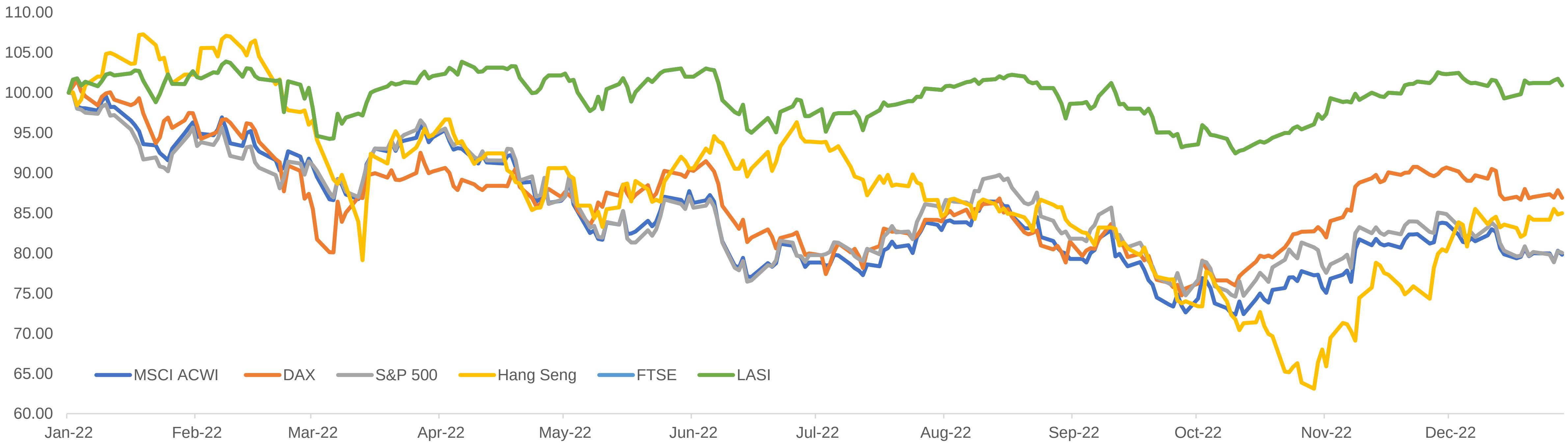
KUKULA

Global Markets Outlook: Q1 2023

23 January 2023

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

Indexed at: 100



2022 a tough year for equities, bottom in 2023?

Global equities closed lower in 2022, weighed down by a decrease in economic activity and high energy prices. This comes after a massive stimulus driven bull run from 2020 to 2021.

We expect equities to trade sideways for most of 2023 with bouts of volatility. Valuations are clearly cheap, and cyclical winds are shifting in favor of emerging markets as global inflation cools.

US inflation is still relatively high with US annual inflation closing out the year at 6.5%. We expect the US federal reserve to hike rates but at a much slower pace than 2022. Short run inflation drivers have mostly died down with pandemic era restrictions mostly removed. However, service cost inflation as well as a tight US labour market may keep inflation high.

Zambia's LASI index was Africa's best performer in dollars (+~12%), driven by gains in Copperbelt Energy Company (CEC). However, Zambian equities remain at a discount, trading below their 3y average P/E multiple at around 9.8x vs 12.1x (Compared to 19.89 for the S&P 500).

Figure 2: Consensus forward P/E multiples*

Developed	Forward P/E
US	16.9
UK	9.8
Japan	12.2
Canada	10.7
Germany	10.4
France	12.0

Emerging	Forward P/E
Brazil	6.8
Russia	2.6
India	21.6
China	10.4
South Africa	8.8
Mexico	11.9
Korea	11.5
Zambia	9.8**

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

Multiples higher for both developed and emerging markets

There has been a slight expansion in multiples generally for both developed and emerging markets. However, high energy costs and a weaker yen has meant a slight contraction in Japanese multiples. US markets are signalling a bit more optimism with investors expecting the federal reserve rate hike programme to be less aggressive this year.

