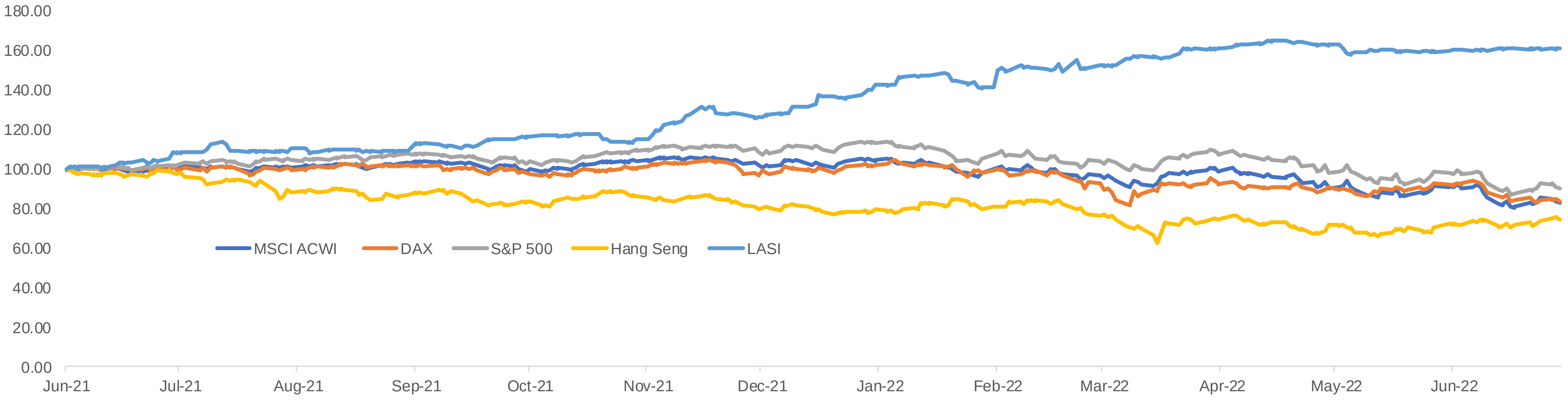
KUKULA

Global Markets Outlook: Q3 2022

25 July 2022

Figure 1: Global equity market performance in respective home currency, LTM

Indexed at: 100



Equities trade lower in Q2 on fears of a recession

Global equities closed lower for the second quarter in a row with the S&P 500 recording its worst first-half-of-the-year performance since 1970 (down 20.6%). Global equities did not fare much better with the MSCI world index down 18%. Erratic European energy supply (with its root cause in the Russian-Ukrainian conflict), low energy output from OPEC members, rising inflation and interest rates, and lately, the prospect of a U.S. recession, have all contributed to the downturn. Zambia's LASI index traded mostly flat up marginally by 0.1% for the quarter with little reaction to fundamental developments (mostly on account of low liquidity).

Most of the factors that fueled the declines in global financial markets at the beginning of the year persisted into the second quarter including supply chain bottlenecks caused by the pandemic, having been exacerbated by more hard lockdowns in China in Q2 this year.

Generally, demand has overwhelmed shippers' ability to get products to market, resulting in higher prices. Consumer confidence has crumpled in light of high inflation expectations which will certainly increase risk of recession due to reduced spending. Retailers are also beginning to feel the pressure with Walmart providing downward earnings guidance for the second time this year citing mounting cost pressure.

There has been very little room to hide with both growth stocks and fixed income having been pulverized by tightening monetary policy. We expect inflation to begin to ease toward the end of the year (Q4) as energy prices begin to cool and as energy supplies stabilize following anticipated OPEC output increases. We are likely hover to see lackluster equity performance over Q3.

