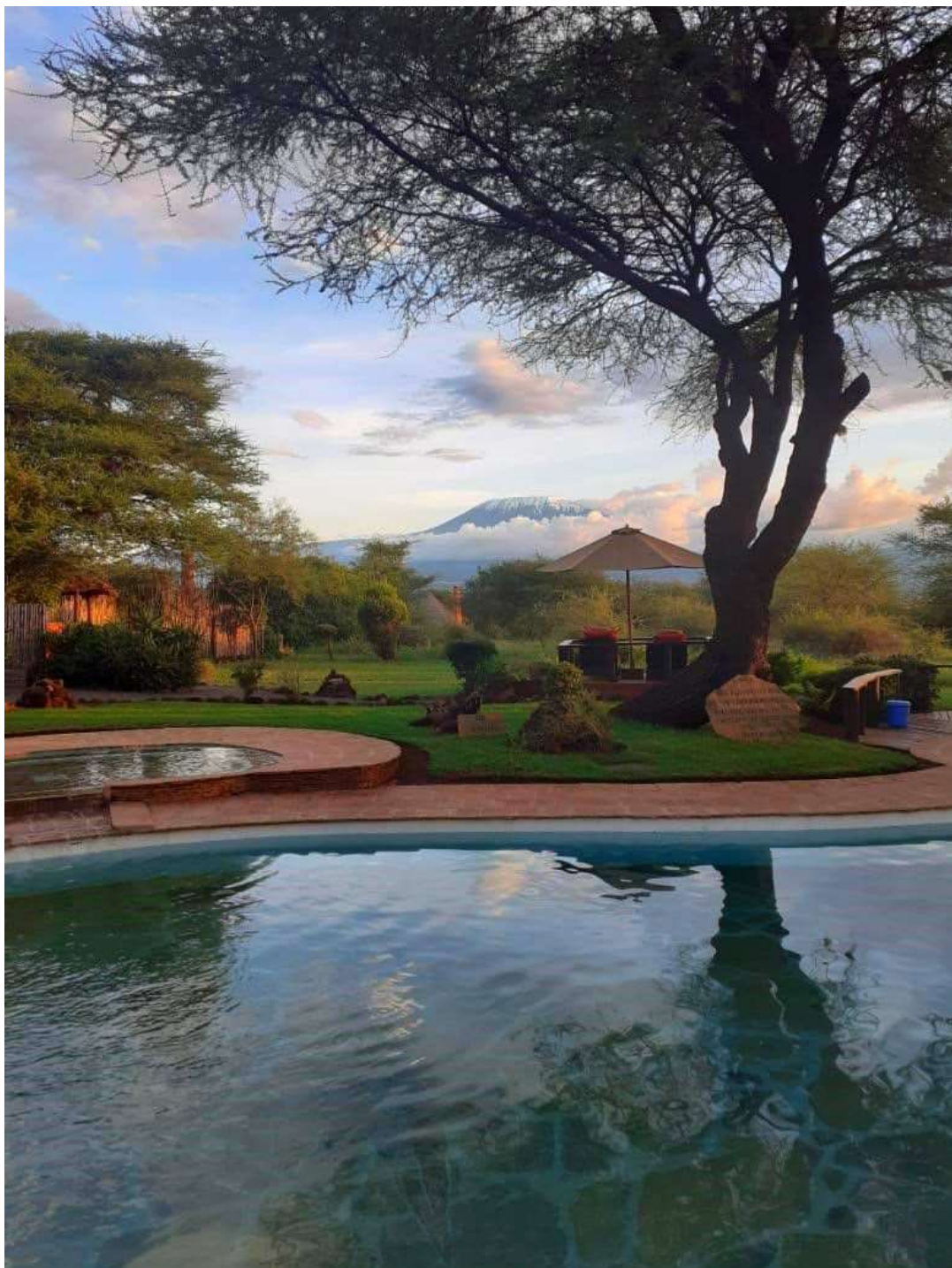


Investment Newsletter April 2021



Tawi Lodge, Amboseli with Mt. Kilimanjaro in background, 14 April 2021 Courtesy - Sophie Spyropoulos-Cocker

