Dry Associates Investment Newsletter

OCT—DEC 2013

Dear Investor,

INSIDE THIS ISSUE:

It has been 5 long years since the financial crisis broke in the US. As investors, we're still dealing with the consequences. Perhaps the most important consequence is Quantitative Easing (QE).

QE has pushed the Fed Funds interest rate in the US to the floor at 0.25% per annum. The European Central Bank (ECB), for its part, has also reduced its key monetary interest rate to 0.25%.

QE was implemented to avoid the US economy from slipping into a downward spiraling worldwide economic depression. On balance, that's worked. Now as we close out 2013, the Fed says it will continue QE until US employment falls below 6.5% - as long as inflation remains below 2.5%. Unemployment in the US is currently 7.3%. Inflation is 1%.

The European Central Bank is pursuing easy money to the extent it can under its more limited Maastricht Treaty mandate.

So the intent of the Fed and the ECB is the same - loose monetary policy. And that policy, we expect, will be with us for a long time, perhaps even another 5 years!

***Le Caudan* Waterfront, Port Louis, Mauritius, Dec. 6 '13 (Courtesy: J. Dry)**

So the implications for investors are several, namely:

- Stock markets will rise
- The rise in stock markets is being fueled by excess liquidity – not actually productivity gains
- At some point, QE will stop.

We're reminded of Herb Stein's 1st law of economics "Things that can't go on forever, don't". But in the meantime …

What to do?

US Markets

On 6 March 2013, the New York Stock Exchange's Dow Jones Industrial Average (DJIA) broke through its highest ever closing price of 14,164 reached on October 9, 2007 just prior to the Lehman Brothers collapse. Today (19 December 2013) the DJIA is 14% higher than that record at 16,167 (see opposite).

With the Fed's $85 billion per month QE added to some $3.8 trillion in US money market funds (which equals approximately 50% of the current S&P 500 market capitalization) still on the sidelines, this market will probably continue to rise. We are therefore bullish on the US market.

Recommended Vehicles for Participation:	Prior 12 Month Performance
Franklin US Small-Mid Cap Fund Class A(acc)	+33.98%
Franklin US Opportunities Fund Class A(acc)	+35.57%
Franklin Templeton Global Balanced Fund A(Qdis)	+20.76%

European Markets

The EURO STOXX 50 is an index of 50 blue chips stocks traded on Eurozone markets. On 18 February 2011 it was at 3068.

Recently, the index broke through that record at 3106, per the chart on the following page:

We are also bullish on the European markets because we think the worst may be over. Germany is begrudgingly acquiescing to a broader monetary and fiscal role for the ECB and share prices of large European companies are still reasonably priced.

Recommended Vehicle for Participation:	Prior 12 Month Performance
Franklin Mutual European Fund Class A (acc)	+31.72%

Kenyan Markets:

We believe the Kenyan stock exchange is being affected by global QE through its substantial foreign participation. Nevertheless, this small market is also subject to local political developments which have the potential to dominate investment sentiments. As long as reason prevails, particularly regarding the on-going ICC trials, we believe the NSE will continue to attract foreign and domestic investment.

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See our recommendations under the NSE review section of this newsletter.

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The obvious question for equity investors is WHEN and HOW will the eventual fall off in QE will affect markets round the world?

"*Clouds*", Mt. Kipiripiri, Wanjohi (Happy) Valley, 1st home of Lady Idina Sackville & Josslyn Hay (Lord Erroll), Courtesy: J. Dry — Nov. 21 '13)

The Fed is aware of the weight investors place on QE. The Fed is also aware of the fact that continuing to "print" money leads to debasement of the currency, asset bubbles and a host of other economic ills.

Our thinking is that US economic recovery will continue, albeit slowly based on improving US consumer confidence, growing emerging markets demand and technology gains worldwide. This slow improvement will provide the basis for measured withdrawal of QE over the next 5 years.

Kenyan Fixed Income Securities

Kenyan 91, 182 and 364 day Treasury bills are paying 9.4%, 10.4% and 10.5% respectively. While these rates appear attractive from an investment point of view they are also representative of Kenya's high interest rates environment.

