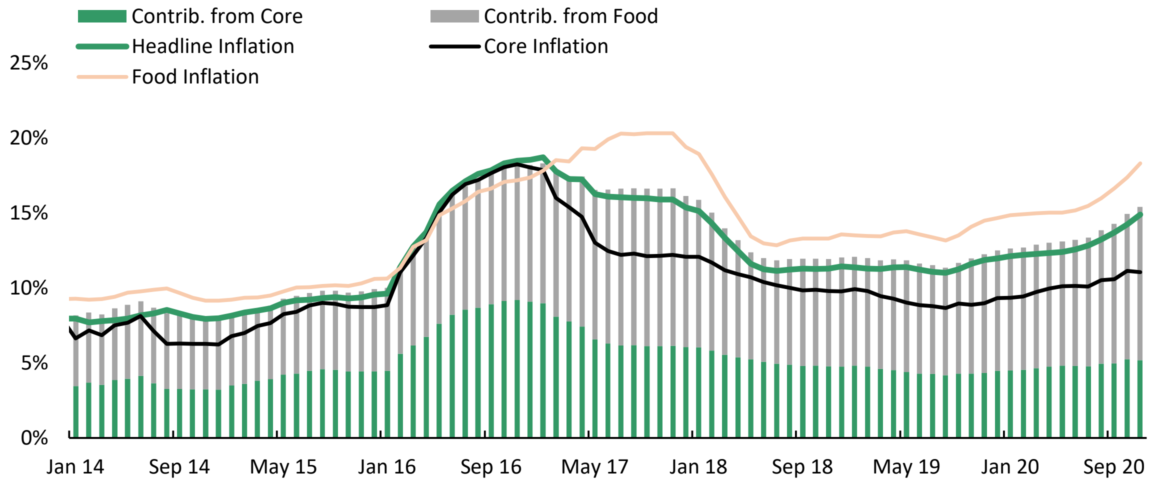
Mixed Bag of Structural Issues Sustain Uptrend in Inflation

Nigeria's inflation trajectory remained on the uptrend in 2020 with the composite index inching higher in all the eleven months for which data is available. Headline inflation thus rose by 2.75pts in 2020 to 14.89% as at November 2020, from 11.98% in 2019FY. The run makes it 15 months of consecutive uptick in the composite price index since the FG's decision to close all land borders last year. The combination of lingering structural challenges and demand side factors within the economy were the major sources of inflationary pressure, as the inflation rate averaged 12.98%, against 11.39% in 2019.

Food inflation continued to rise throughout the year as land borders remained shut, while insecurity in the North-East and other major food producing areas negatively impacted food production. In addition, the perennial inefficiency across the value chains of many agricultural produces further worsened the prices of food items in 2020. Factors such as low productivity, lack of storage facilities, high transport costs were among factors which kept the prices of many staples elevated. Imported food inflation has also increased by 0.54% since 2019FY (at 16.58% as at November) due to restrictions in global trade to combat the spread of COVID-19 and the weakening of the Naira. Hence, food inflation increased by 3.63%, from 14.67% as at 2019FY to 18.30% as at November 2020. Therefore, the contribution of food inflation to headline inflation averaged 67.33%, compared to a 2-year average of 64.2%.

Chart 33: Inflation Trend

Spiralling Food Inflation Underlines the Uptrend in Headline Inflation



Source: NBS, Meristem Research

The trend in core inflation was also skewed to the upside with the non-volatile components of inflation increasing by 1.72% to 11.05% in November 2020. **The hikes in VAT rates at the start of the year and momentary increase in electricity tariffs (before it was rolled back), and a *deregulated* downstream oil market were main drivers of the Core Index. Also, no thanks to the COVID-19 pandemic, the prices of items in the core sub-index like healthcare products and services trended upwards while the inevitable depreciation of the Naira due to the crash in crude oil prices and export earnings further drove price levels higher.** Finally, monetary and fiscal responses to the pandemic have resulted in significant levels of stimulus injections in the economy that has added to the inflation pressure pot.

Will CBN Stem the Tide in 2021?

Our inflation outlook remains tilted to the upside despite the FG announcing the reopening of the land borders. While this should understandably ease the pressure on food prices, the impact will not be immediate as import of most food items remain banned and the Government continues to curb the spate of smuggling activities through those borders.

Also, the issue of insecurity and flooding in major food producing regions along with other structural challenges within the economy will not disappear overnight. Hence, we expect inflation to continue its uptrend in 2021. Our view is reinforced by the body language of the MPC, which is currently in favour of supporting its pro-growth policies, rather than tightening to stem the tide of inflationary pressures within the economy. An increase in interest rate could potentially help with capital inflows and ease the imported component of headline inflation. Our inflation expectation is anchored on different scenarios which is summarised in the table below:

Our 2021 Inflation Expectation

 Base Case	• Land borders are open • FX shortages persists. • Agricultural harvest season is favourable • Monetary policy stance remains loose.	**15.16%**
 Bull Case	• Land borders are open • Monetary policy stance tightens • FX liquidity improves • Food supply shortfalls decrease	**14.97%**
 Bear Case	• Land borders are open • Food supply shortfalls deepen due to prevalent insecurity and flooding in food producing regions. • FX shortages persists • Monetary policy remains loose	**15.31%**

Monetary Policy

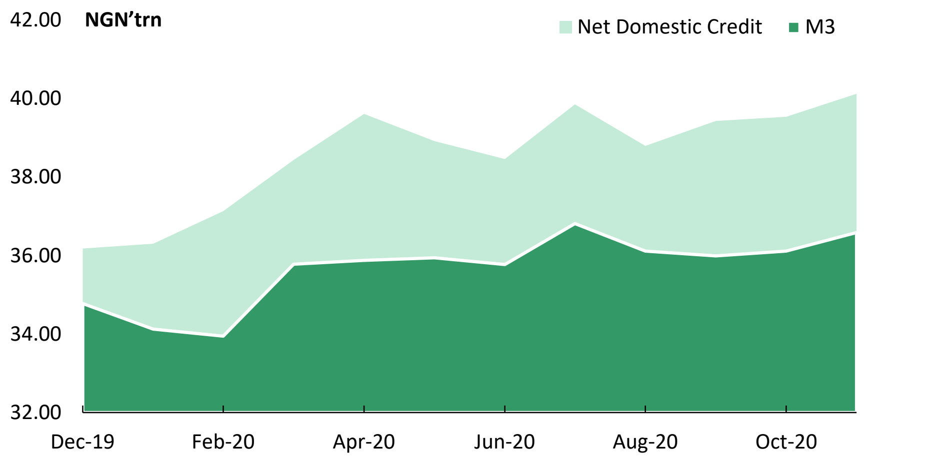
Time to Rethink Expansionary Stance?

Nigeria’s monetary policy in 2020 focused on stimulating economic growth via improved access to cheaper credit, as opposed to pursuing its primary objective of price stability. The Monetary Policy Committee (MPC) and CBN achieved this through reduction of the Monetary Policy Rate (MPR) from 13.50% as at January 2020 to 11.50% as at September 2020; maintenance of the 65% minimum Loans-to-Deposit ratio for Deposit Money Banks; reduction of savings rate to a minimum 10% from 30% of MPR; and several direct credit intervention programs to critical sectors of the economy.

The devastating impact of the pandemic provided extra impetus to the monetary authority to support the economy with low-cost intervention funds. Expectedly, domestic credit and money supply grew significantly during the year; Net domestic credit grew by 10.90% Ytd to NGN40.12trn while broad money supply (M3) grew by 5.21% Ytd to NGN36.59trn.

Chart 34: Net Domestic Credit and Money Supply (M3)

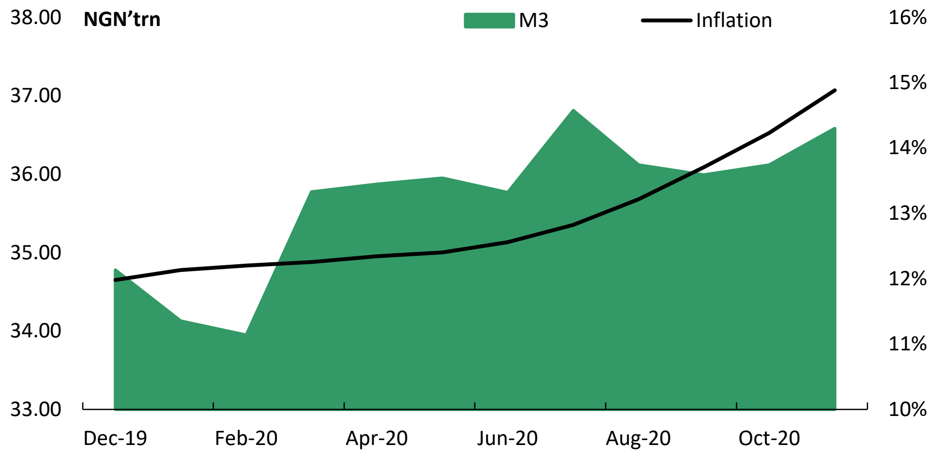
Credit and Money Supply Have Trended Upward Since December 2019



Source: CBN, Meristem Research

While the impact of growth in credit and money supply on domestic output is not yet apparent, the economy's price level has notably headed north. The MPC over the course of its meetings during the year acknowledged the growing threat of inflation but blamed it on structural rather than monetary factors. The MPC also admitted that monetary policy measures have become constrained in combating Nigeria's growing inflationary pressures. Although we agree with the MPC that the current inflation has a clear structural dimension to it, we are of the view that the rapid growth in money supply particularly within the context of subdued domestic output growth is also deserving of blame.

Chart 35: Strong Positive Correlation Between M3 and Inflation in 2020



Source: CBN, NBS, Meristem Research

Although we acknowledge that the positive correlation between money supply and headline inflation (as can be implied from the above chart) does not necessarily imply causation, economic theory suggests that for a given level of output, an increase in money supply will lead to an increase in price level in the short run. High inflation (regardless of its root cause) is detrimental to economic growth. CBN's empirical research pegs the detrimental inflationary threshold for Nigeria at 12%.

Therefore, with headline inflation at 14.89% in November 2020, we expect the CBN to reconsider its expansionary monetary policy stance in 2021 so that the goal of monetary expansion is not defeated. Our expectation is also guided by the fact that the stance of the fiscal authority regarding inflation is unclear; and the structural issues highlighted by the MPC as root causes of Nigeria's inflation cannot be addressed over the short term. Indeed, the options before the MPC in 2021 are limited and potentially conflicting. Given that a contractionary approach to monetary policy could stifle output growth, we expect the MPR (and other policy levers such as liquidity ratio and minimum LDR for banks) to remain stable in 2021 as further loosening could prove counterproductive to the goal of non-inflationary economic growth.

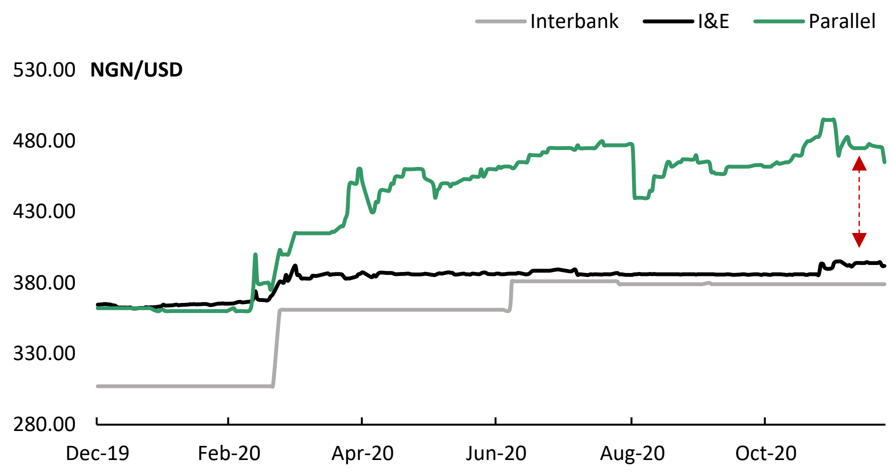
Balance of Payment and Exchange Rate

Dwindling External Finances Trigger Currency Devaluation

Not much has improved in the country's external finances since mid-year. By contrast, recent data have pointed to further weakening in its external sector position. The lingering effects of the pandemic on the global oil environment, along with a weaker current account balance during the second half of the year continued to pile pressure on the capacity of the CBN to defend the currency, leading to a further weakening of the naira across official and unofficial windows.

Chart 36: Exchange rate in 2020

Rates Between the Parallel and Official Windows Widen



Source: Bloomberg, FMDQ, AbokiFX, Meristem Research

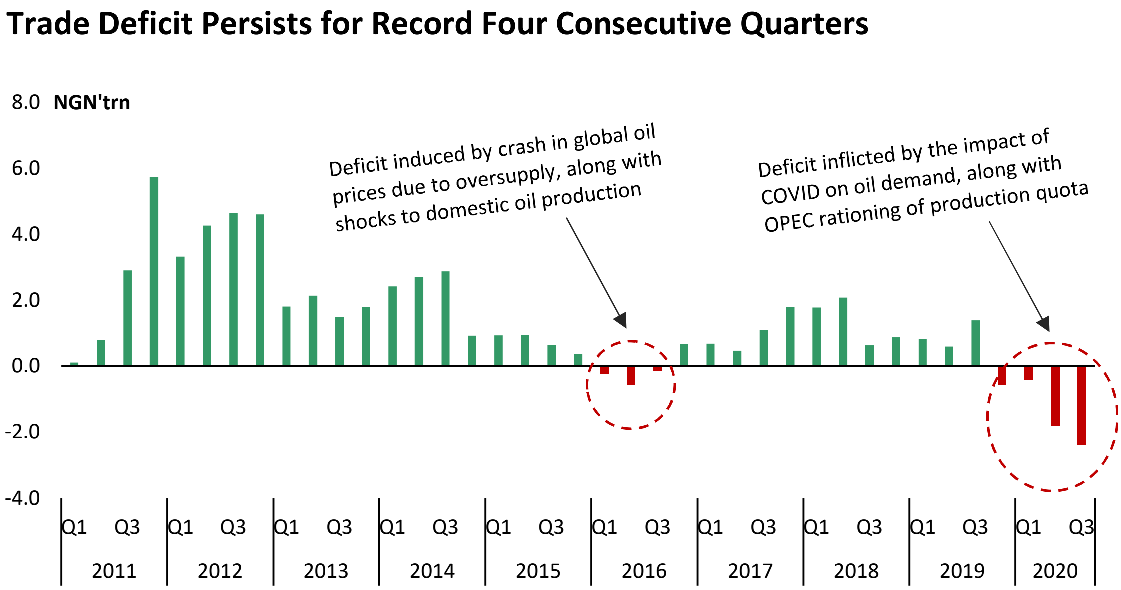
These culminated in an additional currency devaluation at the I&E and Interbank windows in the second half, bringing total number of devaluations in both markets during the year to 2 apiece. Year to date, the currency has lost 7.22% at the I&E Window, 19.00% at the Interbank window and 22.98% at the parallel market.

Fragile Oil Markets and Weak Remittances Deal Blow to Current Account

The deterioration in the country's external sector position was already evident from the first quarter of the year. In our *H2:2020 Outlook*, we indicated that the key factors behind the 79.41% YoY increase in the current account deficit to USD4.88bn during the first quarter were chiefly the depressed oil price environment (leading to a sustained trade deficit) and weaker remittance inflows (both of which resulted from the effect of the pandemic).

By the end of Q3:2020, the country had recorded trade deficits in four consecutive quarters for the first time in over a decade, eclipsing the record set during the recession of 2016. The cumulative trade deficit of NGN4.61trn (or 4.19% of GDP) in the third quarter is already the steepest in the decade and highlights the magnitude of the shocks to the country's external finances. The cumulative value of exports slumped (-35.55% YoY) to NGN9.30trn, while imports have risen (+19.79% YoY) to NGN13.91trn.

Chart 37: Quarterly Trade Balances over the Past Decade



Source: NBS, Meristem Research

In similar fashion, the latest current receipt figures (a summation of exports, income, and remittances from the rest of the world) published by the NBS for Q2:2020 paint a similar story. There was a material decline in the country's Dollar receipts, by 59.83% QoQ and 62.67% YoY, fuelled by the drop in exports, as well as remittances (-26.21% QoQ and -20.67% YoY).

Capital Importation Slumps to 2016 Levels

Since the country's exit from recession in 2017, the high interest rate environment adopted by the CBN encouraged a strong influx of foreign capital into the economy, compensating for the weakness in external finances. This supported the relative stability in the exchange rate and steady accretion to the external reserves.

