



Asset Class Performance In The Nigerian Investment Portfolio

Firstly, what do we mean by an “Asset”? According to the on-line resource tool Investopedia, an “Asset” is simply defined as “a resource with economic value that an individual, corporation owns or control with the expectations that it will provide future benefit i.e. security”. Also in the same context, an “Asset Class” is defined as a group of securities that exhibit similar characteristics, behave similarly in the marketplace, and are subject to the same laws and regulations. The three main types of asset classes are equities (stocks), fixed-income securities (bonds) and cash equivalents (money market instruments). It should also be taken into consideration that real estate is considered as an alternative asset class along with commodities and possibly other types of investments.

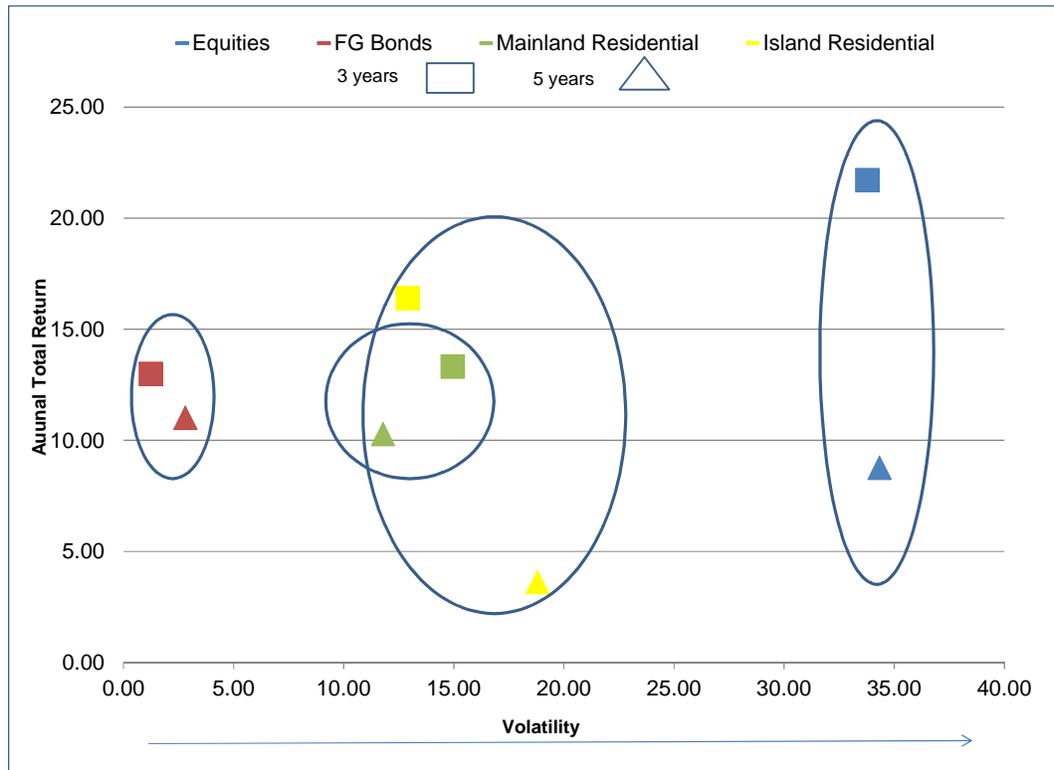
Portfolio Investment is a collection of securities i.e. asset classes in a portfolio. A portfolio is made with the expectation of earning a return on it. This expected return is directly correlated with the investment’s expected risk. Mixed-asset class portfolios consists of two or more asset classes and may include a combination of equities, fixed-income securities (bonds), money market instruments, real estate, commodities and other various types of investment securities. The composition of securities in a portfolio depends on a number of factors, among the most important being the investor’s risk tolerance, investment horizon and amount invested.

Over the years, Residential Auctions Company “RAC” has been consistently collecting data on the various asset classes within the Nigerian investment market i.e. equities, FG bonds and real estate (residential only). Our research has been focused on determining the performance of each asset class in terms of three key variables which are expected Total Return (TR), Capital Growth (CG) and Income Return (IR). The expected total return from an investment/asset class is derived from the addition of the capital growth (appreciation in value) of the security over a time period with the income return which depending on the asset class could be dividends for equities, coupons for bonds and rental income for property.

