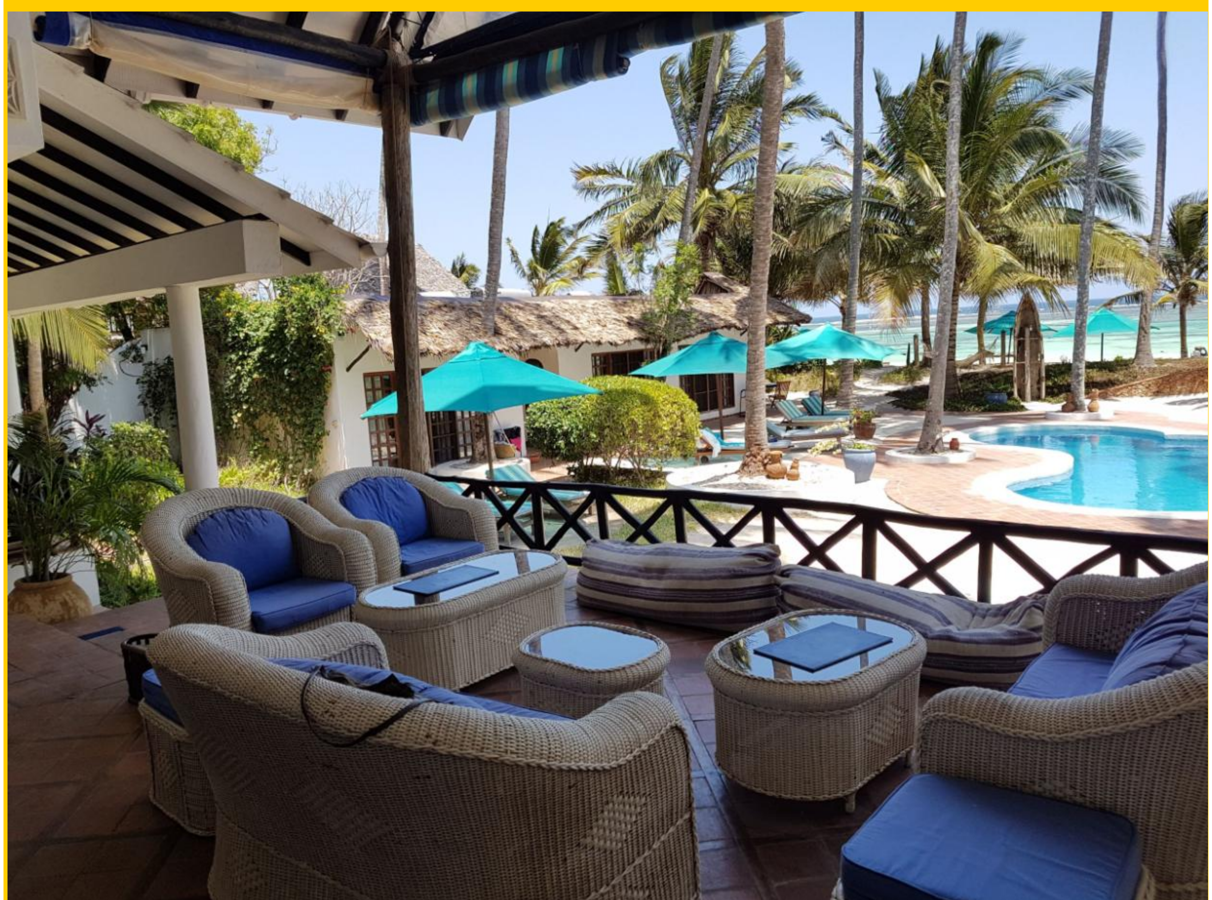
Dry Associates Investment Newsletter

November 2017



Diani Blue, a boutique beach lodge on Diani Beach, February 2017 (Courtesy: S. Dry)

Dear Investor,

IMF Forecasts Accelerating Growth for World Economy

The International Monetary Fund (IMF) recently updated its economic forecasts and they are projecting accelerating growth for 75% of the worlds' economies in 2017 and 2018. The reasons are stronger global investment, trade, industrial production and growing consumer confidence. The Washington DC-based lender of last resort to member countries is estimating global expansion at 3.6% in 2017 and 3.7% in 2018 – up from 3.2% in 2015.