However, like we pointed out in our *Q2:2020 Capital Importation update*, the sudden capital outflows suffered at the onset of the pandemic, alongside the current low interest rate regime have contributed significantly to the significant shortage of capital inflows into the country. Although there was a slight QoQ improvement (+12.86%) in capital inflows in Q3:2020 to USD1.46bn, this still falls significantly below pre-COVID levels and is more akin to levels seen during the recession.

Chart 38: Quarterly Capital Importation

Capital Imports have returned to 2016 Levels

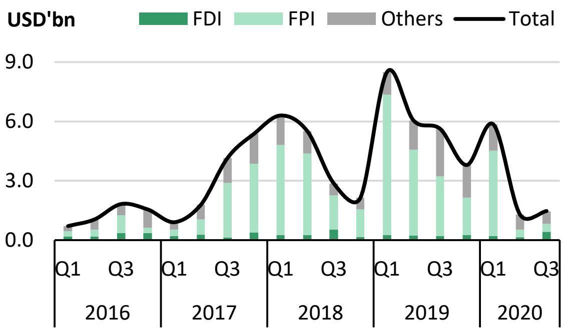
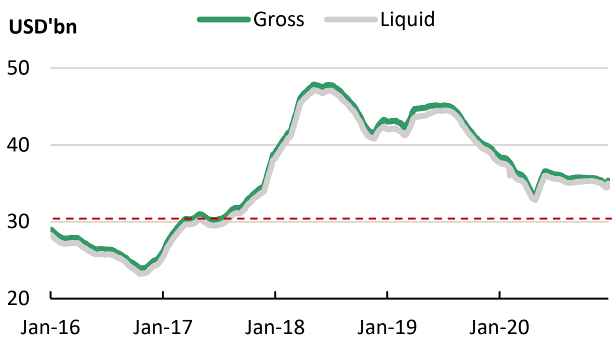


Chart 39: External Reserves

External Reserves are at Lowest Levels in 2 Years



Source: NBS, CBN, Meristem Research

2016 All Over Again but with a Twist

Due to these factors, the tightness in the CBN's foreign exchange policy comes off as no surprise, and some of its policy directives are reminiscent of the 2016 recession. A lack of liquidity in the official FX channels has been a recurrent theme since the occurrence of the pandemic as sources of dollar earnings have dried up, while importation and capital repatriation pressures have mounted.

Daily transaction volumes at the I&E FX window flatlined immediately the pressures began to build and are yet to recover to pre-pandemic levels. In addition, data reveals that the CBN has become the single largest supplier of Dollar liquidity to the window, with its USD7.59bn interventions in the market accounting for over 40% of dollar supply in 2020. This is more than 26 percentage points higher than its contribution in 2019.

Unfortunately, the CBN's interventions have been insufficient to meet the build-up of FX demand. Thus, it was no surprise that we saw the CBN finally yield on its stance towards devaluation of the currency, while further introducing series of FX demand management policies in order to prevent rapid deterioration of external reserves. Some of the policies include the restriction of Form 'M' processing for maize/corn, limitation of FX availability for milk importation to 6 companies, a downward review of international spending limit to USD100 per month, and stricter measures around the processing of Form 'M' applications for importers.

Chart 40: Turnover at I&E Window (5-day Moving Average)

Transactions Volumes yet to Rebound to Pre-COVID Levels

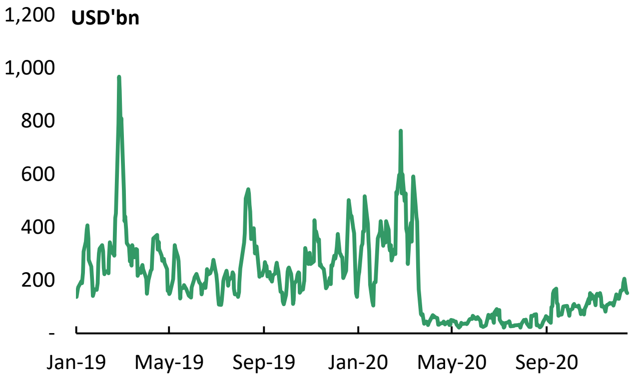
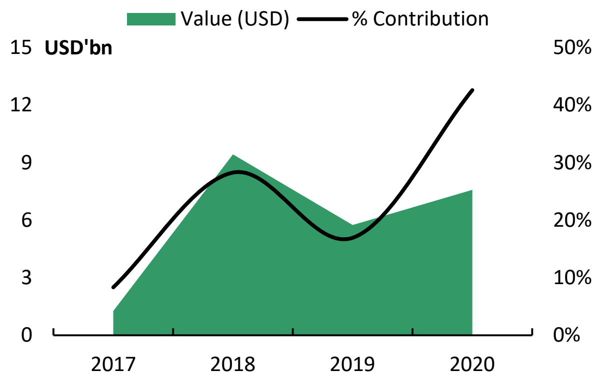


Chart 41: CBN Intervention at I&E Window

CBN Accounted for 42.64% of Dollar Inflows in 2020



Source: FMDQ, Meristem Research

Furthermore, at the peak of the lockdowns, the CBN ceased its weekly supply of Dollars to BDCs, due to the restrictions on international travel. Thus, the imposition of the FX restrictions, along with the shortage of FX supply to the parallel markets, triggered a widening of rates between the parallel market and official windows. At its peak, rates at the parallel market crossed the NGN500/USD mark, while premiums over the official rates widened to over NGN100/USD.

Will the New Remittance Policy Solve the FX Puzzle?

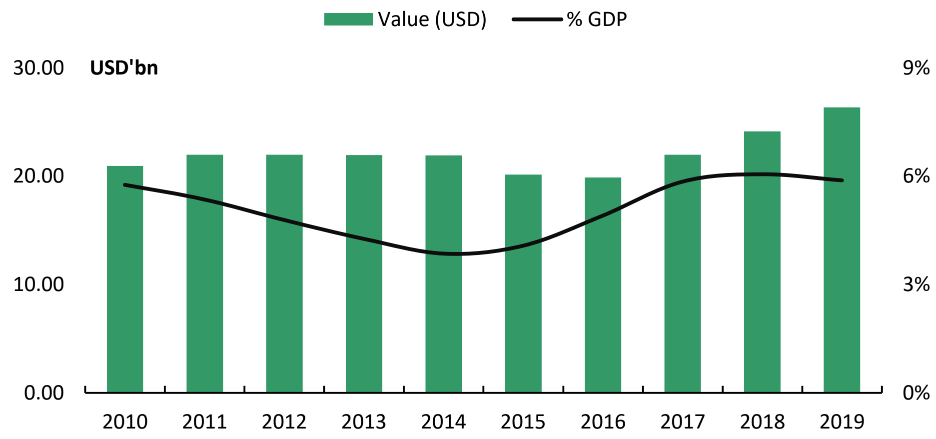
We generally view CBN's new remittance policy as a positive move towards addressing the FX liquidity crunch, particularly as it eliminates the impact of artificial scarcity created by middlemen. The new policy requires that beneficiaries of foreign remittances receive these inflows as foreign currency (US Dollars) through their designated banks either as cash or into a Domiciliary account. Historically, annual remittance inflows into the country averaged USD22bn (c.5% of GDP) over the past decade, however the benefits of these inflows have not been fully transmitted into the economy, particularly during prior episodes of FX scarcity. Thus, it is expected that this new model would ultimately ensure the direct supply of Dollars from remittances to commercial banks and the parallel markets, thereby providing a much-needed boost to dollar liquidity.

Our short-term prognosis is that the impact of this new policy will be inhibitive on the volume of remittance inflows due to operational constraints of cash handling, bearing in mind that most beneficiaries do not operate domiciliary bank accounts. Furthermore, the possibility of beneficiaries withholding cash dollar receipts rather than converting at the parallel market adds another layer of uncertainty to the effectiveness of this policy. **In sum, while we expect the effect of this policy to be**

positive, we do not expect this to completely address the FX liquidity challenge, considering our expectations for current account deficits in 2020 and 2021.

Chart 42: Annual Remittance Inflows (Net)

Remittance Inflows Have Remained Steady Over the Past Decade



Source: CBN, World Bank, Meristem Research

Current Account Prospects Slightly Better in 2021 but Deficit Will Remain

With the global economy largely expected to begin a march towards recovery in 2021 on account of current and expected vaccination efforts, oil demand is also expected to recover which bodes well for oil prices. However, the nature of the recovery and its implication for the domestic economy remains uncertain considering OPEC's need to keep the delicate balance in the crude oil market. While we expect oil prices to fall between USD49-53pb, we expect oil production to remain below pre-pandemic levels. In our view, at current production levels, the country would require oil prices of at least USD75pb to keep the current account balance in the positive zone.

Overall, we expect dollar inflows from oil to still remain considerably below pre-pandemic levels but higher than 2020 levels, which should provide support to the current account in 2021. By contrast, a growing import bill, rising services account deficit and weaker remittance inflows are expected to keep the current account entrenched in a deficit position in 2021. Thus, our forecast for a current account deficit in 2020 remains unchanged, at USD16bn, although we expect this to narrow to a deficit of USD10bn in 2021.

Where will Official Exchange rates Settle in 2021?

 **Base Case**	• Moderate recovery in global economy • Oil prices recover to USD49-53pb • Current account deficit moderates to USD10bn • Foreign capital repatriation pressures lessen	**NGN400-420/USD**
 **Bull Case**	• Global economy recovers faster than expected • Oil prices surge above USD70bp • Domestic oil volumes return to c.2.0mmbpd • Foreign capital inflows improve	**NGN360-390/USD**
 **Bear Case**	• Global economy recovery is slower than expected. • New shocks to oil prices emerge • Oil prices fall below USD30pd • Foreign capital repatriation pressures intensify	**NGN420-470/USD**

Will Foreign Capital Return in 2021?

We highlighted a number of policy options the CBN could adopt towards improving foreign capital inflows in our Q2:2020 Capital importation report, out of which only our currency devaluation expectation played out. Nonetheless, the volume of foreign capital inflows has not improved due to the current challenges with capital repatriation, along with the currently low yield environment. While this has been somewhat compensated for by financing support from multilateral agencies such as the World Bank (USD1.5bn) and IMF (USD3.4bn), we maintain that attracting foreign capital will be crucial to supporting the Balance of Payment in 2021, due to the non-recurrent nature of these support facilities.

At 8.14 months in September, the import cover provided by the external reserves is comfortably above the 3 months benchmark recommended by the IMF. Thus, this position supports the wait and see approach adopted by the CBN throughout 2020. Albeit considering the maturing USD500mn Eurobond obligation in early 2021 and other possible FPI outflows (Foreign Portfolio Investor holdings of domestic debt instruments were reported at USD29.97bn as of December 2020, making up 76.86% of external reserve holdings at the time), we posit that the external reserve position may come under additional pressure particularly if new shocks to the oil markets emerge in our bear case scenario.

Hiking interest rates at the OMO market might still be an option, considering that higher premiums will be required to attract new foreign capital given the heightened risks associated with the country. Nonetheless, given the prevailing low yield environment globally, we only see this playing out under our bear case scenario where new shocks to the oil markets emerge in 2021.

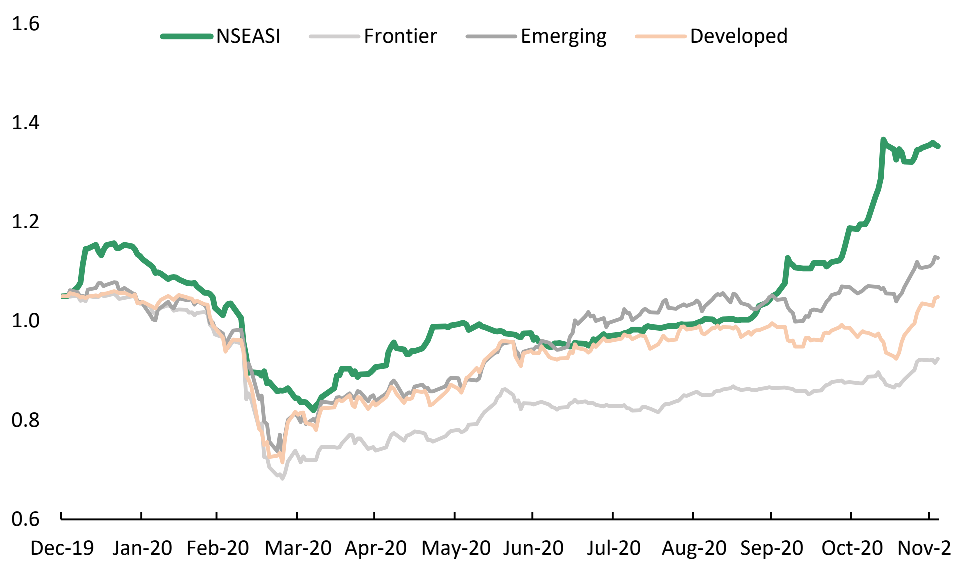
Domestic Equities

The Dominance of the Bulls

In our 2020 Annual Outlook ***Finding Alpha Amidst the Haze***, we had opined that the equities market would feed-off the hunt for dividends, excess liquidity in the financial system and depressed valuation of equities. Despite our optimism, we also highlighted that weak corporate earnings and low foreign participation constitute a downside risk to our outlook. Thus, we held a modest outlook of (10.27%) for the market in 2020FY. The events trailing our outlook pointed towards a bullish year, as the impact of excess financial system liquidity (*amid depressed fixed income yield*), better than expected corporate performance, prompted a sustained rally in the equities market.

After a negative performance in 2019, the year started on a grand note, as the bulls urged the broad market index to 29,710.56pts as at 20th of January 2020. The performance rode on the back of bargain hunting activities as investors sought to capitalize on the depressed valuation of equities from the previous year which made dividend yields very attractive. At a year-to-date return of 10.69%, the Nigerian bourse had outperformed its frontier (1.88%) and emerging (3.11%) market peers by the 20th of January 2020.

Chart 43: Equity Performance Across Markets

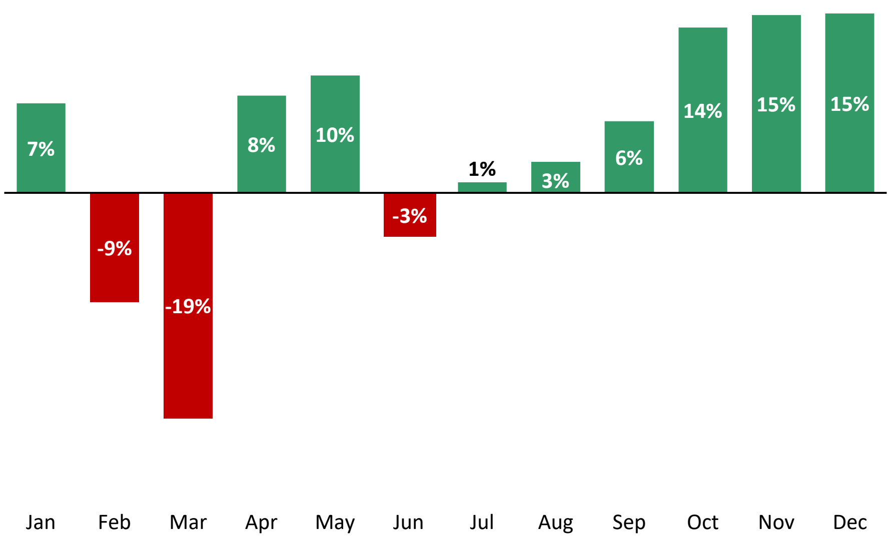


Source: Bloomberg, Meristem Research

The excitement was however short-lived by the twin shocks from the spread of the Coronavirus disease to Nigeria and the price war in the crude oil market (and its grim outlook for dollar liquidity). The resulting bearishness in the market drove prices down across many of the counters as investors exited for havens. By the end of the first quarter, the All-Share Index had lost 20.65%.

The market however took a turn for the better due to a couple of factors; firstly, CBN's FX rationing policy slowed down the tempo of capital repatriation by FPIs, which helped to stabilize market performance. Secondly, a rerouting of liquidity from maturing OMO instruments into the equities market. The sharp drop in yields in the face of rising inflation meant investors were forced to turn to equities for inflation beating return. Dividend yields on some counters offered yields above inflation, considering that entry prices were severely depressed. This led to an extended rally in the market which lasted for months, overturned the losses and settled the NSEASI at 40,270.72pts, an implied annual return of *50.03%*.

