

Investment Newsletter July 2021



"Nairobi Electricity" by Chain Muhandi - Oil on canvas - 100cm x 80cm

Dear Investor,

Short Term Forecast

We expect the investment climate globally to be bullish over the next 3 – 6 months. Indeed, 69% of US investors are bullish according to *Investor Intelligence's* latest survey.

As the world recovers from the pandemic – notwithstanding outbreaks and new variants in Brazil, India, Russia, and other countries – the second half of 2021 should be characterized by recovery and growth in stock markets round the world.

The US economy expanded 6.5% in the first quarter of 2021 and is estimated to have expanded at approximately 10% in the second quarter. The Fortune 500 Conference Board expects 2021 overall US GDP growth to come in at 6.6% (versus negative 2.3% for 2020).

Business Cycles are Forever

But there is no getting away from the business cycle. The resurgence in economic activity will create bubbles as consumers go on a spending spree, prices rise, suppliers rush to produce and eventually overproduce thereby reducing economic activity.

In addition, government fiscal policies (“budget spending”) and central bank monetary policy (“money supply and interest rate manipulation”) will also continue to play an outsized role in investment decisions. To complicate things further, governments often get it wrong.

Inflation?

The Biden Administration’s current fiscal policy may be a case in point. It plans to spend upwards of \$8 trillion over the next eight years on infrastructure. This spending on top of a resurgent economy may well ignite inflation. The US Federal Reserve is targeting 2% inflation, but inflation already accelerated to 5% in May up from 4.2% in April (source: Trading Economics). The Fed says this is only temporary, but no one knows for certain. One thing is certain though, once inflation gets a hold, it is difficult to stop. And the way it is stopped is by raising interest rates. And when interest rates rise, stock markets fall.

Long Term Scenario

Nevertheless, from where we sit, the near term 3 to 6 months looks good.

Long term investing, however, even factoring in business cycles, will be shaped by emerging trends. Right now, there are at least three megatrends in which investors will want to participate:

1. Digital transformation of economies
2. Biological and health advances
3. Recyclable industries affecting water, energy, food, and waste among others.

Digital transformation includes everything from e-commerce to artificial intelligence to robotics. Biological advances run the gamut from gene splitting to anti-aging treatments. Recyclable industries seek to limit climate change while reducing the burden on natural resources.



"Lamu" by S. Lance - Oil on canvas - 115cm x 70cm

Sustainable Recyclable Industries

Any one of the megatrends is worth exploring as an investor. Generating electricity using recyclable materials is one example. The Biden Administration has targeted eliminating oil, coal, and gas as a source of generating electricity by the year 2035. That is fine except that wind turbines, solar panels, and electric vehicles (EVs) all require increasing amounts of copper, lithium, cobalt and other rare earth minerals (REEs).

These minerals are already overmined and REEs are only found in a handful of countries. As Professor Michael T. Klare points, wind and solar power currently generate a mere 7% of global electricity and electric vehicles (EVs) currently account for less than 1% of automobiles on the road. The International Energy Agency estimates that to have a green future, demand for lithium could be 50x higher by 2040 and cobalt and graphite 30x higher. Add to this the fact that China currently provides 70% of the worlds' REEs. These REEs like dysprosium and lanthanum are used as alloys in EVs to help the magnetization in electric motors at high temperatures.

As Prof. Klare points out, the years following the Second World War were dominated by who had access to oil resources. The future may similarly be dominated by access to these REEs. Opportunities yes, but pitfalls as well.

Investors can participate in this sector through Exchange Traded Funds like Van Eck's Rare Earth/Strategic Metals ETF (ticker: REMX) up 125% in the last year. The fund, however, is heavily weighted with Chinese firms. Alternatively, companies like Tronox Holdings (ticker: TROX) based in the US offer similar single stock exposure.

The other reason for investing in tangible assets, that is, in companies producing precious and rare earth elements, is that they are a natural hedge against inflation. In this world of fiat currencies, a strong case can be made for having 15% of one's portfolio in tangible assets like natural resources and real estate.

Franklin Templeton

Investment in Franklin Templeton funds have proven very profitable over the years. Their funds are comprised of numerous, often as many as 50 – 100 different securities much like Exchange Traded Funds (ETFs). They provide targeted regional or industry-specific investment in developed and emerging markets.

