Cytonn Weekly Update #15, with a focus on Savings and Investments

Cytonn Weekly

Executive Summary

- **Fixed Income**: The Shilling touches a 3-year low of 93.5 against the dollar on the back of increased corporate activity and demand for the Dollar and, as expected in our last week's report, the Central Bank in a statement indicated that they will continue monitoring the currency and provide the necessary support;
- **Equities**: Equity markets recover from previous week's losses, with near-term performance dependent on corporate actions, such as dividend book closures, especially in the Banking sector;
- **Private Equity**: Kenya?s share of transaction value in Private Equity the highest in the region;
- **Real Estate**: The first listed REIT approaches, but roadblocks remain to determine their success;
- **Focus of the Week**: With increased disposable income in the economy, we highlight the reasons why individuals should strive to save and give the steps to effectively create a savings plan.

Fixed Income

There was mixed reaction from Investors as they continue to seek clarity on the direction that interest rates will take given the depreciation of the Kenya Shilling and the relatively low levels of Inflation. The combined treasury auctions saw a subscription rate of 133.7%, with rates remaining sticky at 8.4%, 10.3% and 10.6% for the 91-day, 182-day and 364?day bills, respectively.The Kenya Shilling, which has lost 3.1% to the Dollar so far this year, closed at a low of 93.5 on Friday, a level last seen in November of 2011. The depreciation was as result of increased local Dollar demand from the corporate sector, driven by companies such as EABL paying dividends to foreign shareholders and lower investor confidence in the Shilling, which has arisen due to the recent insecurity incident. Over the next few days, the Shilling performance will largely depend on activity by the Central Bank. Key to note is that the Forex reserves have declined to 4.45 months of import cover from 4.85 months in January 2015, however the reserves remain high and above historical levels.

Equities

Despite volatility across the market during the week, the NASI closed 2.1% higher on the back of recovery from large-cap stocks e.g. Safaricom, which had witnessed profit taking from investors. Safaricom ended its recent price drop; rising 8.1% during the week as the company announced plans to move its M-pesa servers locally from Germany, an action that will lead to cost savings and also see improved customer experience.The court battle between Kenya Revenue Authority (KRA) and stockbrokers also took a new twist as the brokers argue that the tax is unconstitutional. The Stockbrokers have renewed the legal battle against the KRA on the capital gains tax (CGT), by filing an application claiming that the High Court relied on a repealed provision of the Finance Act to throw out their case. This might lead to a slow down in the market as seen in January 2015, where market turnover declined 68% from the December volumes as investors shied away over uncertainty on the tax collection implementation.Going forward, the market will be largely driven by corporate actions, mainly dividend book closures for Full Year 2014. The banking stocks will take centre stage as counters such as KCB, Diamond Trust and Housing Finance reach their ex-dividend dates.

Private Equity

Africa continues to stand out as the investment destination of choice, attracting a flood of global capital, driven by factors such as favourable demographics and rapid urbanisation. The most recent development highlighting this was Abraaj closing their USD 990 million Africa Fund. This is Abraaj?s third Africa fund, and will focus on well-positioned companies in sectors such as FMCG, Financial services and infrastructure in Kenya, Nigeria, Ghana, Cote d?Ivoire and South Africa. Abraaj has deployed close to USD 3 billion in Africa making 67 investments in SSA and exited profitably from 30 investments.A recent report from the African Private Equity & Venture Capital Association highlighted the Private Equity opportunity in the East African region. The spotlight is now on East Africa, which has seen 158 deals closed between 2007 and 2014. This is equivalent to 18% of the total Private Equity deals in Sub Saharan Africa in the same period. In East Africa, Kenya has had 55% of the transactions by number and 76% by value, making it the regional leader, as well as highlighting Kenya?s capacity to attract more and larger ticket size deals.PE firms have identified a shortage of key skills in many businesses they invest in, ranging all the way from poor IT platforms, unplanned product distribution networks, and a lack of proper alignment with key management. This has opened doors for PE investors to set up frameworks and structures to derive optimum value from their investments through skills transfer.

Real Estate

The Capital Markets in Kenya continue to deepen with the introduction of Real Estate Investment Trusts (REIT?s). Most recently, Stanlib Kenya announced that they would be launching a REIT in the market by the end of the second quarter, backed by a bucket of income generating real estate assets. It is important to note that despite many service providers being licensed as REIT Managers and Trustees, we are yet to see a single operational REIT listed on the bourse, yet the regulatory framework has now been in place for a while.In our view, as much as REITs will aim to provide an exit for developed properties, income yield for investors, and a tax efficient structure to undertake development, there are many hurdles to cross before this becomes a reality. To begin with, the low investor education on Capital Markets, coupled with the minimum investment amount of Kshs 5 million per investor, locks out a majority of individual retail investors. Additionally, scarcity of institutional grade real estate that is required to support high yields and capital appreciation will continue to hamper the development of listed REITs market. Increased investor education, revisiting the minimum investment level, and the on-going institutionalization of the Real Estate Development arena should help catalyse the sector.