Chart 44: Monthly NSEASI Returns

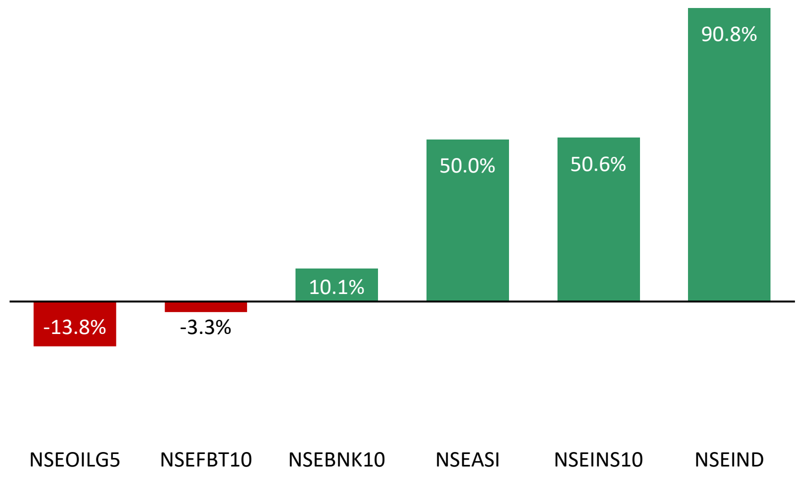


Source: NSEASI, Meristem Research

This Tide Did Not Lift All Boats

Measures of sectoral performance show divergent outcomes across the sectors which to a large extent demonstrates the market did not entirely ignore underlying macroeconomic and sectoral fundamentals. The **NSEOG5**, which tracks the performance of the oil and gas sector lost 13.84%. This reflected the decline in the price of **SEPLAT**, which accounts for more than half of the index's weight. The consumer goods index also failed to fully recover from the deep sell- offs at the height of the pandemic. In contrast, the Insurance, Banking, and Industrial goods sectors, championed the gains on the bourse, with year-end returns of 50.61%, 10.14% and 90.81% respectively.

Chart 45: Sectoral Performance in 2020



Source: Bloomberg, Meristem Research

Market Initiatives and Corporate Actions

NSE Going Public

The bid to demutualize the Nigerian Stock Exchange was taken further in 2020, eighteen years after management initiated the process. In March 2020, members of the NSE passed resolutions for the demutualization and it was sanctioned by the Federal High Court (FHC) on May 15, 2020. This development leaves the process's finalization to its impending approval by the Securities and Exchange Commission (SEC) and the re-registration with the Corporate Affairs Commission (CAC) as a public limited liability company. **This should improve corporate governance for the emerging entities.**

The Launch of the Growth Board

On November 30, the NSE moved four companies (*Chellarams Plc., Living Trust Mortgage Plc., McNichols Plc., and The Initiates Plc*.) from the alternative securities market (ASeM) to the Growth Board index. This effort is part of the Bourse's overarching goal to allow more robustness on the platform by giving more firms the room to raise capital through visibility and enhanced liquidity effectively. The growth board was launched on January 28, 2020, with the object of fostering capital raising activities and promoting liquidity on the float of high growth firms – Start-Ups, Small and Medium Enterprises, and the Fintech industry.

A number of corporate exits (voluntary and regulatory) were recorded on the bourse in 2020. Law Union and Rock Insurance Plc and Continental Reinsurance Plc were delisted from the Exchange to further their respective recapitalization objectives. At the same time, ANINO International Plc. had to leave on regulatory grounds. The delisting of CCNN birthed BUA Cement plc, a firm that currently sits among the top three most capitalized firms in the industry with a market capitalization of NGN1.80trn.

NASD-USI: More Modest Returns

The NASD Unlisted Security Index in H1:2020, followed a similar trajectory to the NSE, evinced by the January rally which took the USI to 705.42pts (YtD return: 1.12%) on January 23, 2020. The emergence of Coronavirus, however, took its toll on the market too, forcing a downturn in the USI as it dipped to a year low of 679.46pts low as of May 27, 2020, shedding 3.68% in the process. Since then, activities of the bulls have continued to outweigh the bears, driving the uptick in the USI to 737.77 index points, implying a year end return at 5.08%.

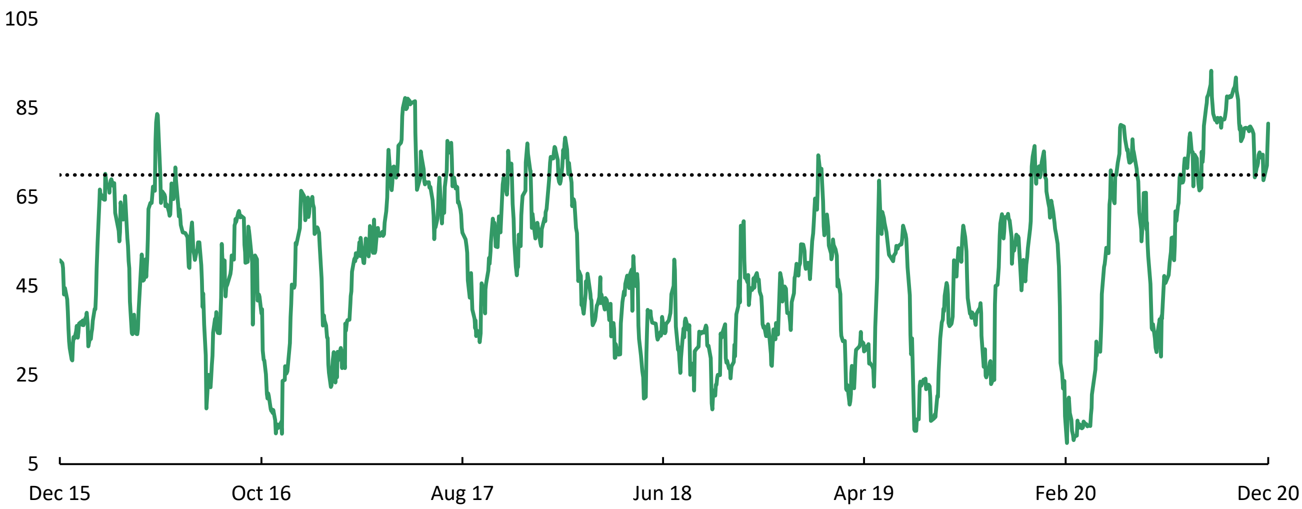
Outlook

Is the Peak Behind?

In the Nigerian equities market, there is a sense that the market is relatively overvalued to its historical. It is also instructive to note that technical indicators show that the market is overbought (see chart below); the All-Share Index is currently trading at about a PE ratio of 15x, 27% higher to its 5-year average of 11.88x and 54% premium to its 3-year average. This suggests a correction is in order. However, the market is still trading at a discount to its peers in Africa and emerging markets (48% discount to South Africa, 33% discount to frontier markets), which suggests the market remains cheaply priced relative to peers.

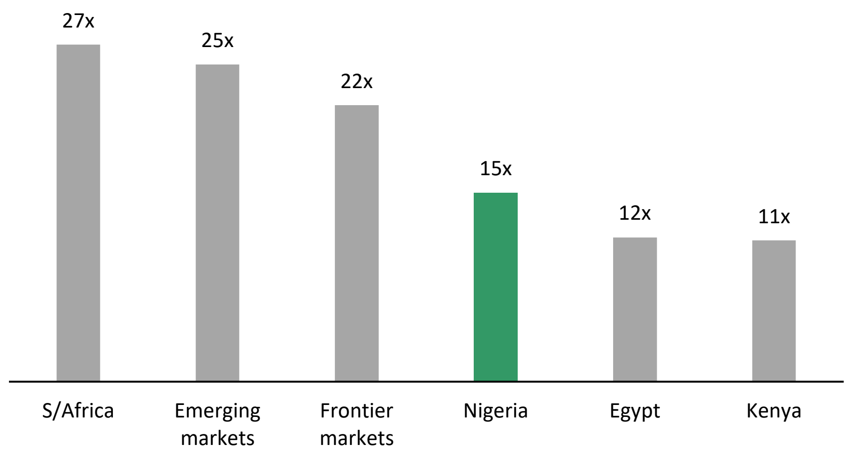
Our view is that the macroeconomic backdrop, especially the scarcity of FX does not make a compelling case from the foreign investor perspective. Our opinion is reinforced by the fact that the MSCI has indicated it will not implement any changes in the MSCI Nigeria Index. This would ultimately mean that foreign fund managers tracking this index will not need to buy Nigerian equities in their portfolios.

Chart 46: Trend in 14-day Relative Strength Index



Source: Bloomberg, Meristem Research

Chart 47: PE Ratio in Selected Markets



Source: Bloomberg, Meristem Research

No doubt the market outlook is clouded by uncertainties in macroeconomic and policy space, which could have telling impact on the market. Nonetheless, we expect the market to maintain its positive momentum till the first half of the year. This is informed by our expectations of the fixed income market; yields have been very low, and we expect this to persist over that time horizon. The need to keep the Government's cost of funding at minimum levels and the impact of a contractionary monetary policy could worsen the recovery from the economic recession. Hence, widening negative real returns make equities the most attractive asset class for now.

Also, corporate performances as at the third quarter of 2020 indicate resilient performances, and as such, we expect many of the dividend paying stocks to sustain distributions to shareholders. The hunt for dividend-paying stock should therefore continue, given the low yield in the fixed income market and rising inflation rate. For the first half of the year, we see the dividend yields of the Aristocrats remaining appealing. Thus, we expect dividend-paying tickers to gain further traction in 2021FY.

Corporate earnings growth is also expected to be positive given the low base of the previous year, and to grow even stronger in the second half of the year when (under our bull case) the health crisis should have reduced given current efforts to peg it back. The release of these results should stimulate positive investors' sentiment especially in the first half of the year. More so, the low yield environment in the debt market has been a source of cheap debt for high quality borrowers with working capital needs. This should translate into improved bottom-lines.

The downside risk to our outlook remains a surprise pick-up in yields in the fixed income space. The success of national governments and health authorities to control further spread of the COVID-19 pandemic is also a significant risk to our expectation. A rise in the number of domestic COVID-19 cases leading to nationwide lockdowns and shutdown of business activities could dampen sentiment in the market.

Overall, we expect the activities of the bears to outweigh the positives in 2021. Our outlook is based on the limited upsides of stocks given the overbought status, mid-term uncertainties relating to the second half, the weak macroeconomic backdrop and thin foreign investors' participation.

POSITIVE TRIGGERS	NEGATIVE TRIGGERS
✓ Ample Financial System Liquidity. ✓ Low Yields in Debt Market ✓ Improvement in Corporate Performance ✓ Dearth of Other Attractive Investment Instrument	✓ Risk of a Second Lock-Down due to the Pandemic. ✓ Yield Reversal in Debt Market ✓ Foreign Portfolio Outflows

Fundamental Approach

Using the fundamental approach, our expected market return for 2021 is based on the target prices of 43 stocks, which accounts for c.99.54% of the market capitalization as of December 2020. The negative return is particularly driven by the downside potential of **BUACEMENT (-36.64%)** which accounts for c.13% of the entire market capitalization.

Projected 2021 Equities Market Return

	Weight	Expected Return	Weighted Return
Financial Services			
Banking	17.4%	4.2%	0.7%
Insurance	0.9%	37.2%	0.3%
Materials and Industrials	34.7%	-18.5%	-6.4%
Consumer Staples and Consumer Discretionary	11.6%	5.6%	0.7%
Agricultural Products	0.8%	-1.7%	0.0%
Energy	2.2%	12.3%	0.3%
Healthcare	0.2%	18.6%	0.0%
Telecommunication	31.9%	0.4%	0.1%
TOTAL	**99.54%**		
Expected Return			**-4.29%**
Expected Return ex-BUACEMENT			**+0.95%**

Neural Network

Artificial neural networks have been increasingly applied to predict stock market returns due to their ability to discover patterns in both linear and non-linear systems. This makes this approach superior to classical statistical models. It is therefore commonly used to forecast index values, as well as daily and weekly direction of changes in the index. Hence, we used annual time series NSEASI data from 1998 to 2020. The trained neural network was used to predict the index level for 2021 at 38,352.09pts. This implies a **-4.76%** return from the 2020 year-end level of **40,270.72pts**.

Econometrics Approach

The NSEASI forecast was obtained using the ARMA econometric model. The ARMA model is one of the most widely used time series model in forecasting stock market series largely due to its integrated property, which reduces the effect of seasonality inherent in stock market variables. This approach appeals more as it applies a weight on its previous terms based on how recently they occur. This enables the model to capture recent sentiment in the equities market and smooth out outliers. **Based on this methodology, we expect the All-Share Index to settle at 35,294.25pts, implying a return of -12.36% by 2021FY.**

NSEASI Projection for 2021

We used a blended approach to arrive at our expected market return of -6.09% for 2021.

Weighted 2021 Market Return

	Projected Index Points	Market Return	Weight
Fundamental Approach	38,543.38	-4.29%	40%
Econometric Approach	35,293.26	-12.36%	20%
Neural Network	38,352.09	-4.76%	40%
Forecast Return	**37,818.23**	**-6.09%**	**100%**

Corporate Earnings Outlook

	Strong	Moderate	Low	Negative	
Agriculture		✓			Although there is a risk of renewed smuggling following the reopening of the borders, the sector should benefit from what is expected to be a good year for CPO prices globally.
Banking		✓			With the yield environment expected to remain depressed, growth in loan and transaction volumes will be critical to earnings growth. On the other hand, persistent regulatory pressure will drag performance, while macroeconomic risks remain.
Brewery			✓		We remain downbeat in our outlook for the brewers in 2021. Although we consider the progress made with vaccine development as a positive, particularly for brewers who rely on on-trade sales/social gathering to push volumes, we believe caution on the part of consumers particularly as the situation with the new viral strain and second wave of infection to have a dampening effect on performance.
Flour Milling		✓			We identify the reopening of the land borders as a major downside risk to earnings in 2021. Nonetheless, we are optimistic economies of scale, attractive prices and new product offerings would see to the improvement of earnings in 2021FY.
Healthcare		✓			For 2021, we expect a repeat of the previous year's theme- revenue growth driven by increase in product demand amidst the pandemic. However, a major determinant of earnings performance would be the firms' ability to put a lid on costs.
Industrial Goods		✓			The sector is set to benefit from the open borders, recovering economic activities and tax incentive which should shore up earnings for the year.
Insurance		✓			We expect the sector to recover from the slowdown in activities in the past year. Earnings growth will however remain modest at best given the low insurance penetration.
Oil and Gas			✓		Although we expect the sector to perform better, there are uncertainties around the timeliness in

					demand recovery in the upstream segment and deregulation for the downstream players.
Telecommunications		✓			Revenue tailwinds garnered from the pandemic will be offset by slower subscriber growth and cost pressures induced by currency devaluation.

Sector Outlook

Agricultural Sector

One key driver of activity in the agricultural sector is its status as one of the targets of the FG's objective to diversify the Nigerian economy away from oil. This is even more critical in the light of the pandemic and how it exposed the nation's economic underbelly to external shocks from the crude market. Against this backdrop, the FG has flooded the space with myriad of intervention programmes such as the Anchors Borrowers' Programme and the NGN600bn COVID-19 Intervention Fund amongst others.

Despite the number of interventions, the country remains a net importer of agricultural products, with a trade deficit of NGN694.67bn in agricultural goods as at Q3:2020. The sector also accounted for just 2% of total exports of goods during the period while the share of agricultural imports stood at 20%.

The insecurity in major food producing regions and perennial flooding continues to negatively impact output of the sector. Also, most of the farmers in the sector are subsistence and hence productivity for many commodities remain low. According to the data published by the NBS, the sector's output grew by a paltry 1.67% as at 9M:2020. This has not encouraged investments into the sector relative to its potential (*capital importation in the sector was about 2.09% in 2020).* There is a need to address these factors, along with the infrastructural challenges and develop strong linkages along the different value chains for strategic commodities.

Land Border Reopening: Pain or Gain

The protectionist policies of the Government, the shutdown of land borders in particular was a welcome boost to the activities of companies under our coverage in the oil palm industry. This policy has helped to curtail the influx of smuggled products into the country, boosting revenue through price increases. With the reopening of the border, the prospect of smuggled products pressuring prices is a clear headwind. Also, the African Continental Free Trade Area also implies more competition from producers in neighbouring countries, even though we expect its impact to be gradual. It should be noted also that the tariff regime on the importation of certain items, including palm oil will remain in place but will gradually reduce before being phased out. On the plus side, however, 2021 should be a good year for global CPO prices. Palm oil prices are expected to remain firm, at least for the first half of the year due to increased demand as economies reopen. This presupposes that the ongoing vaccination efforts will be largely successful for economic activities to pick up pace. Also, the increase in palm oil export levies in Indonesia, tight supply in the face of improved demand, rise in the price of substitute vegetable oils are all factors that are expected to buoy prices next year. This should support domestic price of the commodity given that higher prices in the global market makes importation more expensive.