Dear Investor,

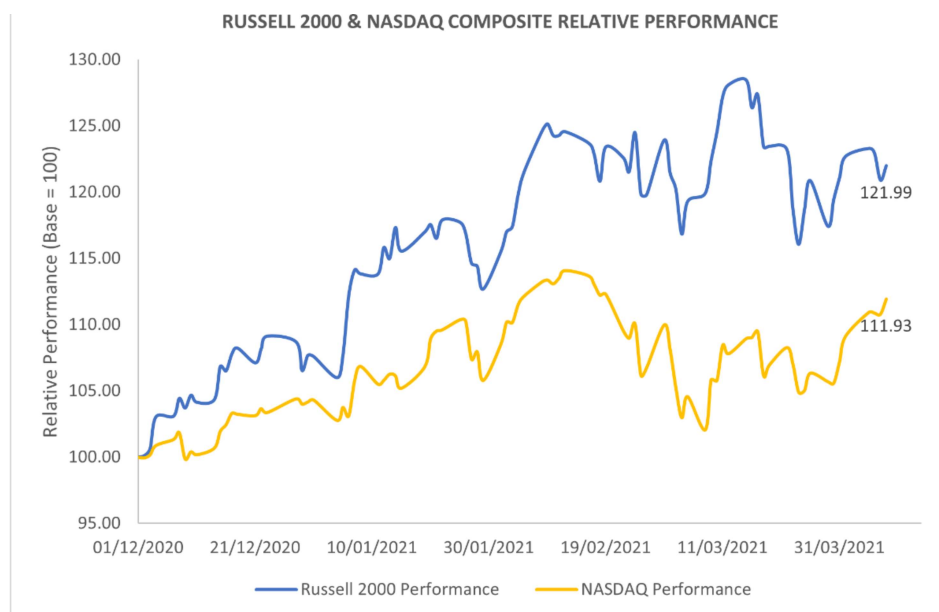
The Great Rotation in Investing

From the moment Covid-19 vaccines came on the scene, the investing world changed. It was the beginning of a rotation in stock market investing and it started mid-December 2020. That was when the first COVID vaccine was approved for use in the UK and US. Other countries like India approved a vaccine soon after in January 2021.

Up until then and during the pandemic, stay-at-home companies like Netflix, Roku, Etsy and Zoom were the rage and their valuations soared. Etsy up 350%, Roku up 160% and so on. Since the arrival of vaccines, however, there has been an increasing rotation away from growth stocks into value stocks.

Rotation in US Stock Market

Investment funds, always seeking outperformance, are buying value stocks which have relatively lower valuations (P/E ratios) and generate cash flow. Value stocks are stocks which are “materials” based like oil, mining and forestry or companies subject to business cycles (“cyclicals”) like banks and manufacturing companies. These stocks generally grow moderately and produce cash. The Russell 2000 Index, an index that captures the performance of 2000 US small cap stocks, are considered core value stocks. This index is up 21.99% over the last 4 months. The Nasdaq Composite, which captures stocks listed on the tech heavy Nasdaq Exchange is only up 11.93% over the same period.



While growth stocks that are focused on technology should continue to perform well (after all, they do represent the future) we expect faster appreciation in value stocks like airlines, banks, and mining companies whose valuations fell sharply during the pandemic.

Interest Rate Rise?

This rosy picture, however, could turn dark if interest rates rise sharply. Some forecasts have the US economy growing as much as 7% in 2021. One line of reasoning is that this is too much too fast. There is some cause for concern that the US is over stimulating. In March 2021, the US Congress authorized its third fiscal stimulus package of \$1.9 trillion which, among other things, will pay \$1,400 to every eligible individual and child in the US. This is much more stimulus than other countries have undertaken. Another thing that will spur growth is the fact that the US has been increasingly successful in vaccinating its citizens. The US has vaccinated some 100 million people or about a third of the US

population with at least one job. So, with fast growth comes capacity constraints with potentially too much money chasing too few goods and services – which can translate into inflation. And when inflation rises, the Federal Reserve bank raises interest rates to keep inflation under control. And when interest rates rise, stock markets fall.

Indeed, there was a scare two weeks ago when the yield on the 10-year Treasury note rose to 1.7% from 0.7% a year ago. Fortunately, it was only a result of panicky investors selling the 10 year note and not direct Fed action. The Fed has said it has no intention of raising rates any time soon. Nevertheless, it still bears watching.



Corporate Tax Rate Increases

Before we leave this issue of a red-hot stock market and possible bumps in the road, there is the issue of additional stimulus in the form of a \$2 trillion infrastructure bill that the Biden Administration is currently proposing. To pay for the spending, the Administration will seek to increase US corporate tax rates from the current 21% to something around 25 – 28%. This will obviously affect US companies bottom line and stock prices negatively.

Rotation into Developed and Emerging Markets

So, if the US economy was to grow by 7% in 2021, that must be compared to other country growth projections. The UK is also projected to grow 7% and the European Union 5% in 2021 according to Russell Investments. In fact, the IMF recently raised its projection for global growth in 2021 to 6%. When economies expand, stock markets tend to follow. Consider also that when global growth picks up, the US dollar tends to lose value vis-à-vis other currencies as it loses some of its “flight to safety” attraction. This presents the possibility of foreign currency appreciation against the US dollar as well as global stock price appreciation.