In the last five years, the Nigerian stock market has experienced a series of shocks from the stock market crash that transpired in 1998/99 and the subsequent global credit crunch. These events have had an adverse impact on the stock market particularly on equity prices. Many investors saw equity prices dropping off rapidly with billions of naira being wiped off the value of companies listed on the Nigerian Stock Exchange (NSE) resulting in major losses. Similarly, the same can be said for the residential real estate market in Lagos which experienced a decline in real estate values following the banking debacle and credit freeze. Our study will show just how each of these asset classes (including FG bonds) performed in terms of expected total return during these crisis periods against the level of risk involved in investing in each asset class over a period of time. For the residential real estate market, we have split the market into two, given the distinct market dynamics which is idiosyncratic to each market namely the Mainstream Lagos Mainland Residential and Prime Lagos Island Residential markets.

In Figure 1, we have a chart showing the performance of each asset class over a period of time from the past 3 years (mid-term) to 5 years (long term) relative to total return and volatility (risk).

Figure 1 Asset Class Performance Chart



Source: Residential Auctions Company and FDHL Analytics

As can be seen from Figure 1, equities (NSE) as an asset class are highly volatile (risky) because they are susceptible to the slightest change in the economy or news filtering through the market. In the last five years (long-term) the expected total return has been low (less than 10%) from this asset class due to the factors highlighted above whereas in the last three years (medium-term) we have seen the total return rise to a new high of 21.70% as the market rebounded with equity prices rising further after the global economic recession. It is important to note here that there exists a direct correlation between the highly volatile equities market and the prime Lagos Island residential property market (Ikoyi, Victoria Island and Lekki Phase 1).

Similarly, like the equities market five years ago, the Lagos Island residential property market also saw low returns as total expected return came to just 3.61%. We also see the trend continuing in the medium-term as the expected total return on the Lagos Island residential property market rose to 16.39% as the market also saw a comeback with real estate values creeping up again after the lackluster preceding years. Without any doubt, having these two asset classes in the same investment portfolio poses a great risk to any investor as they both share a common exposure to external forces that may negatively impact their performance especially with expected total return. The correlation between these two asset classes exhibits characteristics of Margin Loans. Margin buying refers to the buying of securities with cash borrowed from a broker or financial institution, using other securities as collateral.



This has the effect of magnifying any profit or loss made on the securities. The securities serve as collateral for the loan.

On the other hand having the Mainstream Lagos Mainland residential property market in a mixed-asset class portfolio will go a long way to diversify the risks and guarantee expected returns in such an investment portfolio. From the above chart, we see that the Lagos Mainland residential market has a low volatility which makes it a less risky investment with moderate expected total return either in the medium–long term. In the medium term, expected total return on the Lagos Mainland residential property market has been moderately high at 14.96%. While in the long term, the expected total return was a moderate low of 11.80% due to the economic condition that prevailed around that period. It is evident that the Lagos Mainland residential market has an inverse correlation with the Lagos Island residential market and equities which makes it an ideal asset class within a multi-asset class portfolio to hedge against risks. Any shrewd portfolio investment manager will definitely include the Lagos Mainland residential market in their investment portfolio.

