



# WELCOME TO NCBA INVESTOR UPDATE



THEME: **SEIZING OPPORTUNITIES AMID COVID-19 PUZZLE  
SHOULD YOU INVEST DURING A PANDEMIC?**

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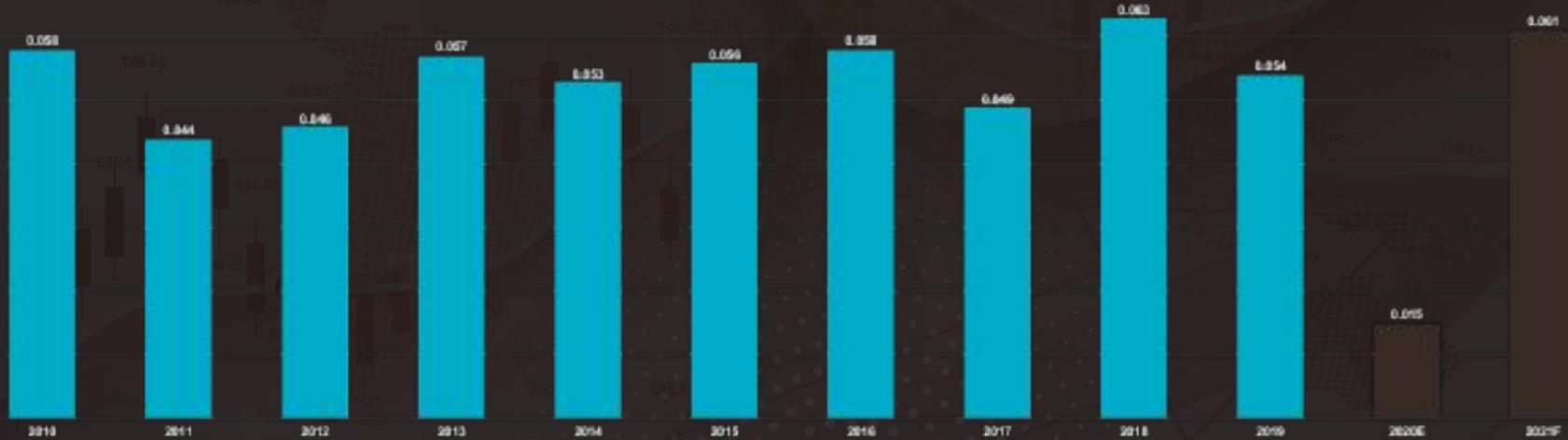
# MACRO UPDATE AND OUTLOOK

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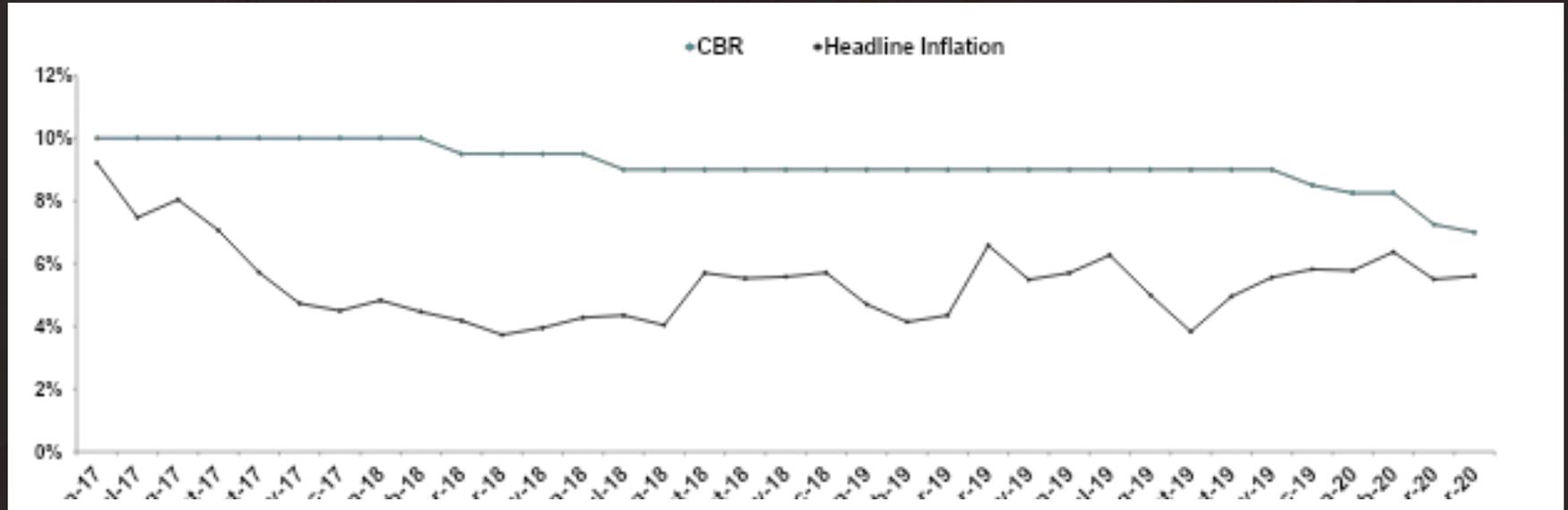
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# COVID-19 TO SLOW GROWTH IN 2020, BASE CASE GROWTH AT 1.5%



