INVESTMENT BANKING
THE YEAR AHEAD

JULY 2020

Q3'2020 MARKETS OUTLOOK & STOCK PICKS

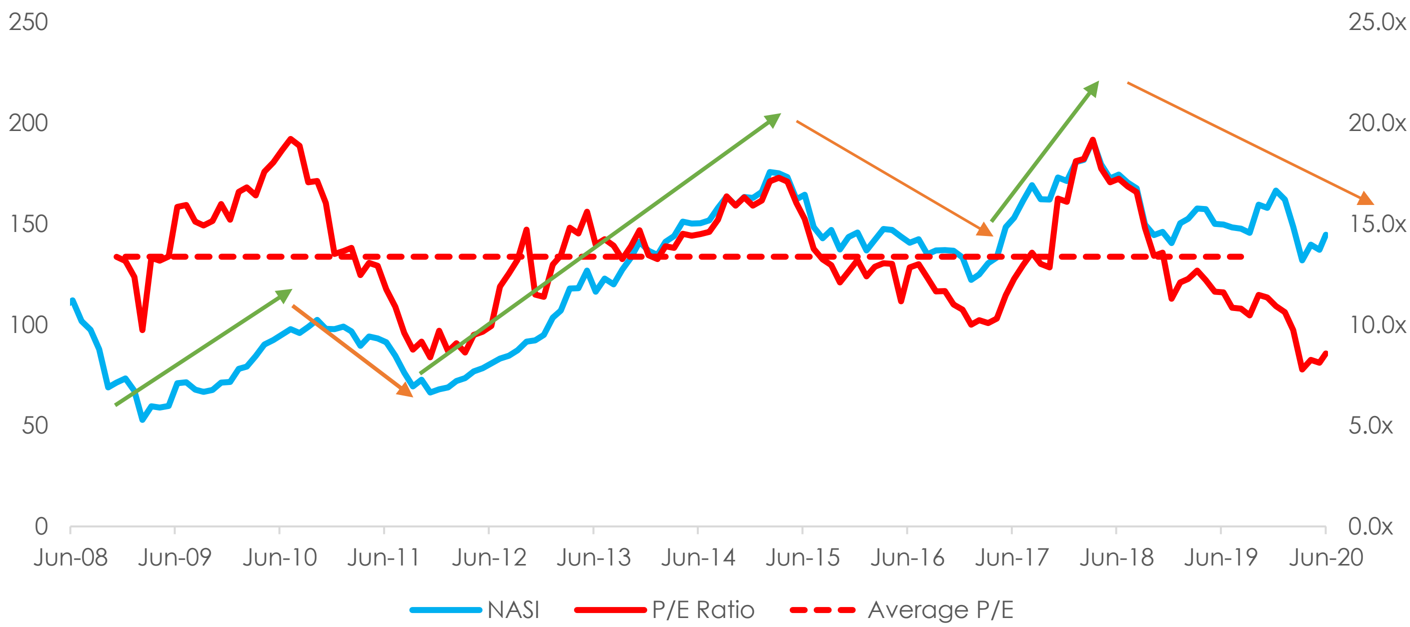
Equities Outlook:

The equities market has seen a sweeping drop in prices (down 20.4% YTD) following the COVID-19 pandemic groundswell that hit the country in the end of the first quarter. The market valuations have dropped to an attractive P/E multiple of 11.5x below the 5-year average of 13.5x indicating select cheap stocks for investors. We anticipate the market to close in the negative territory in regards to capital appreciation driven by lower earnings and subdued foreign investors' appetite. The market has seen a number of companies issue profit warnings for 2020 (*EABL, TPS Serena & Nation Media Group)* with earnings expected to be 25% lower than the previous year.

The performance we forecast this year is likely to wipe out all the gains that were recognized in 2019 (market gained 18.5%) following a rally in the fourth quarter hinged on the reversal in the capping of interest rates. We expect a drastic drop in Dividend payout in 2020 with a probability of smaller firms cancelling the payout and the larger payers reducing by 50% or offering non-cash alternatives.

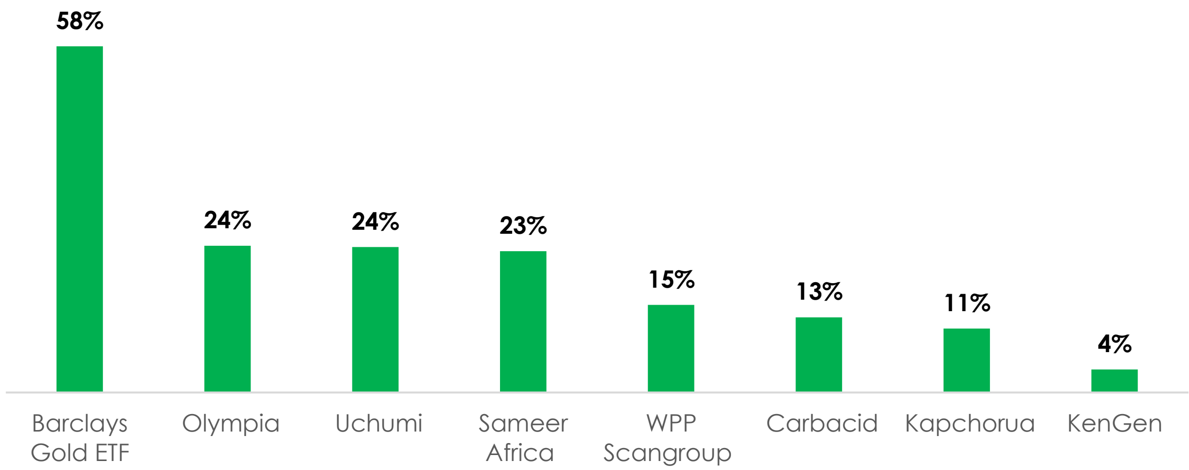
The dip in prices has cut through the market with the large-cap stocks experiencing a substantial sell-off from foreign investors. Foreign investors withdrew USD 216.5mn in H1'2020 compared to a net injection of USD 23.3mn in H1'2019 highlighting the impact of the pandemic on capital flows. The flight of capital has been experienced in majority of the frontier markets and select emerging markets with developed markets remaining investor favorites. Fixed income has been the preferred asset class in the local market. The dip in prices has offered attractive valuations as highlighted below, though we expect continued downward pressure in the remaining part of the year.