That's a 12.5% expansion in global GDP from 2016 to 2017. Welcome news indeed after what seems like one economic crisis after another. We've lived through the financial crisis of 2007-09 followed by the near implosion of the Euro in the wake of the Greek debt crisis (2010-2013) and then the collapse of commodity prices (2014-2015). It's about time we hit bottom. So, if the IMF is right, the global economy is on the move again – particularly emerging markets.

Emerging Markets on the Move

For many years prior to and right through the financial crisis of 2007-09, emerging markets (EM) were engines of growth. That began to change about 2010 when the US economy strengthened and investment capital flowed back to US markets to the detriment of emerging markets.

The fall in value of emerging market equities relative to US equities from 2010-2016 was the subject of a recent study by Mark Ungewitter (*Seeking Alpha*). In that report, using the Exchange Traded Fund EEM (MSCI Emerging Markets ETF) and SPY (S&P 500 ETF) as proxies for EM and US equities respectively, he found EM equities lost more than half their value relative to US equities. This loss in relative value continued until early 2016 when EM equities began to appreciate relative to US equities. The relative appreciation was only interrupted in November 2016 which corresponds to the US presidential elections. Since then, both EM and US equities have been on a tear.

Developed Markets

IMF's global forecasts also project the Eurozone, Japan and Canada to accelerate slightly faster than US and the UK this year and next. The IMF estimates US expansion at 2.3% for 2017. That is respectable. But the IMF estimate assumes no substantial progress on US tax or regulatory reform or for that matter, increased infrastructure spending. We believe some of this legislation will be enacted. Consider also that the US Commerce Department reported last week that the US economy grew at 3% in the 3rd quarter of 2017 - higher than recent estimates. And this is in spite of the damage caused by Hurricanes Harvey (Texas), Irma (Florida) and Maria (Puerto Rico). We expect 4th quarter 2017 to exceed 3rd quarter estimates so that overall US growth in 2017 may well exceed 2.3%.

Where to Invest Now?

Where to invest and the split between developed versus EM economies is the question. Our house view has already shifted from 100% US exposure three months ago to 85%/15% (US/EM) exposure now. Looking forward 3-6 months, a 67/33 split is looking increasingly appropriate.

Exposure to all these markets can easily be accomplished through the Franklin Templeton mutual funds. The table below shows the best performing funds in US dollars. Note, however, these are all equity funds which are focused on capital appreciation – not cash distribution. The top performing equity fund Year-to-Date (YTD) for example, is the Franklin European Small-Mid Cap Growth Fund which is up 33.62% from 1st January 2017. If you run your eye down the list, the Franklin India Fund is up 24% and the Franklin US Opportunities Fund is up 20.71% - both of which many of our investors have exposure. The point being, there is obvious merit in having some exposure to some of the offshore markets below:

Fund Name	Currency	NAV	NAV Change	YTD▼	1 Yr	3 Yrs	5 Yrs	10 Yrs
Franklin European Small-Mid Cap Growth Fund - A (acc) USD	USD	47.37	0.29	33.62%	30.06%	24.18%	78.16%	62.31%
Templeton BRIC Fund - A (acc) USD	USD	18.28	0.05	33.61%	28.33%	19.58%	16.64%	-22.73%
Franklin Technology Fund - A (acc) USD	USD	17.27	0.12	32.82%	28.22%	60.93%	116.94%	161.58%
Templeton China Fund - A (acc) USD	USD	28.81	0.12	31.84%	25.01%	24.23%	28.86%	10.01%
Templeton Emerging Markets Fund - A (acc) USD	USD	42.54	0.27	28.72%	23.84%	14.73%	15.37%	-2.26%
Templeton Latin America Fund - A (acc) USD	USD	63.27	-0.26	28.68%	22.69%	-1.22%	-15.98%	-18.57%
Templeton Eastern Europe Fund - A (acc) USD	USD	28.91	0.00	28.61%	29.29%	12.62%	4.39%	-45.38%
Templeton Africa Fund - A (acc) USD	USD	7.96	0.02	26.28%	21.53%	-24.74%	-13.16%	-
Templeton Asian Growth Fund - A (acc) USD	USD	38.89	0.39	25.55%	29.59%	5.50%	14.76%	15.90%
Templeton Thailand Fund - A (acc) USD	USD	28.24	0.08	25.01%	25.66%	22.22%	43.73%	126.49%
Franklin Global Growth Fund - A (acc) USD	USD	17.61	0.05	24.34%	20.62%	24.34%	50.10%	30.33%
Franklin Biotechnology Discovery Fund - A (acc) USD	USD	30.94	-0.22	24.13%	16.23%	19.07%	124.99%	261.58%
Franklin India Fund - A (acc) USD	USD	39.97	0.07	24.00%	11.81%	28.35%	64.49%	62.24%
Templeton Asian Smaller Companies Fund - A (acc) USD	USD	47.77	0.13	23.78%	12.49%	16.72%	55.32%	-
Templeton Emerging Markets Smaller Companies Fund - A (acc) USD	USD	12.22	0.04	22.90%	14.48%	19.13%	52.92%	-
Templeton Emerging Markets Balanced Fund - A (acc) USD	USD	10.38	0.04	22.50%	20.33%	13.23%	8.87%	-
Templeton Frontier Markets Fund - A (acc) USD	USD	19.74	-0.04	21.72%	24.78%	-1.78%	33.81%	-
Templeton European Fund - A (acc) USD	USD	28.48	0.02	21.24%	26.11%	14.07%	53.03%	0.85%
Templeton ASEAN Fund - A (acc) USD	USD	10.16	0.02	21.19%	13.20%	-	-	-
Franklin U.S. Opportunities Fund - A (acc) USD	USD	14.90	0.09	20.71%	18.12%	27.81%	82.22%	88.20%
Franklin Global Listed Infrastructure Fund - A (acc) USD	USD	13.80	0.01	19.58%	12.69%	16.13%	-	-
Franklin European Growth Fund - A (acc) USD	USD	12.53	0.05	19.52%	17.29%	8.66%	-	-
Franklin Global Small-Mid Cap Growth Fund - A (acc)	USD	34.63	0.11	19.12%	20.10%	18.71%	56.16%	65.16%

For those investors interested primarily in income (as opposed to capital gain), here are the current best performing funds. For example, the YTD column shows the Franklin Euro fund denominated in US dollars has returned 17.53% since the beginning of 2017.

