DRY ASSOCIATES LTD
Investment Bank

Investment Newsletter August 2020

Leopard 'Stretching', Buffalo Springs National Reserve, July 2020 - Courtesy of V. Wroe

Dear Investor,

First and foremost, please know that our hopes and prayers are with you, our clients, as we work our way through this pandemic. While it is testing everyone's resolve, delaying plans, and generally putting everyone's life on hold, we will come out on the other side.

In the meantime, please stay as safe as possible using face masks and distancing, as we wait for the pharma and biotech industries to develop a vaccine or at least treatments that will put this scourge behind us.

The Times They are A-Changin'

"… You better start swimmin'

Or you'll sink like a stone

For the times they are a-changin'"

Bob Dylan wrote these words in 1964 but they could not be more relevant today. Post Covid-19 will be different. Perhaps not as different as some suggest, but certainly different.

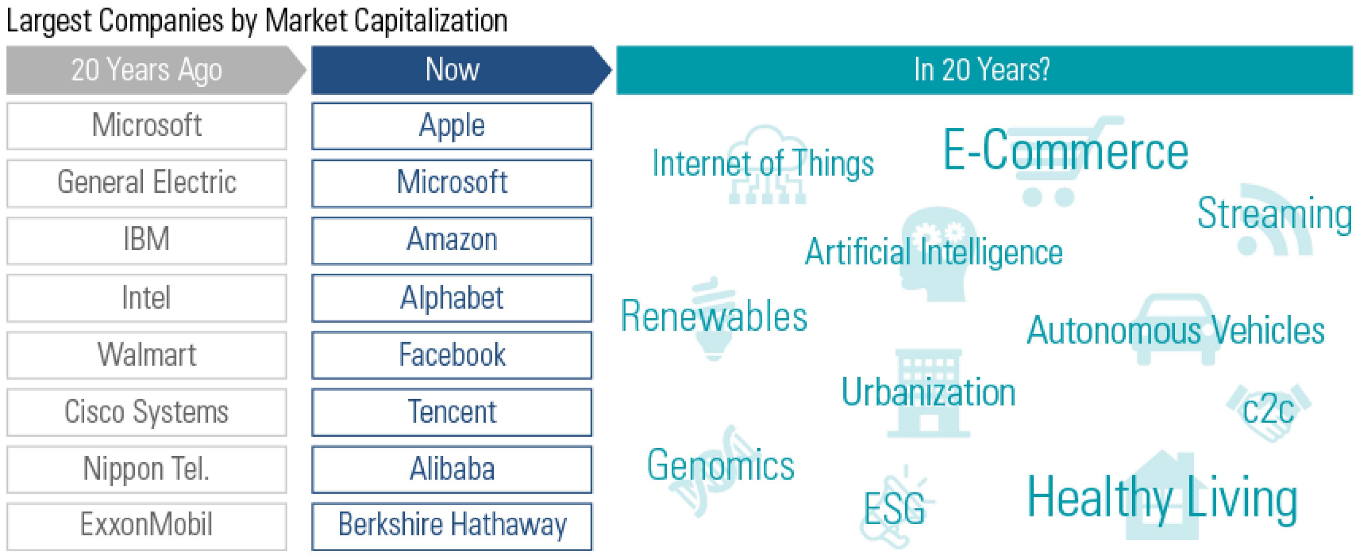
Consider this. E-commerce in the US has increased as much in the first six months of 2020 as it has in the last 10 years according to Goldman Sachs. Technology is changing the world fast and the FANGs (Facebook, Amazon, Netflix, Google) are leading the charge.

Online retailer Amazon's sales increased 26% in the first quarter 2020, to $75 billion while bricks and mortar retailers Macy's, JC Penny and Neiman Marcus have all filed for bankruptcy in the US.

Facebook and Google are taking billions of advertising dollars from newspapers, radio and television and Netflix is killing cable TV.

Other online companies are revolutionizing their respective business sectors. Four-year-old Open Door is an online company that will buy your home 'sight unseen' within 48 hours (subject to a post purchase inspection) and then sell the same house online at a 6% markup. Vroom is selling used cars online like Pez candy from one of its multi-story elevator buildings around the country.

