



Investment Newsletter August 2024



We are Bullish on Kenya

Painting by Ray Mbugua

Dear Investor,

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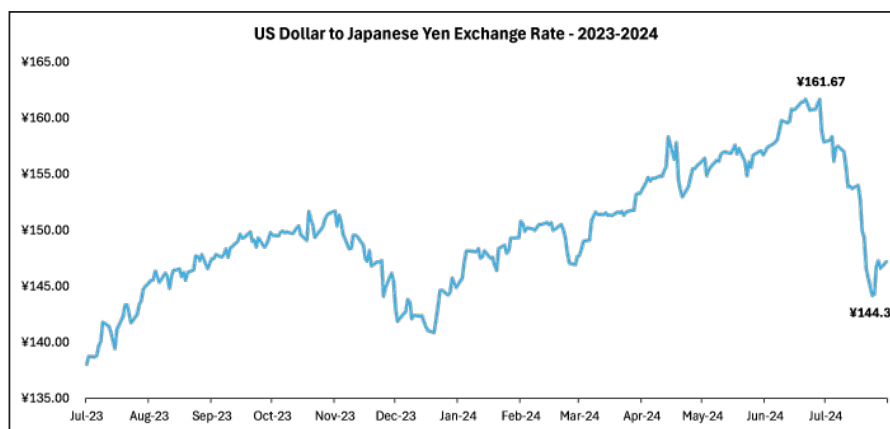
Why Did Markets Tank Last Week?

The turmoil in markets around the world over the past week shows how interconnected capital markets are today. It pretty much began with a small 0.25% hike in interest rates by the Bank of Japan on July 31, 2024. It has resulted in the evaporation of billions of dollars. Here's what happened.

Hedge funds and speculative investors invest in what is known as the "carry trade". The carry trade involves buying contracts for two currencies. In this case, investors sold the yen ("shorted the yen") and bought the dollar ("went long the dollar") to take advantage of the interest rate differentials between the two currencies. Until recently, investors held some 180,000 yen/dollar contracts according to the US Commodity Futures Trading Commission. The amount outstanding is estimated at over a trillion dollars.

These contracts sold Japanese yen with the commitment to buy the yen back later. The prevailing interest rate in yen has been about 0.1% since 2007. Once the yen is sold, the funds would be converted to dollars and invested in higher yielding US dollar fixed income securities of 5% or higher. The dollars could have been invested in other things like high-flying US stocks. Eventually, the investor would sell the dollar investments and pay off the yen that had been borrowed and make a profit.

The Bank of Japan interest rate hike caught investors off guard and caused a panic because the value of the yen jumped. In fact, in the last two weeks the yen has increased in value from 162 yen to the dollar to 143 per the graph below. In other words, dollars will only buy 143 yen today, rather than 162, so it takes a lot more dollars to pay off the yen that was borrowed per the following graph:



Source: XE.com

Obviously, other factors combined to make this a panic driven rout – factors like the increase in US unemployment and the tension caused by the Middle East situation. Nevertheless, once these short yen positions are covered, markets should recover. In fact, most of the affected US equity markets have substantially recovered. When speculators make these kinds of bets, there is often the prospect of losing all one's investment and we discourage serious investors from this sort of forex trading.

The Big Picture

Investing has always been about determining the most successful companies in the most productive sectors. The companies and sectors change over time. They change because of

global trends that start small but become big.

One such global trend is globalization. While globalization is beginning to meet resistance, it has changed the world in the last thirty years or so. By globalization, we mean the opening of markets to world trade. The US was the primary force behind globalization although it has taken on a life of its own. Globalization offered the US the chance to sell its products to the world and perhaps democratize the world at the same time. Along the way, democracy may have been lost, but globalization has pulled many countries out of poverty and into middle class status. China, admitted to the World Trade Organization in December 2001, is a case in point. Another unexpected result is that the US is no longer the singular investment destination. There are now investment opportunities worldwide. Of course, globalization has collateral damage, like the gutting of US manufacturing, but the point is, the entire world is now an investment destination.

