Investment Newsletter December 2020

Looking back towards 'Kampi ya Samaki' from the peak of Teddy Bear Island, Lake Baringo, November 2020 - Courtesy of S. Dry

Dear Investor,

Optimism Returning

As we turn the page on 2020, we are beginning to “see across the valley”. With ten vaccines in phase 3 trails, there is a collective sigh of relief across the land. It is too late for a million and a half poor souls, but the world will go on.

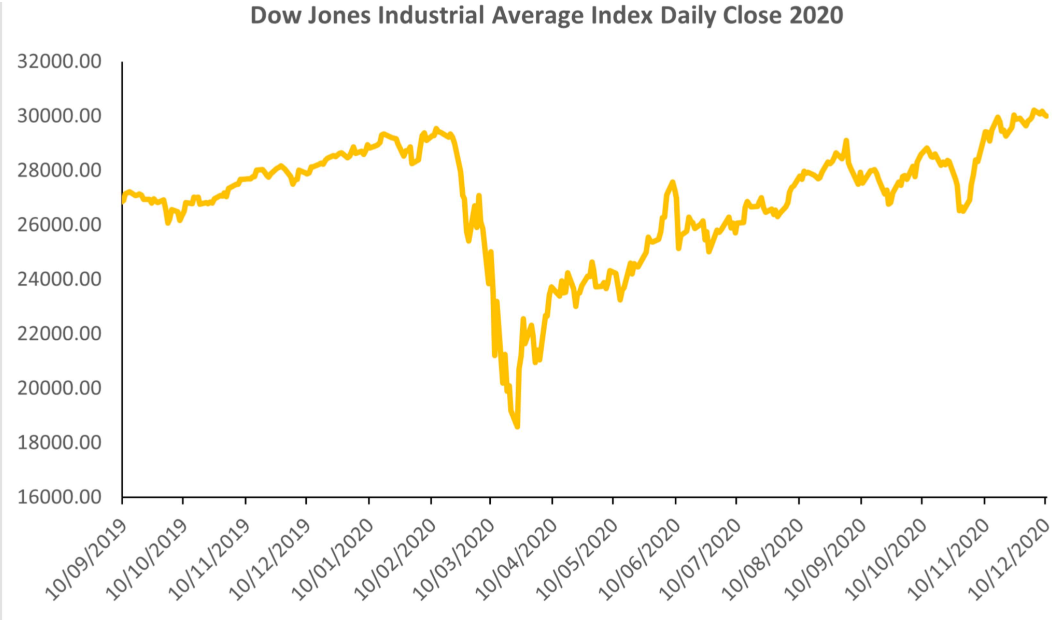
This recession had nothing to do with economics. It was a disease driven recession which had none of the hallmarks of an economic downturn driven by asset bubbles or irrational exuberance.

It was a result of government dictated shutdowns. The cause was disease and the cure was to stop the disease. That is about to happen.

As such, optimism is the reigning sentiment in the investment world. Human ingenuity and science have once again brought us through another crisis. Investment sentiment reflects this optimism with 65% of investment newsletters being bullish according to '*seekingalpha.com*'. While we are usually skeptical of one-sided sentiment, at the present time we are also bullish – particularly for US and emerging markets over the next several quarters.

Why Bullish?

The fact is that investment decisions are increasingly being driven by government monetary and fiscal policy. For better or worse, central banks now have a history of coming to the rescue in times of crisis. In fact, some pundits are calling the US Fed's action the "Powell Put" after Fed Chairman Jerome Powell. A "put" of course is an option to sell a security at a set price even though the price has fallen. So, for better or worse, central banks around the world are intervening in economic affairs and backing up credit and equity markets. When Covid-19 struck the US, the Dow Jones Industrial Average fell 36% in 32 days in February/ March 2020. Almost immediately the Fed went into action pumping billions of dollars into the market. The Dow has risen ever since and is now higher than when the virus struck per the following graph:



Source: S&P Dow Jones Indices

Since March 2020, the Fed has pumped $2 trillion into the US economy which is 13 times more than the stimulus package of $152 billion during the Great Recession of 2008. This has left interest rates near zero and security markets - the ultimate pool of money - flush with cash.

Another reason we are bullish is that COVID-19 has pulled the future forward. The response to the virus has accelerated interest in digital technology, biotechnology and sustainable/recyclable companies in water, waste and energy among other areas. These megatrends are driving investment into companies like Crispr Therapeutics, up 500% in the last 12 months, Invitae Corp up 600%, and Plug Power up 663%. Crispr is a leader in genetic editing and has promising results in curing sickle cell anemia; Invitae is working on breast cancer and Plug Power is an innovator in hydrogen fuel replacing traditional batteries.