Teladoc (ticker symbol "TDOC") has shot from $60 a share to $220 a share over the past 12 months. It has provided more than two million online medical visits complete with Zoom videos. Online learning is nothing new but 2U (ticker "TWOU) is now offering courses from 70 universities including universities like Cambridge and Yale.



Source: Bloomberg and GSAM

Breakfast with Giraffe's, Giraffe Manor, Nairobi, July 2020 - Courtesy of S. Dry

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Long Term (LT) versus Short Term (ST) Investing

We find it helpful in structuring a profitable investment portfolio to think in terms of long- and short-term investments. Long term (LT) investments ought to expose investors to changing themes like technology driven businesses such as those mentioned above. Similarly, ESG (Environmental Social and Governance) investments in areas like green energy and clean water are increasingly attracting investors, if only for our own self-preservation.

Short term investments, on the other hand, typically should generate cash. This means debt instruments or mature companies with high dividend yields.

The right mix of LT and ST investments is an individual choice but there is an old rule of thumb that financial planners often use. Subtract your age from 100 and that is the percentage of your portfolio to be kept in stocks. The balance should be in fixed income securities. So, if your 30 years old, you should have 70% in stocks and 30% in debt. By the time you are 80, you will only have 20% in stocks and 80% in fixed income securities. This obviously tries to de-risk and increase cash flow in a portfolio as one ages.

Long Term Investments

Two easy ways to invest in LT investments are mutual funds and ETFs (exchange traded funds). Both are good ways to invest because they do not concentrate risk in a single stock but rather diversify within a certain business sector. Regarding ETFs, Dry Associates does invest directly on behalf of its clients in ETFs, however, the dealing fees charged by our current offshore broker are high. We are partnering with a direct access electronic broker as we write this letter and whose fees are minimal. We should be online with them within a month.

Another good option is mutual funds. Mutual funds, however, are not created equal. Over the past 26 years, Dry Associates has come to know many mutual funds. Some mutual funds have difficult to understand fees, big buy-sell spreads, vesting periods, on-and-off boarding fees and other expenses that significantly reduce returns to the investor. One offshore fund manager that does not engage in dubious practices is Franklin Templeton. We have been representing Franklin Templeton for the past 25 years. Franklin Templeton Luxembourg, who represents the East African market, offer 100+ mutual funds for the E.A Region and its residents. Below are some of the funds we currently recommend:

Fund Name	Year-to-Date Return	12 Month Return
Technology	24.25%	34.44%
Gold & Precious Metals	18.94%	46.09%
US Opportunities	15.40%	21.62%
Global Convertibles Fund	12.77%	15.73%
Biotech	11.85%	21.32%

Franklin Templeton has recently launched a new fund called the Franklin Innovation Fund which invests in “companies that innovate, taking advantage of new technologies and new products”. While it contains some of the same big tech companies as the Technology Fund mentioned above, it includes newer software companies like ServiceNow providing cloud-based IT services and Dutch company Adyen NV providing mobile payment solutions. The Innovation Fund is up 23.08% year-to-date.

Investment Philosophy

At Dry Associates we treat investing for what it is - serious business. We have recently noticed several money managers in Nairobi that have begun offering dual currency, index, and other types of trading. This is more akin to gambling than investing in our view. In our experience, traders always give back their profits … eventually.

Even LT thematic investing supported by technical and fundamental research is difficult enough. Among the 100+ Franklin Templeton Funds we offer in Kenya, many are not performing well. Emerging markets funds quadrupled investors' money in the 1990's but they have been money losers the past ten years. Investing requires patience but also periodic reviews. A simple buy and hold investment philosophy do not work anymore - particularly in emerging and frontier markets. The Franklin Templeton Frontier Fund, for example, is down 21.56% over the past year. It is important to work with a knowledgeable investment advisor to make portfolio changes in a timely but measured way.

