# Ready for returns

The prospect of political certainty is attracting investors back to Egypt. *Hardeep Dhillon* finds that the country's financial infrastructure is more than capable of handling a boom in asset management

Egypt's economy has suffered from political and social turmoil since the 2011 revolution toppled president Hosni Mubarak, with the army's ousting of subsequent president Mohamed Morsi last July igniting another phase of instability. However, the past two years have at least brought relative economic stability and the situation is predicted to steadily improve.

Egypt's GDP growth has been hovering consistently above 2%, with a rate of 2.3% in 2012, a temporary dip to 2% in 2013, and a predicted bounce back to 2.2% in 2014, according to the World Bank's *Global Economic Prospects Report*. Better is yet to come, with growth predicted to hit 3.1% in 2015 and 3.3% in 2016.

The $12bn in aid from Saudi Arabia, the United Arab Emirates and Kuwait in July 2013, plus another $9bn pledged, is helping shore up the country's reserves. Egypt's net international reserves improved to $17bn in December 2013 against $13.4bn in March 2013. Its balance of payments has been in surplus since June 2013, rebounding from a deficit for 2012.

Synchronised moves from the Central Bank of Egypt (CBE) and the government have helped boost sentiment among the business community. It was a much-needed foundation for a recovery in private investment in 2014, says Eric Swats, head of asset management at EIIB-Rasmala Group. The CBE cut the policy rate by 150 basis points in the past six months and the government's EGP60bn ($8.6bn) stimulus programme is intended to boost demand in the housing, infrastructure, transportation and energy sectors. "Both GCC aid and the interest rate cut were vital for the government to be able to initiate the programme," he says.

For Arindam Das, regional head of HSBC Securities Services Mena, 2014 may be the turnaround year as the restoration of political normality after parliamentary and presidential elections will benefit the economy. "From a political and economic perspective, the tide is changing in Egypt. A more stable situation by the middle to end of this year will also benefit the capital markets, while 2015 will be a better year economically."

The Egyptian stock market performed handsomely between June 2013 and February 2014 in anticipation of a more stable situation, with the main index rising by over 50% and turnover more than tripling from EGP300m to about EGP1bn. These are "remarkable figures given the challenging political situation", adds Das.

### Rising interest

A market trend upwards will drive local mutual funds' positive performance and lead to a pick-up in more subscriptions, suggests Amr Hussein Elalfy, global head of research at MubasherTrade. "This should add more purchasing power to existing mutual funds as local investors' interest grows, supported by an overall positive sentiment in the market. Furthermore, it has recently led to the creation of new mutual funds to take advantage of the opportunity," he says.

Elalfy adds that the firm's February launch of a portfolio management firm, Mubasher Portfolio Formation & Management, was in response to this anticipated growth. "We see the Egyptian market lagging behind the rest of the Mena region in terms of valuation and trading volumes and expect a continuation of the momentum seen over the past six to seven months," he says.

Local asset managers benefited from a recovery in the equity market during the past six months, which Swats says has revived interest in investing in the local market. He notes there was little interest in the second half of 2013, but he is optimistic the political developments expected in the second half of 2014 will likely bring an influx of foreign investment.

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SAMEH KHALIL
CI CAPITAL ASSET MANAGEMENT

Foreign institutional investors are returning slowly, according to Omar Radwan, head of asset management at HC Securities & Investment (HCSI). "Brokers state that some are revisiting their ideas and some are dipping their toes in the water, but they have lost a lot of the market moves," he adds.

International investors are always seeking better opportunities, which can now be found in Egypt, adds Sameh Khalil, managing director at CI Capital Asset Management. "They are keeping an eye on how the current situation develops and once the political roadmap is completed they will return to Egypt [and again consider it] 'the land of golden opportunities'."

Elalfy at Mubasher says international clients still have concerns over a sluggish economy, currency depreciation and capital controls when exiting the market. "Although some international and regional asset managers may opt to wait out these issues, others have made up their mind to build positions ahead of the market-wide recovery," he says. "Another driver is relative valuation vis-à-vis other regional markets, which perhaps are becoming more expensive."