We see at least a short-term opportunity for technology and financial services. Our view is to still to maintain a defensive stock allocation but while capturing some value in technology names that may be oversold.

The market consensus is that equities will trade sideways in 2023. Low unemployment and high wage growth will compress operating margins in markets like the US. The APAC region may provide a spot of growth with China commodities imports picking up which is a useful leading indicator for economic activity. A relaxing of restrictive COVID measures in China also bodes well for economic growth globally.

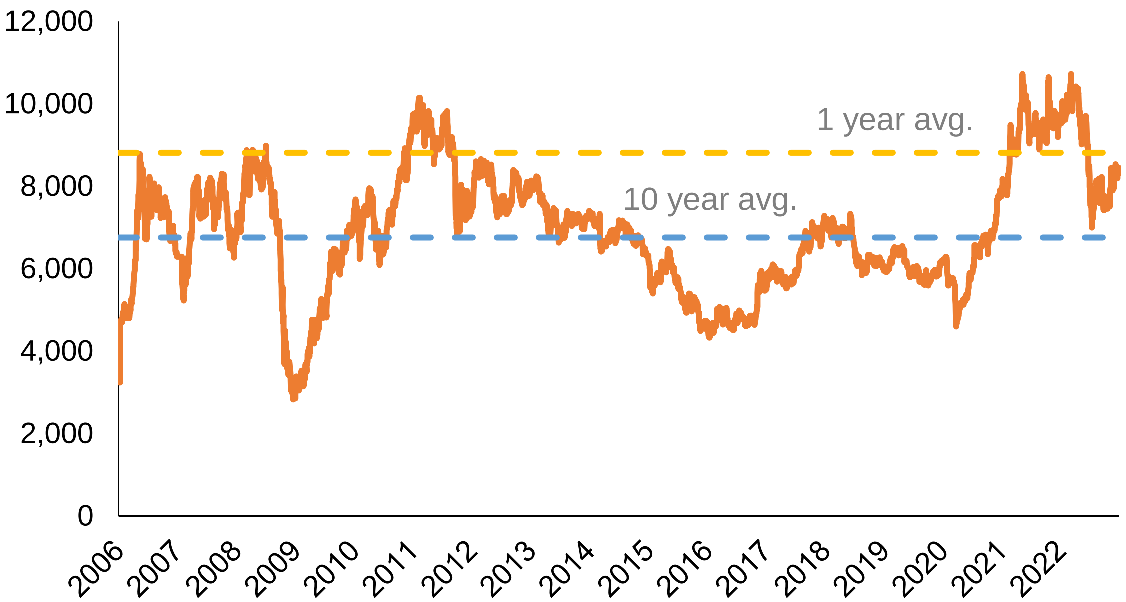
Commodities firms have traded lower following sharp rallies in 2022 on fears of short-term oversupply. Our view is that shortages are structural, and that demand is in fact likely to pick up especially in hard commodities. Oil prices remain relatively high boosting oil majors who have largely been on an upward trajectory over 2022 and may trend upward on the back of constrained oil supply from OPEC members.

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 2022 which we believe may be back in attractive ranges considering the long-term demand side fundamentals.

Zambian equities finished the year strong but remain relatively cheap. Zambian equities are trading at a discount compared to their 3y average PE of 12.1x. Zambia’s LASI index was Africa’s top performing index with gains driven by a rise in Copperbelt Energy Company.

Mopani Copper Mines shaft complex, Zambia

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



Demand up in China, good indication for productivity in 2023

Copper traded lower at the end of 2022 at just under $8400 US$ per ton (-13.7% for the year). The metal is a key component of equipment and production across many different sectors and therefore the metal is a bellwether for economic activity.

