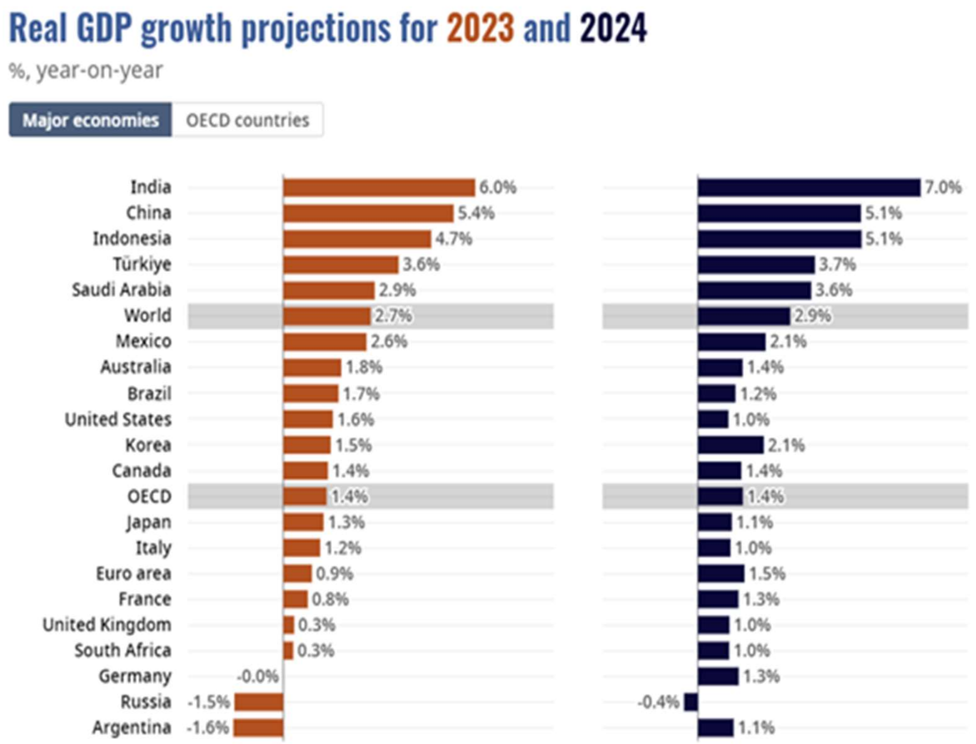
Investment Newsletter June 2023

Pride Rock: inspiration for the Lion King. Borana Ranch, looking up toward the foothills of Mt. Kenya (Mar. 20 '23 - Courtesy: S. Dry)

Dear Investor,

The State of the World Economy

The Organization for Economic Cooperation and Development (OECD) predicts the world economy will grow 2.7% in 2023 and 2.9% in 2024. It describes a global economy expanding slowly but weighed down by raising interest rates in a fight against inflation. Here's the OECD's Gross Domestic Product (GDP) growth predictions by country:



The fight against inflation is a continuing problem and its reasons are many. The Russia/Ukraine conflict is one big reason. It is squeezing energy and commodity markets and pushing up prices. In addition, no one knows how or when the conflict will end. Hopefully, a win for Ukraine but more likely some sort of drawn-out stalemate, like North and South Korea as this war becomes more and more a proxy war between the US and China and their allies. But one thing is certain, it is a drag on the world economy.

The Debt Bomb

The other issue of increasing concern to the serious investor is the constantly expanding debt loads of governments across the globe. While a single year's budget deficit is not a problem for a growing economy, common sense dictates that decades of deficits will have consequences. Those consequences show up as inflation, sovereign debt distress, sovereign debt default and of course, debasement of the underlying national currency. The countries listed above are carrying, on average, a Debt to GDP ratio of 50% or so, but others exceed that significantly.

See below table for illustration:

Country	Debt to GDP Ratio
US	130%
UK	100%
India	130%
Kenya	67%

Professors Reinhart and Rogoff's seminar work in this area argues that for advanced economies, a Debt/GDP ratio above 90% is the threshold for dramatic worsening in growth outcomes. The threshold for emerging economies like Kenya, is presumably much lower. Not only is the quantum of debt alarming, but the recent rapid rise in global debt is historically unprecedented.

US government debt doubled from $15 trillion to $31 trillion (remember: a trillion is a 1,000 billion) in the last 10 years alone. That represents $92,814 for every man, woman and child in the United States. Kenya's government debt has increased almost five times from KES 2 trillion to KES 9.4 trillion in the last 10 years. That debt represents KES 177,359 for every one of Kenya's 55 million citizens.

