DECEMBER 30, 2012

DaMina Advisors 2013 AFRICA Periscope

As we wrote in December 2009; ahead of the Arab Spring that toppled former President Mubarak, or in December 2011 and forecasted that South African President Zuma would trounce his deputy and sack Julius Malema from the ruling party – but adopt redistributionist policies- we once again peer into our DaMina periscope to see what 2013, *the Chinese year of the black water snake*, portends for foreign investors in Africa.

In Egypt, the land of pharaohs, Islamist President Mohammad Mursi is gradually metamorphosing into an authoritarian figure, who will fit neatly into the long line of Egyptian rulers since Imhotep. The year 2013 will likely see Egypt experience serious economic and financial shocks, primarily as a consequence of the chaotic economic effects of the nascent revolution. A $4.8bn IMF loan, which was designed to ameliorate the situation, has stalled and is unlikely to be disbursed until after parliamentary elections at midyear. The country's central bank has in recent months spent over 30% of its foreign exchange reserves defending the Egyptian pound and the governor has spent part of the last few weeks simply trying to hang onto his job. The pound is primed for devaluation in 2013. Unsustainably rising public debt and falling export and tourism revenues will combine to produce a fiscal and a bank liquidity crisis. Egyptian banks with high PE ratios and low earnings per share such as **Egyptian Gulf Bank** or others such as **El Watany Bank** which have performed very poorly compared to their peers in 2012 may be more vulnerable than others in a liquidity crisis. Many of Egypt's non-bank financial services firms are equally vulnerable in 2013, having previously bet heavily on luxury real estate, hotels and other tourism-affiliated businesses. Egyptian public and private sector USD-denominated debts stands at almost $40bn. The biggest risks in Egypt in 2013 will not be political; they will be financial and economic.

In contrast, **Nigeria**, after a hiatus of almost four years, 2013 will likely see a strong influx of new international fixed income equity investors into its capital markets in search of high stable yields and returns in an appreciating currency environment. Nigeria's stock market sentiment, which is heavily influenced by banking stocks, may in 2013 see its strongest run in years, as foreigners and diaspora Nigerians seek to re-invest in the country's cleansed and de-levered banks. Over $35 billion worth of bad loans have been siphoned from the sector over the past three years by the government "bad bank," Asset Management Corporation of Nigeria, leaving Nigerian bank balance sheets, governance structures and quality of assets as among the best in world (OECD inclusive). Unlike in most other emerging and frontier markets, in Nigerian ***all*** pre-2008 bank CEOs have been replaced across the entire sector; and an open forensic audit has been done on all the country's banks- a regulatory feat not even equaled in the UK, Spain, Russia, China, Brazil or the US.

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CONTINUED FROM PAGE 1

The Nigerian banking sector constitutes about 31% of the stock index; and has since 2008, seen more than doubling in foreign participation. In 2013, as the restructured, government-rescued banks are re-listed local and diaspora Nigerian interest in the sector will increase. With a price-to-book ratio of 0.93x; average dividend yield of over 5.8%; and a PE ratio of only 5.92 the sector remains supremely attractive in a world of global quantitative easing with no end in sight. **Fidelity, GT and Diamond** banks still remain very attractive. Nigerian macroeconomic fundamentals continue to be supported by a dearth of serious militia activity in the Niger Delta, stable oil production, a hawkish central bank that will keep the Naira range-bound and possibly even allow it to appreciate if inflation grows, and a dynamic youth bulge demography. Boko Haram, and affiliated Islamist terrorists continue to pose a major challenge to the country's security and political leaders. However, it seems increasingly likely that the activities of these anti-state actors will be confined to narrow geographic areas in the north of the country.

The bullish economic and capital market sentiments emanating from Nigeria are in sharp contrast to the growing investor unease over the seemingly radical adoption of the **faddish new theory of 'nominal GDP targeting'** promoted by a new quasi-orthodox school of economists, dubbed the 'market monetarists.' This group essentially argues that instead of central banks pursing standard orthodox policies focused primarily on checking inflation and maintaining the purchasing power of national currencies, countries potentially caught in a deflationary spiral should stop targeting forward looking inflation indicators, and target backward looking nominal GDP and figures such as unemployment. A corollary to the theory is that the central bank should use every means possible to get the economy to hit those targets – even if in the process monetary policy distorts the value of other assets or precipitates future inflation. Foregoing the maxim that 'no one can serve two masters equally', these theorists believe that prioritizing GDP growth or employment while checking inflation can be simultaneously achieved. In essence, the monetary authorities should take up a quasi-fiscal national governments The US Fed, on December 12, adopted something akin to this potentially inflationary policy. New Japanese Prime Minister Shinzo Abe and newly announced Bank of England Governor Mark Carney are also seemingly on board. Of the major global central banks, only the European Central Bank, always under watchful eye of the inflation-weary German Bundesbank has not jumped on the n-GDP targeting bandwagon yet.

