Investment Newsletter January 2023

Sunset from "Casa di Bacco", Montepulciano, Tuscany, Italy, 28th August, 2022 - Courtesy, S. Dry

Dear Investor,

Global Recession … probably.

Karibu 2023. The new year will bring surprises, as sure as night follows day. While those surprises are unknowable, we can anticipate major themes. One major theme is a global economy adjusting to higher interest rates. These higher interest rates are almost certain to be a drag on economic activity, so much so that we expect a mild global recession in 2023. The World Bank continues to lower growth forecasts for 2023. It is now projecting global growth of 1.7% this year - down from 2.9% in 2022.

While interest rates around the world are rising, they are a direct result of rate hikes initiated by the US Federal Reserve Bank ("Fed") to reduce US inflation. The Fed raised interest rates seven times in 2022 from basically zero 4.5% now. It was raised another ¼ point on February 1, 2023. Nevertheless, inflation remains stubbornly high at 6.5% in the US. The Fed wants it under 3%.

The Fed's interest hikes have had serious knock-on effects worldwide. It has increased the value of the dollar vis-à-vis other currencies, it has caused capital flight from emerging and developing countries to the higher yielding dollar, and it is affecting international trade.

This is all collateral damage, if you will, as the intended effect is to slow US economic activity – to slow inflation. Higher interest costs mean less borrowing by individuals and companies. This in turn means consumer spending falls off. It also means more unemployment as factories produce less. US unemployment is currently 3.5%. The Fed may be targeting 5% which unfortunately will mean pain and suffering for those losing employment.

Generally, however, economists consider inflation the greater evil. In simple terms, if inflation takes hold, prices increase, employment costs increase, and it can spiral out of control – like the hyperinflation of Germany in the 1930's and more recently like that of Zambia. Inflation is always a threat with fiat currency.

So, the global economy is paying the price for too much laxity in monetary and fiscal policy over the past two decades. With low interest rates and governments binge borrowing, the value of all currencies has been degraded.

If the coming recession results in positive interest rates (where interest rates are higher than inflation), money will once again have a price and be a store of value. Prices should stabilize, companies and families can plan, productivity will rise and generally standards of living should rise for everyone.
Before that happens, however, expect some economic contraction. These growth projections by the World Bank all show slower growth for 2023:

	2022	2023
Global	2.9%	1.7%
US	1.8%	0%
Kenya	5.5%	5.2%
UK	4.2%	(1.4%)
India	7.0%	6.9%

Effect on Stocks and Bonds

Rising interest rates are always detrimental to stock prices. There's an old saying on Wall Street "Don't fight the Fed". This is not only because the cost of borrowing by companies rises, but company earnings fall as consumer demand falls. On the other hand, new bonds being issued around the world carry higher coupons, so fixed income assets become more attractive to investors.

What to Do Now with Stocks?

The US National Bureau of Economic Research has determined that the average length of recessions in the US since WW II has been 10 months. And according to a Forbes article (1-Apr-22 "How Stocks Perform Before, During and After Recessions"), while stock market returns for the 12-month period leading into a recession have always been negative since WW II, stock market returns during recessions were positive during recessions 50% of the time. This reflects the fact that stock markets are forward looking – in our experience often six months forward looking. The article also points out that US bull markets averaged 54 months while bear markets averaged only 10 months since WW II, making the point that staying invested in the market long term leads to superior returns.

So, staying invested makes good sense. But dollar cost averaging where you continue buying at preset dates throughout the recession with equal amounts of money makes even more sense. Someone once said that the stock market is the only market that people don't rush to buy when there's a sale on. And there is currently a sale on.

Specific Recommendations

Dry Associates is an active stockbroker in both the Kenyan and international stock markets on behalf of our private wealth clients. Our house view recommendations for Kenyan and international stocks and bonds are continually updated through our "Weekly" publication (link). If you are not receiving this, please have your Investment Executive put you on the distribution list.

The current Weekly, for example, recommends building a position in two local Kenyan counters. The Kenyan stock recommendations offer deep value meaning they are currently trading significantly below their historical multiples. One recommendation is Standard Chartered Bank (KES 157/=) which currently pays an annual dividend of 12%. With a Price/Earnings Ratio of 6.7x and a Price/Book value of 1, this stock and several others offer good value.