Forecasting

A large part of investing is trying to predict the future. We all know the quip "Those who fail to learn from history are doomed to repeat it." But history as a predictor is very limited. This point is well made in a short YouTube video by economist/futurologist, George Friedman, entitled '***The Next 50 Years***'. As an indulgence, we ask the reader to copy the following link into your browser and listen briefly as Friedman predicts the future: https://www.youtube.com/watch?v=zShYE18avNc.

Note that he says the fate of nations, based on his research, suggests that the most important thing in forecasting is the weaknesses of countries, not their strengths. Similarly, in predicting investment performance, we would suggest that it is the weaknesses perhaps more than the strengths, that undermine wealth creation. Too much concentration in a single security, a single country or single currency is a common weakness. Equally humbling, however, is Friedman's statement that predicting the future is largely a projection of current trends. As such, we are probably lucky if our predictions are accurate 6 months into the future.

Strength in Emerging Markets

We mentioned above that we are bullish on US equities and emerging market equities. One major reason is that as we return to normalcy after this pandemic, investors are less inclined to seek out US securities and the US dollar as a "safe haven". Capital has begun to flow back into emerging markets as it looks for good returns after emerging markets were beaten down. As investors sell the dollar for other currencies, the dollar weakens. Barron's reports that the US dollar has fallen 10.2% against a basket of major currencies since March 2020 and continues to weaken through December 2020.

Franklin Templeton Funds

Dry Associates has had a relationship with Franklin Templeton for over two decades. The firm specializes in fund management and has over $1.4 trillion dollars in assets under management. It is perhaps the largest global fund manager in the world with a strong presence in both developed, emerging and frontier markets.

We encourage our clients to invest through Franklin Templeton (FT) for several reasons. Besides their very good financial performance, FT makes investing easy. First, there is no cost to switching funds. Second, it provides a tax-exempt way to invest in almost any country in the world including the US. For example, non-US citizens investing directly in US securities markets are subject to a 30% withholding tax on dividends. This withholding tax is not levied on foreign investors investing through FT because it is an investment company constituted under the US Investment Company Act of 1940 and regulated by the US Securities and Exchange Commission.

In addition, the funds that FT offers in Africa are registered in Luxembourg which is a tax-exempt domicile.

The table below shows the performance of the top 8 FT funds. All figures are based on US dollars. The table shows the performance for YTD (year-to-date), 1 year, 3 years, and so on. Taking the Franklin Technology Fund, for example, note that the fund is up 55.41% YTD. Reading across, the unit price of this fund has increased 445.31% over the past 10 years. These are the types of returns that our clients have been earning and we encourage all investors to include some of these funds in their respective investment portfolios.

Fund	YTD Return	1-year return	3-year return	5-year return	10-year return
Franklin Technology Fund	55.41%	59.26%	116.60%	218.25%	445.31%
Franklin Innovation Fund	50.85%	53.58%	-	-	-
Franklin US Opportunities Fund	37.19%	38.97%	77.16%	115.62%	275.68%
Franklin Global Convertible Securities Fund	33.21%	34.77%	63.93%	92.45%	-
Templeton China Fund	28.34%	35.79%	39.39%	93.00%	54.06%
Franklin Gold and Precious Metals Fund	26.05%	41.51%	64.37%	131.44%	-43.28%
Franklin Biotechnology Discovery Fund	23.19%	27.37%	42.07%	31.40%	355.17%
Templeton Asia Growth Fund	16.62%	24.28%	16.70%	71.78%	31.68%

Source: Franklin Templeton

Based on our house view, we continue to recommend exposure to the US market as it continues to be a dynamic market for innovation. We recognize, however, that valuations in some technology stocks are very high – for example, Amazon's Price to Earnings ratio is currently 91 times and Netflix's is 80x whereas the S&P 500 average P/E ratio is much lower at 31x. As such, we recommend that our clients rebalance their holdings. We are decreasing our weighting in the Franklin Technology Fund and increasing weighting in the US Opportunities Fund, Franklin Biotechnology and Franklin Asian Growth Fund. Unfortunately, the Franklin Global Convertible Bond Fund was closed to new investment last week as FT determined that there were not enough good convertible bonds on the market to meet the growing demand from investors.