Figure 2: Consensus forward P/E multiples*

Developed	Forward P/E
US	16.3
UK	9.7
Japan	12.3
Canada	10.9
Germany	9.8
France	11.4
Korea	8.3

Emerging	Forward P/E
Brazil	5.7
Russia	2.6
India	19.5
China	11.1
Mexico	12.0
South Africa	8.4
Zambia	5.1**

*Data based on Refinitiv & MSCI consensus estimates
** historical P/E multiple

Multiples lower for both developed and emerging markets

Marked contraction of multiples globally on fears of a looming recession. This is uniform across both developed and emerging markets. China bucks the trend however with a slight expansion in multiples compared to Q2 in part due to easing of COVID restrictions. US multiples contract lead by declines in technology sector stocks.

Consumer staples companies are also starting to feel the pressure with big box US retailer Walmart issuing downward earnings guidance as it grapples with grapples with higher costs and a reluctance to raise prices. Inflation continues to weigh on growth stocks with rising rates.

Commodities firms have also traded lower on account of expected slow down in economic activity, oil prices however remain relatively high boosting oil majors who have largely been on an upward trajectory over Q1 and Q2. Easing of energy cost may help relieve pressure on consumers and will be a welcome relief by retailers. We expect multiples for both developed and emerging markets to stabilise this quarter, lead mainly by improvements in the outlook for consumer staples and bottoming out for growth stocks.

We are still in favor of an overweight in consumer staples, but we are beginning to see more attractive tech sector/ growth equity multiples. We see a window of opportunity in copper producers which saw massive selloffs in Q2 which we believe may be back in attractive ranges considering the long-term demand side fundamentals.

LTM multiples on Zambian equities are down reflecting higher risk over Q2 and increased pressure on earnings due to high inflation. The outlook for Zambian inflation however seems positive. With strengthening Kwacha, we may see a boost in earnings driven by lower cost of imports and improved margins due to lag in reduction of shelf prices.

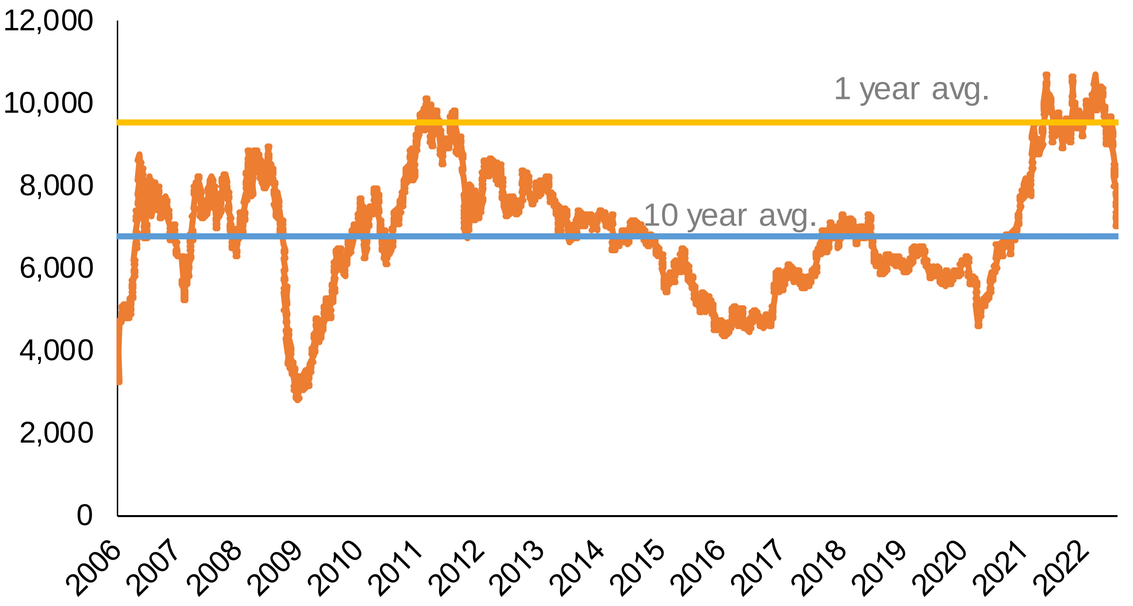
Works at Norilsk Nickel plant, Russia

Hard commodities sink, except oil majors

In the second quarter, commodities experienced mixed results as oil prices continued to rise as a result of Russia's conflict with Ukraine. Important commodities like gold, wheat, and copper all experienced declines at the same period. Industrial metals' performance, with copper down 20.5 percent in the quarter, was one indication of lingering worries in the global economy.