Currently, many smaller capitalized companies ("small cap" companies) are returning to profitability as the pandemic begins to recede. These reflating small cap funds are all up significantly in 2021. The figures below are year-to-date increases from 1st January 2021 to 30th June 2021, the latest aggregate data available:

Templeton Asian Smaller Companies Fund	+26.42%
Templeton Emerging Markets Smaller Companies	+23.33%
Franklin Mutual US Value Fund	+18.50%
Franklin Technology Fund	+16.25%

The Franklin Natural Resources Funds is up an even more impressive 29% but is heavily weighted in oil companies. As a result, the fund is a bit volatile as the Organization of Petroleum Exporting Countries (OPEC) cannot agree on a joint formula for increasing oil production. This, combined with US producers of shale oil reluctant to restart operations until oil markets stabilize, has contributed to an unstable global market for oil. These are very short-term considerations, however, and the serious investor needs to look beyond these events.

US Stock Market

The US market as indicated by the Dow Jones Industrial Average is up 89% from its April 2020 low per the chart below. It is now higher than before the pandemic began in March 2020.



The US market has risen strongly over the past year. We expect it will continue to do well over the next several months. As we noted in our last newsletter, there was considerable rotation from growth stocks like the FANGs (Facebook, Amazon, Netflix, and Alphabet) into value stocks after the Covid vaccines became available. Over the past three months both sectors are up but investors have returned to grow. The exchange traded fund QQQ which captures the largest 100 companies on the tech heavy Nasdaq is up 7.5% over the past 3 months. Value stocks as represented by the S&P Small Cap 600 ETF (RZV) are up only 5.5% over the same period.

Extrapolating these returns over a year gives an annualized return of 30% and 23% respectively. We do not expect to see this sort of price increase over the next 12 months. These sorts of returns are not based on fundamentals. To a large extent, these returns are based on a Covid rebound and money expansion in the US.

Massive amounts of money have been injected into the US economy to the tune of \$80 billion a month over the past year and a half by the Federal Reserve. The Fed even instituted a Commercial Paper (CP) Funding Facility where it bought CP directly from corporations. The CP market in the US is, incidentally, over a trillion dollars. All this buying has ballooned the Fed's holdings of securities to \$8 trillion.

Much of this liquidity has been injected into commercial banks. These banks then relend these funds creating more money. The money supply ("M3" which measures currency, time deposits and money market funds) has grown from \$15 trillion in January 2020 to over \$20 trillion today.

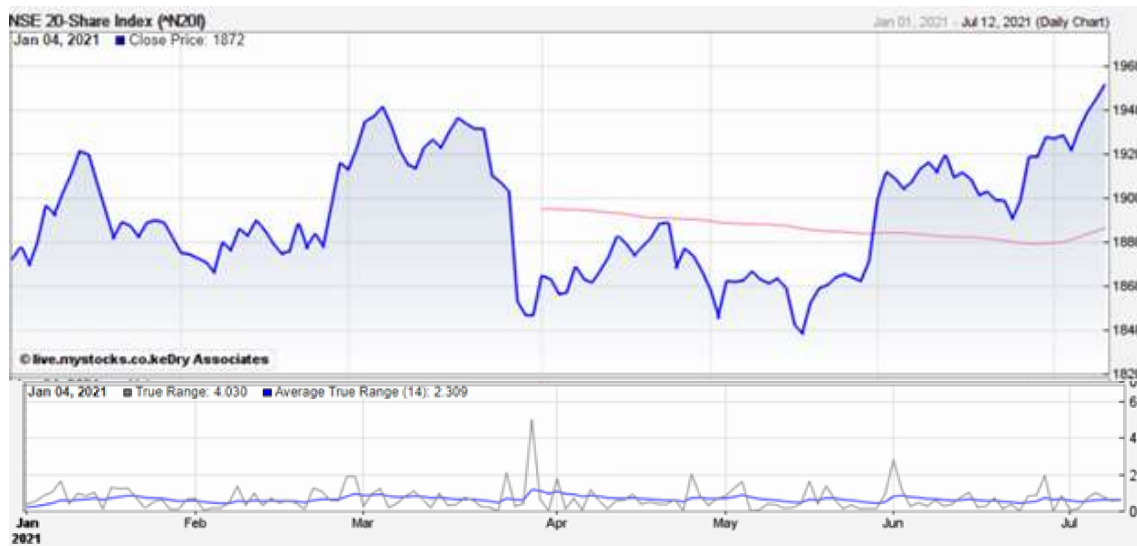
On top of this, the Biden Administration is in its 3rd iteration of Covid-19 relief payments directly to US citizens. Obviously, a lot of this money ends up in stock markets. The sheer amount of money in the system looking for a home should support the market for the near future. Enough said, the modern investor needs a global investment portfolio with continuing exposure to US equities.