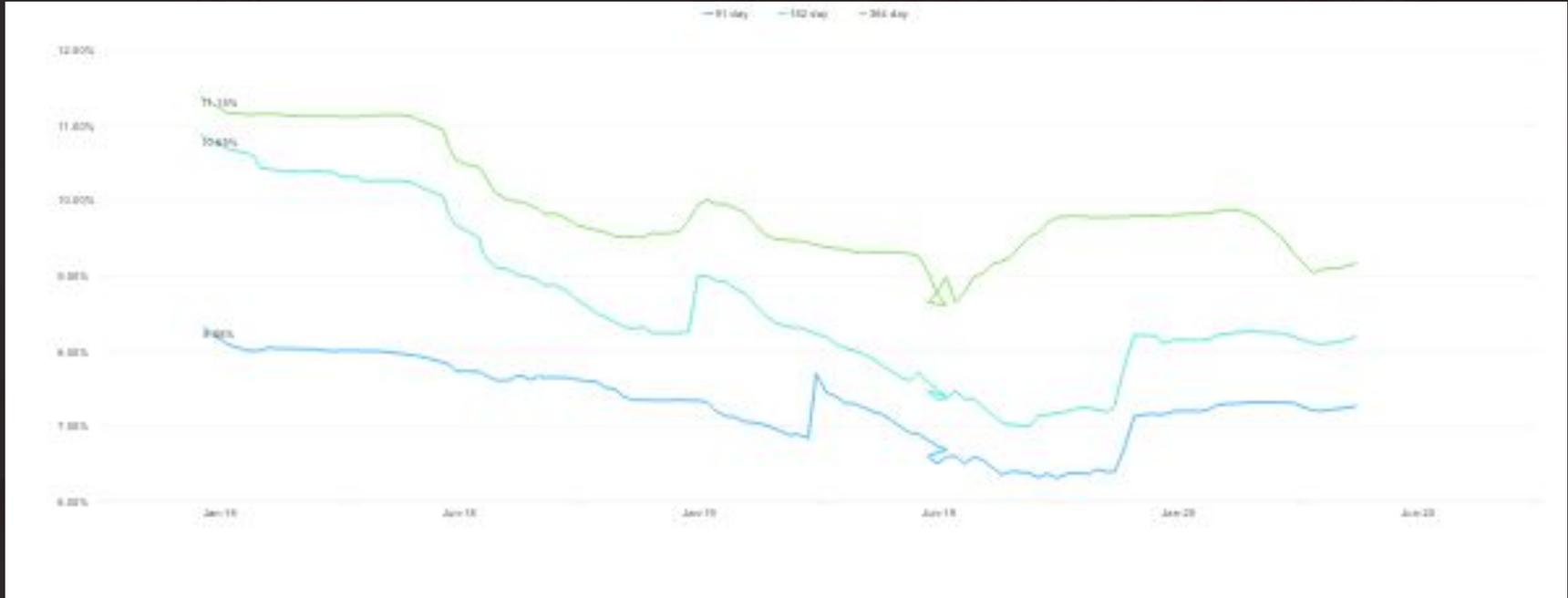
- GDP expanded by 5.4% in 2019 compared to 6.3% in 2018 on the account of a general economic slowdown. Agriculture and manufacturing sectors growth slowed down during the period under review to 3.6% and 3.2% from 6.0% and 4.3%, respectively in 2018. Service sector remained resilient during the period under review growing by 6.6%
- Growth is expected to be dampened further in 2020 on account of negative effects attributable to covid-19 pandemic. The Treasury forecasts growth to come in at 3%, the IMF at 1.0% and the World Bank at 1.5% while in-house we project a base case growth of 1.5%

# INFLATION REMAINS CONTAINED, CBR TRENDING LOWER



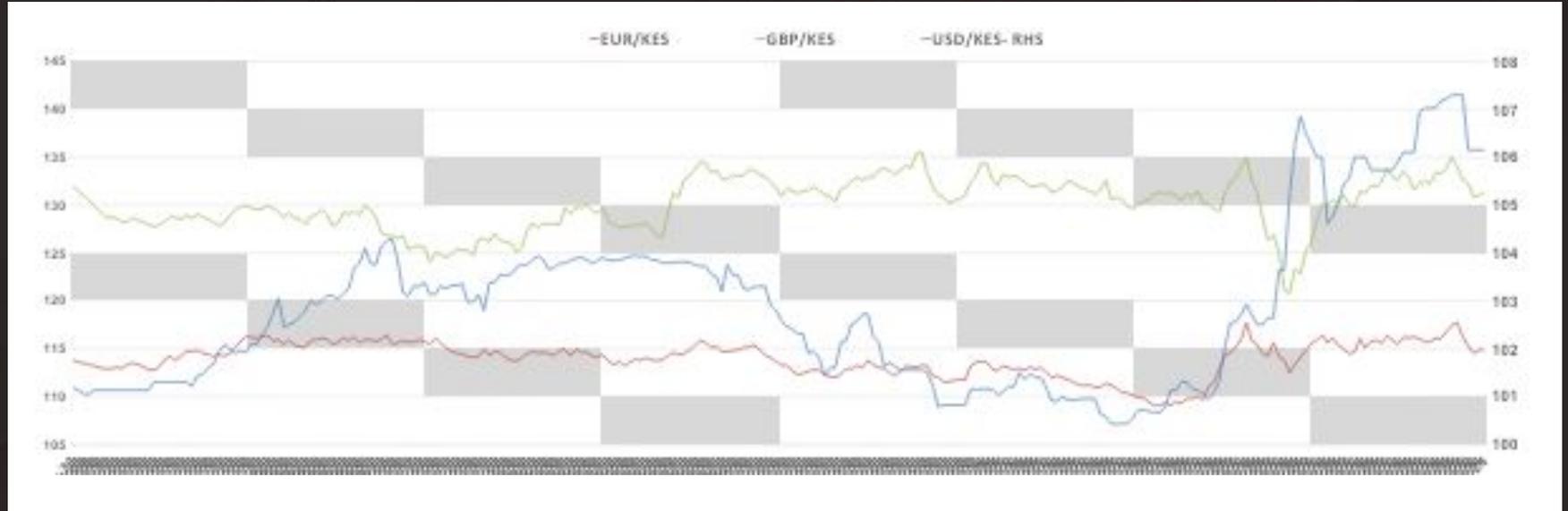
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# SHORT TERM YIELDS REMAIN ARTIFICIALLY LOW