Market Valuation



The top gainer in the local bourse YTD is the Barclays Gold ETF (+58%) following some price discovery and diversification exploration by select clients. WPP Scangroup has gained 15% YTD largely backed by a special interim dividend of KES 8.0 issued following the completion of sale of part of the business in the month of June. The chart below highlights the top gainers Year-to-Date:

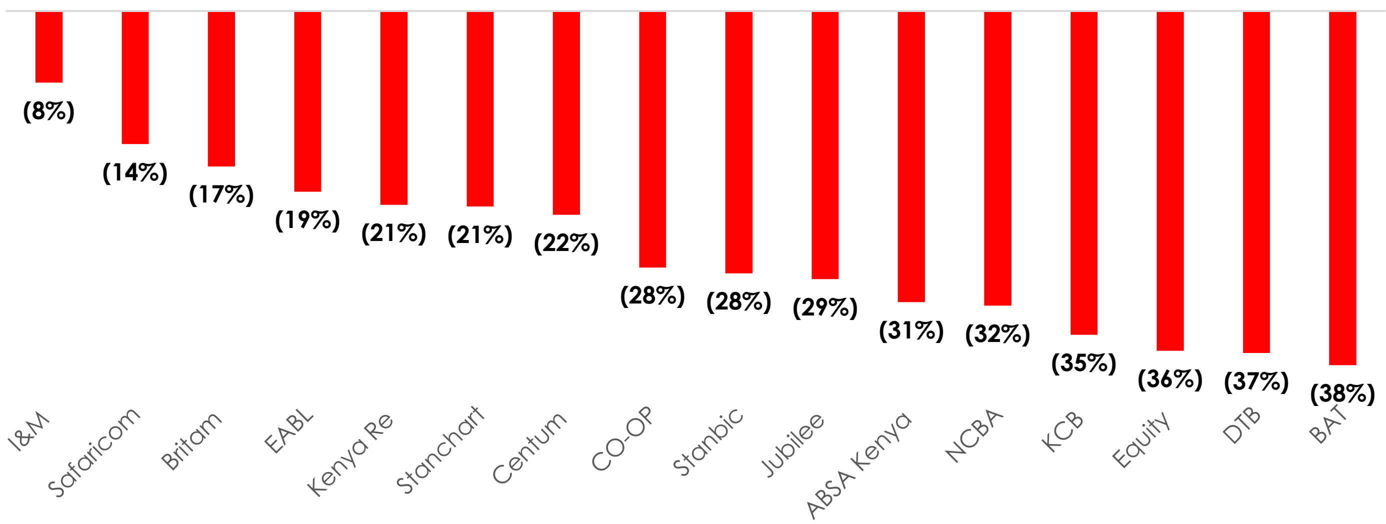
Top Gainers (YTD)



Stock Picks:

Our stock picks are substantively unchanged from a fundamental stand point as we see value in select investable companies. We see value in **I&M Holdings, Safaricom, EABL, Britam, ABSA, KCB & Equity Bank.** At the current price levels, these stocks offer attractive entry positions for a medium to long-term investor as fundamentals remain solid despite the pandemic with the most viable option being accumulation. The banking sector has seen radical disruption in business models with condensed investment options but the sector offers a solid chance of recovery despite asset quality concerns. The large-cap stocks have all been on a loss position YTD as highlighted in the chart below.

Select Investable Universe Performance (YTD)



As highlighted below, our select stocks have fallen close to their 52-week lows with the exception of Safaricom, which has largely maintained value. The fundamentals of these firms support a recovery in prices to the 52-week high levels in the next 9-18 months.

Stock	Current Price	52-Week Low	52-Week High
Safaricom	27.50	20.10	33.50
EABL	160.25	135.00	230.00
Britam	7.00	5.70	10.50
I&M	48.00	42.50	63.00
KCB	34.30	33.75	55.50
ABSA	9.00	9.00	13.85
Equity	31.85	30.50	55.50

Macroeconomic Snapshot:

On the macroeconomic front, we see sluggish recovery in some of the key sectors supporting the economy offering some optimism on output levels. The government lifted mobility restrictions including the partial lockdown of the two major counties to offer some support to economic activities. This came as the economy revealed deeper fragility, with growth declining to 4.9% in the first quarter from 5.50% a year earlier. Considering the size of the external sector, Kenya will be the hardest hit in East Africa. The IMF forecasts that growth will contract by 0.3%, a downgrade from the 1.0% growth projection in April and more pessimistic than our 0.2% growth forecast.

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STRONG BUY – Total expected 12-month return (incl. dividends) greater than 20%
BUY-Total expected 12-month return (incl. dividends) between 10%- 20%
HOLD – Total expected 12-month return (incl. dividends) between 0%-10%
SELL – Total expected 12-month return (incl. dividends) less than 0%

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