Wildebeest at sunset, Masai Mara National Reserve, August 2020 - Courtesy of D. Porter

Kenyan Market

The Nairobi Securities Exchange has not done well all year. The NSE All Share Index fell 28% in February/March 2020, and it has only risen 12% over the past 9 months per the following graph:

Source: MyStocks.com

Bank stock prices are down an average 26% over the past 12 months on the back of COVID non-performing loans. In addition, the expected bump in bank stock prices after the repeal of the interest rate capping legislation in November 2019 never came to pass. A combination of Central Bank jawboning and the virus have resulted in the average lending rate remaining low at 11.75%. Nevertheless, as an entry point, some of these counters have relatively low P/E ratios and high dividends. The three highest yielding banks stocks are Standard Chartered, Absa and Stanbic with 12-month trailing dividend yields of 13.65%, 11.34% and 9.4% respectively.

Carbacid is one bright spot on the NSE. It is in the news with an offer to buy 100% of BOC stock. After some regulatory issues are sorted regarding cross ownership, this deal would be a reversal of fortunes as BOC attempted to buy out Carbacid in 2005. Carbacid's corner on the carbon dioxide market combined with BOC's market dominance in the oxygen and other gases market would appear to be a strategic move with synergies. Investors seem to like the deal with Carbacid's price up 30% since 2nd November 2020.

Safaricom is another steady performer. It has been a very useful payment platform throughout the pandemic and its price shows it. Safaricom traded at KES 33 as the pandemic hit falling to KES 24.50 before recouping lost ground. It is now trading at its pre-Covid price of KES 32/33. With a reasonable dividend yield of 5.5%, it remains a favorite of international and domestic investors.

Elephants and Wildebeest at dusk, Masai Mara National Reserve, August 2020 - Courtesy of D. Porter

Kenyan Economy

We continue to be concerned about Kenya's creditworthiness. Kenya's sovereign debt is credit rated B+ with a negative outlook on an international scale by Standard & Poor. S&P describes B+ has "relatively risky with a higher than average chance of default" although this is the "highest rating in the non-investment category". To be clear, any default would only affect Kenya bonds issued in foreign currency. Kenya should not default on its Kenya shilling debt because it can always "print" more Kenya shillings.

We have always advocated that the most responsible fiscal policy for any government is a balanced budget - meaning a nation spends no more in a year than it takes in in taxes - with exceptions made for war and national emergency. Well, that has fallen on deaf ears around the world as politicians pile up debt and push it into the future. This ballooning debt will have consequences for future generations.

Kenya's current Debt-to-GDP ratio was 40% in 2010. It is 66% today. Anything over 50% is generally recognized by economists to be a drag on a nation's economic prosperity as more and more money is spent paying interest on the national debt.

Economists often view a country's currency vis-à-vis its value with other currencies as an indicator of a nation's economic health. This being the case, clearly there are signs of an erosion of confidence in the currency as it has slipped from KES 101 to the US dollar in January 2020 to KES 111.5 today.

Kenya Debt Securities

Regardless of the depreciating shilling, most of us have Kenya Shilling expenses and the yields on

Kenyan debt securities continue to offer higher yields than the currencies of developed nations. The following are some of the interest rates available in the market today:

Issue	Rate	Source
Commercial Paper (BBB rated) 12 months	15.0%	Dry Associates
Commercial Paper (BBB rated) 6 months	14.5%	Dry Associates
Dry Associates KES Money Market Fund	8.86%	Dry Associates
1-year Kenya Treasury Bill	8.25%	Central Bank of Kenya
182-day Kenya Treasury Bill	7.36%	Central Bank of Kenya
91-day Kenyan Treasury Bill	6.90%	Central Bank of Kenya
Bank Fixed Deposit Receipt KES 5M 91-days	6.41%	Central Bank of Kenya
Commercial Bank Saving Rate	3.78%	Central Bank of Kenya

A bathroom with a view: "The Star Room", Teddy Bear Island Camp, Baringo, November 2020 - Courtesy of S. Dry

New Issues

Dry Associates launched a private issue KES 500 million short-term note program for Watu Credit Limited in late December 2020. Watu is a leading asset finance provider for motorcycles and 3-wheelers across the country providing self-employment in the boda-boda market. As a private issue, it is available to Institutional and Qualified investors only. The issue is credit rated and secured to 125% of the principal note amount by Watu's receivables. Ropat Trust Company is the Note Trustee.

Holiday Greetings

We take this opportunity to wish each of you a joyful and healthy holiday. We look forward to coming back to work in 2021 with a renewed spirit of dynamism and prosperity.

Please note that Dry Associates offices will be closed from December 18th until January 4th.

Sincerely,

Dry Associates

Dry Associates is an Investment Group in Kenya and 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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