



# Dry Associates Investment Newsletter

FOURTH QUARTER 2014

Dear Investor,

## The US Market - Staying the Course ... for now

The Dow Jones Industrial Average (DJIA) dropped 7% between October 1 and October 15. Although it has regained 100% of the loss since then, there is an obvious edginess in the US market these days. We attribute this recent downdraft to an unusual accumulation of bad news - Ukraine, ISIS, slower growth projections for China and Europe – and with the news of two new Ebola cases in the US, it was simply too much for some investors. Once there's a surge for the door, others follow, program trading kicks in and panic ensues.

### SPECIAL POINTS OF INTEREST:

- Staying the course with the US Market
- The US Federal Reserve
- Contrarian Investing
- Kenyan Equities
- Kenyan Fixed Income



Source: [www.bigcharts.com](http://www.bigcharts.com)

And so it goes, but unless the economic fundamentals underlying a market have changed, these sudden downdrafts are usually buying opportunities. And so we think the US market continues to offer further upside potential.

The latest 3<sup>rd</sup> quarter US GDP figures show the economy growing at approximately 4%. Unemployment is down to 5.9% (even though the participation rate is also down to 62.7%) and 3Q consumer spending is up 2%. Equally important for market watchers is that 77% of 3Q corporate earnings for S&P 500 companies reported so far exceed guidance. [Source: Factset]

The other reason we still like the US market is that the dollar as a currency is appreciating against almost every other currency. For example, the dollar has appreciated 8% against the Euro and 4% against the Kenya shilling since January 2014.

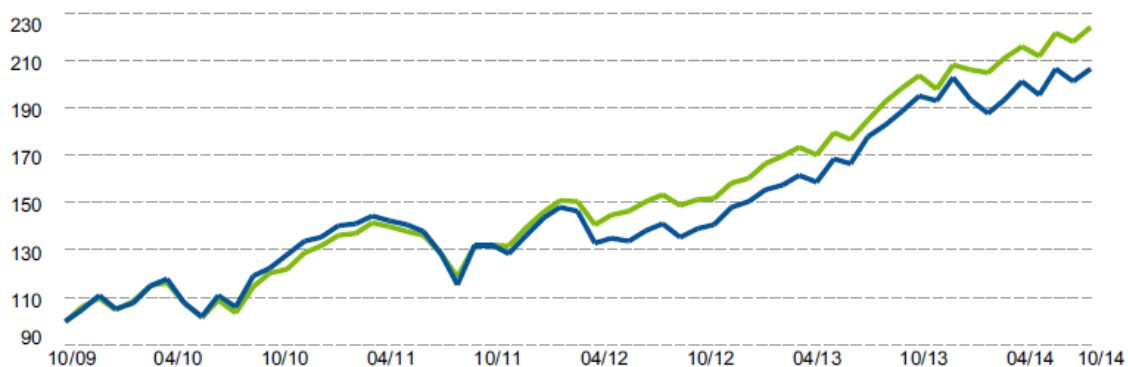
# Franklin Templeton

In our Franklin Templeton range of funds, the US Opportunities Fund, we believe, is a good way to get exposure to the US market. Here's a recap of its performance over the past several years:

## Performance

### Performance over 5 Years in Share Class Currency (%)

■ Franklin U.S. Opportunities Fund A(acc) USD      ■ Russel 3000 Growth Index



### Performance in Share Class Currency (%)

	Cumulative									Annualised
	1 Mth	3 Mths	6 Mths	YTD	1 Yr	3 Yrs	5 Yrs	10 Yrs	Since Incept	Since Incept
A(acc) USD	2.76	5.68	10.02	5.98	12.93	56.02	106.64	140.21	15.30	0.98

## The US Federal Reserve ... is a big factor

But there is reason to be concerned about the end of the Fed's quantitative easing (QE) exercise and its effect on the market. The Fed has added \$3.5 trillion of treasuries and mortgage bonds to its balance sheet since 2008. By buying up this paper it injected \$3.5 trillion into the economy. That in turn has re-inflated stock market and property values. So, the immediate worry is that all this new money has the potential to create asset bubbles such as in the stock market. And history teaches that asset bubbles are to be avoided at all costs.