Fixed income investors, retirees, savers, (especially the elderly) are to be sacrificed for the employment aspirations of the young. The evidence does not, however, support the conclusion that more money printing by central banks will improve growth. The evidence shows that it definitely increases urban inflation and inflation in non-capital intensive goods. No matter how much academic theorists try to persuade the naïve, it is increasingly probable that these new fashionable monetary theories will bring a great deal of inflation worldwide, leading to mal-investment (excess subprime mortgagees being an example from an earlier era) and even greater imbalances in the global economy than exist currently. The major central banks' ideological 180-degree turn may yet in nominal terms prevent both the US, Japan and UK from sliding into official recessions in early 2013 – if a fiscal cliff deal is averted in the US. However, despite valiant efforts by the central banks, it is unlikely that many jobs will be created.

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CONTINUED FROM PAGE 2

As Nobel laureate Simon Kuznets articulated clearly in his 1971 Nobel lecture,

> *"A country's economic growth may be defined as a long-term rise in capacity to supply increasingly diverse economic goods to its population, this growing capacity is based on advancing technology and the institutional and ideological adjustments that it demands. All three components of the definition are important. "*

US banks, according to the Fed, currently hold over 1 trillion dollars in cash. And yet entrepreneurs have refused to create millions of jobs for the millions of unemployed. Why? Over 5 million Americans have simply dropped out of the workforce in recent months, and more will. Almost half of all college graduates are moving back to live with parents at home. No amount of cash funneled through Fed purchases of US debt, or Fannie Mae and Freddie Mac debt instruments, or any of asset purchases can sustainably rekindle what seems dead or at least dormant in the American, European and Japanese entrepreneurs – '**Animal Spirits'!** With an accelerated western redistributionist, policies, 75% French tax rates, a fashionable socio-political philosophy that attacks, mocks, pours scorn upon, and inflicts guilt by association on successful wealthy entrepreneurs, the forces that spur many western entrepreneurs to take on more risk, risk livelihoods, capital to employ more people are simply atrophied. As the Kuznets quote above shows, the combination of technology, institutions and ideology sparks the fire/animal spirits that keep economic growth flames burning. Without strong adherence to a pro-market, capitalist ideology that rewards each according to ability, rather than each according to need or want, the embers of economic growth simply die out. Thus, 2013 will show what road the West (and every other markets) will take.

With unemployment figures in Nigeria, Pakistan and Ghana not even known and with unemployment rates in South Africa at over 25%, if African central banks follow their western counterparts, the coming inflation will be truly global and unprecedented. While Nigeria's central bank, more sensitive to Naira values, is unlikely to shy away, South Africa, Egypt, Ghana, Kenya, Zimbabwe and Zambia are all likely to jump on the n-GDP bandwagon eventually. The **South African Rand** and **ZAR denominated fixed instruments are particularly vulnerable in 2013.**

We have been at this inflation precipice before. On August 15, 1971, US President Richard Nixon in Executive Order 11615 ended the convertibility of the US dollar into gold by foreign investors and ushered in four decades of inflation and lower economic growth. Looser monetary policies over the past few years have not catalyzed higher economic growth. Over the past seven years – a period where the Fed has dramatically expanded the size of its balance sheet, and undertaken several relatively radical money printing exercises to aid the US economy recover- the average GDP growth has been the lowest since the post WW II decade of 1945 – 1955. Yet during the same period, urban CPI measures have almost risen by over 100% from their 1945 –'55 averages and registered the greatest increases since 1915.