These numbers are incomprehensible, but they are a big part of the reason our fiat currencies are devaluing on a monthly basis. The responsibility for this sorry state is irresponsible politicians enacting budgets that have no relation to the funds available. The answer, of course, to this fiscal madness is a a balanced budget, where politicians can only spend what a country takes in in taxes. This is probably dreaming though. Per a recent *Wall Street Journal* information ad by Openthebooks.com quoting a Scottish professor of history in 1887, "the majority always votes for the candidates who promise the most benefits from the public treasury, with the result that every democracy will finally collapse due to loose fiscal policy …". So, perhaps irresponsible voters are equally to blame. In any event, the result is the same, and that is that as investors, we are on our own.

As an investor, it is necessary to see through current geopolitics and make decisions based on a more rational and settled tomorrow. There is no alternative. So here is how we approach this uncertain world.

One of the most impressive specimens of an Adansonia digitata, that we've ever seen. A private residence on the plantation side of Kilifi. (Feb. 12 '23 - Courtesy: S. Dry)

Investment Portfolio – In Broad Terms

Dry Associates has always suggested a dual currency investment portfolio for clients. Over time, a 50/50 split between Kenya Shillings and a hard currency (e.g., US dollar) is about the best you can do. The Kenya Shilling portion of the portfolio ought to focus on fixed income (debt) securities for a couple of reasons. First, Kenya based investors have KES living expenses and secondly, Kenyan debt typically carries much higher interest rates than hard currency debt instruments.

Now, if you are nearing retirement, you ought to refine your KES / hard currency portfolio even further, by summing up your monthly KES expenses – rent/mortgage, insurance, auto, food, travel, entertainment and so on and then annualize that figure by multiplying by 12 to get your total annual expenses. Then, divide the annual expenses by say, 10%, which is the sort of after-tax return one can generally earn on Kenyan fixed income securities. So, if your monthly expenses were KES 350,000 per month, multiply that by 12 months which equals KES 4.2 million. Dividing KES 4.2 million by 10% gives KES 42 million. A KES portfolio of 42 million ought to generate enough income to allow you to live off that investment indefinitely. Any additional investments above KES 42 million can be very profitably placed in hard currency investments – either in Kenya or abroad.

Sample Investment Portfolio

A simple investment portfolio for a mature investor with a round KES 100 million (that is, KES 50M and $350,0000) to invest might look something like the following:

KES Amount	Security	Annual Return		USD Amount	Security	Annual Return
5,000,000	Investment Grade / CP or Bond	14.00%		50,000	Investment Grade / CP or Bond	9.00%
20,000,000	Money Market	10.00%		100,000	US Exchange Traded Funds (ETFs) - SPY (S&P 500 Index) - QQQ (Technology Index) - GLD (Gold)	Variable 11.87%
25,000,000	GOK Infrastructure Bond	13.50%		200,000	US Corporate Bond (BB or better)	7.00%
50,000,000		12.15%		350,000		8.68%

All the above investments are available through Dry Associates. Note, the USD portion of the portfolio (right side) has $100,000 invested in US stocks. The New York Stock Exchange's average annual return over the past 10 years (in dollars) has been 14.83% and 8.91% over the past 20 years. We have used an average of 11.87%. An alternative to investing in the ETF's above would be through our offshore partner, Franklin Templeton, in various mutual funds.

As one may notice, the average overall Kenya Shilling portfolio annual return of 12.15% is higher than the 8.68% return on the dollar portfolio. But as we know, the KES was trading at 100 to the dollar in February 2020. It is now officially trading at 140 to the dollar (and in banking halls, higher than that). The point is, over time, the USD portfolio will almost always exceed the KES portfolio when converted back to KES.

"Our prosperity as a nation depends upon the personal financial prosperity of each of us as individuals … Babylon became the wealthiest city in the ancient world because its citizens … appreciated the value of money. They practiced sound financial principles in acquiring money, keeping money and making their money earn more money. They provided for themselves what we all desire … income for the future." George S. Clason, author "The Richest Man in Babylon"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Getting Started – Money Market Unit Trusts

Of course, many people starting out in life are not going to come to us with KES 100 million. They will start off with smaller sums. One of the best vehicles to start building an investment portfolio is a money market unit trust. The Dry Associates Money Market Fund (KES) or Money Market Fund (USD) are good examples.

The minimum investment in the KES Fund is KES 1 million or $10,000 in the USD Fund. The Funds' interest rate varies daily as there are currently 32 different holdings in the KES fund – mostly commercial banks - paying into the fund, but the annual return as of June 21, 2023, is 10.82%.

