



## INDICATORS OF A SUSTAINED RECOVERY

The first quarter of this year yielded unimpressive results to stock market investors, with almost all share prices continuing on a downward trend. During the quarter, the NSE 20 share index declined by 22% while the all share index went down by 20%. The market's lukewarm reception to the release of 2008 financial results reveals continued investor apathy towards the stock market. Despite most companies posting significantly improved profits, with generous dividends and even share splits and bonus issues in a few cases, share prices failed to react with the expected exuberance.

Almost all share prices were on the decline during the quarter but a reversal started taking place from mid March. What is not clear is whether the sudden but gradual recovery in share prices will continue to gather momentum, or is just a temporary aberration from the bearish mood that has haunted the market since early June last year.

The trend is not unique to the Kenyan stock market, other stock markets around the world have been following a similar trend, rising momentarily then sliding thereafter based on negative information about the extent of the global financial crisis and its continuing effect on the economy.

There is consensus that a complete and sustained recovery will only take place once the global credit markets have fully recovered with a similar impact on underlying economies. The IMF has downgraded previous economic growth rates for 2009 for virtually all countries, with developed economies expected to be the most affected. Kenya's growth forecast for 2009 was revised downwards from 6% to 2.5%, with leading sectors such as agriculture, manufacturing and tourism registering declines from the third quarter of last year.

Most developed countries have assembled massive economic stimulus packages in an effort to support ailing industries, stimulate consumer demand and revive economic activity. Developing countries such as Kenya are constrained by budgetary implications and may not be able to duplicate in scale the economic boosts being implemented by their rich counterparts.

However, there is a growing consensus that monetary measures such as lowering the cash ratio requirement further may inject more liquidity into the money market and spur an increase in lending and economic activity. The cash ratio refers to the minimum amount that commercial banks are required to maintain at the central bank, it is currently 5% and lowering it has the effect of increasing liquidity in the banking system. It was last adjusted in December last year causing liquidity to increase by about kshs.10 billion.

When viewed against this backdrop, a sharp and sustained rebound in share prices is not expected in the short term until economic fundamentals show clear signs of recovery. However, this does not mean that all shares will continue declining in value, there are a few companies that are expected to perform well even in the current turbulent times and their shares are expected to increase in value, or at least not fall by as much as the market on average.

Interest bearing investments like Treasury bills, Treasury bonds and commercial paper, have continued to provide investors with a safe haven for their holdings. Although the principal amount is secure, the fact that the average overall rate of inflation is currently averaging 27.2% means all fixed income securities in the market have negative real returns. The real return refers to the rate of interest on an interest bearing investment less the prevailing rate of inflation.

High inflation eats into the incomes of consumers leaving them with less money for consumption, saving and investing. One of the ingredients of a sustained economic and by extension stock market recovery is a significant reduction in the rate of inflation.

Closely related to inflation and a significant indicator of the performance of the economy is the success of the long rains. Kenya's economy is still heavily dependent on agriculture, which has a direct effect on agricultural produce, industrial production and electricity generation. Recent reports from the meteorological department to the extent that only a few parts of the country may receive sufficient long rains is reason for grave concern. If the prediction comes to pass it will be very difficult to even achieve the 2.5% growth rate this year.

Despite the gloomy outlook for this year, there is still hope for investors. Most shares are currently trading at deep discounts to their fair value and present good return opportunities in the medium term. Additionally, competitive interest rates on fixed income securities, such as provided by the Zimele Money Market Fund, also provide a good avenue for diversification, or for investors with short-term objectives. The important lesson learnt from past economic downturns and bear markets is that they are never permanent, and a recovery is only a matter of time. We do not expect this time to be an exception.

	Q1 31-Mar	Chg
Balanced Fund	2.34	-18.4%
Pension Fund	7.06	-10.4%
MMF Yield	8.5%	-
NSE Index	2,805.03	-21.9%
NASI Index	59.49	-19.8%

	Q1 31-Mar	Chg
<b>Top 3 Stocks</b>		
BAT	139.00	6.9%
Total	33.00	3.1%

	Q1 31-Mar	Chg
<b>Bottom 3 Stocks</b>		
Crown Berger	12.95	-48.2%
Centum	10.25	-45.8%
TPS Serena	29.50	-43.8%

<b>Economic</b>	
Econ. Growth Rate (Q3 '08)	2.1%
Inflation Rate (Mar)	25.78%
91 day T-Bill Rate	7.359%
182-day T-Bill Rate	8.228%
Avg Bank Lending Rate	14.22%
Avg Bank Deposit Rate	5.19%