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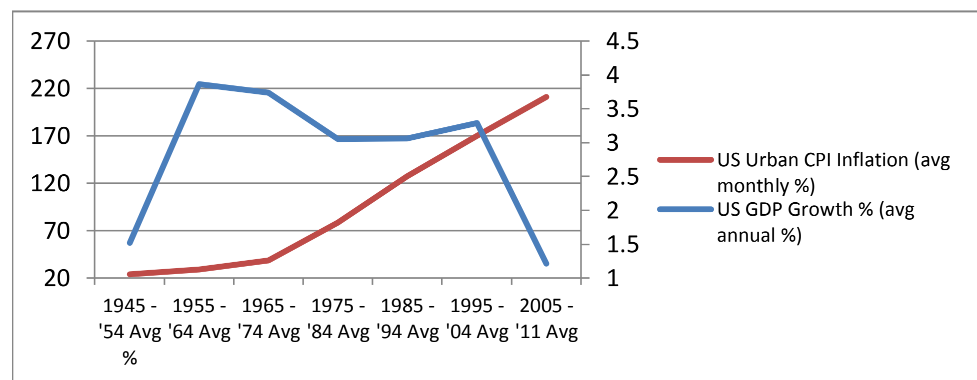
Continued from page 3

It is against this background of an ineffectual monetary policy during the past decade that the US Federal Reserve announced yet another radical step in its quest to resuscitate the slumping US economy – a nominal targeting of US unemployment (6.5% or below) and inflation (at 2% or above).

	1945 - '54 Avg %	1955 - '64 Avg	1965 - '74 Avg	1975 - '84 Avg	1985 - '94 Avg	1995 - '04 Avg	2005 - '11 Avg
GDP Growth % (Avg annual %)	1.52	3.86	3.74	3.05	3.06	3.29	1.21
Urban CPI Inflation (Avg monthly %)	23.79	29.14	38.36	78.24	127.3	170.15	211.011

***Source**: US BLS for CPI; US BEA for GDP figures*



Africa's phenomenal GDP growth and low inflation rates over the past decade are set for deterioration in 2013. African economies – such as Zambia, South Africa, DR Congo and Guinea – which are highly dependent on the mining sector are particularly vulnerable. Oil producers such as Nigeria, Angola, Algeria, Equatorial Guinea, Gabon, Ghana, Cote d'Ivoire, Cameroon and Uganda will however benefit from a widening of the spread between Brent and WTI, as a "hot" war in the Middle East becomes increasingly likely in 2013. Israel's prime minister gave a warning for war in September 2012 at the UN. Civil peace in mining rich countries, South Africa, Tanzania, DR Congo, Zambia, Ghana, Madagascar, Zimbabwe and Guinea could be challenged, as laid-off miners attack facilities and pose a challenge to industrial peace. The post-conflict natural resources FDI investments flows into South Sudan, Liberia and Cote d'Ivoire will also likely stall under strain from negative global economic developments. Guinea, Mozambique, Zambia, South Africa and DR Congo are particularly vulnerable. Major mining exploration projects in several critical African countries may also be delayed, as the cost of capital for mining projects rises and many mining companies undertake new internal NPV reassessments of these projects. Increased resource nationalism, tougher local content and environmental regulations for the private sector are also in prospect for 2013. *(For an exhaustive analysis on Africa's natural resources sector, please request our published 2013 Africa Commodities Outlook).*

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CONTINUED FROM PAGE 4

Elsewhere in Africa, new security dynamics are likely to impact natural resources sector investors in 2013. **In Mali**, a new UN-approved military intervention, slated for later 2013, has a low probability of success. The UN Security Council on 20 December unanimously authorized Resolution 2085 – "an African-led International Support Mission in Mali (AFISMA)." AFISMA is authorized for an initial one-year military deployment, primarily to contribute to the rebuilding of the capacity of the Malian Defense and Security Forces, and support the Malian authorities in recovering the areas in the north of its territory under the control of terrorist, extremist and armed groups and in reducing the threat posed by terrorist organizations. The resolution calls for elections to be held by April 2013. However, because of the chaos plaguing the Malian government, it is very unlikely that both a successful military mission to uproot the Tuareg rebels and Islamists in the north, and a successful logistical preparation for an election will succeed. Despite the UN resolution, UN Secretary General Ban Ki Moon remains skeptical about the military capacity, funding, operational effectiveness, command-control-structure, humanitarian implications and political ramifications of the mission. Effectively, AFISMA will act in a 1970s US 'military advisors' in Vietnam-type role to help Mali's mutinous army defeat the Islamists. This circuitous, rather than direct UN mission will very possibly doom the AFISMA to failure; as neither the Malian government nor the army is fully functional. The time limitation may also signal to the Islamists and Tuareg rebels to simply wait out the beleaguered mission. Lastly, with no specific funding mechanism identified, the major African countries expected to contribute troops such as Nigeria, Cote d'Ivoire and Ghana are unlikely to step forward anytime soon with enthusiasm due to their own domestic challenges. Several gold miners could be impacted by increased insecurity in the Sahel. **IAMGold, Avocet, Endeavor Gold, HighRiver Gold, Semafo, Amara Gold**, etc.