For our clients with international portfolios our recommendations include building a position in the S&P 500 index stock (ticker symbol "SPY"). This stock should be purchased periodically over the next 6 to 9 months. The stock is a composite of all 500 stocks in the index. Of course, for clients wanting a pure play, there are recommendations like Apple, Coca-Cola, and Exxon. For more adventuresome clients, contact your Investment Executive to consider writing call options against these stocks to increase current income.

If a man saves $15 a week and invests in good common stocks and allows the dividends and rights to accumulate, at the end of twenty years he will have at least $80,000. He will have an income from investments of around $400 a month. He will be rich. And because income can do that, I am firm in my belief that anyone not only can be rich but ought to be rich.

John J. Raskob (1928)

Spence Dry saying farewell to long time client, Mr. Naigzy retiring to USA, 11th October 2022

Fixed Income Investments

As always, our Investment Executives construct investment portfolios to reflect the personal characteristics of individuals and families and institutions. For retail clients, other than obvious considerations like age, risk appetite, income level, and specific financial requirements such as education and retirement, we have found it advantageous to take advantage of relatively high yielding fixed income instruments available in Kenya. These debt instruments offer the advantage of regular income and compounding interest.

Starting with unit trusts, for example, the Dry Associates KES Money Market Fund which pays approximately 9.5% per annum (the US Dollar Money Market Fund currently pays 3.25%) and offers periodic distributions – monthly, quarterly, or semi-annually. The funds also offer a sweep feature whereby income from other products is swept into the money market funds.

Private wealth clients meeting certain financial criteria are also eligible for short term fixed income securities such as commercial paper paying 12.5% to 15% per cent per annum in shillings and 8% to 10% in dollars. Tax free Kenyan Treasury Bonds should also be included in well balanced portfolios. Again, our Weekly report captures these securities including the latest offerings.

The following is a summary of Kenyan fixed income securities:

Issue	**Interest Rate**	**Source**
Commercial Paper - 12 months	14.5%	Dry Associates
Commercial Paper - 6 months	13.5%	Dry Associates
Kenya Treasury (tax free) 4-yr bonds (YTM)	12.4%	Market Determined
Kenya Treasury Bill – 12 months	10.0%	Central Bank of Kenya
Dry Associates KES Money Market Unit Trust	9.5%	Dry Associates
Inflation	9.48%	Central Bank of Kenya
Commercial Bank Fixed Deposit Rate	6.82%	Central Bank of Kenya

Turtle Bay, Pointe aux Piments, Mauritius, 2nd November 2022, Courtesy: S. Dry

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Forex Markets

The US Fed's rate increases have also affected foreign exchange markets. The fourth quarter 2022 saw the Euro trade at 1:1 to the US Dollar. The Japanese government intervened in its currency market to stop the yen's depreciation against the dollar. The pound slid to a 20 year low of $1.20. Currency depreciations have been even steeper outside traditional safe-haven currencies. Emerging markets currencies have weakened, with some countries like Sri Lanka reporting an exceptional 70% depreciation against the dollar. The Kenya Shilling has also been affected, officially losing 9.5% over the past 12 months.

As mentioned above, bond yields across the globe have risen in tandem with the rise in interest rates. Emerging market bond yields with low credit ratings have been particularly affected. The Ghanaian sovereign bond is currently yielding 31% obviously showing signs of debt distress and so much so that it is lobbying the IMF for emergency funding.

On the positive side, the higher bond yields have created opportunities in bonds issued in the US and Europe. These issuers are often credit rated by S&P better than emerging market sovereign Eurobonds. As these bonds are denominated in US Dollars there is no currency depreciation effect. These and other issues are captured in our Weekly report.

New Offices for Dry Associates

We are pleased to announce the opening of our new headquarters at ***<u>188 Loresho Ridge Road</u>*** in Westlands. The office entrance is two gates west of the Wine Shop, a restaurant on Loresho Ridge. We officially moved from our Brookside Grove offices on December 5th. Our telephone and email addresses remain the same. We look forward to meeting with you in our more spacious and comfortable offices.

Dry Associates New Headquarters at 188 Loresho Ridge Road, 1st Feb, 2023

Sincerely,

Dry Associates Investment Bank

WE KNOW … INVESTMENT MATTERS

February 6, 2023

DRY ASSOCIATES
INVESTMENT BANK

Dry Associates Investment Bank offers a wide range of products and services:

Private Wealth Management | Unit Trusts | Commercial Paper | Investment Advisory Services | Pension Fund Management | Offshore Funds | Consulting | Corporate Finance | Treasury Management | Portfolio Management

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