



Investment Lessons Through The Decades

The 2000s decade ended on a very low note with share prices mostly on the decline in the last three years. The NSE index closed the year 7.8% weaker compared to declines of 4.1% in 2007 and 35.3% in 2008, which was the single worst year in terms of performance in the history of the NSE.

In terms of dismal performance of share prices, the average return of 41.1% in the 2000s decade comes second to the 1970s decade when the average return was 7.1%. By comparison, shares fared much better in the 1980s and 1990s, when average returns were 116% and 184%, respectively.

However, the below average performance of shares in the last decade is not without explanation. Indeed, the lesson from the past is that share prices do not just rise based on the “animal spirits” of investors, but on factors based on clear and sound fundamentals that cause a permanent increase or decrease in the profitability of most listed companies. Subsequently, periods when share prices under-perform are characterized by negative events that cause investors to move away from shares due to uncertainty about the future.

Ironically, share prices performed dismally in the 1970s yet that was the decade with unprecedented economic growth, peaking at an all time high of 8.1% in 1977, and averaging 5.3% during the decade. The trend might be explained by two factors; first is the political uncertainty following the death of Kenya’s first president, Jomo Kenyatta, which almost resulted in a constitutional crisis on the issue of succession. Second is the adverse effects of the second international oil crisis in 1979 caused by production disruptions in Iran following the toppling of the government of the Shah of Iran, and the Iran-Iraq war not so long afterwards. These events reduced the upward momentum of share prices that would have been buoyed by the surge in economic growth.

The favorable performance of equities in the 1980s may be attributed to two factors; first is the low point of share prices at the beginning of the decade due to the adverse factors in the late 1970s, and second is the effects of a global bull run that started in the mid-1980s and continued until the end of the decade. Unfortunately, the bull run transformed into a bubble that pushed the world into a recession in 1990 after it burst. The excesses of the bubble years are still being felt in Japan up to today, the local index, the Nikkei Average, is currently trading at 27% below its peak value in 1989.

The stellar performance of share prices in the 1990s may be attributed to the lifting of price controls in the economy starting from 1991 when interest rates were liberalized, meaning commercial banks were free to set lending and savings rates based on market forces. By 1994, all prices in the rest of the economy were liberalized which resulted in companies post-

ing record profit levels after years of value-destroying price controls. The phenomenal profits caused most listed companies to declare unprecedented dividend payouts and bonus share issues which sent share prices to stratospheric levels.

The just ended decade was different in many ways from previous ones. Share prices started the decade on a low note, mainly due to a declining economy and sour relations with donors which pushed Treasury bill rates to the 20% range as the government heavily increased domestic borrowing. The entry of a new government in late 2002 raised investor confidence and together with expansionary economic policies in 2003 caused a surge in share prices that lasted 4 years, peaking on 12th January 2007 when the NSE index closed at 6,161.46 points.

Unfortunately, the trend reversed and the twin factors of post election crisis and the worst global recession in 60 years brought the momentum of share prices to an abrupt halt in late 2008. Once again, the year in which the economy grew by 7.1%, the highest since the 1970s, coincided with the beginning of one of worst bear markets in memory, confirming the fact that the stock market is a leading indicator of economic activity.

Looking forward, and barring any negative influences, there is good reason to expect better performance of shares in the current decade based on several factors. First, is the likely increase in investor confidence if a new constitution is enacted, this might bring to an end the long standing issue of political uncertainty in the country, especially during years of general elections. Second is the effects of the “silent revolution” that is likely to be caused by the prevalence of mobile phone technology and high speed internet. Technological change usually leads to increased efficiency and profitability in all sectors of the economy. The third factor is the historical observation that share prices tend to perform better in the years following very dismal economic growth, such as the last two. The reverse is also true.

We therefore advice those with a medium to long term investment outlook to take a chance in shares, unless another global financial crisis is around the corner (or you believe in the Mayan prophecy that the world will end in 2012), things can only look up. The time to act is now!

	2009	Chg
Balanced Fund	2.73	-5.4%
Pension Fund	8.06	1.9%
MMF Yield	8.5%	-
NSE Index	3,247.44	-7.8%

Top 3 Stocks	2009	Chg
Williamson Tea	149.00	159.1%
Carbacid	103.00	125.5%
Kakuzi	31.75	35.9%

Bottom 3 Stocks	2009	Chg
Eaagads	20.00	-45.2%
Centum	11.25	-40.0%
Express	8.05	-38.1%

Selected Indicators	2009
Econ. Growth Rate (Q3 '09)	0.0%
Inflation Rate (Dec)	5.3%
91 day T-Bill Rate (Dec)	6.61%
182-day T-Bill Rate (Dec)	7.25%
364-day T-Bill Rate (Dec)	8.01%
Inter Bank Rate (Dec)	3.83%
Avge Overdraft Rate (Nov)	14.24%
Avge Savings Rate (Nov)	1.71%