In our view, we expect the oil palm millers to enjoy a strong first half (*which is typically their better half due to the cyclicality of the industry*) before the impact of near-term headwinds begin to take their toll on performance.

Valuation and Ratings															
	Fundamentals					Trailing				Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target P/E	Exp. EPS	TP	CP	UPP	Ratings
OKOMUOIL	0.44	27%	18%	12%	1.56	6.23	33.83	14.61x	2.69	12x	7.8	**90.27**	91	-1%	**HOLD**
PRESCO	0.34	22%	17%	8%	2.24	5.22	30.92	13.60x	2.29	11x	6.73	**70.67**	70.95	0%	**HOLD**
LIVESTOCK	3.4	27%	156%	90%	1.73	0.93	0.60	1.5x	2.3x	15x	0.05	**0.72**	1.39	-48%	SELL

**prices are as of 31st December 2020*

AT (Asset Turnover), NM (Net Margin), ROE (Return on Equity), ROA (Return on Asset), Lev (Leverage), EPS (Earnings Per Share), BVP (Book Value Per Share), P/E (Price to Earnings), P/BV (Price to Book Value), TP (Target Price), CP (Current Price), UPP (Upside Potential

Banking Sector

2020 was a particularly challenging year for the Nigerian banking sector. Headwinds emanated mostly from the regulatory environment, while the effect of the pandemic on the general business environment also contributed its fair share. Here is a review of key developments in the sector and their implications for performance.

Reduced E-Business Fees Limit Earnings Performance

The year began with the implementation of the regulatory reduction in electronic transaction fees which adversely affected e-business income of most players during the year. Fee-based income (gross) for commercial banks consequently fell by 8.51% YoY in 9M:2020. Electronic business income expectedly declined by 12.44% YoY to NGN140.25bn in 9M:2020, despite growth in electronic transactions (electronic transaction volume grew by 34.31% YoY in 9M:2020 according to NIBSS data).

Credit-related fees suffered the most decline (-35.49% YoY) despite loan growth over the period. We are of the opinion that technology, coupled with the need to attract borrowers and compete favourably with non-bank lenders is responsible for the sharp decline in credit-related fees as some banks now offer retail loans at minimal-to-zero management costs. Banks in our coverage universe generally performed better than the industry as their net fees and commission income fell by 5.60% YoY vs. 8.12% YoY for the industry.

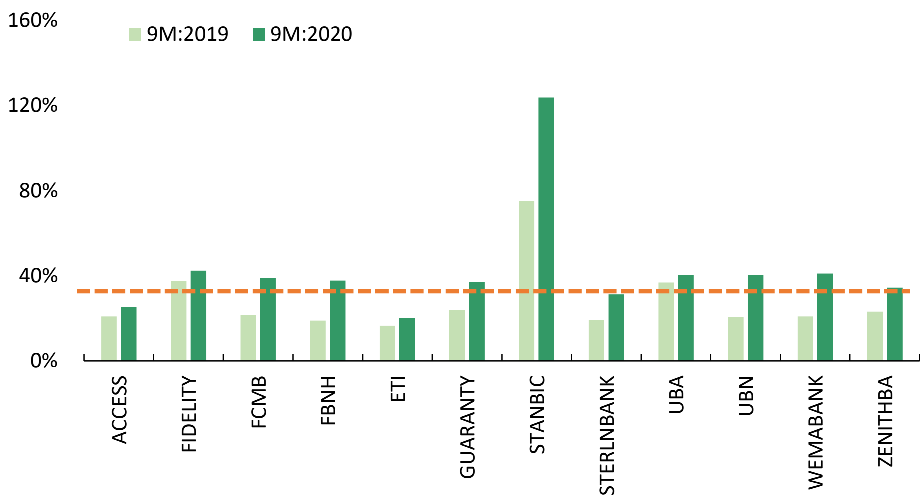
According to CBN's Credit Conditions Survey Report in Q4:2020, credit-related fees for corporate loans are expected to rise in Q1:2021, perhaps due to expected improved business conditions and demand for loans. Also, we are quite optimistic about sustained growth in electronic transaction volumes due to improved business outlook and expected higher velocity of transactions in the economy. Thus, our outlook for fees and commission income in 2021 is positive.

Higher Cash Reserve Requirement Tests Strength of Liquidity

The Monetary Policy Committee, at its January 2020 meeting voted to increase CRR to 27.50% from 22.50%. The decision was aimed at minimizing banking sector liquidity without adversely impacting credit creation. While official CRR has stayed at 27.50% in 2020, effective CRR for most banks are significantly higher, due to minimum LDR shortfalls and other discretionary reasons. Thus, banks (particularly smaller-to-midsized banks) faced considerable liquidity pressures during the year. In 9M:2020, restricted deposits for banks in our coverage universe grew by 82.28%, YoY to NGN12.49trn.

In our view, this was, among others a constraining factor to earnings in 2020 considering significant growth in deposits achieved by banks as at 9M:2020. In December 2020 however, CBN released NGN4trn of excess CRR to the banking sector via special bills which can be traded in the secondary market and which qualifies as a liquid asset for liquidity ratio computations. Notwithstanding this gesture by the CBN, we expect effective CRR to stay elevated in 2021 as the discretionary debits are expected to persist.

Chart 48: Effective CRR as at 9M:2019 and 9M:2020 Vs Official CRR



Source: Company Filings, Meristem Research

COVID-19 Pandemic and Credit Loss Provisioning

The main impact of the pandemic on the banking sector was via increased impairment provisioning and the implications for bottom line performance. Industry impairment charges rose 77.49% YoY to NGN140.11bn in 9M:2020, while our coverage banks recorded a 127.63% YoY increase over the same period. The elevated impairment charges were necessitated by worsening business conditions and outlook especially for vulnerable sectors such as oil and gas (negatively impacted by weak crude oil demand and low crude oil prices), manufacturing, trade and agriculture. As at Q3;2020, aggregate banking sector credit exposure to these sectors stood at 49.95% (51.70% as at Q1:2020. **As these sectors are critical to the growth of the Nigerian economy and at the center of CBN's real sector credit drive, we do not expect a significant decline in banking sector exposure to them. However, we note that downside risks to these sectors are less severe than they were as at Q1:2020 and as such, we expect less impairment provision in 2020FY. This expectation assumes that the current recovery path is maintained with minimal threat from the second wave of COVID-19.**

Declining Interest Rates Hurt Margins

The decline in interest rates which began late 2019 was sustained in 2020. Average yield on treasury bills and bonds declined to 0.48% and 5.83% as at end-2020 from 4.67% and 10.57% as at end-2019 respectively. Prime and maximum lending rates for the sector which tend to be sticky downwards also fell from 14.99% and 30.72% to 11.60% and 28.85% respectively between December 2019 and November 2020.

Chart 49: Average Bond Yields from December 2019

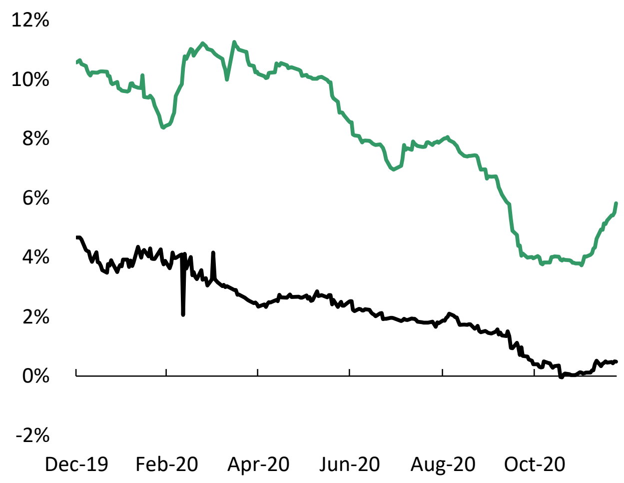
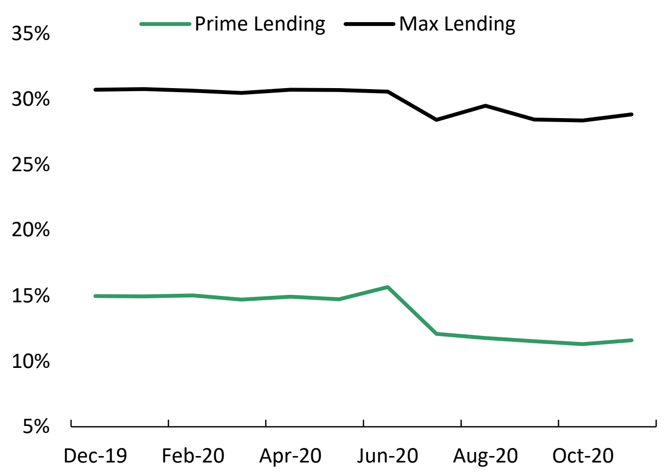


Chart 50: Average Lending Rates 2019

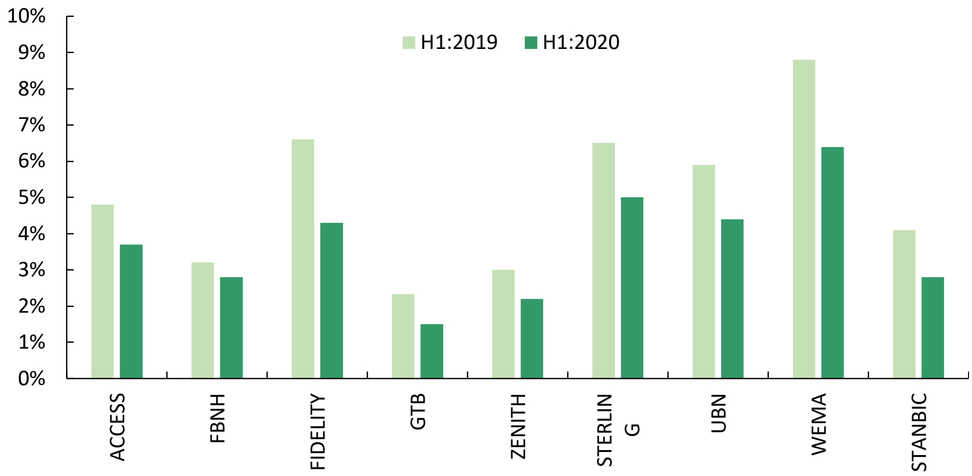


Source: CBN, Meristem Research

Industry interest income thus fell by 8.06% YoY in 9M:2020. The decline was muted at -0.98% YoY for our coverage banks as they met the depressed yield environment with aggressive growth in earning assets especially customer loans which grew on the aggregate by 12.31% between 9M:2019 and 9M:2020. Similarly, the decline in deposit and risk-free borrowing rates pushed Interest expense down by 19.05% YoY (Meristem Coverage Banks: 13.29% YoY) despite 26.49% growth in customer deposits.

Net interest margins however did not, as net interest income fell by 4.66% YoY while average earning assets grew as already noted. Earnings were thus supported by securities trading and currency revaluation gains during the period. **We expect net interest margins to remain tight in at least H1:2021 as we do not envisage a significant rise in interest rates over the near term. We maintain that the ability to grow earning assets will make the difference between banks that will grow shareholder value and those that will not. This puts the bigger banks viz: GUARANTY, ZENITHBANK, ACCESS, FBNH, UBA, STANBIC and FIDELITY at an advantage.**

Chart 51: Decline in Cost of Funds Across Selected Banks



Source: CBN, Meristem Research

The Quest for a Holding Company Structure

In 2020, **GUARANTY, ACCESS** and **STERLNBANK** announced plans to restructure their businesses by adopting the Holding Company structure. GUARANTY which led the pack is expected to transition fully into its new structure by Q1:2021. Under the current banking model in Nigeria, banks are prohibited from undertaking non-banking activities. This, however, limits value maximization by banks from other capabilities developed while carrying out the business of banking. **It is our view that this restructuring exercises is an attempt to lift this constraint while satisfying the requirements of the law, as the CBN permits conversion to a non-operating holding company.** Furthermore, a diversified business portfolio is a positive especially in view of declining interest margins and the heightened regulatory risks facing the banking sector in recent times. **This should however not be construed to mean that the new entity will face any less regulatory burden. We do not consider the risk of higher operating costs significant over the medium-to-long term, although initial conversion costs may bear on operating expenses in the early stages of transition.**

Banks and Other Financial Institutions Act (BOFIA) 2020

BOFIA 2020 was signed into law by President Muhammadu Buhari during the year to repeal the extant BOFIA 1991 (as amended). The new legislation introduces new key provisions aimed at strengthening banking operations such as the creation of a special tribunal for enforcement and recovery of eligible loans; and the establishment of a Resolution Fund for the banking sector. The Act also empowers CBN to issue regulations to combat cybersecurity threats associated with the financial services sector. **While we acknowledge the potential positive impact of the new Act on the banking sector, especially as regards asset quality and overall**

public confidence in the system, we are noted that the amended Act grants increased powers to the CBN. For instance, the Act provides that uncollateralized loans in excess of NGN3mn require CBN approval. This could stifle growth by slowing down the loan process. Also, the immunity granted CBN by the Act may further increase the regulatory burden for players. We consider this a significant matter given the level of regulatory risk currently facing Nigerian banks.

Technology and the Competitive Landscape

Banking activities continued to evolve with increased participation of non-bank players along the value chain. The lending space has arguably seen the most competition in 2020. Aided by technology, non-commercial bank lending institutions have either emerged or gained prominence during the year, providing quick consumer loans with zero or no collateral requirement. They also enjoy greater flexibility due to relatively minimal regulatory requirements and lean cost profile. The major advantages commercial banks possess over these lenders are access to lower cost funds and greater economies of scale. **In our opinion, the activities of non-commercial bank lenders do not constitute a significant threat to interest margins in the near-to-medium term as consumer loans makeup just about 10% of total loans, and commercial banks offer comparatively lower rates on consumer loans.** The payments space also witnessed increased non-bank participation with the issuance of final approvals to three Payment Service Banks to commence operations in Nigeria. Furthermore, the acquisition of Paystack by Stripe is a testament to the growth and significance of non-bank players in the space. **We however view the non-bank players in the payments space as collaborators rather than competitors and thus consider their growth as a performance enabler rather than a threat.**

Our Outlook for Key Banking Sector Metrics in 2021

Metric	Upside Factors	Downside Risks	Outlook
Earnings	Transaction volume growth (via agent banking and e-channels), higher loan volume growth, low cost of funds,	Persistent low asset yield, high asset contribution to proposed Banking Resolution Fund, higher OPEX due to inflation	Stable
Asset Quality	Implementation of Global Standing Instruction, recovery and stability of oil prices, establishment of special tribunal for loan recovery, improved use of technology to	Resurgence of COVID-19 induced shocks to the oil markets, Slow economic recovery.	Positive

	profile borrowers and hence lower probability of default.		
Capital Adequacy	Earnings recapitalization, Cheap funding from the capital market may support tier 2 capital.	Slower than expected economic recovery could lead to a faster rise in risk-weighted assets due to loan book expansion, than qualifying capital.	Stable
Liquidity	Release of excess CRR via CBN special bills, access to capital market funds	Sustained arbitrary CRR debits in excess of regulatory guidance	Negative
Overall			**Stable**

Valuation and Ratings

	Fundamentals					Trailing				Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target P/E	Exp. EPS	TP	CP	UPP	Ratings
ACCESS	0.10	17%	16.3%	1%	11.59	2.71	18.86	2.75x	0.45x	2.5x	3.41	**8.53**	8.45	+1%	**HOLD**
ETI	0.09	4%	4%	0%	13.31	1.26	28.81	4.77x	0.21x	3.03x	3.50	**10.62**	6.00	+77%	BUY
FBNH	0.09	15%	13%	1%	10.17	2.51	19.84	2.85x	0.36x	3.30x	2.63	**8.69**	7.15	+22%	BUY
FCMB	0.09	11%	10%	1%	9.48	1.03	10.85	3.22x	0.31x	2.34x	1.09	**2.55**	3.33	-23%	SELL
FIDELITYBK	9.75	14%	11%	1%	9.82	0.98	8.37	1.80x	0.20x	2.27x	0.89	**2.02**	2.52	-20%	SELL
GUARANTY	0.10	44%	25%	4%	6.05	6.53	25.67	4.95x	1.26x	4.70x	6.93	**32.57**	32.35	+1%	**HOLD**
STANBIC	0.09	36%	23%	3%	7.05	7.71	32.92	5.71x	1.34x	5.80x	8.41	**48.75**	44.05	+11%	BUY
STERLNBANK	0.11	7%	8%	1%	10.25	0.36	4.42	5.65x	0.46x	4.06x	0.45	**1.83**	2.04	-10%	**HOLD**
UBA	0.08	14%	13%	1%	10.77	2.47	19.16	3.50x	0.45x	3.40x	2.80	**9.50**	8.65	+10%	**HOLD**
UBN	0.08	12%	8%	1%	8.52	0.68	9.01	7.88x	0.59x	6.37x	0.90	**5.73**	5.35	+7%	**HOLD**
WEMABANK	0.10	4%	7%	0%	15.42	0.1	1.45	7.10x	0.48x	3.27x	0.17	**0.56**	0.69	-19%	SELL
ZENITHBANK	0.09	32%	21%	3%	7.71	6.93	32.94	3.58x	0.75x	3.85x	6.99	**26.91**	24.80	+9%	**HOLD**