Egypt has been a destination for international funds since its inclusion in the MSCI index in the late 1990s, and no major administration or custodian problems have arisen since then, says Swats. However, he notes that one recurring issue is repatriation of funds. "Currently, international investors who had their money invested before March 2013 are faced with long waiting lists for transferring funds outside of Egypt. Those who invested their money after the introduction of the new repatriation mechanism in March are not facing the same problem," he says.

Egypt is no stranger to international investors, and foreign investments are crucial to Egypt's economy, adds Elalfy, and the government facilitates the transfer of foreign investments in and out of the country. "However, due to a lower level of foreign reserves, banks guarantee transfers using the official exchange rate, but the process often takes a bit longer than before, in the region of a few days," he adds.

The government announced a new transaction tax of 0.1% on both buyers and sellers in February 2013 and started implementation in May 2013. The tax was widely criticised for achieving very small revenues as well as lowering the competitiveness of the Egyptian market compared with others in the region. Elalfy expects the tax may be cancelled by a judicial rule in April.

Indeed, the government has already cancelled a controversial proposal to tax share dividends and capital gains made in merger and acquisition deals and initial public oferings. "We believe it is highly improbable to propose any new taxes on stock market transactions in the foreseeable future, due to the high volatility of the market," says Elalfy.

Egypt's financial system has not deteriorated significantly over the past three years. Corporate activity is likely to resume, adds Swats, especially as the Egyptian Financial Supervisory Authority (EFSA) is working hard to list additional companies on the market and promote a more active fixed income market. "The regulatory platform is intact. Previously planned developments for the infrastructure of the market and financial system were only delayed. The current regulators, however, are now actively seeking to recover the pace of improvement," he says.

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### Restoring confidence

Reforms of the financial sector set out by the EFSA's new chairman, Sherif Samy, are aimed at restoring foreign investor confidence by improving the overall governance and transparency of the market and trimming red tape and bureaucracy. Measures include encouraging more Egyptian companies to list their shares – and therefore boost the stock market's capitalisation – improving the processing of corporate actions, enhancing disclosure rules and introducing a bond trading platform – planned for the second quarter.

The government began issuing 18-month bonds last year alongside its traditional maturities of three, five, seven and 10 years, which is a step towards building a yield curve and encouraging bond trading. The EFSA submitted new rules to the government in January to govern sukuk transactions.

Additional proposals relate to money laundering, Fatca, imposing timely reporting, introducing delivery-versus-payment (DvP), rights trading and exchange traded funds. Das at HSBC notes these are all steps in the right direction, and although DvP is still a work in progress, it will radically improve the current situation where the settlement cycles for purchases and sales are on two different days.

While the last Egyptian IPO was in November 2010, there could be a revival this year due to a rising equity market and the revision of rules to facilitate listings and attract new companies to the Egyptian exchange. EFG Hermes co-chief executive Karim Awad announced in January that following recent gains in the Egyptian stock market the bank planned three share flotations worth over $300m, one for Arabian Cement.

New executive regulations governing mutual funds are also imminent. They will force all Egyptian mutual funds, about 100 of them, to hire an independent third-party administrator to handle net-asset-value calculations and the shareholder register. It will also introduce forward pricing to stop manipulation – on redemption – and make them employ an independent board.

Fund administration is a new industry in Egypt, having been established in 2007, and is dominated by domestic players such as ServFund, Fund Data, Prime, Beltone and Noon. "This is a very exciting area of development in Egyptian financial markets, which will hopefully kick-start the market for index trackers, and exchange traded and real estate funds," says Radwan.

The regulations relate to mutual funds established before 2007, since those set up later are already legally obliged to have a fund administration company. Gamal Moharam, chairman of ServFund, expects the fund administration market to grow from $1bn to $10bn in the next year and is optimistic about further growth.

"Legislation is also anticipated for the pension funds and insurance industries, which will also be required to use a fund administration company," he adds. "We have had a tough five years and are now seeing better prospects."

He suggests that the industry requires the number of players to increase, even though it will mean increased competition for his firm. "We hope to see the international fund administrators come to Egypt because we can learn from them. We will be looking to service clients outside Egypt, in other countries in the Gulf region, such as Saudi Arabia, or even Europe."