Another underlying trend affecting investment decisions is demographic changes affecting countries and regions. Africa has a young population and China has an aging population. Thomas PM Barnett in his book "America's New Map" highlights the coming demographic "dividend" that will benefit countries like India and Indonesia with young populations. The benefit of younger populations comes in several forms, perhaps the most important being a low dependency ratio meaning numerous young workers supporting the elderly. Younger populations also correlate with more dynamic economies. In 2050, the median age in China is estimated to be 51 years old. It will be 38 in India.

Another obvious trend affecting investment is climate change. To modify rising temperatures, new industries are evolving and old ones declining. New industries in power generation and declining industries in fossil fuels are obvious examples.



Hells Gate cliffs, Lake Naivasha, Aug 9, 2024

Courtesy: JDry

Country Focus

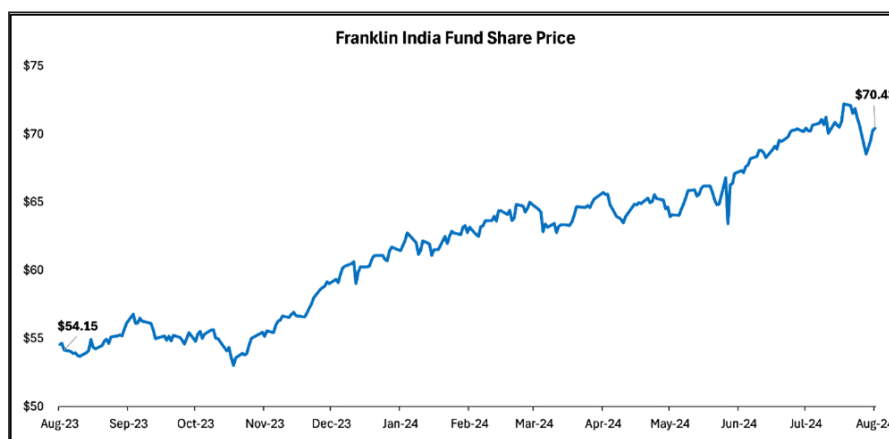
The World Bank's latest estimate of global GDP expansion over the next twelve months is 2.6%. This is considerably lower than the 3.1% average for the ten years preceding Covid. The World

Bank generally attributes this slowdown to increased debt servicing, slowing trade and climate events. Nevertheless, these averages mask a wide range of national growth projections.

US – The US is the world's largest economy with a GDP of \$28 trillion. The World Bank forecasts the economy will expand 2.5% in 2024 which is the same as last year. JP Morgan's commentary characterizes the economy as "cooling, not collapsing". The Federal Reserve will probably lower interest rates 0.25% to 0.50% in September which should give the equity markets a slight boost. The reduction in interest rates is even more likely as US unemployment rose slightly to 4.3% in July from 4.1% in June. Nevertheless interest rates are expected to stay high for longer as inflation is still 3%, which is higher than the Fed's 2% target. On balance, we continue to recommend exposure to the US equities market as innovation and new technology in particular drive this market.

China – China's \$18 trillion economy seems to have long Covid. After blistering economic growth for years, the World Bank forecasts China's growth this year at 4.8%. The economy's exposure to a real estate implosion has taken the wind out of the economy's sails, so to speak. In addition, President Xi's recent clamp down on free market enterprise has resulted in nearly a 30% fall in Foreign Domestic Investment (FDI) this year. History shows that authoritarian regimes that seek control and loyalty over market solutions do not sustain economic growth.

India – India's \$4 trillion economy is expected to expand 6.6% in 2024 according to the World Bank. It has a vibrant stock market with a total market capitalization (that is, number of shares outstanding multiplied by the share price) of \$4.3 trillion. The country is also benefiting from the demographic dividend mentioned earlier. India has a young population with an average age of 28. It's education system boasts some 37% STEM (Science, Technology, Engineering and Mathematic) university graduates. That is 2.6 million STEM graduates versus the US's 568,000 annually. This, no doubt, accounts for the fact that 37% of engineers and 23% of scientists working for IT and software companies in the US are from India, according to a recent Barclays report. From an investing point of view, the Indian securities market is particularly attractive as it has a low correlation with other markets including the US with only a 0.54% correlation according to Allianz Global Investors. The graph below shows Franklin Templeton's India Fund (in US dollars) performance over the last 12 months:



Source: Franklin Templeton website

UK – The UK's \$3.3 trillion economy has exhibited slow growth since Covid. It is expected to expand by a meager 0.5% in 2024. The UK has been beset by a number of problems since Covid. The country had three prime ministers in 2022. In the same year, inflation rose to 11% although it has now come down to 2%. The price for this lower inflation has been high interest rates although the Bank of England lowered its prime rate a quarter point to 5% on July 31, 2024.