- Yields on short term papers have remained low through the year with mild sticky movements. This has mainly been attributed to high investor preference for short-term government securities amid heavy liquidity in the market
- We expect interest rates to tick up gradually as the need for government borrowing increases in bid to bridge revenue short fall. Further, abolishing of interest rate cap will offer alternative investment channels for financial institutions through lending to private sector

# DECLINE IN DOLLAR LIQUIDITY FROM EXPORTS & REMITTANCES HURTS KES



- The Kenya shilling has depreciated significantly against the dollar in the past two months. This is attributed to a decline in dollar liquidity from exports, remittances and capital
- We expect the shilling to weaken further albeit modestly during the year given the current uncertainty surrounding the economic environment.



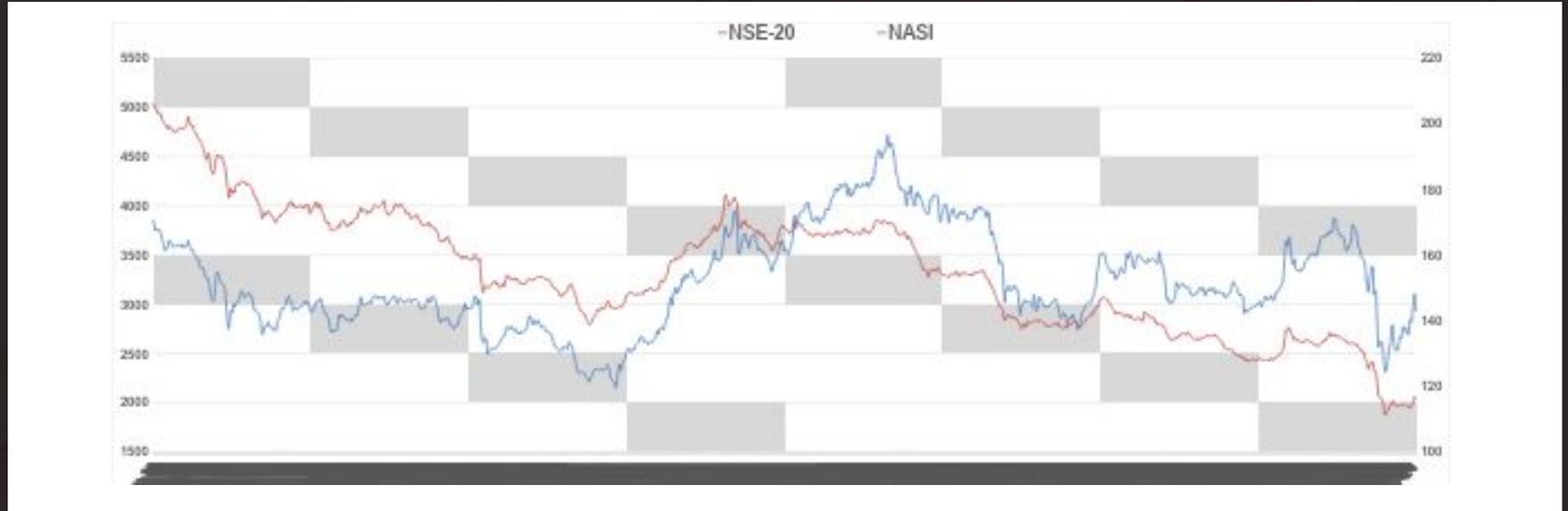
# EQUITIES OUTLOOK

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# NASI & NSE-20 5-YR RETURNS



- Equities market are trading at 5 year low levels. NASI and NSE-25 have eroded 2018 gains within the first quarter of 2020. The losses have been driven by foreign investors exiting the local market on account of COVID-19 related fears.
- We expect the equities market to close in the negative territory in 2020.
- That said, we opine that at the current levels, it presents an attractive entry point for select stocks.



- Continuous innovations continues to unlock value
- M-Pesa and fixed data are the key enablers
- We see opportunistic growth ventures
- Favorite of foreign investors due to its liquidity



- Favourite of foreign investors due to their liquidity
- Focus on non funded income to drive topline growth
- Efficiencies to improve Cost to income ratio
- Attractive Valuations due to lower pricing but we expect prices to rebound.