The Funds are considered low risk because of the diversity and quality of the underlying holdings. Funds can be redeemed within 3 days if needed, but many investors prefer standing instructions to receive interest payouts from the Fund on a monthly or quarterly basis. Allowing your hard earned savings to compound interest daily is one of the key features of the Unit Trusts.

The other feature of these Dry Associates Unit Trusts is that our Private Wealth clients have access to a sweep feature that allows all funds being paid out on any investment held through us, to be swept automatically into the respective Funds, thereby putting your money to work right away. Attached is a link to the Dry Associates Money Market Fund (KES). Link

Investing in US and international securities markets

We have suggested investing in the US stock market on a "dollar cost averaging" basis for the past year or so. This has proved beneficial as the market has had significant pikes and troughs over this period, per the following Standard & Poor 500 (S&P 500) Index:

Source: Bigcharts.com

We continue to recommend a dollar cost averaging strategy when investing in the US market. While there appears to be early signs of support for the S&P 500 at 4,200, the US Federal Reserve may decide on one or two more quarter point hikes this year, pushing the Fed rate to 5.50% or 5.75%. Inflation is running at 4.90% in the US, which is still above the Fed's 2.00% target. While the Fed did not raise rates in their most recent June 14th meeting, there are four more Fed meetings before year end. Until these rate hikes are over, the stock market will face headwinds.

Franklin Templeton (FT) Funds

We spent a day with Michel Karkour, Franklin Templeton's Business Development Manager from Dubai, on May 17th here at our new offices in Loresho and further with a few clients for a private event thereafter. We reviewed our FT recommendations against FT's global sector outlook for 2023 and 2024. That review confirmed most of our client recommendations including the following:

Franklin Income Fund
Franklin Technology Fund
Franklin US Opportunities Fund

FT's Michel Karkour meets with our private wealth clients at Shamba Café, 17-May-23

Dry Associates Investment Bank has acted as Arranger and Placement Agent for the following recent fixed income issuances and continues to bring to market new issuances:

Mogo Auto, one of Kenya's largest lenders in the vehicle (car and motorcycle) sector, originally came to market in August 2022 with a KES 1 billion issue. This A-rated secured note programme was increased to KES 2 billion in January 2023.

Watu Credit (Kenya) is a first mover in the 2 and 3-wheel boda boda financing sector. We arranged and placed a Kenya Shilling KES 1 billion BBB-rated secured programme for Watu Credit (Kenya) in 2021. It was increased to KES 2 billion in 2022 and fully subscribed. In June 2023, Watu (Uganda) came to market with a US Dollar 5 million short term programme which has also been well received.

Burn Manufacturing comes to market in late June 2023. This BBB+ rated company will raise US Dollars 5 million through a secured one and two-year note programme. This US-based company manufactures cookstoves with advanced technologies like improved insulation and combustion resulting in fuel savings and reduced emissions.

Note, these and other Dry Associates arranged programmes are private issue and offered only to accredited Private Wealth and institutional clients.

Kenyan Debt Securities and Yields

The recent Government of Kenya tax-free Infrastructure Bond issued on June 19th 2023, maturing in 2030, has raised eyebrows in the fixed income space. The average yield accepted by the Central Bank of Kenya was 15.837%. As the bond is tax-free, the yield for individuals is equivalent to a taxable yield of 18.63%. For corporates who hold the bond to maturity, the return is an eyepopping 22.62%, as corporate income tax of 30% applies - not 15% as it is for individuals. While this is an attractive return for individuals and corporate investors, it will be a heavy burden for the government.

Here's how interest rates stack up generally in Kenya today:

Issue	Interest Rate	Source
GOK Infrastructure Bond – 7 years (tax-free)	18.67% (equivalent)	Central Bank of Kenya
Commercial Paper – 12 months	15.00%	Dry Associates
Commercial Paper – 6 months	14.00%	Dry Associates
Kenya Treasury Bill – 1 year	11.73%	Central Bank of Kenya
Dry Associates Money Market Fund (KES)	10.82%	Dry Associates
Inflation – May 2023	8.03%	Central Bank of Kenya
Commercial Bank – Fixed Deposit Receipts	7.60%	Central Bank of Kenya

We end this newsletter by reminding our readers that there are always opportunities to create and preserve wealth even in this uncertain world.

We look forward to doing just that for all our clients – today and tomorrow.

Sincerely,

Dry Associates Investment Bank

WE KNOW … INVESTMENT MATTERS

June 30, 2023

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

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