With former US presidential candidate and Senator from Massachusetts **John Kerry** slated to replace Hillary Clinton as US Secretary of State, two African countries which seem to have fallen off the front pages of US foreign policy primacy may return because of Kerry's longstanding personal interest. The humanitarian disaster in Darfur, and the unsettled peace beaten Sudan and **South Sudan** will come again into focus. Kerry has made several trips to Sudan and will focus his Africa attention there. South Sudan's stability will likely become a major focus at Kerry-led State Department; and American companies seeking to invest there will benefit. Benign neglect of Rwanda may well be over.

In **Kenya**, financial, consumer and retail companies seeking to expand their reach to the new market will benefit from a stabilizing American presence in South Sudan. However, a Kerry-led State Department is likely to make a major attempt to prevent International Criminal Court (ICC) indictees Uhuru Kenyatta and William Ruto from ultimately running in the March 2013 polls. The US is likely to push the ICC to accelerate its legal proceedings against the duo in order to send a strong signal to the Kenyan electorate that the US will not be able to have a normal relationship with the country if it elects Kenyatta and Ruto. But with both the presidential and vice-presidential candidates possible war criminals, Kenya will be thrown into a major political, legal, diplomatic, constitutional and crisis if Kenyatta and Ruto win, only to be hounded by the ICC and isolated by the West. Heavy handed interference by the US may also spur patriotic anti-colonial feelings in the electorate and possibly tilt the election towards Kenyatta and Ruto as an assertion of national sovereignty.

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CONTINUED FROM PAGE 5

Furthermore, Kerry's stint at the US State Department may also witness a growing distance between the US and its traditional central African ally, **Rwanda.** Rwanda's President Paul Kagame has in recent months come under withering criticism for supposedly financing the M23 ethnic Tutsi militia in eastern DR Congo. In late 2012, the numerically small contingent of troops routed a Congolese army brigade stationed in the densely populated town of Goma. While there has been growing disquiet in western corridors of power over aspects of the Kagame administration, Kerry, as former longtime chair of the US Senate Foreign Relations Committee has a stronger grounding in the issues and allegations that surround possible Rwandan mischief in DR Congo; and, unlike former Secretaries of State Colin Powell, Condoleezza Rice, or Hilary Clinton, may take a stronger stance against Kigali. A souring of diplomatic relations between Kigali and Washington will negatively affect all American companies operating in Rwanda; and possibly prolong the conflict in eastern DR Congo.

In South Africa, after a long period of foreign investor weariness, a ray of hope may have appeared because of the outcome of the recent ruling African National Congress (ANC) party conference that saw mine nationalization dropped from the agenda entirely and the election of pro-business candidate Cyril Ramaphosa as the party's deputy president (and next deputy president of the country). With Ramaphosa's election and the renewed attempt to make the moderate national development plan formulated under the leadership of pro-markets former minister of finance Trevor Manuel the centerpiece of the party's agenda for 2013 and beyond, the decades-long negative foreign investor sentiment that has shadowed South Africa may yet change. Renewed FDI inflows and internal economic reforms will accelerate economic growth and increase tax revenues for the many redistributionist polices of the ANC. However, it remains to be seen how much power Ramaphosa will really have; and whether Zuma will allow Ramaphosa to lead the cabinet in a prime ministerial style role, or, fearing usurpation of power or a political challenge, curb Ramaphosa's enthusiasm. Like Zuma, who mounted a campaign against Thabo Mbeki, and former deputy President Kgalema Motlanthe who mounted one against Zuma, Ramaphosa, in spite of his vaunted talents may be consigned to an ornamental role. The year 2013 will determine whether South Africa will leap forward or fall backwards. Renewed major investment interest in South Africa will see a spate of new M&A deals, large private equity placements and outright purchases of some of the country's best known corporate brands. Such as **Sasol, MTN, Old Mutual, Anglo-American**.