- Strong margins owing to cost savings results in a strong bottom line performance
- Innovation to drive value for the firm creating different niches
- Regional markets to contribute to the strong top line growth



# INVESTING DURING COVID-19

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# The COVID-19 MARKET CRASH: A GRIM REALITY



Governments and investors woke up too late to the crisis. Now they are facing the deepest global recession in history

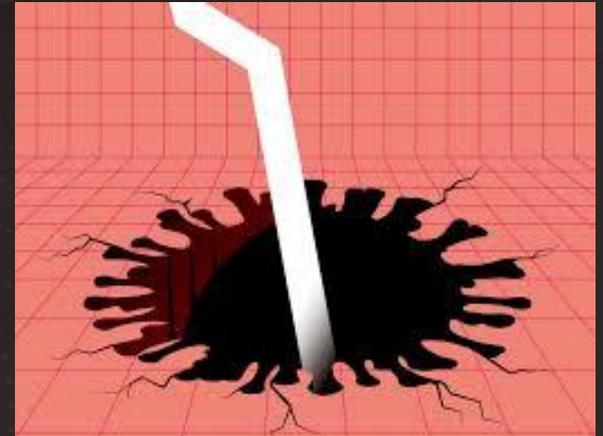
Global stocks have had the best and worst sessions in a decade on consecutive days

Global market Indices fell by more than 20% from previous peaks – the definition of a bear market – in little more than 20 days, outstripping the speed of the slide during the 1929 Wall Street crash.

investor panic sent markets into their fastest bear plunge in history.

The stock market has responded to the COVID-19 pandemic with worrying volatility, as traders have panic-sold out of fear.

As a result of the recent turmoil, NSE invoked a market-wide circuit-breaker to prevent panic-trading for the first time in its history.



*"There's no doubt that, I think, many of us are feeling a little like, when we're watching the stock market, that we're a bit like a boxer taking body blows and just trying to stay off the mat..."*

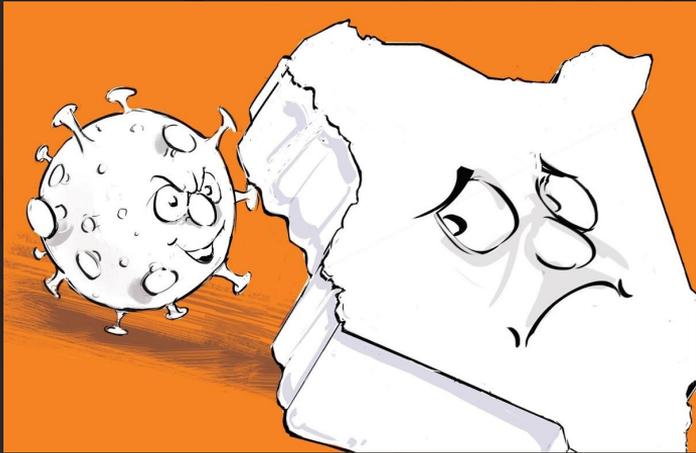
— Mark Hamrick, Bankrate Senior Economic Analyst - March 18, 2020

# DOOM AND GLOOM OR OPPORTUNITY

OR



Sample comments on SSA from various COVID-19 published articles.



- Sub-Saharan Africa is set to experience a major economic downturn as a result of COVID-19
- Recent commodity and financial market swings have left some investors running for the door.
- Many economists are struggling to call the bottom of the global downturn or forecast what shape and duration a recovery might take
- The International Monetary Fund announced that the world would likely experience the worst recession since the Great Depression this year, with global GDP contracting by 3%.

# DOOM AND GLOOM OPPORTUNITY

OR



- From an investing perspective, it's good news!
- A stock market crash is an opportunity for investors to make incredible investment decisions by having a strategy in place outlining what to do when the stock market dips or dives ultimately aiming to be able to come out on top.
- With global interest rates at rock bottom, there has never been a better time for the world to invest in Africa and its industries.
- By investing in Africa now, we create a more robust workforce for tomorrow
- Stocks are trading at lows last recorded in 2017 after interest capping was introduced.



# Should you save or invest during the pandemic?

## 1. Are your emergency savings fully funded?

Start with your emergency fund. It should be stocked with three to eight months' worth of living expenses before you invest anywhere.

## 2. When do you need the money?

If your emergency fund is in good shape, think about your goals and your time horizon — when you want to use the money you're saving.



## 3. How much risk can you tolerate?

If you have a healthy emergency fund and you've thought carefully about your financial goals, consider investing. You can calculate your risk tolerance

## 4. How much cash do you actually have?

You don't need a ton of money to save or invest. Saving — even as little as Kes10,000 or Kes 20,000 per month — is a good habit to cultivate.

# COVID-19 Do's and Don'ts



## **Don't: Panic by selling all your investments**

Your investments may all be in red at the moment, but you must recognize the fact that you will not experience a loss until you sell them off.

## **Don't: Put your money before your health**

Financial wellness is important, but physical health should always take priority.

## **Do not shy away from diversification**

Diversification is more important than ever in a bear market. The coronavirus pandemic will not have the same repercussions on all sectors.

## **Don't give up on retirement savings (and on stocks)**

because of a temporary setback. Almost all financial advisors suggest that investors have a percentage of their retirement savings in stocks.

## **Don't focus on price, focus on value and fundamentals.**

Cheap is relative and can be very expensive so penny stocks should be bought based on strong fundamentals.



## **Do: Trim your spending**

The thriving economy the country has enjoyed for a while has prompted a gradual lifestyle inflation for many people.

## **Do: Consider a refinance**

The silver lining of an economic environment like this is falling interest rates.

## **Do: Average down aggressively on value stocks**

remember, the current financial crisis will pass, just like other crises that have preceded it. Those stable stocks that have lost value in your portfolio will recover too Buy more!

## **Do: Choose well-established names over smaller businesses**

An important thing to note about the current market conditions is that the slowdown is not a result of economic fluctuations.

## **Evaluate your risk appetite**

With a high probability of losing a job or receiving a pay cut, you may want to look at your risk appetite again. factors like income, future goals, career prospects, and market conditions.

# Simple steps to investing during COVID-19



- **Cash is King:**

- be liquid so that when there is a dip, you are ready to buy.
- If your shares have not dropped yet, sell and buy when they dip so you have more shares
- Seek the best price as this is the best time to buy.