**prices are as at 31st December 2020*

AT (Asset Turnover), NM (Net Margin), ROE (Return on Equity), ROA (Return on Asset), Lev (Leverage), EPS (Earnings Per Share), BVP (Book Value Per Share), P/E (Price to Earnings), P/BV (Price to Book Value), TP (Target Price), CP (Current Price), UPP (Upside Potential

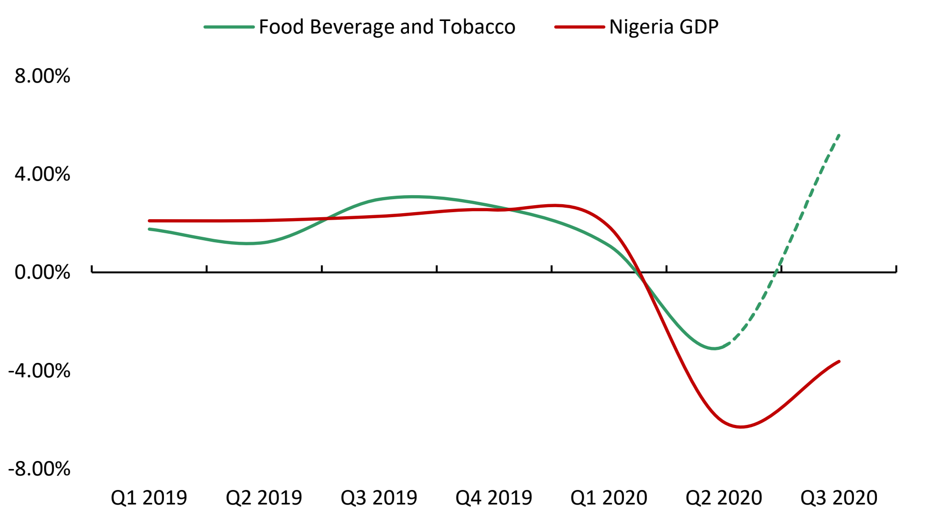
Consumer Goods Sector

Despite the outbreak of the Coronavirus pandemic, constrained consumer income and tough operating environment, the domestic consumer goods sector, true to its defensive nature showed remarkable resilience in 2020. The sector, which is the largest constituent of the manufacturing industry in Nigeria (*accounting for c.48% of manufacturing GDP*) recorded strong improvement in output, amidst the economic contraction.

After contracting along with overall output in Q2:2020 (at the height of the pandemic shock), the sector rebounded strongly, up 5.57% YoY in Q3:2020 (outperforming the overall GDP of -3.62% during the same period).

The tailwinds for the sector include the FG's closure of the borders which limited competition from smuggled goods and boosted sales volumes, resumption of economic activities after lockdowns were relaxed in Q3:2020, as well as the non-discretionary nature of most products that fall under this category.

Chart 52: Consumer Goods Sector GDP vs. Real GDP



Source: NBS, Meristem Research

Covid-19 Outbreak Presented New Challenges

The outbreak of the pandemic was met with strict lockdown measures, specifically in economically important States as Lagos, Abuja and Ogun. This also included a ban on interstate transport - a major source of concern for industry players at the time, particularly the brewers whose products failed to meet essential status required to carry on operations.

Also, as most of these companies still rely heavily on imports to source their production inputs, the restriction on movement of goods and resulting breakdown in global supply chains, meant that production materials had to be sourced with increasing difficulty and at higher costs, further eating into companies' margins. For domestically sourced raw materials it is important to mention that heightened security risks and unfavourable climatic conditions were also damaging to output.

The slump in global crude oil prices (*the country's major foreign exchange earner*) to historic lows, and the dollar scarcity that ensued presented another challenge. The inability to access foreign exchange from official channels pushed these companies to increasingly rely on the more expensive parallel (black) market to meet their FX needs, thus adding another layer of costs. Currency devaluation, increased VAT and excise duties, higher energy costs and skyrocketing inflation were other factors responsible for increased cost pressure over the period.

Despite gloomy macro indicators and a general fall in income levels, some companies took the hard decision to review upwards some of their product prices to lessen the blow from cost pressures, while others opted to introduce smaller pack sizes (effectually taking prices). Yet, performance have been mixed across sectors due to a confluence of industry-wide and in some cases company specific factors.

Upon the availability of the vaccine in Nigeria and the continued adherence to safety precautions, we expect improvement across supply chain to eliminate a re-emergence of nationwide lockdowns, leaving devaluation risks, FX scarcity and inflation as the major pressure points in 2021.

As we highlighted in our *Consumer Goods Sector Outlook* published in H1:2020, we believe that the pandemic has shone the spotlight once more on the need for FMCG companies to increasingly adopt effective e-commerce strategies and refocus on backward integration efforts – both factors that would limit their exposure to external shocks and prepare them for a different future post covid-19.

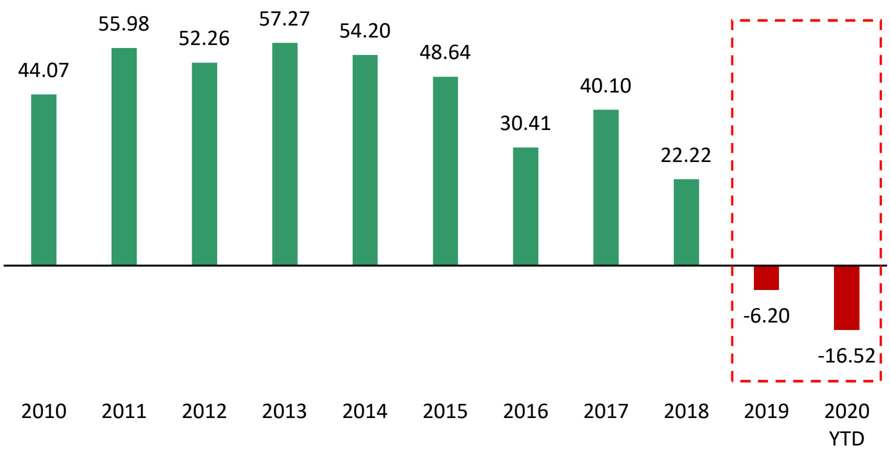
The Brewery Industry

True to our expectation at the start of 2020, the brewery sector's performance has been underwhelming, dragged by weak sales and faltering demand, intense industry competition and the impact of Government regulations (*the last phase of the excise duty increase kicked off in 2020*) on the sector.

The impact of the Coronavirus outbreak worsened the brewers' already fragile position as consumers held off on discretionary spending, and restrictions on social gathering (on-trade sales) meant slower alcohol demand. Also, higher excise duties/taxes, currency devaluation, material cost inflation and promotional intensity (which however slowed across board in 2020) are other factors that have historically hindered the beer industry's profitability.

Profit for the three (3) major listed players - *which we assume as a proxy for the entire market,* has declined significantly for the second consecutive year (*see Chart 2 below*) from a loss of NGN6.20bn to NGN16.52bn (as at September 2020).

Chart 53: Brewery Sector Profit Pool 2010 – 2020YTD (NGN'bn)



Source: NSE, Meristem Research

Brewery Sector Outlook

Although the economy is expected to rebound in 2021, we are not particularly bullish about the growth prospects for the brewery sector. As a discretionary item and based on our expectation that consumer income and spending will remain pressured, our 2021 outlook for the brewers remains downbeat.

Pre-existing headwinds such as weaker demand/sales stemming from strained consumer wallets, infrastructure and logistics bottlenecks, cost pressure (from higher energy prices and inflationary pressure), intense competition among industry players and other company-specific challenges will continue to constrain industry growth.

We expect that across board, the focus for the brewers would be to manage their costs. At best, we expect that a moderation in topline growth met with effective cost-cutting initiatives would support company margins.

Flour Millers

Benefitting from the Shift to Essential Consumption

Recall that in our half year outlook, we identified **FLOURMILL**, **DANGSUGAR** and **NESTLE** as likely winners following the outbreak of the Coronavirus disease. Our expectation was hinged on the FG's lingering border closure directive that shut out competition from smuggled alternatives, the essential nature of the products of these companies, small packages that are affordable to the value end of the market which provide room to push volumes, panic buying, stockpiling and increased government spending, particularly on food items to support vulnerable households.

With the exception of **NESTLE**, these companies recorded strong year on year growth in revenue (**FLOURMILL**: 31.15%, **DANGSUGAR**: 36.70%, **NESTLE**: 0.66%) in line with our projections and this trickled down to enhance earnings growth

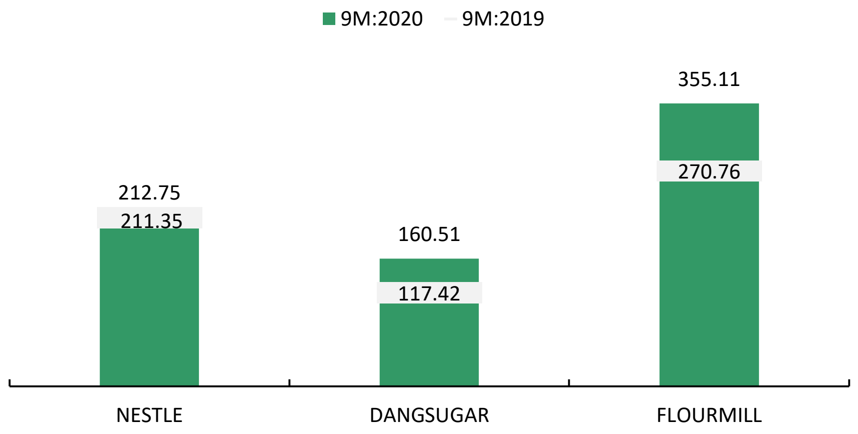
(**FLOURMILL**: 68.26%, and **DANGSUGAR**: 81.12%), and supported share price performances.

Outlook

Our overall outlook for the flour millers is moderately positive. Despite the essential nature of the sector's products, we expect prevailing headwinds in the consumer goods sector and heightened cost pressures (particularly stemming from logistics and electricity costs) to exert downward pressure on bottom line growth in 2021.

The implementation of the Africa Continental Free Trade Agreement (AfCFTA) would also have similar effects to the reopening of the borders – chiefly competition from foreign alternatives. In our view, the impact of the AfCFTA would be more pronounced in the longer term.

Chart 54: Year on Year Growth in Revenue (NGN'bn)



Source: NSE, Company financials, Meristem Research

Valuation and Ratings

	Fundamentals				Trailing					Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target P/E	Exp. EPS	TP	CP	UPP	Ratings
NESTLE	1.47	14%	90%	21%	4.24x	51.45	57.48	29.25x	26.18x	25.0x	64.85	1,621.25	1,505	+8%	HOLD
DANGSUGAR	0.76	17%	28%	13%	2.22x	2.82	10.01	6.24x	1.76x	8.0x	2.75	22.00	17.60	+25%	BUY
NASCON	0.64	7.0%	17%	5%	3.60x	0.80	4.65	18.16x	3.12x	12.50x	1.22	15.25	14.50	+5%	HOLD
HONYFLOUR	0.69	0%	1.0%	0%	2.48x	0.08	7.22	14.42x	0.17x	6.0x	0.17	1.02	1.20	-15%	SELL
FLOURMILL	1.33	3%	10%	3%	3.1x	3.76	39.02	6.92x	0.67	8.0x	3.93	29.48	26	+21%	BUY
NB	0.69	3%	6%	2%	2.88x	1.7	20.64	20.6x	1.7x	50.0x	1.21	60.5	56	+8%	HOLD
GUINNESS	0.78	-3%	-18%	-9%	1.92x	1.18	39.76	12.7x	0.4x	50.0x	0.35	17.5	19	-8%	HOLD
INTBREW	0.35	-15%	-20%	-9%	2.33	-1.13	5.65	-5.27x	1.05x	-	-	5.9	5.95	-1%	HOLD

**prices are as at 31st December 2020*

AT (Asset Turnover), NM (Net Margin), ROE (Return on Equity), ROA (Return on Asset), Lev (Leverage), EPS (Earnings Per Share), BVP (Book Value Per Share), P/E (Price to Earnings), P/BV (Price to Book Value), TP (Target Price), CP (Current Price), UPP (Upside Potential

Healthcare Sector

The year 2020 was an overwhelming year for the global healthcare industry. A substantial level of urgency to develop a vaccine for approval within the shortest possible time amidst a breakdown of healthcare systems and global supply chains was borne by the sector. Prior to the pandemic, the existing global healthcare systems were inadequate in terms of policies, infrastructure, resources, risk and supply chain management. Therefore, the COVID pandemic, exposed these deficiencies as well as the supply-demand imbalance existing within the industry.

Despite these, the market for Personal Protective Equipment (PPE) and test kits witnessed immense levels of growth in demand. The increase in healthcare spending by Governments across developed countries also created an avenue for these manufacturers to prosper amidst the pandemic.

Pandemic Fuels Sector Performance

The pharmaceutical firms listed on the exchange recorded improved performances in 2020 as anticipated. **FIDSON** stood out amongst the rest, reporting a 30.28% jump in revenue for the nine-month period. **GLAXOSMITH** and **MAYBAKER** performance also saw an increase in revenue, however, marginal, up by 3.34% and 8.85% respectively. While **FIDSON** and **MAYBAKER** reported a surge in earnings, up by 257.74% and 43.95% respectively, **GLAXOSMITH's** performance was weighed down by cost, resulting in a 1.71% increase in profit after tax.

Amidst the soaring COVID cases in Nigeria, the budgetary allocation for basic healthcare spending was slashed by forty-three percent from NGN44bn in the initial budget to NGN25bn in the revised budget. The new 2021 budget, however, proposes an increase of 17.88% in healthcare allocation to NGN546.98bn.

In a bid to support the efforts of healthcare practitioners and pharmaceutical firms in expanding their capacity, the CBN introduced a NGN100billion credit support facility to the industry. **Going forward into 2021, we expect continued disbursement of the NGN100 billion CBN facility to operators in the pharmaceutical sector as access to cheap funding would help expand existing capacity.**

In line with the Government's effort towards damage control of the pandemic and preventive measures against another outbreak, we anticipate rekindled investment in primary healthcare facilities. The increase in the 2021 Basic Healthcare Fund to NGN35bn from NGN25bn in 2020 lends credence to this expectation.

The private sector has been a major contributor to the fight against COVID. The Coalition Against COVID (CACOVID) set up in March has so far, fully equipped thirty-nine isolation centres across the nation. Over NGN4bn was spent on building isolation centres, while NGN9bn was allocated to the procurement of medical equipment and supplies. As highlighted in our healthcare sector update, going forward, a major theme within the healthcare space would be an increase in the collaborations between the public and private healthcare players.

During the heat of the pandemic in Nigeria, the Management of Jubilee Syringe Manufacturing Company- the largest syringe manufacturer in Nigeria and Africa- announced its intention to begin the production of specialized syringes for administering the COVID-19 vaccines. The firm currently produces over a million syringes daily and is strategically positioned to benefit from the pandemic through domestic and export sales. Upon the availability of the vaccine to the nation, we expect firms such as Jubilee to benefit from the sales of syringes and other medical supplies.

On a broader note, the pharmaceutical industry has been one of those to profit from the pandemic. From the development of vaccines on the global scene, to the increase in demand for drugs on the domestic front. Local manufacturers of drugs witnessed a surge in demand across all therapeutic categories- especially in Over-the-Counter segment. The outlook for the industry in 2021FY is positive, as medical institutions and households stock up on pharmaceutical products and supplies for preventive and curative purposes.