Focus of the Week ? Why and how do I save and how do I Invest my savings?

Savings refer to any disposable income not spent on consumption and it is aimed at securing future needs. Rather than save what is left of your income after deducting expenses, it is more prudent to first deduct a set savings amount from you income and only spend what is left after saving. Savings can be negative if an individual is spending more than they are earning, by taking on debt to pay living expenses. Positive savings can help one achieve both current and future financial goals; whether it?s a comfortable retirement, a down payment for a house or even education; you can achieve your goals by setting money aside and investing it. At the very minimum, the basic rule of thumb is to save at least 6 months of their living expenses to withstand any unforeseen shocks such as illnesses, job loss or even a sabbatical.Key things to note while saving and investing:

1. **Make a budget**: A budget is an estimate of the incomes and expenses for a set period and is a key tenet to proper financial planning. Since budgeting allows you to create a spending plan for your money, a budget is a way of being intentional about the way you spend and save your money. Not only does a budget give you control over your money, but it also saves you the stress of suddenly having to adjust to lack of funds because you did not initially plan how to spend them. Additionally, a budget also aids in deciding which short term expenditure to sacrifice in order to

enjoy long term benefits like a holiday or comfortable retirement;
2. **Pay yourself first**: Saving should not be viewed as what is left after current needs and wants have been satisfied. "Pay yourself first" is an effective savings strategy that can help individuals choose saving over spending money. It entails first saving a portion of the money earned, say 10-20% of net income, before spending on consumption;
3. **Set goals that will inspire success**: To successfully practice the ?pay yourself first? strategy, a person should set personal goals. Saving becomes easier if you set a clear goal because that way, rather than thinking about the money you are setting aside each month, you can focus on what you will be able to do once you?ve reached your goal;
4. **Do not take unnecessary risk**: It is important to know the risks inherent in all the savings products or channels before committing your money. Ideally, savings should be invested in in the highest returning assets, on a risk-adjusted basis;
5. **Put time to work for you**: The concept of time value of money is one that everyone should learn about and live by, since it can give financial security that one may otherwise not have. The more time that an individual has to save and invest, the more they can end up with in the long run since money invested is compounded so that even small amounts invested regularly can add up to impressive sums in the long run;
6. **Diversify**: Never put all your eggs in one basket. Spread your money between different kinds of savings products to help reduce the overall risk of your savings. The need to diversify is essential because no investment product performs well all the time; when one type of investment is down another tends to be up.

Where Can Money Be Saved?

In Kenya, there are a range of saving options and products, which can be broadly categorized into:

1. **Deposit Accounts**: These are accounts held by banks and earn interest on the amounts deposited. They can either be savings or fixed deposit accounts. Their risk profile is low since the returns are guaranteed which ensures safety of one?s funds but there?s a downside in that your money?s buying power is eroded over time if inflation is higher than the interest rates paid, which is the typical situation given the rates offered by most banks.
2. **Financial Markets Instruments**: This refers to the investment in shares of quoted companies at the NSE or investment in fixed income securities such as Treasury bills and bonds. Stocks are suitable for long-term investors due to the volatile nature of the market and since the returns are not guaranteed, stocks have a higher risk profile. Fixed income securities on the other hand are suitable for short to medium-term investors and are not as volatile as stocks. Fixed income securities offer issuer-guaranteed returns hence have a lower risk profile.
3. **Collective Investment Schemes (Pooled funds)**: This is an investment vehicle made up of a pool of funds collected from many investors for the purpose of investing in securities such as stocks, bonds, money market instruments, Property, Private equity and similar assets. Such schemes include unit trusts, mutual funds.
4. **Structured / Private Solutions**: These are usually saving solutions such as Structured Notes and Cash Management Solution (?CMS?), which are packaged by investment professionals, typically tailor made for the investor, to enable investors access pockets of returns in the market that are not readily accessible through traditional investment avenues such as stocks, bonds and bank deposits. Structured products are relatively more complex, but they also offer higher returns relative to traditional products.

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financial advisor to advise them of the suitability of any financial product for their investment purposes.

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