The metal is a component of equipment and production utilized across many different sectors. Copper Prices were under pressure in May, mostly because of concerns about the restrictions imposed by Covid-19 lockdowns in the world's largest consumer China. A combination of severe restrictions on business and worries that Beijing may go into complete lockdown also sent prices plunging. Prices were further pressured downward by bleaker global GDP growth expectations, monetary policy tightening by influential central banks, and the growing economic effects of the conflict in Ukraine On the supply side.

Figure 3: Copper $US/t. (2019-2022)



China's imports of copper concentrate, or partially processed copper ore, was 2.06 million tonnes in June, down 5.9% from 2.19 million the previous month, according to customs data, decreased copper production in Chile in April and disruptions brought on by protests at the Las Bambas mine in Peru (which happens to be one of the largest producers of copper globally) affected prices to some extent due to reduced supply. The decline in copper may have implications for Zambia's balance of trade and consequently its FX earnings, although we expect relatively high prices to persist.

This year, the energy industry has outperformed the markets, and oil stock prices have increased. Despite falling 20% from its quarter-high price, oil prices rose and ended up 33 percent higher than they had started. On the other hand, rising oil costs are fueling global inflation. As the purchase of oil is a non-discretionary expense, consumers have less money to spend on other goods.

Copper prices declined over the past month, mostly due to weaker demand conditions amid a worsening global economic outlook. June prices averaged USD 9,023 per metric ton while May prices came out at 9,395 per metric ton which was down 7.7% from April's price and was 7.4% lower than in the same month last year. Meanwhile, on 31 May, copper traded at USD 9,446 per metric ton, which was 3.3% lower than on the same day of the previous month.

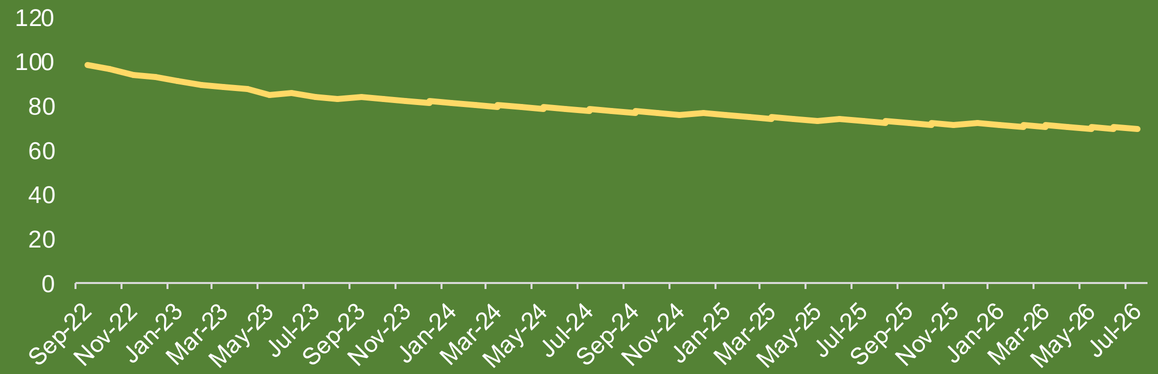
Mine workers at an underground mine, South Africa

Platinum futures stayed close to a 21-month low of about $870 per tonne, potentially signaling a slowdown in economic activity as platinum is a key industrial metal. As the Ukraine conflict rages on and the West continues to apply economic sanctions on Russia, it is anticipated that shipment disruptions from Russia would keep the metal supplies lower.