- **Understand how COVID-19 will affect different industries.**

- Look for those companies/industries whose stocks lost value but remain fundamentally sound and profitable (banking, tech, investment).
- Target "Stay at Home" stocks (technology & digital services, groceries & grains, medical equipment, and cleaning supplies).
- Avoid high impact industries like Business travel and airlines.

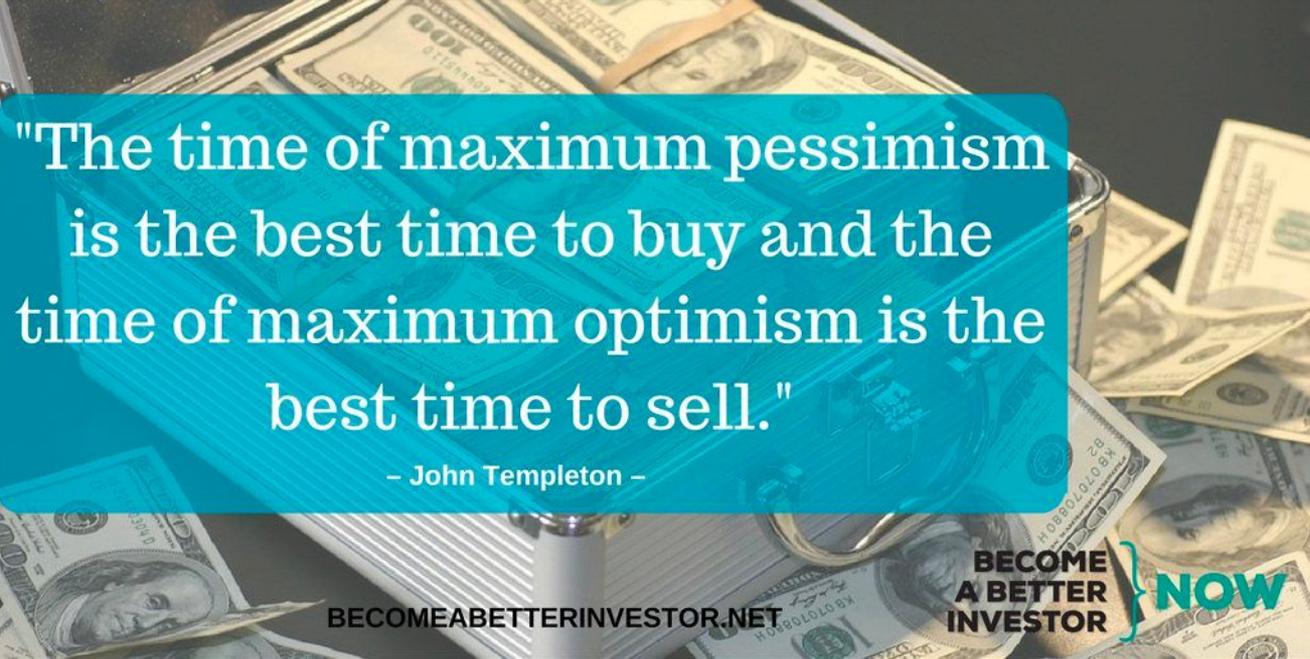
- **Prepare a watch list of companies of interest and monitor their share price movement.**

- Establish whether there is any discernible patterns in the price movements and their correlation with the progress of COVID-19. (where is the support point and the resistance point.)
- Average down on those selected companies that are already in loss.

- **Seek for undervalued Quality stocks.**

- Buy Value and not the trend. Remember the economic outlook is uncertain. Value is the Key Focus more on your Long term investment objectives for now but by all means, take advantage of short term rallies

- **Discuss your current portfolio status with your advisor: "Information is the Key".**



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

– John Templeton –

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A BETTER  
INVESTOR**

**NOW**

# “There’s a new category called a ‘stay-at-home stocks’”

Amro Zakaria Abdu



## High COVID Impact, Quick recovery (hibernate)

- Food processing (horticulture, fish, fruit & meat)
- Tea/Coffee/Flowers
- Textiles.
- Restaurants/pubs/food vendors
- Automotive

## Low COVID impact. Quick recovery (new winners)

- ICT and digital (data providers, digital banking, E-Commerce platforms, internet shopping platforms)
- Health supplies providers (Pharmacies)
- Health Product Manufacturing (Pharma)
- Detergent and sanitation manufacturers.

## High COVID Impact, slow recovery

- Hospitality and tourism.
- Private sector education
- Retail trade and beauty products
- Heavy Manufacturing (Cement, Motor)

## High COVID impact. Gradual decline

Business tourism  
Second hand clothing



# NEXT

## NSE DERIVATIVES MARKET

Terry Adembesa  
Chief Officer – Derivatives Market

## STRATEGIC FOCUS



- Due to direct risk exposures on the traditional asset classes many investor portfolios have been adversely affected.
- There's greater need to develop risk management strategies that would mitigate against the uni-directional Kenyan market and associated volatility.
- There is also a need to create diversification in investable assets, which will in turn drive revenue growth.
- The NSE has been working on introducing new alternative investments that will address these needs and concerns of various investors.