A recent easing in COVID related border restrictions in China is positive for commodities demand. China's imports of copper concentrate, or partially processed copper ore, was 2.41 million tons in Nov, down 28.9% from 1.87 million the previous month, according to customs data (large number partially attributable to base effect). This is positive for productivity at the beginning of 2023. Copper prices have rebounded in the last few weeks, with Chinese demand providing support to prices. Copper prices have been driven down by the urgent need to fulfill inventory needs in preparation for the looming pickup in demand expected in 2023.

The copper market is expected to remain in deficit in the longer term as the green transition accelerates, along with the demand for 'green' metals including cobalt and lithium. Additional copper supply is expected to come online over the course of 2023 potentially creating a short-term surplus. We remain bullish on copper in the long term. Our view is that supply will be in deficit as project lead times are usually in the order of several years and demand will outpace the arrival of new supply.

The Chinese government is considering issuing CNY3.81 trillion in local government bonds, which would result in further growth in infrastructure spending and a rise in the cost of industrial metals. Beijing's budget deficit might rise from 2.8% of GDP in 2022 last year to 3% of GDP this year.

Supply constraints in PGM market good for platinum price

Maintenance and power supply challenges in South Africa which supplies over 70 percent of the world's mined supply of platinum, resulted in an 18 percent decline in production yoy (ended Q3 2022). We are bullish on PGM miners for 2023, we believe the structural supply constraints are unlikely to be resolved in the short term. The rebuilding of Anglo-American Platinum's Polokwane smelter and flooding at Sibanye-Stillwater's Montana mine are major impediments to production.

Anglo-American Platinum's Bathopele underground mine, South Africa

Platinum prices picked up toward the end 2022 closing at USD 1069 per ounce to reflect the constrained global supply. Disruptions related to Russia-Ukraine conflict i.e., sanctions and other logistical impracticalities, will likely keep the metal's supplies low.

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

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

Chinese demand up

Crude oil prices remain above US 80/BBL. as fiscal stimulus measures augur well for China's demand outlook. In its second allocations for 2023, China announced a fresh batch of import quotas, totaling nearly 112 million tons, as an indication that it is stepping up to fulfill the rising demand. Travel demand is also expected to pick up as China reopens.

Image: 'Island Innovator' semi-submersible rig, South Africa

We expect oil prices to average US$85/bbl. in 2023 as OPEC production (including Russia) falls by about 3m barrels/day from its recent peak in late 2022. OPEC's reluctance to increase production (and to a large extent an inability to increase production due to underinvestment in new drilling and exploration) and commitment to lower production quotas in the face of pressure from Western countries should be watched in 2023.

Figure 6: Wheat, US$/Bu. (2020-2022)

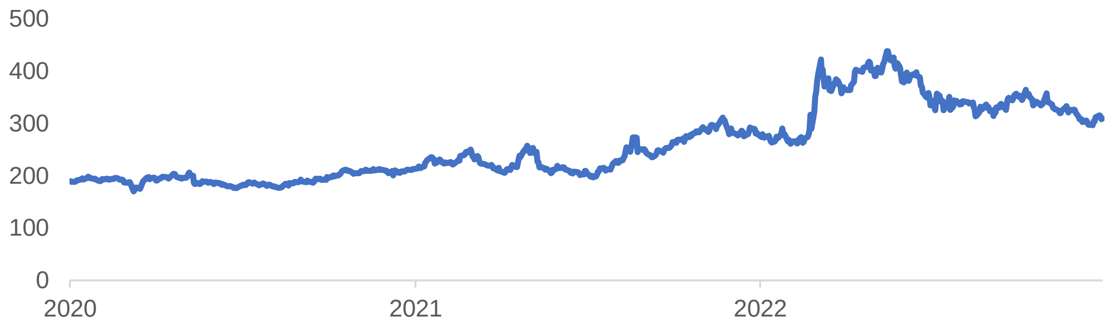


Figure 8: Rice, US$/cwt. (2020-2022)