Figure 4 : Platinum, USD/Oz (2017-2022)

Figure 9 : Brent crude oil, US$/bbl. (2017-2022)

Figure 10: WTI futures (Sep 2022 – Jul 2026)



OPEC slow to increase output, relief in Q4

We have revised our oil outlook to USD 100 p/bbl. over Q3 down from our USD 125 p/bbl. estimate for Q2. November WTI futures suggest a price of USD 94 USD per barrel. We expect oil prices to ease in Q4 going into 2023. According to Reuters, from sources familiar with the matter, a modest increase in OPEC output is on the cards for September and is to be discussed at the Aug. 3 meeting of OPEC+ members. This will help relieve some of the supply side pressure that has driven high energy costs.

Image: Engineers work on Rompco gas pipeline, Mozambique

Zambia, being a net oil/fuel importer, is quite sensitive to global oil price movements. We expect relatively high consumer goods prices to persist but anticipate marked downward adjustments over Q3 due to strengthening Zambian Kwacha. The implementation of the 2022 National Budget may also be complicated by current price of oil due to changes in budget spending that will necessitate additional funding to fuel subsidy. We expect the current high energy prices to feed into Q3 earnings especially for companies in energy-intensive industries i.e. LaFarge and Zambia Sugar. High transport costs will also cost more putting pressure on retailers and curbing consumer spending, but this is likely to ease in Q4 into 2023.

Figure 6: Wheat, US$/Bu. (2019-2022)

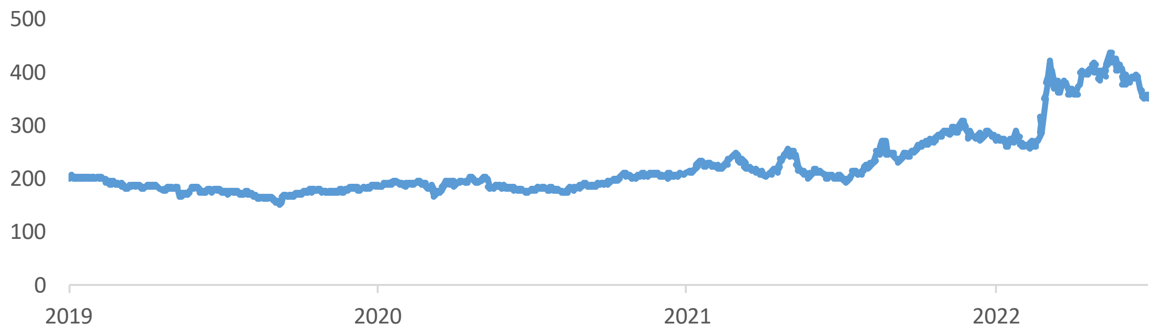


Figure 8: Rice, US$/cwt. (2019-2022)