In 2013 a number of critical African elections are scheduled, beyond the contentious one in Kenya highlighted below and a legally disputed one in **Ghana** which may be re-run. **Zimbabwe, Ethiopia and Madagascar** are all scheduled to go to the polls. All three are likely to witness varying degrees of violence and controversy. DaMina Advisors will be making more precise forecasts and analyses as these elections approach. Ghana's recent elections yielded a result; a narrow re-election of the president, but not a concession from the major opposition party. The opposition party is headed to the Supreme Court and there is a high – if not definite - risk that Ghana could be ordered to have another election in early 2013. That will be a first in Africa, a court-invalidated presidential poll. But it will also add several hundred millions to the national deficit and lead to heightened political tensions and possible ethnic clashes.

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ABOUT THE COMPANY

DaMina is a preeminent independent frontier markets risk advisory, research and consulting firm.

With a special focus on African capital and commodities markets, DaMina provides exclusive, highly-tailored, 360-degree and around-the-clock regulatory and political risk advisory and consulting services to a range of marquee global corporations and investment firms.

Damina Advisors LLP is registered in the UK, NY and Ghana as a limited liability partnership.

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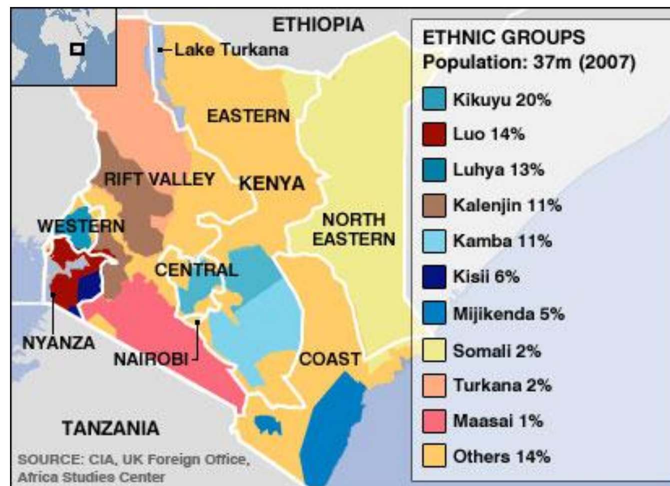
CONTINUED FROM PAGE 6

Spotlight – KENYA 2013: Of all the major African elections in 2013, none will probably more important than Kenya's. Kenyans will get the opportunity to elect the fourth president of Kenya, and also new governors and senators under the new constitution. Just like in 2007, ethnic politics, money and generational arguments will be to be the deciding factors. The country has been split into two large coalitions—The Jubilee Coalition and The Cord Coalition. The Jubilee Coalition is led by wealthy Uhuru Kenyatta, son of the first president, and William Ruto—both under indicted by the international criminal court for crimes against humanity committed in the post-election violence in 2007. Jubilee until recently had their flag bearer as Musalia Mudavadi, the political leader of the Luhya community, the second largest ethnic group. Now Uhuru Kenyatta will be Jubilee Coalition's presidential candidate with Ruto as the deputy president. If the three—Uhuru, Ruto, Mudavadi—had maintained the coalition, this would have been the obvious winning team but Mudavadi was adamant on being nothing less than the presidential candidate. Mudavadi's absence weakens the Jubilee coalition. He may run as a third party spoiler or eventually rejoin Jubilee as he is unlikely to rejoin his estranged former allies in Cord. Whichever group Mudavadi joins will have the upper hand. The other coalition is The Cord. This coalition comprises of Raila Odinga, Kalonzo Musyoka's and Moses Wetangula's. They belong to the Luo, Kamba and Luhya ethnic groups respectively. However Wetangula does not sway as much influence amongst the Luhya's as Mudavadi does. This means that the Luhya vote will be split, with Mudavadi carrying the lion share.



Jubilee Coalition
Kikuyu (Uhuru) 20%
Kalenjin (Ruto) 11%

Cord Coalition
Luo (Raila) 14%
Kamba (Kalonzo) 11%
Somali (Farah Maalim) 2%
Luhya 1/3% (Wetangula) (4%)

Voters who lie outside—Mt Kenya, Nyanza, Eastern, and Rift Valley—the strongholds of these two coalitions, will determine who the next president will be. The total of this swing votes is approximately 5million. The swing votes belong to the following ethnic groups: Kisii, Maasai, Turkana and others. The swing votes command a total of 28% of the registered voters. Close elections are always plagued by violence, but the violence will be very sparse because the incumbent will not be running and therefore state machinery will not be used to sway the election. DaMina Advisors will make more precise forecasts using its proprietary praxeological statistical models in early 2013 on Kenya.

WISHING YOU A HAPPY & PROSPEROUS NEW YEAR!

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