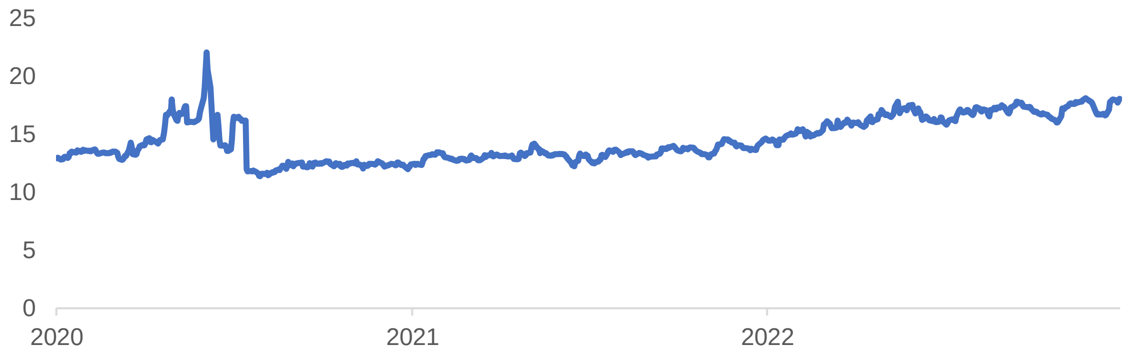
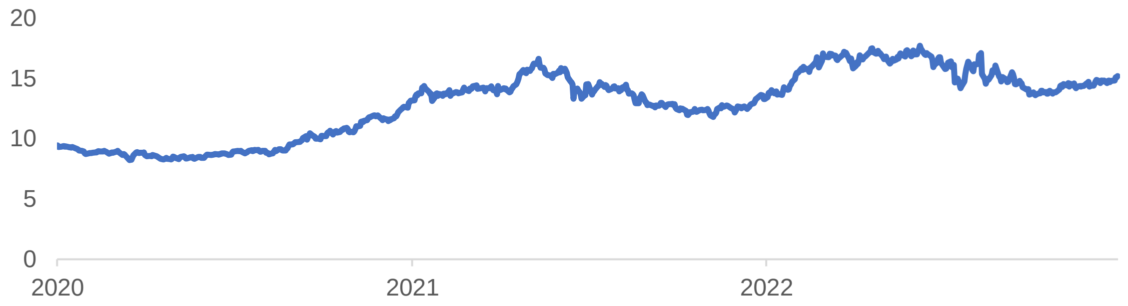


Figure 7 : Soybeans, US$/Bu. (2020-2022)



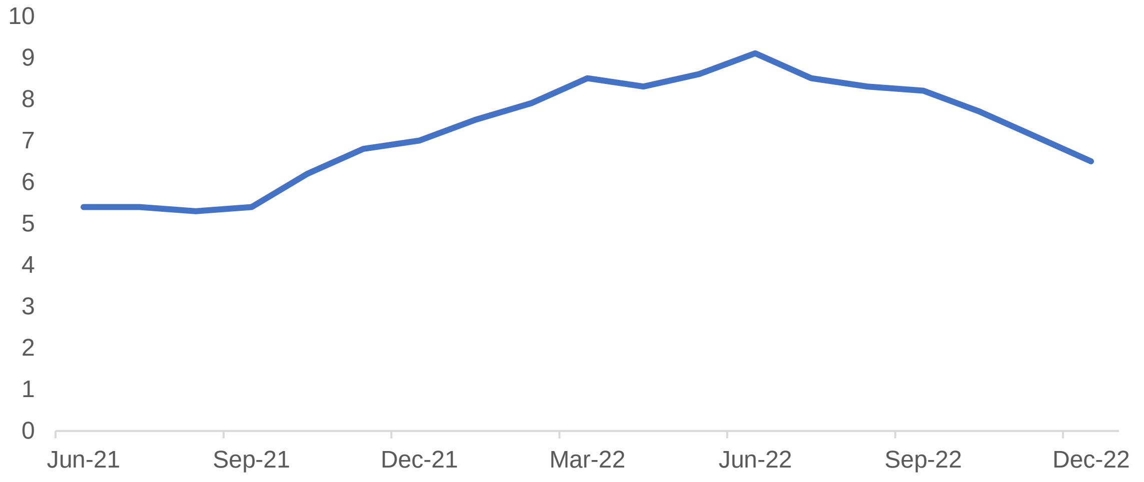
Soft commodities stable which may ease inflation