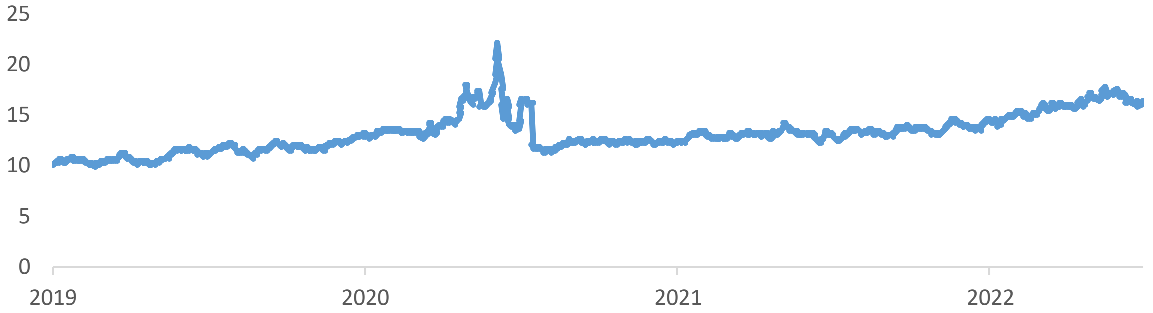
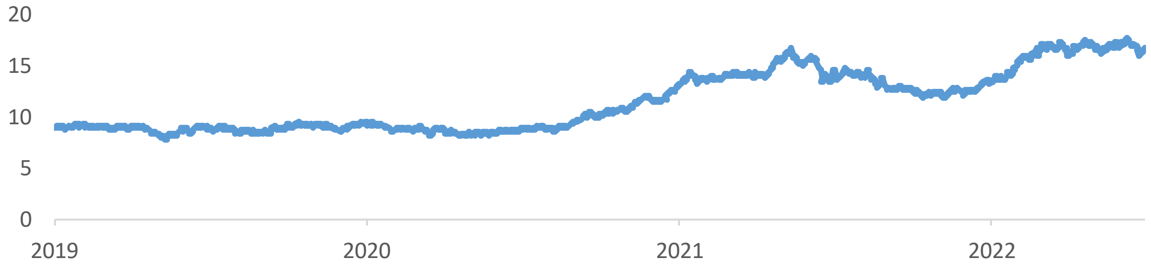


Figure 7 : Soybeans, US$/Bu. (2019-2022)



Soft commodities cool off slightly which may ease inflation

Following a whirlwind few months when wheat prices spiked after Russia's invasion of Ukraine, they recently experienced a dramatic decline in futures prices. Wheat futures hit their lowest level since February, and this decline can be attributed, among other things, to the weather in the Northern Hemisphere, which has improved after hot, dry conditions made it difficult to plant spring wheat in North America and threatened to impede progress on farms in the European Union. Additionally, investors' expectations of inflation have decreased as a result of the U.S. Federal Reserve's decision to raise interest rates which has caused money to flow out of commodities.

The price of rice increased globally for the sixth month in a row in June, rising to a level that was 2.3 percent higher than in June 2021. The quest for substitutes for wheat and other products that have been lost to the world market due to the conflict caused by Russia's invasion of Ukraine is driving up global rice prices. As the Middle East and North America search for alternative calories, rice is likely to become a primary alternative source to wheat. Concern over fertilizer is a further aspect that can put pressure on the global rice market as recently growers in Asia were forced to ration fertilizer on higher prices. "China has already reported an increase in pest and disease problems with its rice crop, while Thailand expects reduced yields as a result of the high fertilizer and chemical costs.

According to customs data, imports from China, the world's largest buyer of soybeans, decreased 23% from a year earlier in June as unfavorable weather increased the cost of the crop in Brazil. Although US imports increased in June, they are lower than expected for the first half of the year.. We expect soft commodities to remain at relatively high levels and we may see more meaningful reductions if grain exports from Ukraine are able to resume.

Figure 11: US Inflation (Jun 2021 – 2022 YTD)