These historically high rates have raised the cost of living for Britons. Saddled with relatively high taxes to pay for public services like national health for an aging population and the war in Ukraine, the new prime minister will need to find a way to improve productivity. Although the UK financial services sector is very robust, its manufacturing sector is considered increasingly uncompetitive as high transport, fuel and labor costs combined with weak supply chains have taken their toll on manufacturing.

Kenya – Kenya's \$104 billion economy is expected to grow 5% in 2024 down from 5.6% last year. Inflation is a continuing problem at roughly 6% but better than in prior years. Kenya's real problem is public debt with a Debt/GDP ratio of 73% and growing. Kenya's public debt has grown 91.8% over the past 5 years while GDP has grown only 47.6% according to our analysis. This highlights the inefficiency of government spending to grow the economy. Too much private sector debt is also a problem with parastatal companies like Mumias Sugar, East African Portland Cement and Uchumi on the ropes or now in bankruptcy and completely private companies like Tusky's, TransCentury, Deacon's and Kaluworks underwater or bankrupt. More importantly, government fiscal irresponsibility is a blight on the entire economy. It is behind corruption, high taxes, the debasement of the shillings six months ago, Moody's recent sovereign downgrade to junk status, and the recent demonstrations by Gen Z. On the positive side, the Kenyan economy has great entrepreneurship and is more diversified than many of its neighbors. It has a thriving tourism sector and a vibrant horticultural sector. There are well managed companies in Kenya despite the tough operating environment, but a fiscally responsible, pro-business government would spur the country to much greater heights.



Sanctuary Park, Lake Naivasha, Aug 10, 2024

Courtesy: JDry

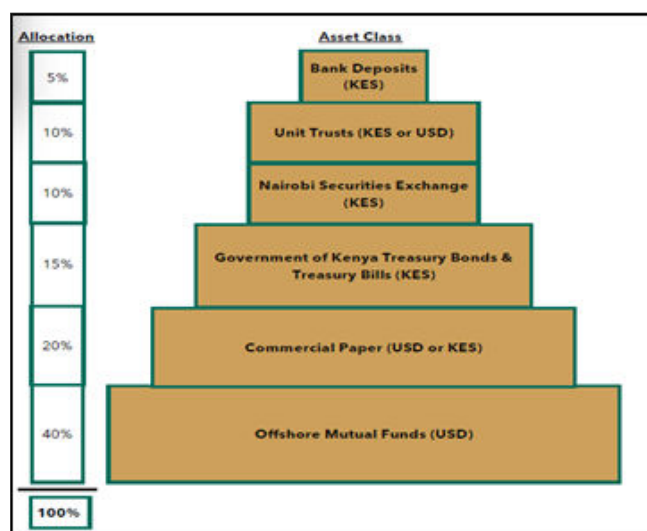
Long Term (LT) Investing

Unless the downpayment for that house had to be paid this week when US markets dropped 1,000 points or more, you ought not to stress – that is, if you have a balanced investment portfolio and a LT investment strategy. The old 60/40 rule of thumb – 60% equity and 40% debt – is a good starting point, but that should be refined according to age and other factors.

At Dry Associates, we work with our clients to adopt a balanced portfolio in terms of currency, geography, and asset categories. In fact, we have model portfolios that are crafted for individuals between the ages of 25 – 35 years old, 35 – 55 years old and 55 years plus (see below). Note particularly how the equity / fixed income percentages change as one gets older for obvious reasons.