On the other hand, if the Fed were to start selling this paper, it could force interest rates up dramatically. Janet Yellen, the Fed's Chair, says there are no plans to sell the Fed's holdings before the end of the decade. That's somewhat reassuring, but the Fed has indicated that it will begin to raise interest rates in 2015. And of course, when interest rates go up, stock markets tend to go down in large part because higher interest costs reduce profits.

So, while we're still bullish on the US market we realize that this bull market is getting a little long in the tooth and we have yet to deal with the unwinding of QE. As such, we're always appraising other opportunities for our investors.

# Contrarian Investing

The Eurozone continues to underwhelm with its currency problems and 3Q GDP estimates for Germany and Italy are both slightly down. Franklin Templeton describes emerging market grow as “patchy” which also sums up our view pretty well. There are outlier countries that are doing well but underlying regional trends are mixed and unconvincing.

But we are sure of one thing. Bull markets are always followed by bear markets. We offer here several contrarian investment ideas. These contrarian investments will all eventually come right. Salting a little away in these investments now and heading for the beach might not be a bad thing.

<u>Asset Category</u>	<u>Approx. Loss (in \$)</u>	<u>Suggested Investment Vehicle</u>
Shares in Gold Mining Companies	Down 50% since 2011	Franklin Gold & Precious Metals Fund
Shares in Natural Resource Companies	Down 30% since 2011	Franklin Natural Resources Fund
Eastern Europe (inc. Russia)	Down 25% since 2011	Templeton Eastern Europe Fund



Wildebeest Migration in the Mara Triangle -  
Courtesy: P. Wesolek (Sept. 18, 2014)

# Kenyan Equities

The NSE All-Share Index and the NSE 20 Share Index are up 5% and 6.7% respectively since our last newsletter in mid-July 2014. These are good results although there was some market weakness in late September and early October. We attribute that temporary fall off to uneasiness surrounding President Kenyatta’s appearance at the ICC. In any event, the NSE continues to show signs of strength per the graph (right):





# Equities contd...

There also continues to be strong interest from foreign investors in portfolio investment. More broadly, Kenya is implementing a broad based infrastructure investment program targeting road, rail, water and power generation and in some cases in conjunction with multilateral institutions which will lay the foundations for future development.

In other developments, Kenya' has revised its calculation of GDP. As a result, Kenya's GDP has officially increased 25% incidentally lifting the country from low income status to middle income status. It has also had the effect of reducing the country's Debt to GDP from 57% to 50% - at least on paper!

In any event, Kenya's GDP growth for 2014 will exceed last year – the drop in tourism notwithstanding. The African Development Bank is now estimating the economy will expand 5.7% over last year.

## Kenyan Fixed Income

The Kenyan government closed bids on October 21<sup>st</sup> on its latest tax free 12-year Infrastructure Bond carrying an 11% coupon. It sought to raise KES 15 billion and received offers of 39 billion. The average yield accepted was 11.26%. With that kind of interest, the GOK decided to re-open the bond in a “tap” sale which continued through mid-November.



Le Paradis Hotel, Le Morne, Mauritius— Courtesy: S. Dry (Aug. 28, 2014)

Overall, interest rates remain relatively stable per the following:

Average Commercial Bank Lending Rate	16.04%	[Source: Central Bank of Kenya]
Average Commercial Paper Lending Rate	12.50%	[Source: Dry Associates]
Average Deposit Rates (with DAL partner banks)	11.00%	[Source: Dry Associates]
Average 3 and 6 month Treasury Bill Rate	8.88%	[Source: Central Bank of Kenya]
Average Commercial Bank Deposit Rate	6.64%	[Source: Central Bank of Kenya]

As we approach the end of 2014, we'd like to remind investors to make an appointment with your Dry Associates' Investment Advisor to review your portfolio to ensure it reflects clear thinking going into 2015. Please note also that our offices will be closed from December 22<sup>nd</sup> 2014 to January 4<sup>th</sup> 2015.

Sincerely,

*Dry Associates*

November 18<sup>th</sup>, 2014