



2009: REIGN OF THE BEAR OR RETURN OF THE BULL?

Last year is one many investors would like to forget. There was optimism that the country would go back to business as usual after the general elections in December 2007, but Kenyans were in a for rude shock when a political crisis resulted in wide-spread violence that threatened to tear the country apart. In a departure from previous years, share prices declined by 9.2% in the month of January mainly due to panic selling.

The Safaricom IPO renewed investors' hopes about the recovery of the stock market but the global financial crisis resulted in foreign investors selling heavily after the IPO to cover their losses back home and in the process depressed the share price below its offer level. First time individual investors were shocked as the substantial gains they had anticipated quickly turned into double-digit losses. By June it was evident that one of the longest stock market rallies that started in late 2002 had come to an end as prices of almost all shares headed south. The NSE index closed the year 32% weaker, the first time it posted a double-digit decline since 2001, when it decreased by 29%. Only share prices of three companies went up during the year (see table on the right) with share prices of 45 companies on the decline, clearly signaling a bear market.

In addition to the effects of the post-election violence, the stock market decline was driven by high inflation brought on by rising food and fuel prices. Overall inflation rose to a high of 31.54% in May and averaged 26.2% during the year, the highest rate experienced since 1994 (29%). High inflation has the direct effect of reducing consumer purchasing power and eroding investment returns. In an environment where high inflation is not as a result of monetary factors it becomes very difficult for investments to generate returns that can even match the rate of inflation.

As the global financial crisis continued to take its toll, stock markets around the world recorded their worst performance in decades, declining by 45% on average, with the most dismal performers coming from China's SSEB index (down 72%), Russia's RTS index (down 67%) and Egypt's Case 30 index (down 59%). Noteworthy of 2008, no stock market index around the world recorded a gain last year, an indication of the severity of the global financial crisis.

The main concern currently is how Kenya's economy and financial markets will be affected by the global financial crisis, and prospects of the stock market in 2009. According to information from the Kenya National Bureau of Statistics, the economy expanded by 2.1% in the third quarter of last year compared to an increase of 6.3% over the same period in 2007; agriculture, manufacturing and tourism were all on the decline. Remittances from Kenyans abroad were on the decline from July, mainly as a

result of the financial crisis. A larger oil import bill caused by rising international oil prices was mainly attributed to a steady decline in official foreign exchange reserves from 4.05 months of import cover to 3.35 months of import cover by year end. The shilling consequently weakened against the US dollar and Euro by 23% and 18%, respectively.

Short-term interest rates were relatively stable during the year and Treasury bill rates averaged 7.7% and 8.5% for the 91-days and 182 days tenors, respectively. Perhaps what prevented a steeper decline in share prices last year was relatively low and stable short-term interest rates. The decision by the Central Bank of Kenya to lower the cash ratio from 6% to 5% in December increased liquidity in the money market and helped ease upward pressure on interest rates.

A few important lessons may provide a useful guide for investing in 2009. First, always have a long-term outlook when investing in shares, that way, any unforeseen fluctuations in the short-term will not surprise or disappoint you. Second, avoid speculation; no one can predict the future direction of share prices with certainty, always go for companies with sound fundamentals and be patient. Third, economic cycles are inevitable; don't focus on the negative side of economic downturns, instead buy shares of undervalued companies and wait for the next upswing, it always comes as long as you are patient. Fourth, unless you have an emergency, or the fundamentals of the company you invested in have suddenly changed for the worse, avoid selling to "cut losses." As long as the losses have nothing to do with the fundamentals of underlying companies, share prices eventually recover.

Finally, most analysts around the world are forecasting that 2009 will be a very bad year for stock market investors because most economies are already in deep recession and corporate earnings are expected to decline. This presents an excellent and rare opportunity to make significant returns in the next few years, for those who are bold and patient to take their chances today. Go on, dare yourself!

"The time of maximum pessimism is the best time to buy and the time of maximum optimism is the best time to sell." Sir John Templeton.

Performance: Jan '08 to Dec '08

| | 31-Dec | Chg |
|---------------|----------|--------|
| Balanced Fund | 2.88 | -39.5% |
| Pension Fund | 7.91 | -20.5% |
| MMF Yield | 8.76% | - |
| NSE Index | 3,521.18 | -31.9% |

| Top 3 Stocks in | 31-Dec | Chg |
|-----------------|--------|-------|
| Nation Media | 144.00 | 39.4% |
| Equity Bank | 176.00 | 24.8% |
| Total Kenya | 32.00 | 4.9% |

| Bottom 3 Stocks in 2008 | 31-Dec | Chg |
|-------------------------|--------|--------|
| Sasini | 7.00 | -58.9% |
| Eveready | 3.50 | -54.8% |
| Housing Finance | 19.40 | -53.8% |

| Economic Indicators | |
|----------------------------|--------|
| Econ. Growth Rate (Q3 '08) | 2.1% |
| Inflation Rate (Dec) | 27.72% |
| 91 day T-Bill Rate | 8.488% |
| 182-day T-Bill Rate | 8.972% |
| Avg Bank Lending Rate | 14.33% |
| Avg Bank Deposit Rate | 4.86% |