We leave you with these sobering statistics from Vanguard which we verily believe to be true:

30-year annualized Standard & Poor return

	S & P 500 Index	Average Investor
Returns	**11.06%**	**3.79%**
$100,000	**$2,326,645**	**$305,257**

"Investor behaviour is not simply buying and selling at the wrong time, it is the psychological traps, triggers and misconceptions that cause investors to act irrationally. That irrationality (loss aversion, narrow framing, anchoring, herding, regret, …) leads to the buying and selling at the wrong time which leads to underperformance." Source: Dalbar

Orange-bellied Parrots, Samburu National Reserve, July 2020 - Courtesy of V. Wroe

Short Term (ST) Investments

The other part of a solid portfolio is ST investments. These are the securities that throw off cash and ultimately provide the reason you began investing in the first place. Here are some of the fixed income securities available in Kenya today:

Private Issue 5-yr Bond (BBB rated)	15.00%	Source: Dry Associates
Private Issue 2-yr Notes	13.25%	Source: Dry Associates
Average Commercial Paper (91 – 364 days)	12.50%	Source: Dry Associates
Dry Associates KES Money Market Unit Trust	8.63%	Source: Dry Associates
1-year Kenyan Treasury Bill	7.37%	Source: Central Bank of Kenya
Tier I Commercial Bank Fixed Deposit (91-days) (5M)	6.96%	Source: Central Bank of Kenya
182-day Kenyan Treasury Bill	6.44%	Source: Central Bank of Kenya
91-day Kenyan Treasury Bill	6.11%	Source: Central Bank of Kenya

Special Situation

In an attempt to support economies during this pandemic, central banks have injected some 19 trillion US Dollars' worth of money into their respective economies. This is staggering.

This money will never be repaid or if it is, it will be in debased currencies. Governments will do what they have always done – inflate it away. While the velocity of money – the speed at which money is changing hands – has slowed during Covid-19 and reduced the likelihood of inflation for the moment [see Jim Rickard's commentaries on this], inflation is in our future.

The debasement of the US Dollar took off in earnest in 1971 when President Nixon took the dollar off the gold standard. Ever since, central banks have been printing more and more fiat (paper money backed by nothing physical). While it is doubtful this paper money will create growth, it will inflate asset prices.

From an investing point of view, it makes sense to buy tangible assets in an inflationary environment. Gold and precious metal prices stand to profit. In fact, according to Daniel Amerman, gold is not just an inflationary hedge since inflation cannot explain its 24% rise in 2020 alone, but it is acting as a "crisis" hedge for investors against the on-set of hyperinflation. A 5 or 10% portfolio exposure to gold in these times makes sense to us.

US Dollar versus Kenya Shilling

Dry Associates has always advocated a 50/50 portfolio split between US Dollars and Kenya Shillings. This rule of thumb is paying dividends as we see the Kenya Shilling slide past 108 to the US Dollar.

This fast-moving Shilling devaluation since February 2020 represents about an 8% appreciation of the US Dollar. If one were invested in, say the Dry Associates USD Money Market Fund, paying 3.4% currently, that is an 11.4% (8% + 3.4%) annual return on the US Dollar. This return is significantly higher than the 8.63% yield on the Dry Associates KES Money Market Fund. A re-balancing might be in order for some of our unit trust investors.

Looking north from 'Neem Tree House' along the Kuruwitu shoreline at low tide,Vipingo, July 2020 - Courtesy of S. Dry

New Issues

In light of high-profile defaults of several big-name corporations and banks in Kenya over the past 3 years, the investment community is coming to the realization that quality rather than size is more important in issuing creditworthy debt instruments.

We have taken this to heart in our pipeline of new issues. In February 2020, we acted as Transaction Advisor for Repelectric (Kenya)'s US Dollar 500,000 2-year private issue note programme. The take up was excellent and the first tranche was completed within weeks. The notes pay 8.0% and were secured by cash deposits.

In late July 2020 we have come to market with another $10 million note programme for RA International. RA International is an international facilities management company serving clients like the United Nations, USAID and the World Bank around the world with emphasis on Africa. Two million dollars has been raised in the first two weeks of the subscription. The AAA-rated notes pay 7.5% in USD and 7.0% in GBP Sterling. These notes are private issue and only available to Qualified and Institutional Investors.

RA INTERNATIONAL

We end this newsletter with the same sentiments that we began with. We wish each of our investors a safe return to normalcy within the year. In the meantime, there are numerous opportunities which we see and invite investors to profit from ... even amidst this temporary calamity.

Sincerely,

Dry Associates Investment Bank

For more information visit our website www.dryassociates.com or speak to us directly on
+ 254 (0) 705 799 971/ (0) 705 849 429/ (0) 738 253 811/ (020) 445 0520/1