# DERIVATIVES HAVE BEEN AROUND FOR A LONG TIME



- Bible: Gen 29: Jacob's purchase of an option: paying 7 years' labor for the right to marry Laban's daughter, circa 1700 BC
- Japan: "futures" contracts traded on Yodoya-Komeichi rice market in Osaka, 1650 (also 1st securities exchange in Japan)
- US: Chicago Board of Trade, 1848 - originally only spot grains were traded. Treasury Bond futures contracts were launched in 1977 and went on to become the Exchange's highest volume product.
- Post 2008 the derivatives world has been split into two distinct segments:
  - Over The Counter" or OTC markets
  - Centrally cleared, exchange traded markets

# KEY CONCERNS ON DERIVATIVES MARKETS



- Can lead to large uncontrolled losses due to their leveraged nature:
  - Barings
  - Orange County
  - LTCM
  - Sumitomo Copper
  - China Aviation Oil
- Weapons of Mass Financial Destruction (Warren Buffet)

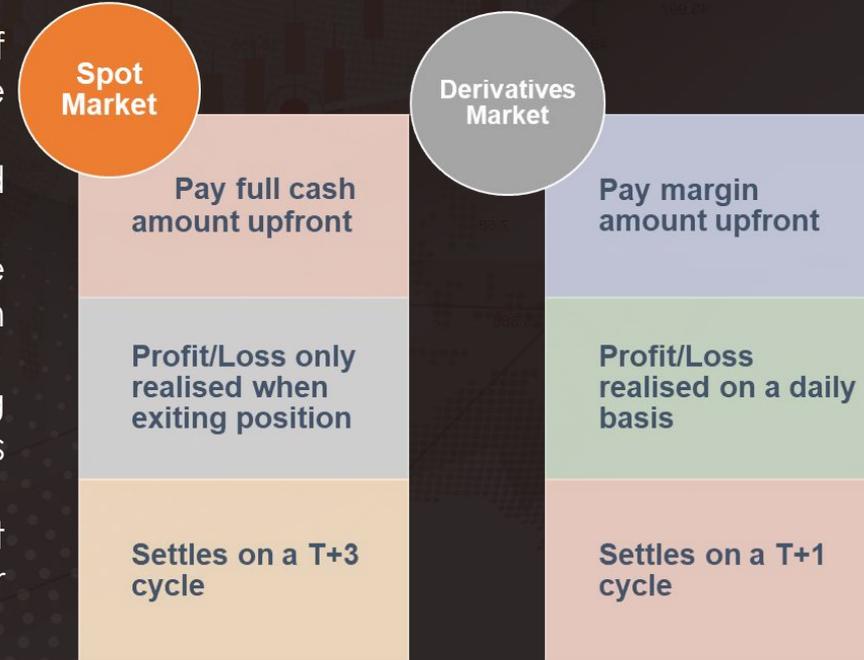
# DERIVATIVES ARE CONTRACTS



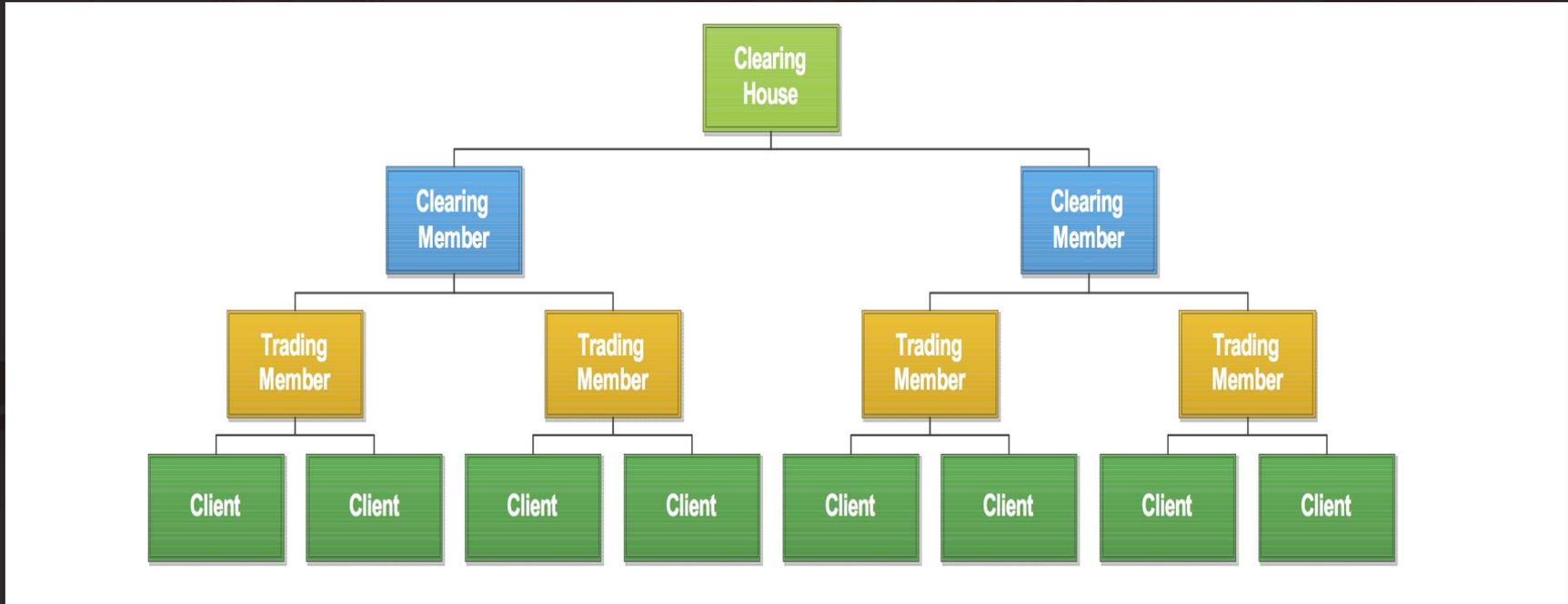
- Financial instruments whose characteristics and value depend upon the characteristics and value of an underlying asset which is typically a commodity, bond, equity or currency.
- The derivative itself is merely a contract between two or more parties.
- The buyer in the futures contract is known as to hold a long position or simply long. The seller in the futures contracts is said to be having short position or simply short.
- Investors buy or sell derivatives to manage the risk associated with the underlying security, to protect against fluctuations in value, or to profit from market movements.