Consider also that many stock markets outside the US, particularly emerging markets, have stock markets which are not technology heavy and have much lower valuations than US securities. As such, we are seeing a large rotation from US stocks markets into emerging markets as investors seek value overgrowth. The MSCI World Value Index is up 10% since the beginning of 2021 while the MSCI World Growth Index is flat for the same period. These changing dynamics suggest that some portfolio reallocation away from growth into value and non-US equities makes investment sense.

Over the last several months, Dry Associates' Weekly bulletin has been recommending investment in several Franklin Templeton funds focused on emerging markets. To this list we add the following funds focused on "value" factors as opposed to exclusively "growth" factors:

Fund Name	Year-to-Date Return (%)	1-Year Return (%)
Natural Resources	17.84	87.72
Mutual US Value Fund	12.66	54.98
Asian Smaller Companies	12.53	88.95
European Small-Mid Cap Companies	10.30	47.47
Global Smaller Companies	9.79	47.79
Emerging Markets Smaller Companies	8.31	81.27

Note: The YTD figures are 1st Jan – 31st March 2021. All returns are net of any fees.

Kenyan Investment Portfolios

As investors with Dry Associates know, a balanced portfolio investment of debt and equity structured to meet the needs of the individual investor, makes the most sense. It is also a fact that Kenyan debt securities pay significantly more than developed country debt. The US 10-year Treasury as noted above pays 1.63% as opposed to 11.453% for the latest issue 10-year Kenyan Treasury.

A judicious mix of Kenyan debt and offshore equities provides current income and capital appreciation. Below are yields available on Kenyan debt securities.

Issue	Interest Rate	Source
Kenya Treasury (Tax Free) 12 year Bond	15.57% (taxable equivalent)	Market Determined
Commercial Paper - 12 months	14.0%	Dry Associates
Commercial Paper - 6 months	12.7%	Dry Associates
Kenya Treasury Bill - 12 months	9.40%	Central Bank of Kenya
Dry Associates KES Money Market Fund	9.00%	Central Bank of Kenya
Kenya Treasury Bill - 6 months	7.90%	Central Bank of Kenya
Kenya Treasury Bill – 3 months	7.10%	Central Bank of Kenya
Commercial Bank Fixed Deposit Receipt	6.46%	Central Bank of Kenya
<i>Inflation Rate</i>	<i>5.90%</i>	<i>Central Bank of Kenya</i>
Commercial Bank Savings Rate	3.35%	Central Bank of Kenya



Kilfi Boatyard at low tide, Kilfi, February 2021 - Courtesy of S. Dry

Kenyan Economy

Kenya's economy was hit hard by corona in 2020, particularly the second half of the year. GDP growth fell to negative 1% in 2020. Forecasts for 2021 are scattered from a high of 6.9% (Source: statista.com) to the World Bank's 5%. Of course, this is a moving target with the announcement on 26 March 2021 locking down Nairobi and 4 surrounding counties.

What is particularly troubling, however, is the continuing accumulation of government debt. Debt to GDP is now at 72% up from 61% in 2019, admittedly exacerbated by the pandemic. Even before the pandemic, however, Kenya was already too far in debt. The massively expensive \$3.6 billion spent on building the Standard Gage Railway is a case in point. The IMF says Kenya is now at high risk of what it calls "debt distress" meaning essentially that it cannot service its debt without refinancing and other concessions. A sovereign debt default would have serious negative repercussions for the country resulting in high interest rates, high taxes, higher cost of living and the possibility of hyperinflation. It is time for fiscal restraint.