Valuation and Ratings

	Fundamentals					Trailing				Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target P/E	Exp. EPS	TP	CP	UPP	Ratings
FIDSON	0.66	4%	6%	2%	2.53x	0.30	4.94	15.1x	0.91x	7.0x	1.00	7.00	4.50	+56%	BUY
GLAXOSMITH	0.96	4%	10%	4%	2.49x	0.77	7.47	8.97x	0.92x	8.0x	0.89	7.12	6.90	+3%	HOLD
MAYBAKER	0.62	11%	15%	7%	2.27x	0.53	0.53	6.63x	0.99x	9.0x	0.59	5.31	3.51	+51%	BUY
NEIMETH	0.47	12%	26%	6%	4.51x	0.19	0.19	11.45x	2.96x	3.6x	0.28	1.01	2.23	-55%	SELL

**prices are as at 31st December 2020*

AT (Asset Turnover), NM (Net Margin), ROE (Return on Equity), ROA (Return on Asset), Lev (Leverage), EPS (Earnings Per Share), BVP (Book Value Per Share), P/E (Price to Earnings), P/BV (Price to Book Value), TP (Target Price), CP (Current Price), UPP (Upside Potential

Industrial Goods Sector

Market conditions in the construction materials sector in 2020 varied by product segments. While the cement sector was largely resilient, the paint and coatings segment felt the brunt of the economic downturn. The downward revision of capital expenditure plans by the Federal Government, closed borders and expectations of a prolonged lockdown period had led us to expect weaker sales volume for cement makers. Rightly, cement makers recorded lower volumes in Q2:2020 (the lockdown period) but the strong growth in Q1:2020 masked the weak outing to deliver an impressive H1:2020 topline performance. Although the composite PMI readings through Q2:2020 (May- 42.4pts, June- 41.1pts) suggests deep contraction in manufacturing activities led by the cement sector, we reason that contraction in the cement sector was mainly due to lower new orders, longer supplier delivery time and a comparatively slower raw material conversion rate. On the other hand, paint manufacturers reeled from a heavily impacted hospitality and real estate sector. We see this in significantly lower turnover and high impairment charges on trade receivables.

Moving into 2021, our view of the macroeconomic environment is less pessimistic. We anchor our expectation on four major factors; the early passage of the 2021 budget, prospect for oil prices, favourable climatic conditions and open borders. Given the early passage of the budget, it would not be surprising to see strong demand from the public sector in Q1:2021, especially as the dry season that characterizes the early part of the year gives room for infrastructure project execution. However, this is premised on absence of shocks to government earnings. Barring any significant shock to the global oil market, earnings from oil should support government's ability to sustainably carry-on capital projects. In 2020, one major tailwind was the relatively short rainy season. This is a possible scenario that could support sales in Q3:2021. However, in the event of a normal rain cycle, exports volumes arising from re-opening the land borders and new capacity for clinker export via sea still present a strong case for higher volumes. On pricing, by our estimate, we expect the ex-factory price of cement to average NGN40,000/tonne (vs. an estimated average of NGN38,500/tonne in 2020). We however expect higher energy costs and finance costs (a result of debt issuances in 2020).

Also, for companies like BUA Cement Plc. and Lafarge Africa Plc. with existing tax credit facilities, we expect improved earnings supported by tax waivers in 2021. For Dangote cement Plc, we expect the newly completed Obajana line to be granted the tax incentive. Overall, the existing infrastructural deficit, alternative use for cement and increasing middle class population still hold promises for the sector in 2021, even as current capacity suffers significant under-utilization.

In the paints industry, a major highlight in 2021 would be the merger between CAP plc and Portland Paints. In our view, we see the merger as a good starting point to drive further market penetration. Also, following the pick-up in economic activities, we anticipate writebacks of some impairments charged on receivables in 2020 which will support earnings in 2021.

Dangote Cement Plc: Improved Exports to Highlight Performance in 2021

Dangote Cement Plc's expansion into Central Africa and the rest of West Africa is expected to be a key value driver in 2021. This would be supported by freer border conditions and the developments on the African Continental Free Trade Agreement (AfCFTA). By our estimates, we expect total export volumes to come to 1.11MT by 2021FY (vs. an estimated 0.45MT by 2020FY). We factor in expected volumes from the fully functional Apala and One export terminals and unfettered export volumes via the land borders. However, downside risks to the company's performance include a potential increase in energy costs, and higher finance costs (as a result of debt issued in 2020).

Share Buy-Back: EPS to receive a face lift

Recently, the counter has gained significant traction and gone far past our 2020TP, returning +72.46%YtD as at 31st of December 2020. Clearly, the relative strength index (81.58pts) shows the counter to be firmly in the overbought region. Regardless, the company has announced the commencement of its share buy-back Programme where it intends to buy back 10% of its issued shares. While this is expected to give the boost the company's EPS, we project this will have minimal impact on the stock's price. We expect that fundamental drivers of value, system liquidity and the stock's liquidity will remain the determining factor of the stock's pricing in 2021.

Lafarge Africa Plc. (WAPCO) Expected to Reinforce Cost Optimization

In 2020, the company's margin was supported by its cost optimization initiative (Health, Cost and Cash Initiative). The result was a reduction in the cost to sales ratio from 69.11% in 9M:2019 to 68.80% in 9M:2020 and a slightly lower OPEX to sales ratio (8.78% vs. 9.50% in 9M:2019). In 2021, we expect the company to intensify efforts on reining in costs to further support margins. It is worthy of note that the company currently enjoys the pioneer status on its Maoming line. This should support the earnings in 2021.

BUA Cement Plc Eyes Capacity Expansion and Further Synergy

Since the merger, the company has sought stronger market presence in North Central and Southern Nigeria. So far, the company has reaped synergistic benefits in terms of cost and market share. We note that the Sokoto plant is close to full utilization, thus necessitating additional capacity. The company is on course to commission its new 3MTPA capacity in Q1:2021 and as well disclosed plans of further capacity expansion across its locations (Sokoto and Edo), and a new one in Adamawa. Considering that, the company has also announced a debt issuance plan to the tune of NGN100bn to fund its expansion plan. Going into 2021, we expect higher exports volumes to its Niger market following the open border and the AfCFTA. We also expect to see cost gains arising from the use of more efficient fuel options at its Sokoto plant while the company's pioneer status on its Abu line should shore up earnings.

Chemical and Allied Products Plc (CAP) set to Merge with Portland Paints

CAP Plc is set to merge with Portland Paints Plc., and based on the agreement, CAP Plc is proposing to shareholders of Portland paints the choice to either receive NGN2.90 cash for every Portland share held OR 1 new ordinary share of CAP for every 8 Portland paints shares held. Per our analysis, we expect the merger to result in a dilution of CAP Plc's outstanding shares by about 28%. However, we expect the consolidated company to leverage on Portland Paint Plc's presence in the standard decorative segment and marine coatings segment to expand its market reach and thus improve earnings per share in subsequent years. Ultimately, we anticipate this to translate into value creation for shareholder's through improved asset utilization.

Valuation and Ratings

	Fundamentals					Trailing				Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target P/E	Exp. EPS	TP	CP	UPP	Ratings
CAP	2.5	17%	18%	42%	0.44x	2.06	11.17	9.72x	1.79x	9.50x	2.69	25.56	20	+28%	BUY
BUACEMENT	0.33	35%	17%	11%	1.64x	5.38	31.66	14.37x	2.44x	-	-	49.01	77.35	-36.64%	SELL
DANGCEM	0.53	26%	31%	14%	2.26x	14.96	48.02	16.37x	5.10x	-	-	220.70	244.9	-10%	HOLD
WAPCO	0.45	10%	6%	4%	1.46x	1.44	22.16	14.65x	0.95x	-	-	22.48	21.05	+7%	HOLD

**prices are as of 31st December 2020*

AT (Asset Turnover), NM (Net Margin), ROE (Return on Equity), ROA (Return on Asset), Lev (Leverage), EPS (Earnings Per Share), BVP (Book Value Per Share), P/E (Price to Earnings), P/BV (Price to Book Value), TP (Target Price), CP (Current Price), UPP (Upside Potential

Insurance

In line with the weakness in the domestic economy, the Nigerian insurance industry declined by 18.67% YoY (in real terms) as of Q3:2020. This is on the back of the 29.53% contraction of the sector in the second quarter of the year. The financial performance of most of the companies under our coverage followed a similar trend, with just a few matching their performance in the previous year. The industry continues to be plagued by perennial challenges such as high fragmentation, low insurance penetration and the struggle to expand insurance products outside the compulsory classes of products. Hence, NAICOM's insistence to proceed with the recapitalization of the insurance sector in order increase the industry's underwriting capacity.

Insurance Industry Recapitalization: Will the Goal Post Shift Once More?

After several unsuccessful attempts to recapitalize the sector in the past (recall the Tier Based Policy), NAICOM had issued a circular in May 2019 raising the minimum capital for insurers (see table below) effective June 2020.

Insurance Capitalization Requirement

	Life	Non-Life	Composite	Reinsurers
Previous	2bn	3bn	5bn	10bn
New	8bn	10bn	18bn	20bn

This is expected to bolster the firms' solvency capital and improve underwriting capacity. The process was also expected to deepen insurance penetration and improve insurance density in Nigeria. The outbreak of COVID-19 appeared to be another reason to delay the latest attempt at recapitalising the sector given the initial impact on the economy and capital markets and the ability of insurers to raise the needed capital.

In consideration of this, NAICOM has tweaked the implementation of the recapitalization to occur in phases; In the first phase, the deadline remains December 31st, 2020 and insurers and reinsurers are expected to have 50% and 60% of their required capital respectively. Furthermore, by September 2021— the deadline for the second phase, firms are expected to have met the minimum threshold outlined in the plan *ab initio*. There are however indications that the process may yet be delayed as the House of Representatives has urged the NAICOM to give insurers a six-month reprieve.

New Additions: Five New Firms Join the Fray

NAICOM has issued five additional operating licenses to four new insurance firms and a reinsurer; Heir Insurance Limited (General); Stanbic IBTC Insurance Limited;

Heirs Life Assurance Limited; Enterprise Life Assurance Company Nigeria Limited, and FBS Reinsurance Limited. Heirs and Stanbic IBTC's entry represent vertical integration in the industry given that both firms already have existing brokerage businesses in the insurance industry. This fact already implies even more intense competition in the sector. The move towards life insurance also reflects the rapid rate of growth in that segment of the industry in the past five years.

In our opinion, the entry of these new players will boost overall industry capacity (since the required capital is the new capital requirement). However, the well documented challenges of the sector will persist without consolidation of the non-viable players in the industry.

We expect the sector to recover from the decline in 2020, given the moderate improvement in economic activities.

Valuation and Ratings

	Fundamentals					Trailing				Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target P/E	Exp. EPS	TP	CP	UPP	Ratings
AIICO	0.24	11%	20%	3%	7.40x	0.41	2.03	2.77x	0.56x	1.65x	0.95	**1.68**	1.57	+7%	BUY
CUSTODIAN	0.38	12%	14%	4%	3.12x	1.12	8.18	5.22x	0.72x	5.1x	1.42	**7.24**	5.5	+32%	BUY
MANSARD	0.44	11%	17%	5%	3.41x	0.49	2.89	2.13x	0.36x	9.3x	0.31	**2.88**	1.76	+64%	BUY
NEM	0.66	11%	16%	8%	1.95x	0.45	2.81	4.02x	0.64x	4.0x	0.73	**2.92**	2.06	+42%	BUY
WAPIC	0.42	8%	5%	3%	1.68x	0.09	1.8	4.38x	0.22x	1.9x	0.31	**0.59**	**0.4**	+48%	BUY

**prices are as of 31st December 2020*

AT (Asset Turnover), NM (Net Margin), ROE (Return on Equity), ROA (Return on Asset), Lev (Leverage), EPS (Earnings Per Share), BVP (Book Value Per Share), P/E (Price to Earnings), P/BV (Price to Book Value), TP (Target Price), CP (Current Price), UPP (Upside Potential

Energy Sector

Upstream Oil and Gas

The domestic oil and gas industry reeled from the impact of COVID-19 on the global crude oil market. The crash in the price of crude oil and the sharp decline in demand (*following the lockdown measures and slow economic activities*) also wore heavily on the fortunes of players in the sector. Following the historic agreement by OPEC+ to deepen output cuts in May, Nigeria's production quota (ex-condensate) dropped to 1.412MMbpd (May to June 2020), 1.495MMbpd (July to December 2020), and 1.579MMbpd (January to April 2021) respectively from the previous cap of 1.75MMbpd. Apart from the impact of the crash in price on revenue, earnings were also affected by the recognition of significant impairment charges on production assets.

Marginal Fields Bidding Round Continue as Planned

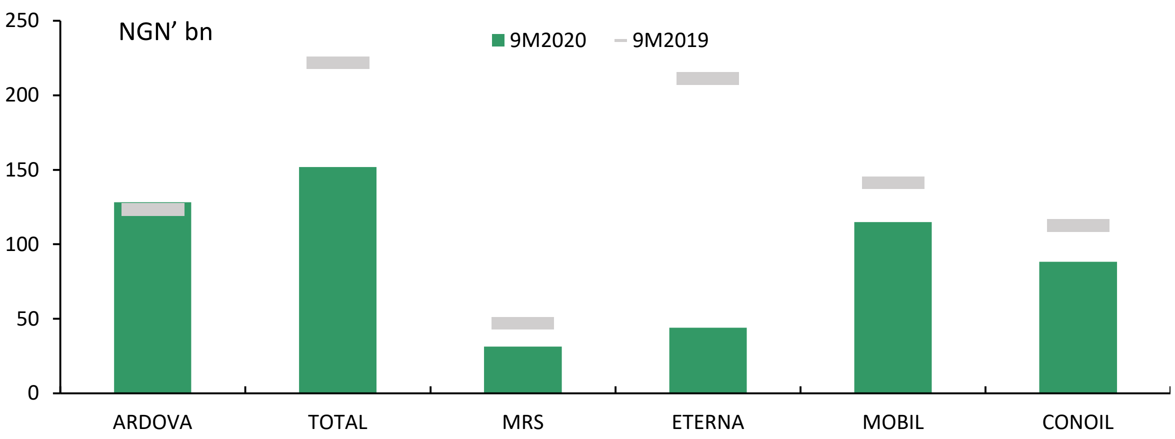
During the year, the Department of Petroleum Resources conducted the marginal fields bid round, about seventeen years after the last exercise. Fifty-seven fields were available to offers from indigenous players and investors in a move that is expected to further bolster Nigeria's production capacity. The planned oil licensing rounds was however ditched till 2021 given the weakness in the price of crude oil.

On the regulatory end, the much-vaunted Petroleum Industry Bill suffered further delay given the failure of passage which is expected to bring sweeping reforms to the sector and align the Nigerian oil industry with global trends. For context, Nigeria is estimated to have accounted for only 4% of the USD75bn investment in the African oil and gas industry. Therefore, the passage of the bill is expected to reverse years of stalled investment in the sector. This is more so given the global shift from hydrocarbon energy sources to cleaner and more eco-friendly alternatives. There are, however, hopes that the Bill may yet be passed by the first quarter of 2021 with the prospects of favourable fiscal terms for producers.

Downstream Sector: Deregulation at Last?

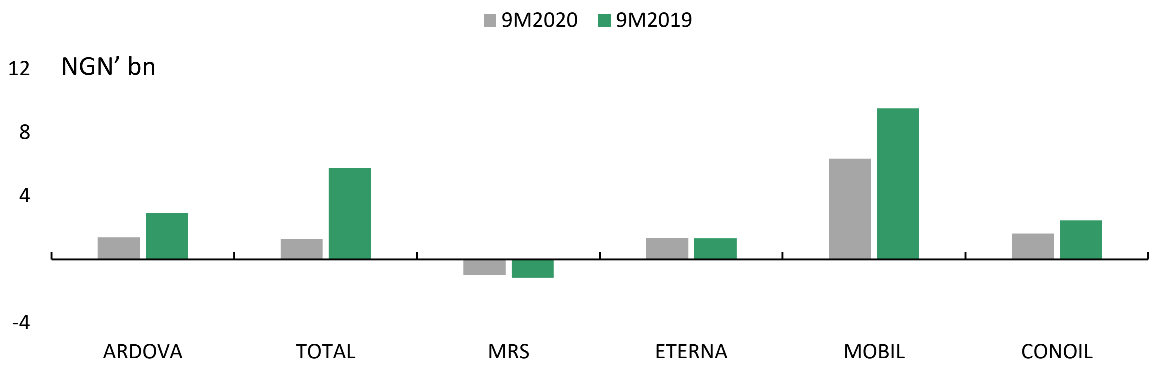
The highly regulated structure of the downstream segment continued to be a major drag on the activities and profitability of operators in the sector. The scarcity of FX meant most downstream players rely on the NNPC for the importation of refined PMS while the extant subsidy regimes effectively placed a cap on margins. The imposition of lockdowns due to the pandemic burdened the turnover of companies under our coverage; revenue declined on average (median) by 27%, although with a wide range of c.60%. Cost to sales however improved slightly (down by 2% to 91% on average, compared to 93% as at 9M2019) due to the drop in the landing costs of petrol. The decline in operating profit was even steeper, at an average of 33% among tracked companies.