Franklin Templeton Investment Funds

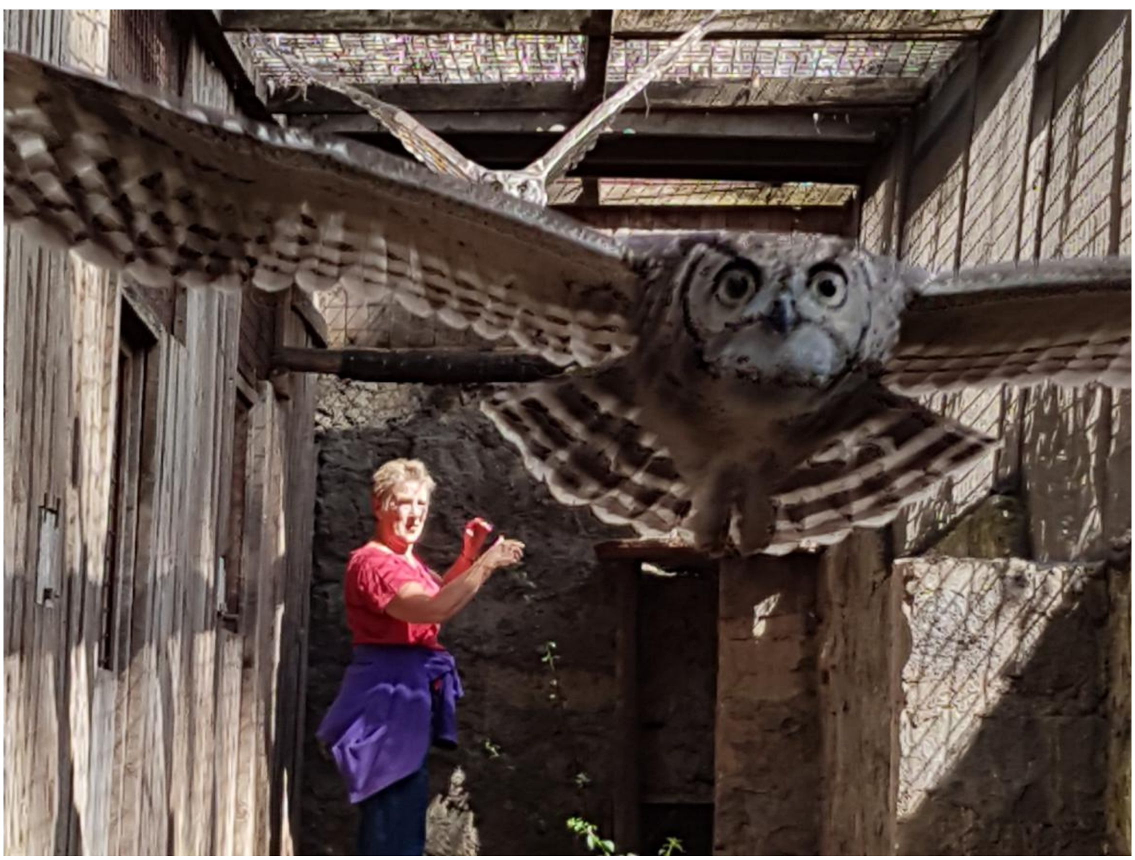
		As of 01/11/2017		As of 30 September			
Fund Name	Currency	NAV	NAV Change	YTD▼	1 Yr	3 Yrs	5 Yrs
Franklin Euro High Yield Fund - A (Mdis) USD	USD	9.30	-0.02	17.53%	11.18%	4.99%	20.34%
Templeton Global Bond (Euro) Fund - A (acc) USD	USD	10.47	-0.03	13.12%	7.11%	-3.17%	0.75%
Franklin European Total Return Fund - A (Mdis) USD	USD	11.94	-0.02	13.03%	4.76%	1.04%	15.14%
Templeton Emerging Markets Bond Fund - A (acc) USD	USD	14.18	0.01	11.22%	14.68%	9.19%	14.87%
Templeton Emerging Markets Bond Fund - A (Qdis) USD	USD	15.47	0.01	11.16%	14.65%	9.05%	14.80%
Templeton Emerging Markets Bond Fund - A (Mdis) USD	USD	9.03	0.01	11.12%	14.58%	9.05%	14.77%

Source: www.franklintempletongem.com

Kenya

Closer to home, the Kenyan economy is obviously facing headwinds. The country has been preoccupied with politics for over a year. The country must get back to work. Unemployment particularly in sectors like banking, manufacturing, and the consumer goods industry has risen dramatically. The Nairobi Stock Exchange is the worst performing stock market in the world YTD according to *Bloomberg* with a loss of KES 654 billion in market losses since the bear market began several years ago. The private sector is starved for credit and the interest rate capping legislation makes things worse. The government is displacing the private sector in financial markets. Many existing businesses, not to speak of start-ups, simply cannot get bank credit.