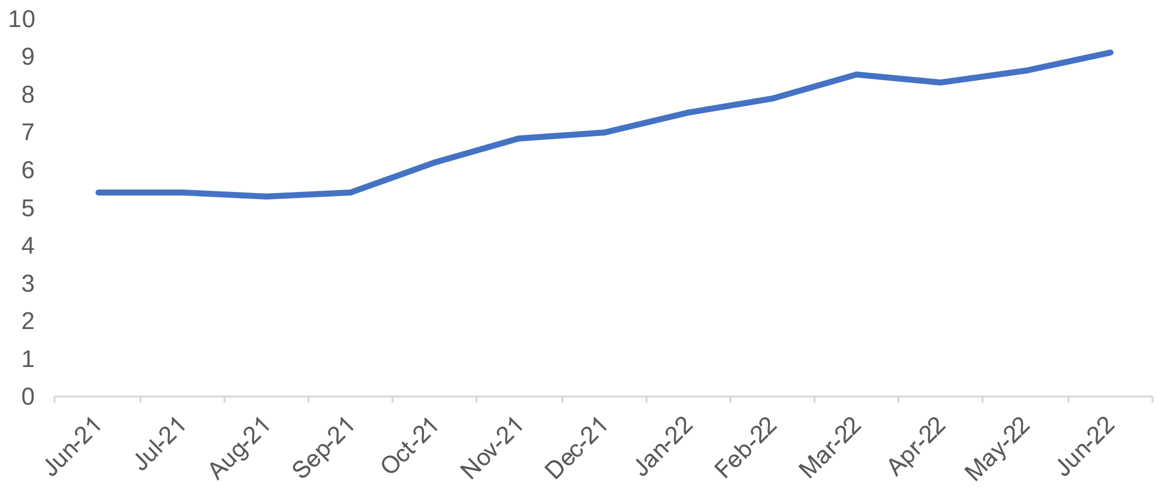
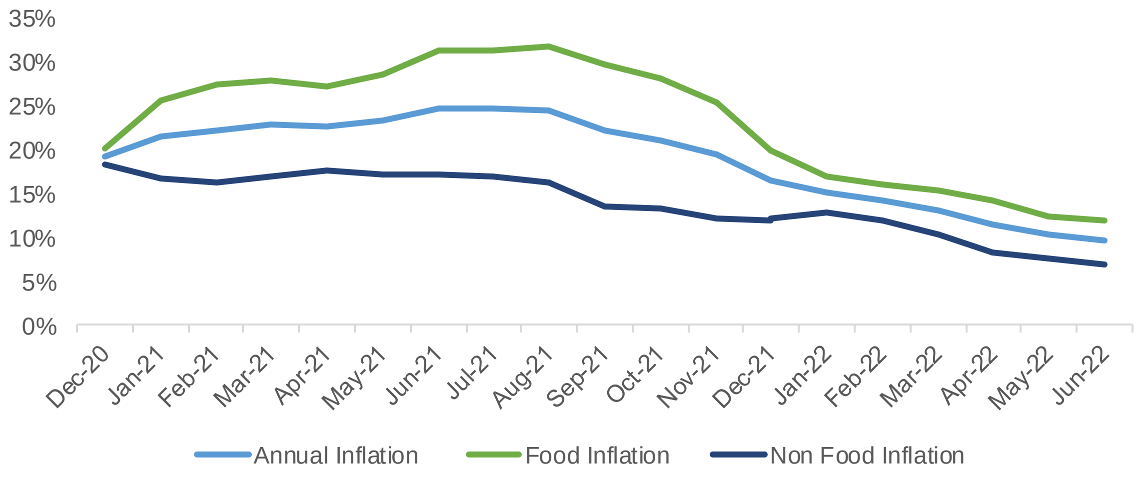


Figure 12: Zambia inflation (Dec 2020 – 2022 YTD)



US grappling with stubbornly high inflation – Fed raises rates

The US annual inflation rate increased from 8.6 percent in May to 9.1 percent in June 2022, surpassing market predictions of 8.8 percent and reaching its highest level since November 1981. The price of energy rose by 41.6%, the highest since April 1980, in part due to rises in gasoline (59.9%, the highest increase since March 1980), fuel oil (98.5%), electricity (13.7%), and natural gas (38.4 percent , the largest increase since October 2005).

