MARKET COMMENTARY SEPTEMBER 2022

Dual Return Fund - Vision Microfinance
Dual Return Fund - Vision Microfinance Local Currency

The month in bullets:

- Promising microfinance investment pipeline for Q4 2022
- Spotlight: Impact of inflation on end-clients

I. Manager Commentary

During the first half of 2022 geopolitical tensions, inflationary pressures, recession fears and rising rates were added to the pandemic as worldwide concerns. The Micro- and SME (MSME) finance markets have been affected in different ways but showed persistent resilience overall. Sound management, support from regulators, governments, development banks and international creditors have helped microfinance institutions operating to weather these crises.

The Dual Return Fund continues to promote sustainable delivery of financial services to the working poor. During the first half of the year 2022 as well as during the past years the Fund remained true to its strategy of investing in the microfinance asset class irrespective of world economic trends in accordance with the Dual Return Fund's investment policy and objectives.

During the month of September, the Dual Return Funds disbursed loans with a total amount of 12mil USD in seven different countries (China and India are among the highest volumes). One new institution in China was added to the portfolio. Thus, further increasing the diversification of the Dual Return portfolio. So far, more than 2.3 billion US-Dollars were distributed in the form of 1315 loans to 331 different MFIs in 69 countries.

The fund has already established a promising pipeline for the last quarter of 2022, continuing its momentum with the proven diversification and focus on high quality institutions.

II. Fund Performance

Dual Return Vision Microfinance Fund

The Dual Return Fund Vision Microfinance registered a negative net return of -0.07% for the USD (I-T) share class for the month of September. The EUR (R-T) and EUR (I-T) share classes registered a negative monthly performance of -0.35% and -0.30% respectively. During the month of September, the fund's investment level remained at around 91%.

As part of the portfolio is mark-to-market valued temporary monthly positive or negative effects impact the performance. This was also the case this month when the valuations had a negative effect on the performance. The previously very low hedging costs from USD to EUR or CHF are currently increasing. The volatility of about 0,7% p.a. since inception underscores the diversification potential of the Dual Return Vision Microfinance Fund for investors' portfolios.

Dual Return Vision Microfinance Local Currency Fund

The Dual Return Fund Vision Microfinance Local Currency's strategy of lending in local currencies is very important within the microfinance world as the Fund holds a unique position. It contributes to the process of sustaining the MFIs' access to private money in local currencies and developing local financial markets.

The Dual Return Fund Vision Microfinance Local Currency registered a negative net return of -0.68% for the USD (I-T) share class for the month of September. The EUR (R-T) and EUR (I-T) share classes registered a negative monthly performance of -0.89% and -0.83% respectively. During the month of September, the fund's investment level increased to around 89%.

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III. Local Currency Update

Emerging and frontier market currencies as well as fixed income markets were rattled by another exceptionally strong US-Dollar performance during the month of September, which temporarily reached below 0,96 USD for one EUR. The already high volatility of commodity prices keeps spiking and will remain elevated as overall liquidity levels keep decreasing while inflation pushes bond yields higher as Central Banks try to bring CPIs down via significant rate adjustments. The war in Ukraine and governments' sanctions on Russia add to the complexity of the ongoing year for investors and central bankers alike. From a local currency perspective, some frontier market currencies appreciated again in this environment by profiting from high commodity prices, rate hikes and spill-over effects - especially Central Asian foreign exchange notably the Georgian Lari and the Tajikistan Somoni remain in the tailwind of a strong RUB buoyed by the energy price spike.

In this uncertain environment the US Dollar remains firmly in its role as a safe haven also due to the lead in interest rate hikes. An attractive carry for several local currencies is key in these fixed income markets and helps buffer shocks to a certain extent. Yields have become ever more appealing during the last months. More certainty about an eventual path to peace negotiations, inflation as well as rate hikes by EM/Frontier central banks are expected to trigger positive developments for emerging market foreign exchange versus the US-Dollar.

Besides Central Bank as well as Development Finance Institutions' announcements, we keep monitoring any discussion involving the energy sector like the OPEC+, trade negotiations, political developments in frontier as well as emerging market and the health developments.

IV. Social Impact Corner

In August 2022, Symbiotics conducted a study on the impact of rising inflation on end-clients in Ghana, Colombia, Kyrgyzstan and Sri Lanka with a focus on five topics of interest.

First, they find that end-clients are still able to access goods of first necessity. However, prices for these goods have risen due to i) increased fuel prices and ii) a devaluation of most emerging market currencies against the US dollar.

Moreover, inflation has not been a driver of social unrest or protests so far. However, Symbiotics assumes that fuel prices locally will remain an important factor for social stability.

Third, inflation has had a negative impact on end-clients' disposable income. Nevertheless, the impact on end-clients' ability to repay has remained moderate so far.

Symbiotics further find that a large portion of the costs incurred due to the increased local reference rate is expected to be passed on to the end-clients. Therefore, respondents do not expect the quality of their loan portfolio to deteriorate. However, this is only a short-term solution. Investees may have to restructure portfolios and reduce disbursements.

Further, there seems to be no major shortages of USD due to inflation. At the same time, devaluations affected disposable income and the ability to purchase imported goods. Micro end-clients are expected to be less affected.

In summary, the impact of inflation on end-clients has so far remained moderate. Possible reasons could be that people are familiar with an environment of high inflation and volatility and their ability to pass on increased costs in sale price in some cases. However, more volatility is expected, especially in economically fragile countries that are unable to guarantee the supply of essential goods, with fuel being the key commodity.

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V. Microfinance & Development Finance News

MICROFINANCE PAPER WRAP-UP: "Banking in Layers: Five Cases to Illustrate How the Market Structure for Financial Services is Evolving"

Over the past 15 years digital innovations strongly influenced the financial inclusion of low-income people in emerging and developing countries. Further profound changes could lead to greater modularization of the financial sector. In turn, this could expand financial inclusion while increasing the sector's competitiveness and efficiency. The authors examine this trend using five illustrative companies.

Read more here.

MICROCAPITAL BRIEF: Committee in Bangladesh Considering Cutting Microcredit Interest Rate Cap Below 24%

The committee, recently convened by the government, aims to analyze the cost of MFI services and determine whether these costs can be reduced by setting a maximum cap nationwide. The committee is mandatory to be formed every two years by the MRA (Microcredit Regulatory Authority). The MRA is responsible for monitoring and supervising the microfinance operations of NGOs in Bangladesh. In 2010, the committee reduced the annual maximum rate to 27% and to 24% in 2019.

Read more here.

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