Average commercial bank lending rates are 17% per annum according to the Central Bank of Kenya. This is a challenge that must be overcome everyday by the private sector – particularly smaller companies that are the true engine driving the private sector.

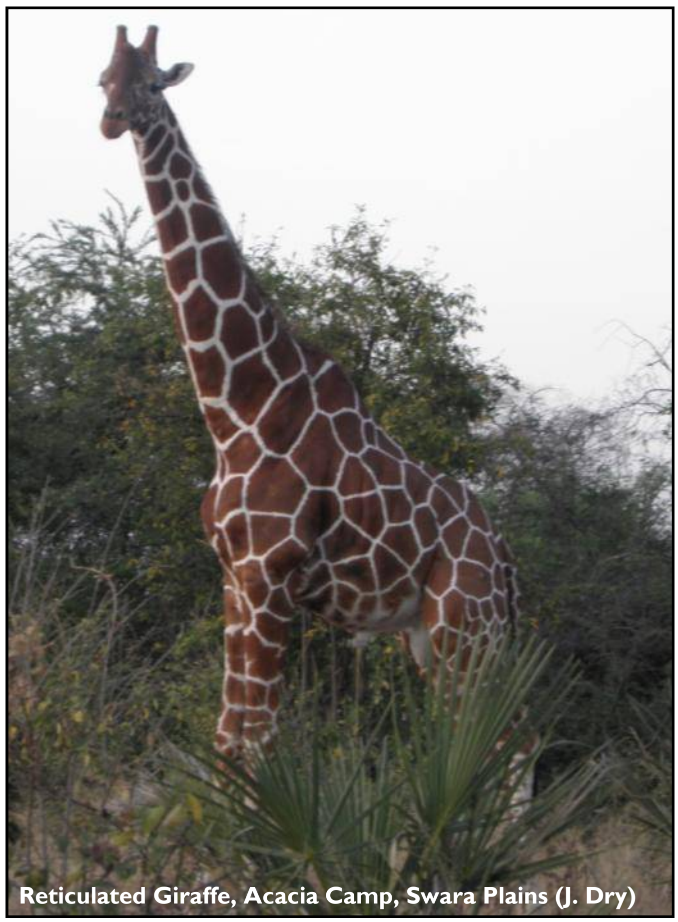
Below is a table of some key interest rates:

Average Bank Lending Rates:	17%	(Source: CBK)
Average Commercial Paper Lending Rates	12%	(Source: Dry)
Average Deposit rates (w/ Dry Assoc. partner banks)	10.5%	(Source: Dry)
Average 3 and 6 month Treasury Bill Rates	10.1%	(Source: CBK)
Average Bank Deposit Rates	6.4%	(Source: CBK)

Nevertheless, in spite of high interest rates and all the other shortcomings in infrastructure, security, civil society, and government, the Kenyan economy continues to do well. The burgeoning number of private equity companies setting up in Kenya is testimony to that. Indeed, the World Bank estimates Kenyan's GDP will grow 5.8-6% this year which is significantly higher than last year's 4.6%.

Kenyan Equities

The NSE 20 Share Index is up 25% over the past 12 months. It breached the psychological 5,000 mark on 18 November 2013. We still haven't surpassed the heady days of 2007 as Kenya headed into elections, but we are within striking distance as the 10 year chart on the following page indicates.



Reticulated Giraffe, Acacia Camp, Swara Plains (J. Dry)

There is short term uncertainty in the air as the February 5th ICC trial date for President Kenyatta approaches. There is no clear indication whether his attendance will be required or not. The ICC judges have it in their power to rule either way.

We sense nervousness amongst investors, but we also sense a general feeling that whatever transpires at the ICC, the economy will continue growing at a strong pace. Consequently, we would not be surprised to see the market move sideways for a month or so before it starts to trend up again.

As such, we continue to be impressed with the outstanding performance of Safaricom. In the banking space, we like Diamond Trust Bank and KCB. In the building and construction sector Athi River Mining also continues to outperform.

Christmas Greetings

We would like to take the opportunity to wish each and every one of our clients and friends a very Merry and Prosperous Holiday Season.

Please note that the Dry Associates offices will be closed from December 23 to January 6!

Sincerely,

Dry Associates