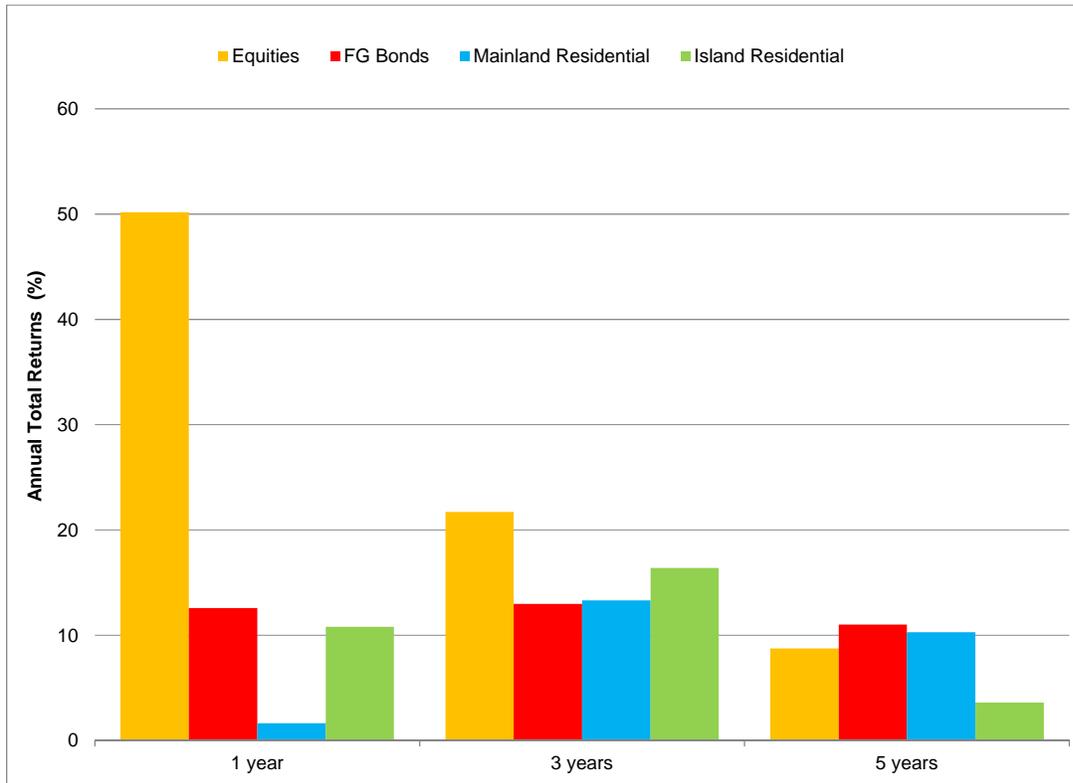
Last but not least is the fixed-income securities also known as bonds and in this case Federal Government bonds. Bonds in general are as considered very low risk assets, especially government bonds which are considered as risk-free securities due to the fact that they are backed by the government with very little or no default on them. Their inclusion within a mixed-asset class portfolio offers moderate returns and extremely low volatility for any portfolio manager to consider. Similarly, just like the Lagos Mainland residential property market, bonds can be used to hedge risks in a multi-asset portfolio. In the medium to long term, they offer moderate returns and extremely low risks.

Finally, we take a look at the annualized total returns on each of the various asset classes from the short term (1 year) to the medium term (3 years) and the long term (5 years). This is presented in Figure 2.

- **Equities:** In the short to medium term we have seen total return to be very high, hence out-performing the other major asset classes. While for the long term, total return on this asset has been dismal and out-performed by bonds and mainland residential property.
- **FG Bonds:** As can be seen the total return on this asset class has remained very stable over the short, medium and long term making this asset class a trustworthy investment.
- **Lagos Mainland Residential:** In the short term, this asset class was out-performed by all the other asset classes due to falling capital values recorded for this period. However, in the medium to the long term, the total return has remained stable. In the long-term, it out-performed its rival the Lagos Island residential property market.

- **Lagos Island Residential:** In the short term to the medium term, the total return on this asset has been stable with a slight rise in the medium term. However, in the long term it was out-performed by all the other asset classes as total return dropped off sharply.

Figure 2 Asset Class Performance In A Mixed- Asset Portfolio



Source: Residential Auctions Company and FDHL Analytics



Important Note

Finally, in accordance with our normal practice, we would state that this report is for general informative purposes only and does not constitute a formal valuation, appraisal or recommendation. It may not be published, reproduced or quoted in part or in whole, nor may it be used as a basis for any contract, prospectus, agreement or other document without prior consent, which will not be unreasonably withheld.

Our findings are based on the assumptions given. As is customary with market studies, our findings should be regarded as valid for a limited period of time and should be subject to examination at regular intervals.

Whilst every effort has been made to ensure that the data contained in it is correct, no responsibility can be taken for omissions or erroneous data provided by a third party or due to information being unavailable or inaccessible during the research period. The estimates and conclusions contained in this report have been conscientiously prepared in the light of our experience in the property market and information that we were able to collect, but their accuracy is in no way guaranteed.

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