

Recommendation:

WATCH

NAIROBI STOCK EXCHANGE UPDATE

Foreign Investor Selloff Continues to pound market Turnover...

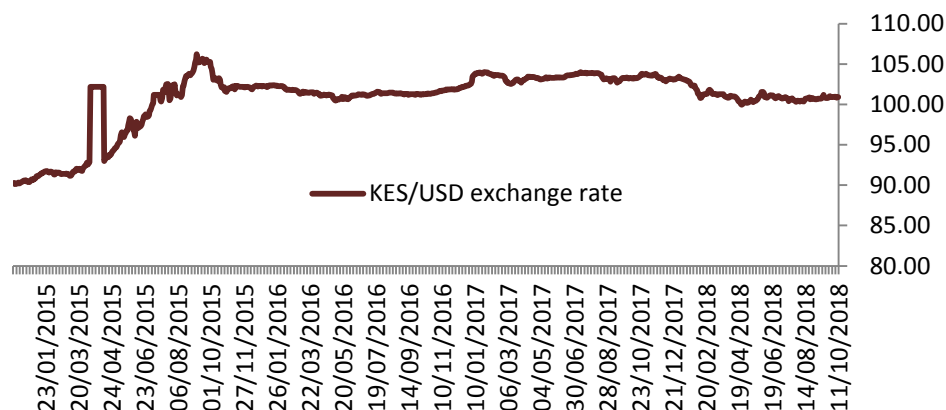
Equity Market turnover on the NSE has shown general decline since March of this year. The Equity Market turnover on the NSE in September was recorded as **KES 11.94 Billion**, a decline of about **47.87%** from the current year high of **KES 22.89 Billion** registered in March. The general decline of the bourse can be attributed to both idiosyncratic macroeconomic factors and global macroeconomic factors. We outline the key factors that explain the slide in the equity market turnover:

	January	February	March	April	May	June	July	August	September
Equity+I Reit Turnover (KES Billion)	20.34	17.92	22.89	15.08	18.38	13.69	9.74	10.44	11.94
Bond Turnover (KES Billion)	37.52	62.99	46.74	40.69	54.11	56.33	44.71	45.06	38.09
Foreign Buys (KES Billion)	13.81	6.38	11.30	8.55	7.28	8.25	4.69	5.59	6.22
Foreign Sales (KES Billion)	15.22	11.47	12.35	10.52	11.73	10.47	6.78	7.04	9.25

Market expectation of a declining Kenya shilling:

The KES has shown astounding resilience in the last two years against the greenback. In the period between the 13th of April 2015 and the 8th of February 2016 the Kenya Shilling depreciated by **9.8%** from the exchange rate of **KES 92.98/USD** to **KES 102.13/USD**. The period of slow but persistent depreciation of the currency has since been succeeded by a period where the **KES** has remained within a tight range **4%** range between the high of **KES 99.98** (on 24th of April 2018) and a period low of **KES 104.02/USD** (on 12th of July 2017) despite the Fed rate increasing from an historic low of **1.25%** to **2.75%** during the period to date. In light of the normalization of Global Financing Conditions and its impact on International Capital Flows on Emerging Market Economies, many analysts and market participants see the current **KES/USD** exchange rate as **OVERVALUED** with an end year target exchange rate of between **KES104/USD** to **KES 106/USD** currently touted. The market expectation of a reversal may have motivated the foreign participants to sell.

KES/USD



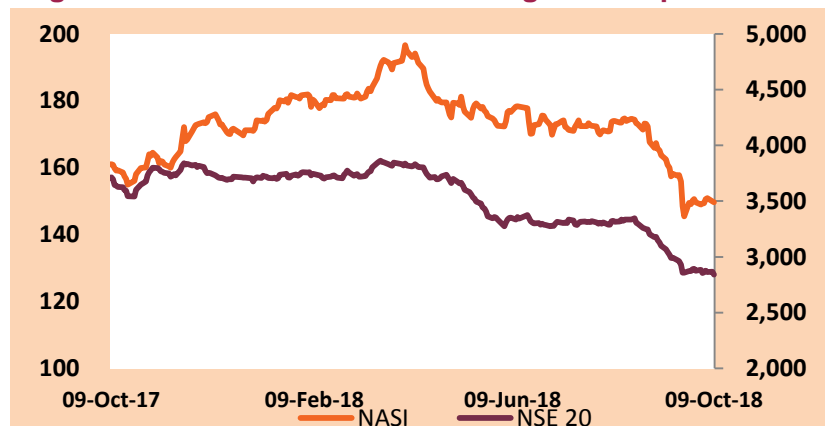
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Negative Market Sentiments following i-rate cap removal failure:



We believe that the market sentiments have taken a nose dive since the last week of August when the Kenyan parliament vote to retain the interest rate cap. The decline in market turnover and especially the market valuation is reflective of the negative market outlook of the potential returns from the NSE. Market we observed, before the disappointing news, was riding a high wave of optimism, with the market expecting that the government was on course to repeal or at least modify the i-rate cap. The decision to maintain the status quo came as a surprise to the market despite the government previously communicating the opposite to the market. The surprising reversal we believe to be the root of the market disproportionate contraction since August.

IMF Standby facility Expiry in September:

The foreign market participation on the NSE may be accounting for the risk that the KES is currently "naked" after the expiry of both the 2016 Stand By Agreement (SBA) facility of **\$989.8 Million** extended in March and a Stand By Credit Facility **\$ 494.9 Million** Kenya had with the IMF to cushion unforeseen external shocks. With the risk of a huge currency depreciation overpowering any possible return on the NSE, most participants may be currently exiting to manage their overall risk exposure.

Emerging Market Sell Off:

Fear, a powerful emotion, despite years of attempts to stem it, still remains contagious in the global market. The Emerging Market rout, which is now considered the longest Emerging Market selloff recorded post the 2008 financial crisis is currently being driven by the strong emotion. The evaporation of confidence in the Emerging Market and by extension the frontier market is currently being propelled by market fear of the contagion from the Turkey crisis and Argentina crisis spreading all over the emerging markets. Fear of Kenya falling victim to the same fate as Turkey, may have convinced foreign funds to sell securities no matter the fundamentals as most foreign participants do view all emerging markets as a homogenous group.

Local Fund Managers are trying to avoid a falling knife:

Uncertainty over the length of the falling price momentum we believe is keeping away the local market fund manager from coming into the market to provide price support to the market. The fund management business in Kenya is very competitive and there is a disproportionate compensation structure in place. The fund trustees in Kenya are known to be loss averse and many have without knowing, instituted a compensation structure where gains are less valued than the way losses to a portfolio are punished. We believe that fear of losing business from any possible portfolio losses are delaying buy decision and accelerating selling decision in the current bear market. Portfolio managers will continue defending their returns in safe havens such as T-Bills until the market downturn reverses.

Our Overall Equity Market Outlook:

We advise investors on the Nairobi Stock Exchange to brace for the possibility that the selloff will continue in the, short term, driven by Foreign Net Selling. We see such macro factors such as the risk aversion in the emerging markets and negative sentiments on the NSE taking a hold of the Equity market in the short term and therefore we don't expect a market reversal to happen in 2018. Active investors and managers should hold on to their BUY decisions with a view of avoiding the current negative price momentum. A market bounce back from the current equity market rout could materialize if there is enough upside and market volatility in emerging markets to attract the value investors and speculators back to the Nairobi Stock Exchange.

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