We expect global supply-chain disruptions stemming from the covid-19 pandemic to be mostly resolved in 2023. Along with increasing production volumes of agricultural commodities, we expect the price of food and feed to reduce. However, prices of agricultural commodities will continue to be influenced by events in the Black Sea region, in particular any extended agreements allowing Ukraine to export wheat. The war will also have an indirect impact on other agricultural commodities due to high fertiliser prices.

Wheat outlook uncertain - but better harvest expected in 2023

India’s wheat production is expected to increase to a record level this year as farmers chose high-yielding varieties and expanded their planting areas as a result of record-high prices. However, the unpredictable flow of wheat out of Ukraine makes accurate forecasting challenging. India, the second-largest producer of wheat in the world, may think about removing the restriction on exporting the food item due to the increased production, according to Reuters. The action will aid in assuaging worries about continuously rising food prices. We expect soft commodity prices to similarly trade sideways (as we do for other asset classes) with a slight positive drift.

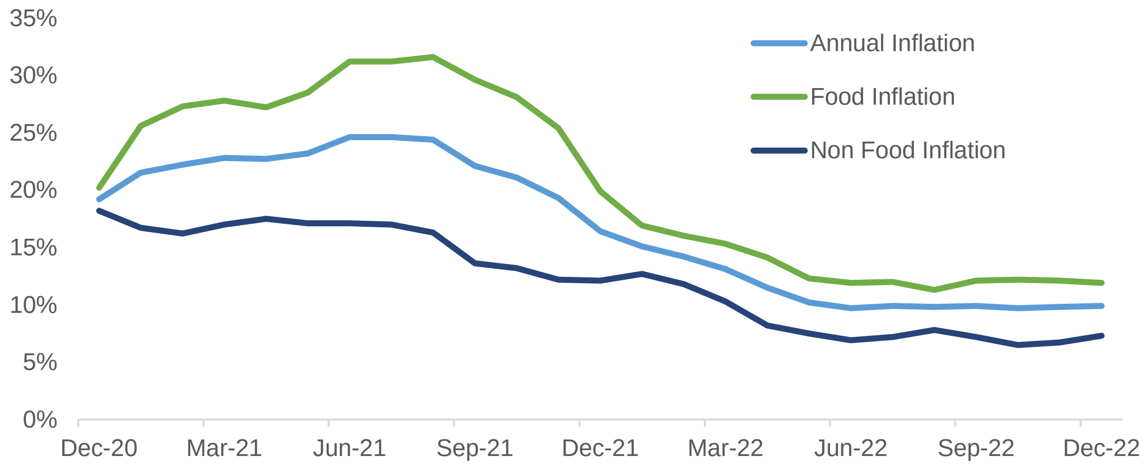
Figure 11: US Inflation (Jun 2021 – 2022)



US inflation cooling of, rate hikes expected to be slower

Inflation is expected to stabilize in 2023 with the market expecting a less hawkish response from the US federal reserve. Investors should pay attention to quality. U.S. high-yield corporate bonds which are offering attractive yields. We believe that in general, high yield securities are risky during this extended default cycle, however this broad selling also tends to put pressure on the securities of otherwise solvent and high-quality issuers.

