New Commodities Bull Market Very Positive for African Equities

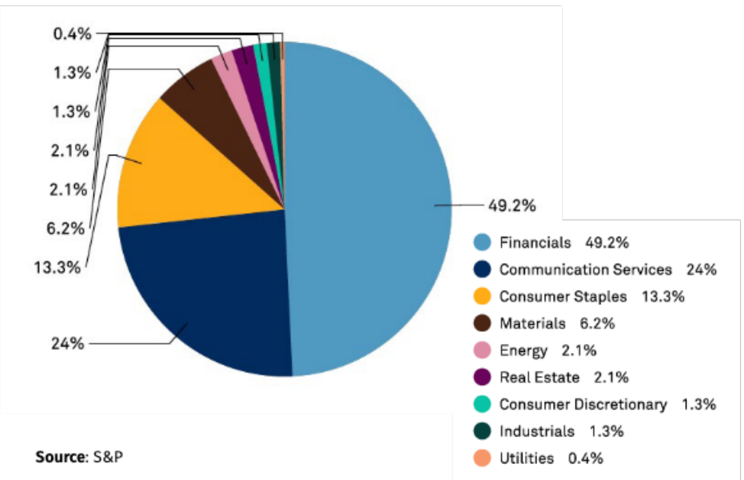
By Tim Staermose,
Founder; CEO
African Lions Fund, ST Funds Management

It is not a revelation that many African economies remain heavily reliant on commodities exports. But just how closely African frontier equities markets' performance (in USD terms) generally correlates with the global level of commodities prices is somewhat surprising. That's because the equity market indices of sub-Saharan African frontier markets are completely dominated by domestically focussed sectors, such as financials and telecoms.

Telecom and mobile money payments innovator Safaricom in Kenya, for example, now accounts for an extraordinary 63% of the Nairobi Stock Exchange's market capitalization, while in Africa's largest frontier market, Nigeria, the banking sector completely dominates.

Indeed, there is not one pure resources business in the Top-10 stocks by market capitalisation of the S&P Africa Frontier BMI Index, which I use to compute the hurdle rate for African Lions Fund's performance.

SECTOR* BREAKDOWN



Source: S&P

Almost half the index is financials, and nearly one quarter is telecoms.

As you can see from the chart (gold line), bull (and bear) markets in commodities tend to last a long time. From 1994 to 2008 the general trend of the CRB Index was up. From 2008 to 2020 it was down.

Now, after a 12-year bear market, the CRB index of 19 commodities, including: aluminum, cocoa, coffee, copper, corn, cotton, crude oil, gold, heating oil, lean hogs, live cattle, natural gas, nickel, orange juice, gasoline, silver, soybeans, sugar and wheat, looks to have commenced a new bull market.

The CRB index includes a heavy weighting of energy and agricultural commodities in addition to precious and industrial metals: energy: 39%, agriculture: 41%, precious metals: 7%, base/industrial metals: 13%.

The rise in prices is broad-based. Of all the commodities prices tracked by Trading Economics, just five are down year to date. Those are tea, rubber, cocoa, orange juice and neodymium.

The LME Index, which tracks only metals, and the Goldman Sachs Commodities Index (GSCI), are up even more strongly than the CRB Index year to date.

Strong economic rebounds around the world, supply bottlenecks, inventory restocking, and a general expectation by investors and speculators that as the world transitions to an electric vehicle fleet, metals demand will see a huge structural increase are all contributing factors.