# DERIVATIVES ARE CONTRACTS

- To trade, each party pays a nominal amount of the contract value known as initial and house margin.
- The Exchange novates all trades – mediate and facilitate all trades
- Since the futures prices are bound to change every day, the differences in prices are settled on daily basis from the margin.
- If the margin is used up, the investor on the losing side has to replenish their margin account. This process is called marking to market.
- On the day of delivery it is only the spot price that is used to decide the difference as all other differences had been previously settled.



# MARKET STRUCTURE



# CONTRACTS

Available Contracts	Initial Margin Requirements
Safaricom	Initial Margin – KES 3,000 per contract; Approx. 11% of notional value.
KCB	Initial Margin – KES 6,200 per contract; Approx. 17% of notional value.
Equity	Initial Margin – KES 6,200 per contract; Approx. 18% of notional value.
ABSA	Initial Margin – KES 2,300 per contract; Approx. 26% of notional value.
EABL	Initial Margin – KES 3,000 per contract; Approx. 19% of notional value.
BAT	Initial Margin – KES 7,200 per contract; Approx. 23% of notional value.
NSE 25 Share Index	Initial Margin – KES 25,200 per contract; Approx. 8% of notional value.

## TRADING FEES

Fee	Single Stock Futures	Index Futures
NSE	0.025%	0.02%
Clearing Member	0.025%	0.02%
Trading Member	0.10%	0.08%
Investor Protection Fund	0.01%	0.01%
Capital Markets Authority	0.01%	0.01%
<b>Total</b>	<b>0.17%</b>	<b>0.14%</b>

Note: Trading fees are charged as a percentage of the value of the trade.

E.g. A single stock future trade worth KES 1,000,000 would attract a total fee of KES 1,700

## TRADING FEES

Derivatives Market	Equity Index Futures	Single Stock Futures	Equities Market	Shares
NSE	0.02%	0.025%	NSE	0.12%
Clearing Member	0.02%	0.025%	CMA	0.12%
Trading Member	0.08%	0.10%	CDSC	0.08%
Investor Protection Fund	0.01%	0.01%	CDSC Guarantee Fund	0.01%
CMA	0.01%	0.01%	Investor Compensation Fund	0.01%
			Broker	1.36%
<b>Total</b>	<b>0.14%</b>	<b>0.17%</b>	<b>Total</b>	<b>1.70%</b>

Trading futures is significantly cheaper than trading equities.

# TRADE EXAMPLES

Trade Date	4-Aug-19
Trade Type	Buy
Contract Name	19 DEC19 SCOM
Contract Size	1,000
Quantity	10
Trade Price	25
Exposure	250,000
Funds Deposited by Client	100,000
Initial Margin @ KES 3,000	30,000
Additional Margin @ 10%	3,000
Total Margin	33,000
Entry Fees @ 0.17%	425
Exit Fees @ 0.17%	408

Assume the client is a **BUYER**. By buying futures, the client gains from upward price movements.

Since the mark-to-market process is zero-sum, the buyer's profit is the seller's loss.

The client enters the position at a price of KES 25 before exiting four days later at a price of KES 24 before contract expiry.

Date	Closing Price	P/L Calculation*	VM	IM	AM	Fees	Net CF	Trust A/C Bal.
4-Aug-19	24	(24 - 25) X 10 X 1000	-10,000	-30,000	-3,000	-425	-43,425	56,575
5-Aug-19	22	(22 - 24) X 10 X 1000	-20,000				-20,000	36,575
6-Aug-19	23	(23 - 22) X 10 X 1000	10,000				10,000	46,575
7-Aug-19	25	(25 - 23) X 10 X 1000	20,000				20,000	66,575
8-Aug-19	24	(24 - 25) X 10 X 1000	-10,000	30,000	3,000	-408	22,592	89,167
			-10,000	0	0	-833	-10,833	

\*Note: Buyers profit from price increases. Sellers profit from price decreases.

# TRADE EXAMPLES

<b>Trade Date</b>	4-Aug-19
<b>Trade Type</b>	Sell
<b>Contract Name</b>	19 DEC19 SCOM
<b>Contract Size</b>	1,000
<b>Quantity</b>	10
<b>Trade Price</b>	25
<b>Exposure</b>	250,000
<b>Funds Deposited by Client</b>	100,000
<b>Initial Margin @ KES 3,000</b>	30,000
<b>Additional Margin @ 10%</b>	3,000
<b>Total Margin</b>	33,000
<b>Entry Fees @ 0.17%</b>	425
<b>Exit Fees @ 0.17%</b>	408

Assume the client is a **SELLER**. By selling futures, the client gains from downward price movements.

Since the mark-to-market process is zero-sum, the buyer's profit is the seller's loss.

The client enters the position at a price of KES 25 before exiting four days later at a price of KES 24 before contract expiry.