Figure 12: Zambia inflation (Dec 2020 – 2022)

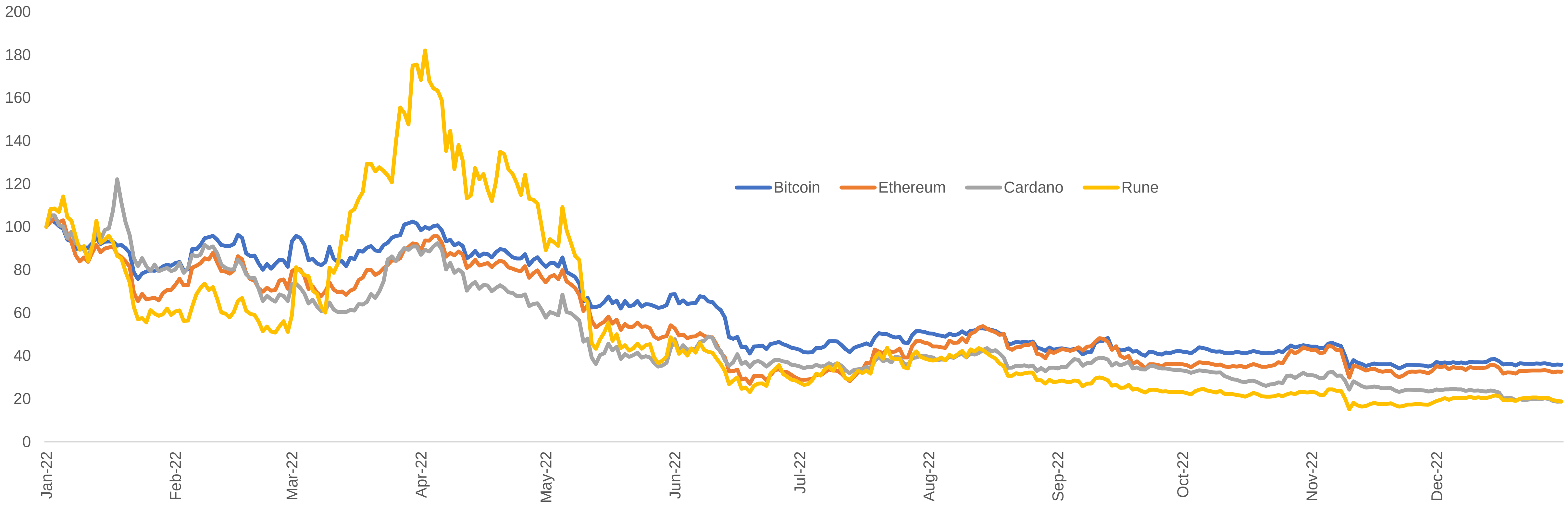


Zambia inflation remains in single digits, FX slips

Zambia annual inflation narrowly remained within single digits closing the year at 9.9%. Compared to 9.8% YoY in November.

Fiscal policy is expected to remain tight with government making tight fiscal control a top priority. High energy costs globally play a role in forward looking inflation as global oil supply is impacted by sanctioned Russian oil supplies. A decrease in soft commodity prices may help ease food inflation. This might however be offset by short term weakness in the Kwacha could mean higher inflation going into 2023 due to fuel imports being more expensive.

Figure 13: Selected cryptocurrency performance (LTM)



Cryptos end the year deep in the red. Slower rate hikes may mean relief in 2023.

Crypto news has been dominated by stories of the collapse of both the Celsius network in the middle of 2022 and the subsequent folding of FTX later in the year. Crypto returns are mostly correlated to other risky asset classes like stocks, so we expect a similar sideways profile with slight upside skew for the year but with marked volatility as we've come to expect form crypto currencies.

At the end of 2022, the market value of cryptocurrencies had fallen by $1,429 billion (65.4%) to $756.15 billion. The market capitalization of cryptocurrencies has returned to levels last seen at the beginning of 2021. We are however optimistic that a cool off in inflation will help boost prices over the coming year as investors get back into risky assets in general.

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