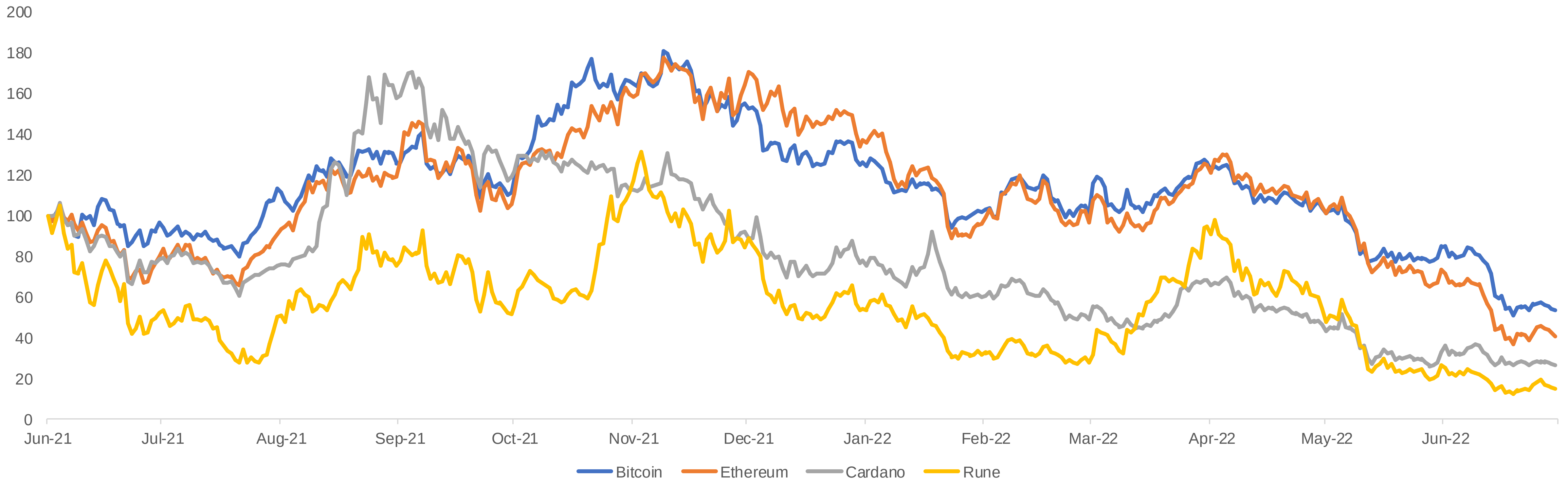
Food costs rose by 12.2% percent, which is the highest level since April 1979, while food prices rose by 10.4%, the highest level since February 1981. Price increases for new cars by 11.4 percent, home goods and services by 5.6 percent, and housing by 5.6 percent—all the highest percentage increases since February 1991.

Zambia inflation back to single digits, strong FX performance

The annual inflation rate for 2021 reduced to 16.4% from 19.2% recorded in 2020 (a decrease of 2.8%). YoY inflation figures for June indicate a substantial reduction in inflation with June 2022 inflation closing in single digits compared to the 10.2% measured in May 2022.

Fiscal policy is expected to remain tight with government making tight fiscal control a top priority. Rising energy costs globally play a role in forward looking inflation as global oil supply is impacted by Russia-Ukraine conflict. High cost of key agricultural inputs may put pressure on agriculture production in tandem with impact of adverse weather conditions across several regions globally. However, the expectedly appreciating Kwacha will help alleviate some inflationary pressures in the medium term.

Figure 13: Selected cryptocurrency performance (LTM)



Crypto decline continues Q2 may see temporary relief in Q3

The price of Bitcoin, the first and largest cryptocurrency, decreased by 58 percent in the second quarter of 2022. Bitcoin prices peaked at $46,282 at the beginning of the quarter and fell below $20,000 for the first time since December 2020 on June 18 before settling at $19,784.73 at the end of the period. Cryptocurrencies have always been extremely volatile, but losses of this size have never been recorded for any quarter since the first Bitcoin began trading in 2014.

As the market continued to bleed during the second quarter, Celsius Network, one of the largest cryptocurrency lenders stopped accepting withdrawals whilst some cryptocurrency-focused businesses such as Crypto.com and lending platform BlockFi laid off employees. Stablecoins such as Luna which were designed to reduce the volatility common of cryptocurrencies were put to the test during the second quarter aswell. The crypto market has seen a few crashes, including the 2014 and 2018 crashes, which were much worse than the current situation. This is a sign that the cryptocurrency markets are developing..

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Important information

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