Age →	25 – 35	35 – 55	55+
Equities	70%	60%	25%
Fixed Income	30%	40%	75%

Within these categories, investors should make choices that reflect their risk tolerance, current financial situation, financial goals and so on. This is where an Investment Executive is useful as he/she is familiar with the different investment products. If we were to blend the above age groups together, we show here for illustrative purposes, the sort of balanced portfolio we want our investors to have:



New Issues and Updates



4G Capital - On May 30th, Dry Associates hosted an investor briefing for Fourth Generation Capital (“4G Capital”) at our headquarters. Dry Associates acted as Arranger and Placement Agent for a new KES 800 million short term note programme. 4G Capital is a leader in technology-driven financial inclusion in Africa. It provides working capital loans and training to Africa’s informal micro, small and medium enterprises - sectors typically overlooked by banks. The company has 167 branches in Kenya and 22 in Uganda. 4G Capital’s loan repayment rates are high at 95% with 81% of customers being repeat customers. 4G is a certified B-Corporation based on a rating of five metrics for governance and impact on workers, community, customers and environment.



CEO and Founder of 4G Capital, Wayne Hennessy-Barrett, shares his inspiring vision for the future during an event hosted at our headquarters.



Mogo Auto - On July 18th, Dry Associates held an investor briefing for Mogo Auto. Mogo is part of the Eleving Group, an international FinTech company, operating in 16 countries and 3 continents. The briefing reviewed its recent \$7 million funding award from the US Development Finance Corporation (DFC) as well as the 3-year KES 2 billion floating rate note program arranged and placed through Dry Associates.

Mogo's mission is to enable entrepreneurship through providing credit to those excluded from traditional banking. It provides affordable financing options for used cars, logbook loans, Boda Boda and Tuk Tuk loans. The company specializes in used cars and new motorcycle financing in Kenya processing loan requests with 24 hours with loan repayment periods up to 60 months.



Mogo Kenya's CEO, Domas Mineikis, delivers an in-depth speech about their dedication to empowering underserved communities through accessible financing during an event hosted at our headquarters.

Specific Investment Recommendations

The Dry Associates Weekly Report contains specific equity recommendations for onshore and offshore securities. These recommendations are continually reviewed by our Investment Committee and generally reflect Dry Associates' own proprietary investment portfolio.

Nairobi Securities Exchange: Although the Nairobi Securities Exchange broad indexes are all down year on year, there are individual counters that we recommend. One counter is Standard Chartered. With a dividend payout of 15.30%, if one were to reinvest the dividend in the company, and the share price just remained the same at KES 190/=, you would double the number of shares owned every 4.8 years. Alternatively, you could instruct your Investment Executive to sweep your dividends into your Dry Associates Money Market Fund, currently earning 14% per annum. Another recommendation is Carbacid, a consistently profitable company, with a 10% dividend payout which can similarly be used to compound your holdings or money market funds.

New York Stock Exchange: In the offshore space, the Dry Associates' portfolio has a healthy exposure to Cubes (ticker symbol QQQ), Spiders (SPY) and Diamonds (DIA) which trade on the New York Stock Exchange. These are ETF's (Exchange Traded Funds) which track the performance of the Nasdaq, S&P 500 and the Dow Jones Industrial Average indexes respectively. Owning these ETF's gives you broad exposure to the US markets and we recommend continuing exposure to US equities.

Franklin Templeton: In our Weekly, we break out FT recommendations for conservative, moderate and aggressive investors. The US Opportunities Fund for moderate risk and the Technology Fund for aggressive investors are currently on our recommended list and are prominent in our own portfolio.

Yields Available on Kenyan Fixed Income Securities

As our investors know, we typically recommend structuring investment portfolios with a 50/50 split between Kenya shilling and US dollar (or other hard currency) investments. Kenya shilling fixed income securities pay higher yields than dollar securities, so it is usually advantageous to include these in a well-structured portfolio. The following are some of the yields available on shilling fixed income securities today:

Security	Interest Rate Yield
3-year Corporate Note (adjustable every 6-months)	20.89%
6-year Infrastructure Bond (taxable equivalent)	18.82%
1-year Corporate Note	18.50%
1-year Gov't of Kenya Treasury Bond	16.94%
91-day Gov't of Kenya Treasury Bill	15.92%
Dry Associates Money Market Fund	13.96%
Annual Average Inflation in Kenya	5.97%

As we close out this newsletter, we recommit to all our clients to work to structure investment portfolios that generate wealth regardless of current political and economic events and always with a discerning focus on the future.

Sincerely,

Dry Associates Investment Bank
August 16, 2024

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