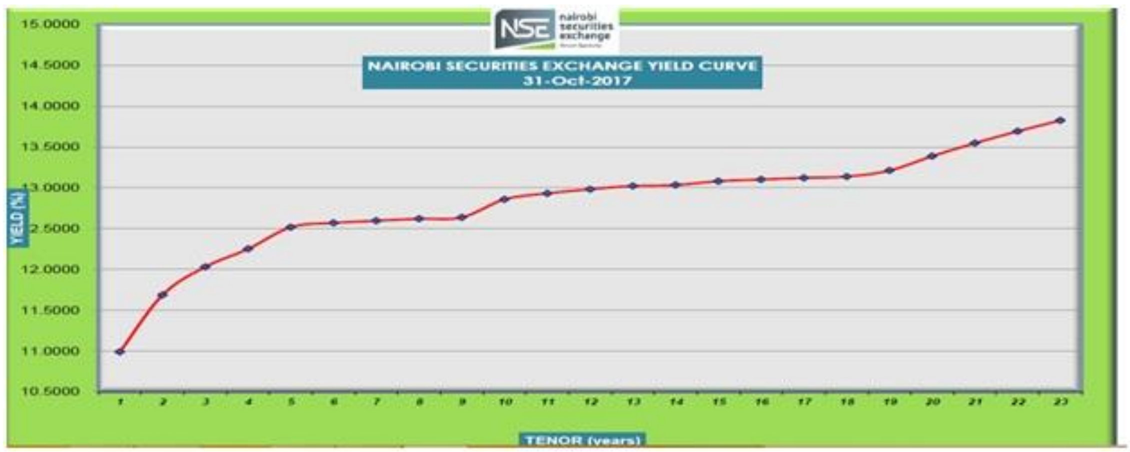
Even so, the IMF still projects Kenya's economy will expand 5% in 2017. This may be a bit opportunistic in our view. But there are always investing opportunities in any market.



Owls on the attack! In memory of the late Sarah Higgins, Naivasha Owl Centre, January 2017 (Courtesy: S. Dry)

Kenyan Fixed Income Securities

The Government of Kenya sovereign debt yield curve is the benchmark against which other fixed income securities in Kenya. Here is the current yield curve for government of Kenya short and long term paper:



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

Instrument	**Yield (KES)**
Corporate Bonds (5 year)	15%
Corporate Medium Term Notes (2 years)	14%
Commercial Paper (less than 1 year)	12–13%
Treasury Bill (1 year)	11%
Treasury Bill (6 months)	10.4%
Unit Trust Money Market Fund (Dry Associates)	9.45%
Treasury Bill (3 months)	8.0%
Tier I Banks(Fixed Deposit Receipts)	8-9%

Chase Bank (IR)

On 5th October, SBM (State Bank of Mauritius), through their local subsidiary, SBM (Kenya), announced that the Central Bank of Kenya had accepted its proposal to take over the majority of assets currently held by Chase Bank.

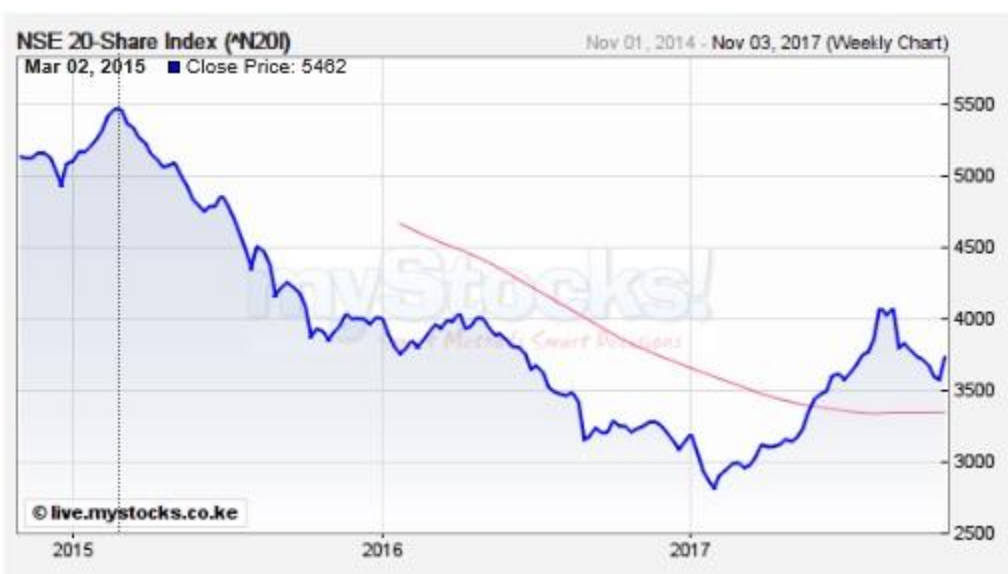
Under the proposal, 25% of the assets currently on the books of Chase Bank will remain with Chase Bank for the time being as they represent non-performing assets and liabilities of shareholders. The Central Bank of Kenya will endeavor to monetize these assets and return the funds to depositors.