Chart 55: Revenue of Companies Under Coverage



Source: Company's Financials, Meristem Research

Chart 56: Operating Margins of Coverage Universe



Source: Company Financials, Meristem Research

Not Wasting a Crisis

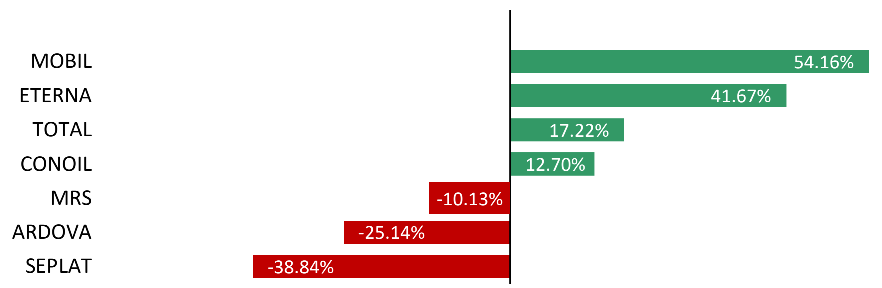
The drop in the landing costs of petrol eliminated the need for the expensive subsidy regime in the sector. The Federal Government through the Petroleum Products Pricing Regulatory Agency (PPPRA) reviewed that the ex-depot price to NGN125.63 in March from the previous price of NGN145/litre, resulting in an over-recovery of about NGN30.47 to the NNPC (Nigerian National Petroleum Corporation). This provided an opportunity for the Government to scrap a policy that has constrained the profitability of the sector. The announcement was made through the PMS Market Based Pricing Regime Regulations, 2020. However, the proviso that *the agency shall monitor trends and advise the NNPC and oil marketing companies on the monthly guiding price* however suggests the policy to be more of a *pseudo deregulation*. It remains to be seen if the industry will move towards a fully deregulated state given the Government's penchant for interference (*like the reduction in petrol price by NGN5.00 announced arbitrarily in December*).

In our view, the so-called deregulation of the sector merely allows the FG to halt the expensive subsidy regime. For as long as it will continue to provide **guiding prices** for players in the sector, then margins will continue to be pressured by the limits imposed by such prices. More than that, other structural challenges remain, like the access to FX to import refined products. On the upside, we expect these to ease in the medium term, should the Dangote refinery become operational despite disruption in the spate of work caused by COVID-19, along with other modular refineries. However, the Dangote Refinery may not commence operations as expected, given the impact of the virus outbreak.

Share Price Performance

Investors sentiment was rather mixed towards tickers in the sector. The worst performer was **SEPLAT**, down by 38.84% which is understandable given the impact of COVID-19 on the revenue and earnings of upstream players. **MOBIL's** fate, however, took a different turn in 2020 with a year-end return of 54.16% (vs. -20.27% in 2019FY).

Chart 57: Share Price Performance



Source: NSE, Meristem Research

Valuation and Ratings															
	Fundamentals					Trailing				Valuation					
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target P/E	Exp. EPS	TP	CP	UPP	Ratings
CONOIL	2.21	1%	7%	3%	2.54x	1.99	29.66	10.48x	0.70x	8.50x	2.94	**24.95**	20.85	+20%	BUY
ETERNA	1.89	2%	8%	3%	2.54x	0.81	9.92	6.33x	0.51x	12.50x	0.44	**5.55**	5.10	+9%	**HOLD**
ARDOVA	3.64	0%	3%	1%	2.76x	0.42	13.88	32.31x	0.98x	25.00x	0.53	**13.17**	13.55	-3%	**HOLD**
MRS	1.31	-3%	-8%	-4%	2.06x	-4.76	59.81	-2.89x	0.23x	4.00x	4.47	**17.87**	13.75	+30%	BUY
SEPLAT	0.18	31%	10%	6%	1.72x	105.44	1,087.26	3.82x	0.37x	6.85x	72.55	**496.96**	402.3	+24%	BUY
TOTAL	1.80	1%	11%	2%	4.66x	8.77	78.17	14.82x	1.66x	13.00x	9.16	**119.06**	130	-8%	**HOLD**

**prices are as at 31st December 2020*

AT (Asset Turnover), NM (Net Margin), ROE (Return on Equity), ROA (Return on Asset), Lev (Leverage), EPS (Earnings Per Share), BVP (Book Value Per Share), P/E (Price to Earnings), P/BV (Price to Book Value), TP (Target Price), CP (Current Price), UPP (Upside Potential

Telecoms Sector Outlook

The Telecommunications sector remains one of the few sectors to have benefitted from the onslaught of the pandemic. This is supported by recently released Q3:2020 GDP data, which revealed that the sector enjoyed an average growth rate of 15.06% YoY in 2020, despite the domestic economy slipping into a recession. Subscriber growth has also maintained a steady upward trend, rising by 12.59% Yd to 208 million subscribers.

Data Revenue Set to be New Leading Light…

Across the listed companies (MTN Nigeria and Airtel Africa), revenue growth was robust in 2020, fuelled largely by growth in data revenue. Both companies enjoyed significant improvements in the data revenue during the period (**MTNN**, +48% YoY and **AIRTELAFRICA**, +30.11% YoY), which has been fuelled by increased smartphone penetration as well as higher data demand, as the pandemic necessitated fundamental changes to the business environment. As a result, the revenue contribution of data has increased by about 500bps on average for both companies (**MTN**, 24.76% and **AIRTELAFRICA**, 30.19%), a trend which we expect to continue over the mid-term as new business trends such as telecommuting, virtual conferencing, and remote working are expected to persist even after the economy recovers from the pandemic. We expect this to be supported by higher capital expenditures for network upgrade and expansion.

…As Voice Revenue Slows, with prospects worsened by New Sim Registration Rules

However, we saw a significant slowdown in voice revenue for both companies in 2020, partly explained by reduced voice traffic in Q2 due to weaker consumer income levels, as well as a cannibalization of voice revenue by the data segment, due to the widespread adoption of alternative channels which use VoIP (Voice over Internet Protocol) Technology to provide call services (e.g., WhatsApp calls, Microsoft Teams). Thus, we expect this to engender a longer-term slowdown in voice revenue growth as more subscribers increasingly make use of these technologies.

We view the short-term impact of the new SIM registration rules imposed the NCC as detrimental to subscriber growth, with slightly worse implication for voice revenue growth considering that the new rules will prevent operators from adding new subscribers, till at least early February.

Currency Risks May Heighten Cost Pressures

Despite the positive revenue tailwinds, higher cost pressures suffered during the year negatively impacted margins, preventing an expansion in bottom line. The increment in VAT to 7.5% ushered in by the 2019 Finance bill caused a spike in lease payments, while the currency devaluation suffered during the year caused additional pressures to EBITDA margin. **MTNN** already indicated that the increment in the benchmark rate for its tower lease contracts to NGN385/USD from NGN360/USD, triggered a 40bps reduction in EBITDA margin. Given that currency devaluation pressures are still very much existent, we expect this to trigger higher capex costs and negatively impact margins in subsequent periods should they eventually crystallize.

PSB License – To be or not to be?

Several months after releasing guidelines for the operation of Payment Service Banks in the country, the CBN finally granted full approval to 3 entities to begin operations in mid-2020. Interestingly, MTN and Airtel were not part of the licensed companies considering that they were among the first to apply for the license.

Nonetheless, both companies have made significant strides in improving their mobile money network while they wait for final approval from the apex regulator. **AIRTELAFRICA** has built a strong mobile money network in its other operating regions across Africa, and in its H1:2021 result, the company processed mobile money transactions worth a cumulative total of USD20.68bn (+45.67% YoY), generating USD181mn in mobile money revenue (+24.30% YoY). As we reported in our *AIRTELAFRICA H1:2021 Earnings Update*, we like that the company has continued to expand its mobile money ecosystem, announcing new partnerships with Standard Chartered Bank, Mukuru, WorldRemit and MoneyGram.

The same scenario is also applicable to **MTNN**, which currently has a Super-Agent license under its belt. Since securing its license in late 2019, the company has grown its agent network to over 300,000 as at Q3:2020, leading to growth in both fintech subscribers and transaction volumes.

Thus, while the timeline for the PSB license approval for both companies remains uncertain, we can expect the license to serve as a positive boost to earnings for both companies.

Valuation and Ratings

	Fundamentals					Trailing				Valuation						
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target P/E	Exp. EPS	TP	CP	UPP	Ratings
MTNN	0.73	15.0%	168.0%	11.0%	15.02x	9.68	5.77	17.54x	29.45x	15.79x	10.93	**172.65**	169.9	+2%	**HOLD**
AIRTELAFRI	0.39	9.0%	11.0%	4.0%	2.90x	35.19	334.61	24.20x	2.55x	17.24x	48.96	**844.11**	851.8	-1%	**HOLD**

**prices are as at 31st December 2020*

AT (Asset Turnover), NM (Net Margin), ROE (Return on Equity), ROA (Return on Asset), Lev (Leverage), EPS (Earnings Per Share), BVP (Book Value Per Share), P/E (Price to Earnings), P/BV (Price to Book Value), TP (Target Price), CP (Current Price), UPP (Upside Potential

Fixed Income

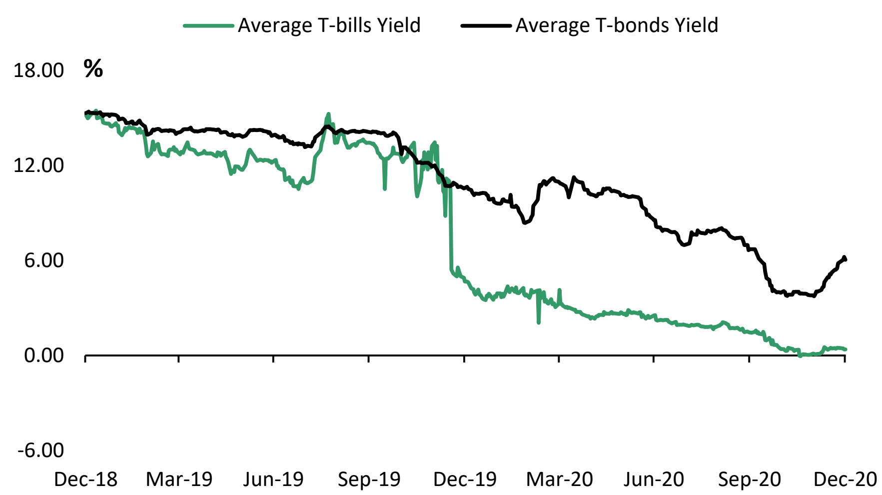
Abundant System Liquidity, the Song for 2020

The domestic fixed income market lost its shine as the preferred destination for investors in 2020, as the hey-days of double-digit interest rates now seem like a distant memory. Ever since the CBN decided to shut out domestic corporates and High Net worth Individuals (HNIs) from the OMO market in late 2019, yields at both the short and long ends of the fixed income market have tumbled, due to the sheer volume of liquidity the policy unlocked – the CBN reported that the stock of outstanding OMO instruments at the end of 2019 was NGN15.92trn, of which, about 20-25% was widely estimated to be held by domestic corporates and HNIs (translating to about NGN3.18 – NGN3.98trn). For context, the unlocked liquidity is roughly equivalent to the total size of Treasury bills auctioned in 2020.

This decision, in our opinion, bore the most weight in determining the direction of yields at the fixed income environment in 2020. Nonetheless, we also acknowledge the impact of the easy monetary stance adopted by the CBN, fuelled by its bid to shield the economy from the effects of the pandemic, while also seeking to keep borrowing costs for the Federal Government at manageable levels.

Faced with a dearth of alternatives, it came as no surprise when we saw a rerouting of investor demand to the Treasury bills and T-bonds market, as their funds gradually exited the OMO market. Over-subscriptions were a constant fixture at primary market auctions, causing the rates on offer to trend lower. The CBN auctioned a total of NGN3.25trn at the T-bills primary auctions in 2020, recording an overall subscription of NGN6.91trn during this period (implied bid-to-cover ratio of 2.12x).

Chart 58: Average T-bills and T-bonds Yield Trended Downwards in 2020



Source: FMDQ, Meristem Research

Sentiment at the secondary market also reflected this trend; average yields fell by 427bps Ytd in the secondary T-bills market to close the year at 0.40%, and by 452bps Ytd in the T-bonds market to close at 6.06%. **Worryingly for investors, real**

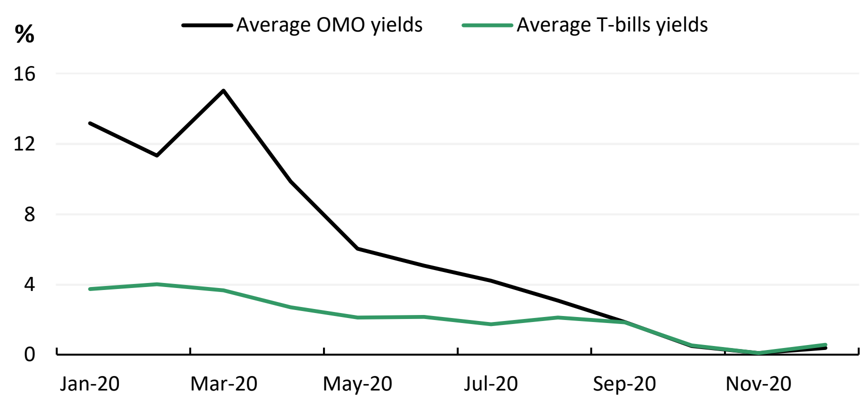
rates of return are now firmly entrenched in the negative, as short-term rates no longer reflect near-term inflation expectations. Instead, they bear more semblance with rates in advanced economies. This is best explained by the fact that we saw average yields at the secondary T-bills market fall to negative territory in mid-November.

OMO Market Performance Mirrors T-Bills Market

By the end of October, the OMO market no longer housed local corporates and HNIs. This segment of the market now plays host to only commercial banks and Foreign Portfolio Investors. We note that with this segmented market approach, theoretically, the CBN will be able to raise rates to attract foreign investors without significantly altering rates at the T-bills market. Albeit this will be at a cost to its balance sheet.

The once high-yielding OMO market was not immune to the declining yield environment, as rates moved in line with the direction of yields in the T-bills market, ending the year at an average of 0.39% across all tenors. We are aware that foreign investors will not be pleased with the rates at the market, which do not offer adequate compensation for the risks inherent in the economy. No sale auctions were a regular fixture at the OMO market at the height of the pandemic in late March/early April, as investors expressed dissatisfaction over FX illiquidity and weakening macro fundamentals. Unfortunately, due to the dearth of FX for capital repatriation, most had no choice but to roll-over their maturities at prevailing yield levels. Thus, we posit that an improvement in FX availability will spark selloffs by Foreign Investors and subsequently trigger a rise in yields in this segment of the market.

Chart 59: Average OMO and T-bills Yields



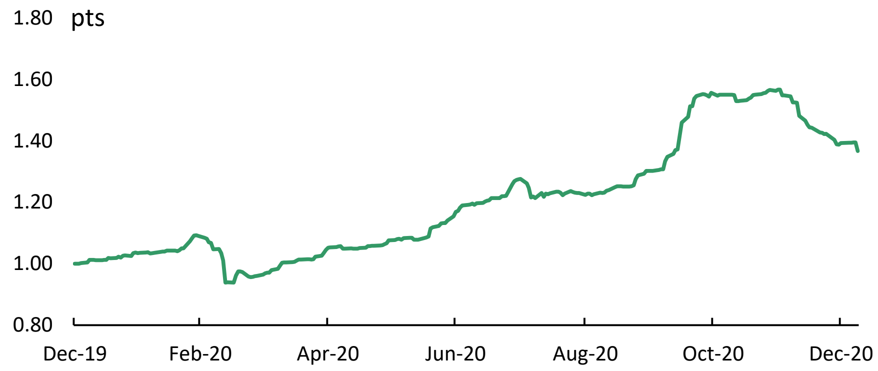
Source: FMDQ, CBN, Meristem Research

Positive Outing for Bond Holders in 2020

Nonetheless, the mood was not all sour in the fixed income market. As opposed to their peers in the money market, sovereign bond holders enjoyed a broadly positive outing in 2020. The decline in yields triggered by the surge in liquidity and easy monetary environment resulted in a jump in prices of bond assets. For this, we point to the trend observed across our coverage banks who, on aggregate, recorded growth in trading income from bond assets.