"Street Scene" by Rob Karanja - Oil on canvas - 20cm x 30cm

Kenyan Stock Market

The Kenyan stock market is showing signs of life. The following Nairobi Stock Exchange 20 Index is up 4% over the past 6 months and the index is trading above its 66-day moving average. The large cap companies are coming out of the pandemic more vigorously than the small cap companies.



We continue to recommend the following securities as noted in our *Weekly Commentary Bulletins*:

Security	6 Month Increase	Current Price	P/E Ratio	Dividend
Equity Bank	36%	49.00	9.35x	-
EA Breweries	22%	187.50	26.08x	4.53%
KCB	20%	45.50	7.46x	2.20%
Safaricom	20%	41.25	24.12x	3.32%

Kenyan Fixed Income Securities

Kenyan fixed income securities continue to be an attractive source of current income. Money Market Unit Trusts offer safety, liquidity, and reasonably high returns in the 9% area in Kenya Shillings. Dry Associates offers both a Kenya Shilling and a US Dollar money market fund as well as a Balanced Fund combining fixed income securities and stocks. These funds are regulated by the Capital Markets Authority.

Tax free GOK Infrastructure Bonds are also a popular fixed income security for investors. Although these are long-term securities, Dry Associates keeps an inventory of these securities and makes a secondary market in them so they can be sold fairly easily.

The yields available on various fixed income securities in Kenya today are as follows:

Issue	Interest Rate	Source
Commercial Paper (12 Months)	14%	Dry Associates
Commercial Paper (6 Months)	13%	Dry Associates
Kenya Treasury (Tax Free) 12-yr bond	12.88% (taxable equivalent)	Market Determined
Dry Associates KES Money Market Unit Trust	8.65% - 9%	Dry Associates
Kenya Treasury Bill - 12 months	7.58%	Central Bank of Kenya
Kenya Treasury Bill - 6 months	7.10%	Central Bank of Kenya
Kenya Treasury Bill - 3 months	6.61%	Central Bank of Kenya
<i>Inflation</i>	6.32%	Central Bank of Kenya
Commercial Bank Fixed Deposit Receipt	6.30%	Central Bank of Kenya
Commercial Bank Savings Rate	2.55%	Central Bank of Kenya

Art as an Investment

Art as an investment is always interesting because it has the potential to give pleasure while appreciating in value. Admittedly, art is subjective but good art seems to be able to connect with a larger audience. As Marcel Marceau apparently said of great art "il faut toucher le publique" ("it must touch the public"). In as much as landscapes and portraits have always been popular, modern art, despite being controversial, has gained a huge following. It has been suggested that because it does not have a recognizable subject, it can

be interpreted by the viewer in their own way much as an author takes credit for anything the reader reads between the lines. Whatever genre of art appeals, it is evident that African art is gaining currency in the art world. Nigerian and South African artists tend to be in the vanguard at leading art auctions, but frankly some Kenyan artists seem equally gifted in our opinion. In recognition of Kenya's growing artwork, we substitute in this newsletter the normal pictures of flora and fauna with a few Kenyan artists currently exhibited on the walls of our Dry Associates' offices. We look forward, with our clients, to being a part of the growing Kenyan art scene.



"Car Problems" by Chain Muhandi - Oil on canvas - 60cm x 50cm

Wheel Covers

We are delighted that so many people have requested free tyre covers. They continue to be available for anyone who would like to dress up their vehicles with these fine colors. Please call Maureen on 0752 100 311 for a free black and gold Dry Associates' tyre cover.



Sincerely,

Dry Associates Investment Bank

“Invest Today for a Better Tomorrow”



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

For more information visit our website www.dryassociates.com or speak to us directly on
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