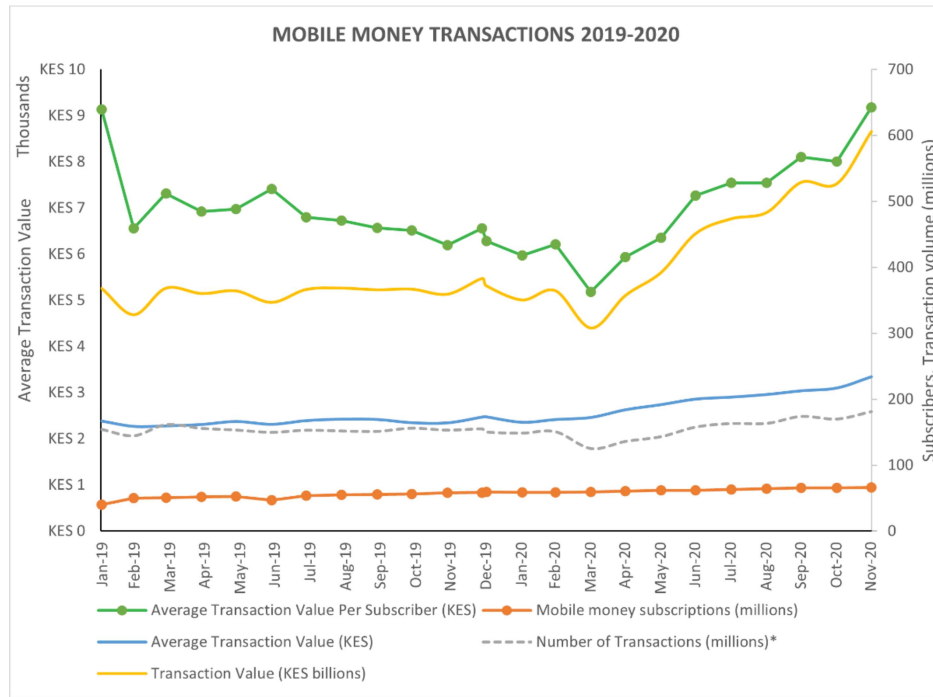
Nairobi Securities Exchange Equities

The NSE continues to underperform. This is a direct result of the pandemic. Nevertheless, there is latent value in the NSE. With a view to the future, our Research Department investigated the effects of mobile money technology on certain NSE stocks and financial institutions in Kenya today.

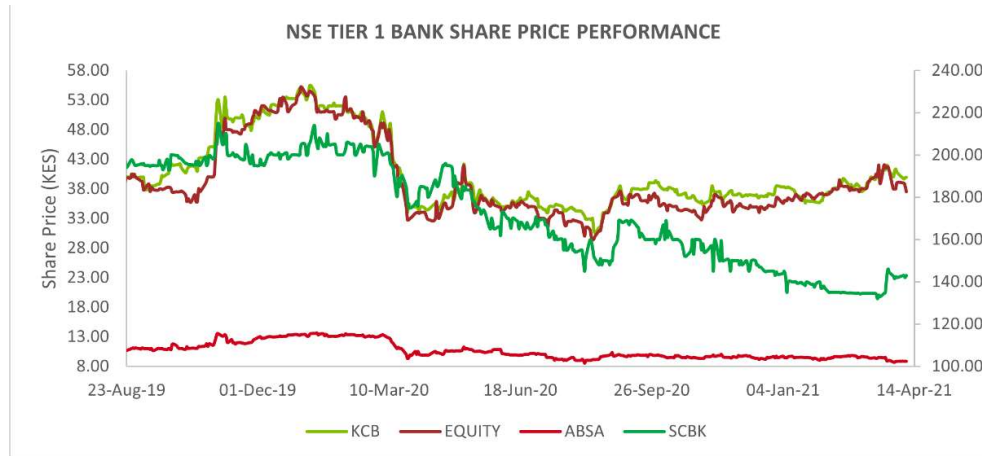
Technology has been the clear winner during this pandemic. While banks, apart from Equity Bank, have been slow to move their operations online, the pandemic accelerated their business models shift to digital transactions. Prior to 2020, Equity Bank managed the transition through Equitel (Finserve Kenya Limited) that grew to become Kenya's third largest mobile money platform with 1.882 million subscribers in 2019. Safaricom, however, led the charge with mobile money subscriptions increasing 13% between 2019 and 2020. Overall, mobile money transaction value grew from KES 4.345 Trillion in 2019 to KES 5.213 Trillion in 2020.

Furthermore, the numbers tell a deeper story. Kenyans not only transferred more mobile money last year; they transferred more money on average. The average value per transaction increased 35.17% from KES 2,471 to KES 3,340

between December 2019 and December 2020. The biggest beneficiaries of the growth in mobile money were mobile only microfinance lenders like Platinum Credit and asset finance lenders like Watu Credit, both whose loan books grew with stable default rates despite the pandemic.



2020's digital disruption separated the winners and losers amongst Kenyan banks. Furthermore, these industry shifts show no sign of slowing down. Banks that continue to innovate in ways that favour digital distribution are better positioned to exit the pandemic with leaner costs and fatter margins. Equity Group Holdings and I&M Bank Plc are the standout performers to date.



Going forward, we are bullish on Equity Group Holdings Plc and KCB Group Plc. Equity is currently trading below its short-term moving average but above its long-term moving average, implying a long-term bullish trend and KCB is currently trading above its short and long-term moving averages, implying both short-term strength and a long-term bullish trend.

In concluding this newsletter, we are aware that Covid is still with us. We know it has been a difficult year for everyone. We sincerely appreciate our clients' patience in dealing remotely in the area that is best dealt with person to person. Nevertheless, now that this scourge of Covid is being brought under control, we look forward to reconnecting with each of you in 2021.



Entrance to Emakoko Lodge, Nairobi National Park, February 2021 - Courtesy of S. Dry

BTW – Did you know that Dry Associates offers free wheel covers to its clients? Please contact Maureen Anyama on 0705 799 971 to pick one up.



Sincerely,

Dry Associates Investment Bank



Dry Associates is an Investment Group in Kenya and offers a wide range of products and services:

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