Chart 60: S&P/FMDQ Sovereign Bond Index in 2020

Sovereign Bond holders enjoyed 39.31% Capital Appreciation in 2020



Source: Bloomberg, Meristem Research

Although the markets suffered a brief dip in March due to the spread of the pandemic, bond prices rebounded in April and reached a peak Ytd return of 56.75% in early December, before the index retraced slightly, closing the year with a Ytd return of 39.31%.

A Good Year for Corporate Borrowers

While most fixed income investors may not have been very pleased with the low yield environment, corporate borrowers took advantage of the situation to issue new debt instruments mainly for liquidity and refinancing purposes. The only noteworthy exception to this trend was the decision of UBA Plc. to redeem its NGN30.50bn, 16.45% fixed rate bond in June 2020, earlier than the original due date of December 2021. While only eight new corporate bonds listed on the FMDQ were issued in 2020 (vs. 6 in 2019), we note that several bonds were privately issued during the year.

Market turnover on bonds other than FGN bonds grew sharply by 31.74% YoY to NGN13.97bn between January and November 2020, indicating marked increase in activities within that space. In our view, the significant increase in turnover in that segment of the market was driven by both demand and supply conditions. On the supply side, issuers were attracted by low interest rates, while on the demand side, investors were motivated by the higher interest rates relative to Treasury instruments. The high level of liquidity in the financial system driven by CBN's expansionary monetary stance was also partly responsible for the increased turnover.

In 2021, we expect the tempo of activities to be sustained with more eligible corporates and sub-nationals entering the debt market in search of cheap funding. Investors on the other hand, discouraged by yields on Treasury instruments, will increasingly opt for corporate and sub-national fixed income securities with good credit quality.

SSA Eurobond Yields Circling Close to Pre-COVID Levels

The sub-Saharan Africa's sovereign Eurobond space recorded a volatile yield performance in 2020. The year had started with most instruments trading at a premium to par. However, the tide changed at the onset of the pandemic as investors sold off en-masse, in expectation that sovereign economies within the region would be severely impaired. These expectations fed-off the negative impact of the pandemic on commodity prices and tourism, while bearing in mind that most sovereign entities in the region entered the pandemic with high debt levels and weak fiscal buffers.

Ratings downgrades by Fitch, S&P and Moody's on SSA sovereigns also did not help matters. Angola, Zambia, Nigeria, and South Africa are some of the major countries that suffered ratings downgrades. Consequently, most countries found it difficult to raise new capital from international markets due to the increased cost of borrowing and lingering currency risk. Therefore, it was unsurprising that there was little SSA sovereign activity in the Eurobonds in 2020 (save for Ivory Coast, Gabon, and Ghana), with most relying on multilateral support to meet dollar obligations. The same trend was witnessed in the domestic economy as the Federal Government was forced to shelve plans to raise NGN850bn via Eurobonds in 2020, opting to tap local markets instead.

Quite positively, yields began circling back to the Pre-COVID-19 levels from the second quarter, as easier lockdown conditions and a gradual recovery of commodity prices birthed optimism on risk assets. Thus, the renewed demand in sovereign Eurobonds within the region sparked upward movement in prices, resulting in a moderation in yields and tightening of risk spreads. The major exception to this trend was Zambia, who was the only major SSA sovereign to default on its Eurobond obligation in November.

In 2021, we expect the current liquidity crunch in the foreign exchange market and a heightened borrowing cost profile to limit the Federal Government to domestic borrowing and loans from supranational organizations to meet its funding deficit.

Corporate Eurobonds Witnessed Little Activity

The Corporate Eurobond market witnessed little activity in 2020, heightened by currency risks induced by the COVID-19 pandemic. This risk coupled with the depression in yields in the domestic fixed income market, has influenced corporate preference for the local markets. The primary market recorded a single issuance throughout 2020, as First Bank floated a USD350mn Eurobond.

We expect the corporate Eurobond space to remain quiet as companies seek to limit FCY liabilities and reduce currency risk. This outcome also feeds off the prevailing uncertainties in the foreign exchange market.

Alternative Fixed Income Markets Were Quiet

Activities in the alternative bond market were quiet for most of the year, except for the NGN150bn 7-Year Ijarah Sukuk bond issuance in May 2020. This was the third Sukuk issuance since the DMO began issuing this instrument back in 2017. Investor participation remained strong, reflected in the bid-to-cover ratio of 4.12x. This triggered an additional allotment of NGN12.56bn, raising the total sum to NGN162.56bn from the earlier intended NGN150bn. There were no activities in the Green-bond market in 2020.

The Sukuk instrument has gradually gained prominence as the preferred funding vehicle for infrastructure projects. Hence, we can envisage more activity in this space in coming periods. In contrast, we are not optimistic about the issuance any green bond issuance considering its specialized nature, although we do not completely rule out any issuance in 2021.

Fixed Income Outlook

Odds in Favour of Yields to Remain Low

A lot of uncertainty surrounds the direction of yields in 2021, a situation which is not helped by the lack of proper market guidance from the CBN. As we indicated above, the market has been awash with liquidity since the CBN banned domestic investors and local corporates from the high yielding OMO market in October 2019. Thus, as long as the liquidity surfeit persists, the fixed income market will continue to trade at current levels. With this in mind, our outlook for 2021 is largely influenced by themes that would impact liquidity in the market.

First off, the Federal Government has announced a NGN5.06trn deficit in the 2021 budget which will more than likely be financed predominantly from the domestic debt market; macroeconomic conditions have deteriorated significantly and borrowing in the international capital market will attract a high premium. Thus, we posit that this would form a viable outlet for excess liquidity and help to prop up yields across the market.

We postulate that the activities of corporate borrowers would help to absorb some maturing liquidity. However, we expect the impact of this on fixed income rates to be minimal. Given our estimate for the size of the unlocked liquidity (see opening fixed income section), we postulate that total corporate issues in 2021 would need to be very sizeable, in the region of NGN1.5trn – NGN2trn, for it to drive any meaningful uptrend in the direction of yields. We also see the CBN's recently issued Special Bills as a possible outlet for system liquidity in 2021. At the moment, the CBN has issued a total of NGN4.1trn worth of bills to commercial banks to support liquidity, which is currently held by banks. We opine that a liquidity crunch for the banks could spark a sale of these bills for cash in the secondary markets, thereby triggering an uptrend in yields in the money market.

However, we consider the easy monetary stance adopted by the MPC as a major inhibitive factor towards a sustained upward movement in yields. The prevailing accommodative monetary policy stance suggests yields will remain low, even for corporate issues, as policy makers encourage cheap credit to prod the economy out of the current bout of recession. This is pertinent, given that the MPC has preferred a focus on supporting economic recovery over price stability. **Therefore, our prognosis is for rates to remain low until at least the end of H1:2021, after which a reassessment of key macro variables would govern the policy direction of the MPC.**

However, on the upside for hawkishness, there is an argument to increase interest rates in order to attract foreign capital. While raising rates in the OMO market is an option, it is not news that FPIs are neither happy with the yields in the market nor liquidity, given that the CBN is the major counterparty. In addition, we do not think the CBN's balance sheet is strong enough to afford the cost of attracting FPI via this means, considering the huge premiums that would be required by new investors. This would force the CBN to share this burden with the Government via increased rates at the T-bills market, a scenario which we consider as less likely.

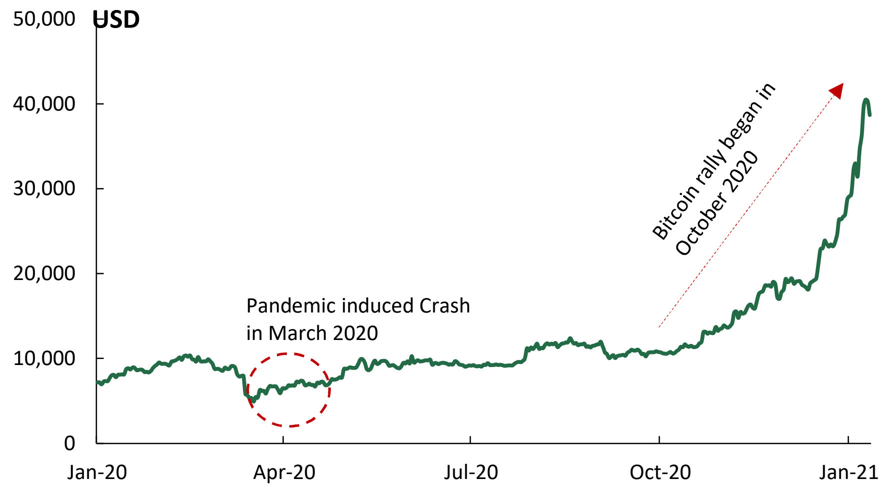
Alternative Investments

A Stellar Year for Cryptocurrencies

In the rapidly shifting financial landscape, the year 2020 will be remembered for the growing acceptance of cryptocurrencies and digital assets since it was first introduced in 2009. In our view, several factors have contributed to its growing adoption and the resulting price surge. These factors include – institutional buy-in to hedge against currency loss, excess liquidity from pandemic support packages, media frenzy and quite frankly, FOMO (fear of missing out on the part of investors) which made the increase in price a self-fulfilling prophecy.

As Chart 1 below shows, Bitcoin (*the largest digital currency by market cap*) quadrupled its value over the course of the year 2020, surpassing its all-time high of USD19,800 to just under USD29,000.

Chart 61: **Movement in Bitcoin Prices Between Jan 2020 – Jan 2021**



Source: Coindesk, Meristem Research

Bitcoin has also enjoyed growing popularity in Nigeria, as restrictions on sending/receiving foreign currency (as well as other policies to support the Naira) continue to gain ground. Global industry reports ranked the country as the world's second largest Bitcoin market in 2020, ahead of China, the United Kingdom, Canada and India.

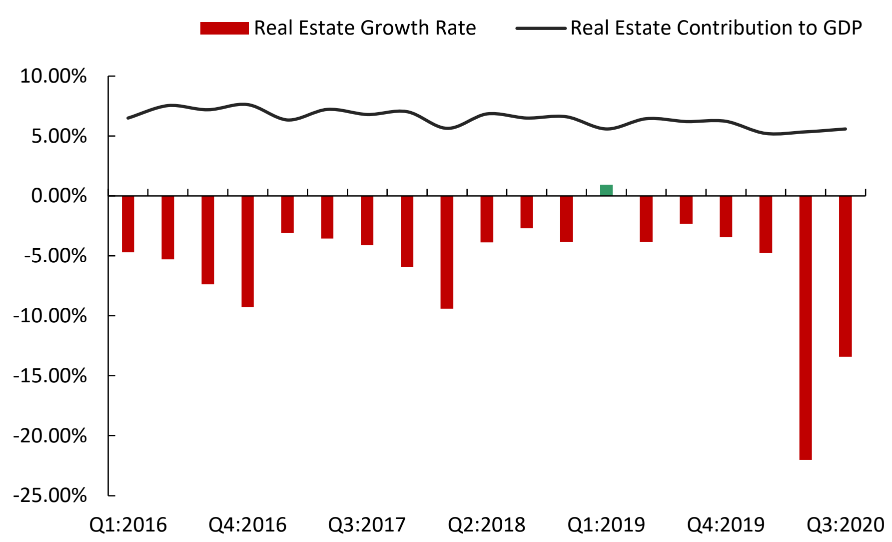
While the SEC guidelines acknowledging crypto-linked assets as securities inspires some confidence, we remain sceptical of volatility associated with crypto investments and advice investors to trade very cautiously.

Real Estate Backed Investments

Unlike the broader economy, the real estate sector has yet to recover from the impact of the 2015/2016 recession. After briefly exiting twelve consecutive quarters of contraction in Q1:2019 (*when it posted a meagre 0.93% growth*), real estate sector output has continued to contract quarter after quarter. With the outbreak of the pandemic in 2020, the sector has also been adversely impacted, contracting by an average of 13.38% between Q1 and Q3:2020. As the pandemic necessitated the implementation of lockdown measures, social distancing and encouraged companies to adopt work from home strategies: all factors that would negatively affect demand for real estate (including commercial, retail and office spaces).

As an asset class, real estate continues to appeal to investors seeking a stable source of cashflow, especially as fixed income yields remain unattractively low. Despite the current realities and how they would affect demand for real estate in the near term, we are of the view that the industry still offers opportunities for willing and patient investors.

Chart 62: **Real Estate Growth Rate and Contribution to GDP (2016 – Q3:2020)**



Source: NBS, Meristem Research

Equity Strategy

A Review of Meristem's 2020FY Equity Strategy

Our 2020FY strategic portfolios: Dividend and PFA Portfolios returned 29.45% and 11.03% respectively. Upon the outbreak of the pandemic and our analysis of its impact on the equities market, we created a universal portfolio consisting of dividend aristocrats in the second half of 2020. The H2:2020 strategic portfolio posted a return of 33.88% YoY.

Our 2021 Strategic Portfolio is composed of stocks screened in line with our equity outlook for the year. Its constitution is based off our expectation of sustained low yields in the fixed income market through H1:2021 and system liquidity as a major driver of the market's direction. The timing of the portfolio is structured for entry in the first quarter and constructed based on our top-down analysis of each company's fundamentals and strategy. Specifically, we screened the stocks in the portfolio for the following:

a) At least three consecutive years of earnings growth in the past five years.
b) At least three consecutive years of turnover growth in the past five years.
c) Double-digit Return on Equity (> 10%)
d) Expected Dividend Yield at least 5%
e) Attractive 2021 upside potential based on our target prices.
f) Expectation of topline Growth in 2021FY.

2021 Strategic Portfolio

	Fundamentals					Trailing				Valuation							
	AT	NM	ROE	ROA	Lev	EPS	BVP	P/E	P/BV	Target P/E	Exp. EPS	TP	CP	Exp. Div. Yield	UPP	Portfolio Weights	Tot. Return
MTNN	0.73	15.00%	168.00%	11.00%	15.02	9.68	5.77	17.54	29.45	15.79x	10.93	**172.65**	169.9	5.07%	**1.62%**	4.84%	**6.69%**
GUARANTY	0.1	44.00%	25.00%	4.00%	6.05	6.53	25.67	4.95	1.26	4.70x	6.93	**32.57**	32.35	8.60%	**0.68%**	7.47%	**9.28%**
CUSTODIAN	0.38	12.00%	14.00%	4.00%	3.12	1.12	8.18	5.22	0.72	5.10x	1.42	**7.24**	5.50	6.31%	**31.64%**	16.69%	**58.31%**
NEM	0.66	11.00%	16.00%	8.00%	1.95	0.45	2.81	4.02	0.64	4.00x	0.73	**2.92**	2.06	7.32%	**41.75%**	21.18%	**49.07%**
NESTLE	1.47	15.00%	90.00%	21.00%	4.24	51.45	57.48	29.25	26.18	25.00x	64.85	**1,621.25**	1,505	8.94%	**7.72%**	10.29%	**16.66%**
UBA	0.08	14.00%	13.00%	1.00%	10.77	2.47	19.16	3.5	0.45	3.40x	2.8	**9.50**	8.65	7.32%	**9.83%**	9.69%	**17.15%**
FBNH	0.09	15.00%	13.00%	1.00%	10.17	2.51	19.84	2.85	0.36	3.30x	2.63	**8.69**	7.15	6.00%	**21.54%**	12.79%	**27.54%**
WAPCO	0.45	10.00%	6.00%	4.00%	1.46	1.44	22.16	14.65	0.95	-	-	**22.48**	21.05	4.45%	**6.79%**	6.18%	**11.24%**
ZENITHBANK	0.09	32.00%	21.00%	3.00%	7.71	6.93	32.94	3.58	0.75	3.85	6.99	**26.91**	24.8	9.29%	**8.51%**	10.87%	**17.80%**
Expected Portfolio Return																	**27.27%**

Fixed Income Strategy

We expect interest rates to remain low over the short term (until at least the end of H1:2021) however, we acknowledge that pressures for an upward movement in - yields are building, as the prevailing macro fundamentals do not support the low yield environment.

For Buy and hold strategy investors seeking to generate above average returns, the focus should be tilted away from risk free Treasury instruments to investment grade commercial papers and bonds which satisfy investment objectives. Given the current yield environment, investors would need to assume higher risk to generate above average returns.

For active traders with higher risk appetite, we advise a strategy with focus on high-yield short duration instruments, which would be re-invested into a higher yield environment when rate reversals occur. Investors can take solace in the expectation that yields are not envisaged to fall significantly lower than current levels, which helps to cap downside risks to this approach.

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