Date	Closing Price	P/L Calculation*	VM	IM	AM	Fees	Net CF	Trust A/C Bal.
4-Aug-19	24	(24 - 25) X 10 X 1000	10,000	-30,000	-3,000	-425	-23,425	76,575
5-Aug-19	22	(22 - 24) X 10 X 1000	20,000				20,000	96,575
6-Aug-19	23	(23 - 22) X 10 X 1000	-10,000				-10,000	86,575
7-Aug-19	25	(25 - 23) X 10 X 1000	-20,000				-20,000	66,575
8-Aug-19	24	(24 - 25) X 10 X 1000	10,000	30,000	3,000	-408	42,592	109,167
			10,000	0	0	-833	9,167	

\*Note: Buyers profit from price increases. Sellers profit from price decreases.

## Q1 2020 TRADING PERFORMANCE

The derivatives market offered investors significant returns between January 2020 and March 2020. The period saw a general market decline which allowed investors to profit from short positions.



Security	Equities	Futures	Futures Trade	
SCOM	-21.93%	203.01%	Short	↓
KCBG	-28.13%	249.26%	Short	↓
EQTY	-30.94%	293.32%	Short	↓
ABSA	-20.70%	126.18%	Short	↓
BATK	-21.50%	116.14%	Short	↓
EABL	-21.20%	118.15%	Short	↓
N25I	-24.58%	360.70%	Short	↓

# SCOM - LOW CAPITAL REQUIREMENTS AND LEVERAGED RETURNS



Trade Type	Buy	Buy	Sell
Asset Class	Shares	Futures	Futures
Contract Name	SCOM	SCOM	SCOM
Quantity (Shares/Contracts)	798,722	787	787
Target Exposure	<b>25,000,000</b>	<b>25,000,000</b>	<b>25,000,000</b>
Actual Exposure	25,000,000	24,987,250	24,987,250
Initial Margin @ 2,800	-	2,203,600	2,203,600
Additional Margin @ 10%	-	220,360	220,360
Total Funds Required	25,000,000	2,423,960	2,423,960
Entry Price	31.30	31.75	31.75
Exit Price	25.40	25.40	25.40
Gross P/L	-4,712,460	-4,997,450	4,997,450
Total Fees	769,888	76,461	76,461
Net P/L	-5,482,348	-5,073,911	4,920,989
Gross Return	-18.85%	-206.17%	206.17%
Net Return	<b>-21.93%</b>	<b>-209.32%</b>	<b>203.01%</b>

- Investor requires SCOM exposure worth KES 25 million;
- Approximately KES 2.4 million is required in margin;
- A net return of approximately KES 4.9 million is generated (203%) on the short position.

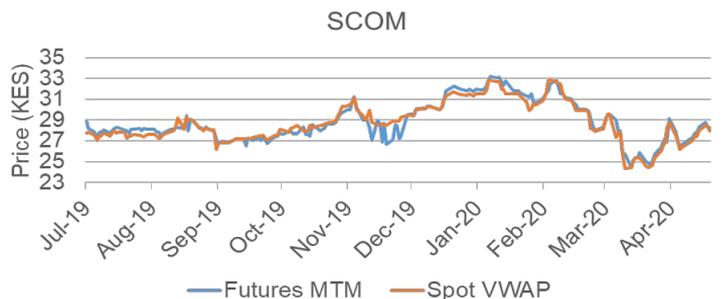
# SCOM - LOW CAPITAL REQUIREMENTS AND LEVERAGED RETURNS



Trade Type	Buy	Buy	Sell
Asset Class	Shares	Futures	Futures
Contract Name	SCOM	SCOM	SCOM
Quantity (Shares/Contracts)	798,722	8,117	8,117
Exposure	25,000,000	257,714,750	257,714,750
Initial Margin @ 2,800	-	22,727,600	22,727,600
Additional Margin @ 10%	-	2,272,760	2,272,760
Target Funds Required	<b>25,000,000</b>	<b>25,000,000</b>	<b>25,000,000</b>
Actual Funds Required	25,000,000	25,000,360	25,000,360
Entry Price	31.30	31.75	31.75
Exit Price	25.40	25.40	25.40
Gross P/L	-4,712,460	-51,542,950	51,542,950
Total Fees	769,888	788,607	788,607
Net P/L	-5,482,348	-52,331,557	50,754,343
Gross Return	-18.85%	-206.17%	206.17%
Net Return	<b>-21.93%</b>	<b>-209.33%</b>	<b>203.02%</b>

- Investor deploys approximately KES 25 million in SCOM margin;
- This generates an exposure of approximately KES 257 million;
- A net return of approximately KES 50 million is generated (203%) on the short position.

# SCOM



- After a decline during Q1 SCOM has experienced a recent surge.
- The decline around March 2020 saw SCOM trading at levels of about KES 24 last seen in late 2018 and early 2019.
- Futures requirements:
  - Initial Margin – KES 3,000 per contract.
  - Approx. 11% of notional value.

## IN SUMMARY, DERIVATIVES ARE IMPORTANT FOR;

<b>Hedging</b>	Investors can protect their portfolios against adverse price movements by trading futures that reflect their stock portfolios.
<b>Wider variety of trading strategies</b>	Access to strategies such as shorting securities, replication of index performance, arbitrage etc.
<b>Enhanced returns due to leverage</b>	Since only a small margin is required upfront, the investor stands to gain significantly more than they put in.
<b>Lower transaction costs</b>	<p>The trading fees for single stock futures are 0.17% while fees for index futures are 0.14%(fees are based on the value traded)</p> <p>Trading fees on shares can range between 1% and 2%</p>
<b>Less counterparty credit risk</b>	<p>By acting as the central counterparty for every trade, NSE Clear ensures that settlement is completed each day.</p> <p>The investor therefore does not need to worry about credit risk.</p>



**THANK YOU**

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