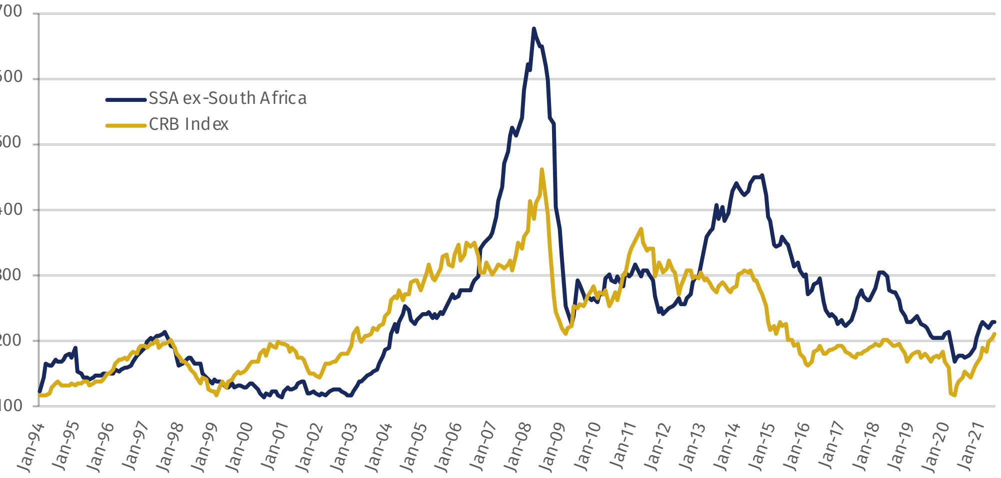
Both the batteries and engines required for electric vehicles are much more metals intensive than cars built with internal combustion engines. Battery materials such as graphite, lithium, and cobalt have had big bull markets before. Another such bull market appears underway. Lithium is up an incredible 91.4% year to date and leads the field of all commodities.

Copper is another metal set to benefit. While cars using internal combustion engines require up to 23 kilograms of copper each, a hybrid electric vehicle uses nearly double that at 40 kilos and a plug-in electric vehicle uses as much as 60 kilos.

Index	Price	Change	Day	Weekly	Monthly	YTD	Date
CRB Index	218.60	0.08	-0.04%	2.40%	2.51%	22.61%	May/28
LME Index	4,328.50	0.00	0.00%	3.48%	3.38%	26.77%	May/28
S&P GSCI	2,490.86	9.06	-0.36%	2.53%	1.96%	25.99%	May/28

All this brings me back to Africa. It's no secret that Africa is renowned for its commodity production and for having economies reliant

SUB S H R N FRIC EX-SOUTH FRIC EQUITY INDEX (USD TERMS) VS. CRB COMMODITES INDEX



Source: Commodity Research Bureau, Hartland-Peel frica Equity Research, and globalvaluehunter.com

on commodity export earnings.

Many frican economies get the bulk of their foreign exchange earnings from commodities exports – and good times appear to be rolling again.

Nigeria and ngola rely on oil. Zambia relies on copper. Guinea is heavily dependent on bauxite and gold. Ghana relies on gold and petroleum. Cote d'Ivoire's external trade is heavily dependent on cocoa.

In Kenya, it's tea and other agricultural produce, such as cut flowers. Uganda earns most of its export revenue from gold and coffee. Ethiopian exports are dominated by coffee.

Tanzania is a major gold producer. Rwanda exports gold, refined petroleum, and tin. Botswana's exports are totally dominated by diamonds. But perhaps no country relies more on exports of its vast minerals wealth than The Democratic Republic of Congo (DRC). The country is the dominant producer of cobalt in the world and exports vast quantities of copper as well.

With commodities seemingly in a new, long-duration, secular bull market, and metals in particular seeing strong structural demand increases, as the world transitions to green energy and electric vehicles, it's a relatively straightforward matter to extrapolate this and consider the second and third-order effects for frican economies and stock markets.

Rising commodities prices **->** Strong export earnings and impr0ving foreign currency inflows for many frican economies **->** Greater economic activity and rising aggregate demand for local goods and services, as well as more domestic liquidity that should find its way into money markets and stock markets on the continent. Certainly the historical record, charted above, has shown this to be the case.

Coupled with frica's generally bullish demographics plus frican frontier markets' generally low correlation with developed market equities, there are many good long-term structural reasons to invest, as well as significant portfolio diversification benefits.

Unfortunately, there aren't many easy ways for investors in the developed markets to invest in frican frontier market equities. That's one reason I founded the frican Lions Fund.

If I'm right that we've entered a long-duration bull market for commodities, there may even be a foreign exchange tailwind for US dollar investors over the decade to come. Indeed, so far this year, several sub-Saharan frican countries have seen their currencies appreciate versus the US dollar. In the universe of countries where I invest, these include the West frican Economic Union, where the Franc is pegged to the Euro, as well as Botswana, Uganda, Kenya, and Ghana.

In this context, it is worth noting that the corollary of rising commodity prices is a falling US dollar. Graphed against each other over the past 25 years, you can see how the two indices, the US Dollar (DXY) and CRB Index (CRB) are almost perfectly anti-correlated.

This is yet another good reason to consider some exposure to frican equities, as a hedge against a declining US dollar.

SOURCE: TRADINGECONOMICS.COM