SBM will then take 25% of the assets and place them into current accounts at SBM from which depositors may withdraw the funds, by January 1st 2018. Another 25% will be placed into SBM savings accounts which will pay depositors 7% per annum, accessible by end of January 2018. The remaining 25% will be split into 1, 2, and 3 year Fixed Deposit Receipts – redeemable in equal proportions yearly over 3 years.

SBM is the second largest bank in Mauritius with assets of $4 billion. The bank entered the Kenyan market in May 2017 when it took over troubled Fidelity Bank. The takeover of Chase Bank is part of a strategic expansion into India and East Africa. While due diligence is still ongoing by SBM, we wish SBM and the takeover every success.

Kenyan Equities

As noted above, the Nairobi Stock Exchange has been the victim of political uncertainty for several years. The bear market has gripped the NSE since early March 2015 when the NSE 20 Index stood at 5,462 – a 10 year high – only to decline dramatically since, per the following chart:



The market index fell to a low of 2,806 on 30th January 2017. That represents a 50% fall in the market. However, the market rose from early 2017 right through the August 2017 elections but topped out on 28th August 2017 when the presidential elections were annulled. Today, as we move into November 2017, the NSE 20 stands at 3,735 representing a 31% decline from its March 2015 heyday.

In spite of this awful showing, Safaricom has continued to defy this down market. The chart below shows the extraordinary performance of Safaricom over the same 3 year period:

So, while Safaricom has been a source of joy to equity investors over the past 3 years, the recent boycott of Safaricom may negatively impact the company. In any event, other counters offer long term opportunities for investors with deeper pockets. Valuations are low on the NSE by historical measures, and there will eventually be a reversion to the mean. Just how long that will take, that is the obvious question.

Keeping It in the Family – Establishing and Managing an Investment Portfolio

Most people work a lifetime to put money away for themselves and their progeny. Unfortunately, many people find it difficult to keep what they have. Taxes, inflation, currency debasement, poor planning, lack of knowledge and other life events often part an investor from his/her money.

Working with an investment advisor or financial planner tilts the advantage in the investors' favour. There are many studies which attempt to quantify the increased wealth resulting from working with a financial planner but they all seem a bit subjective. Suffice it to say that working with an individual skilled in financial planning almost always results in better planning, fewer mistakes, more reasoned investing, and a structured program for "keeping it in the family". In fact, in the US, the Investment Adviser Association reports that over 36 million people – that is 11% of the US population - are now using the services of a registered investment adviser. We contend that everyone with a modicum of income and some will power should be able to accumulate enough wealth over a lifetime to be comfortable in old age and leave a legacy to his/her family. Contact Dry Associates for an appointment to discuss our Private Wealth Programme.

Sincerely,

Dry Associates

10th November 2017

A view from the Crab Shack, Watamu, as the sun sets over Mida Creek, October 2017 (Courtesy: S. Dry)

Disclaimer

This Dry Associates Newsletter has been prepared using information known to and within the public domain. The information materials and opinions contained on this Newsletter are for general information purposes only, are not intended to constitute legal, financial or other professional advice and should not be relied on or treated as a substitute for specific advice relevant to particular circumstances and situations. Dry Associates make no warranties, representations or undertakings whether express or implied, about any of the contents of this Newsletter (including, without limitation, any as to the quality, accuracy, completeness or fitness for any particular purpose of such contents), or any contents of any other source referred to.

Dry Associates Ltd
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 **+254 (0) 705 799-971 / (0) 705 849-429 / (0)738 253-811 / (020) 445-0520/1**

Our mailing address is:
Dry Associates Investment Group
Brookside Grove
P. O. Box 684 - 00606
Nairobi, Kenya