MONTHLY INVESTMENT NOTE

Key Investment Highlights

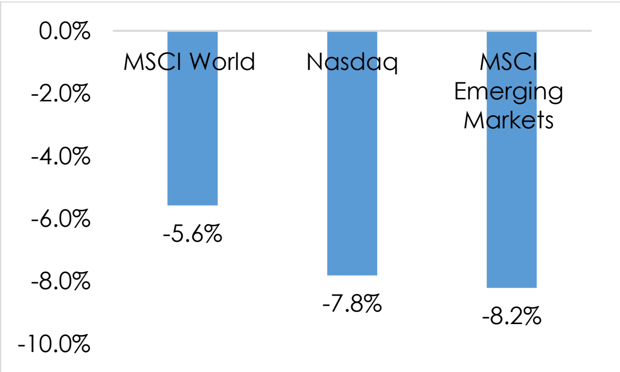
- Global fixed income yields maintain an upward trajectory as the US Fed continues to hike interest rates
- Emerging markets debt, African Eurobond in focus, correct sharply and are currently trading at attractive discounts to face value
- US dollar rallies against all major currencies

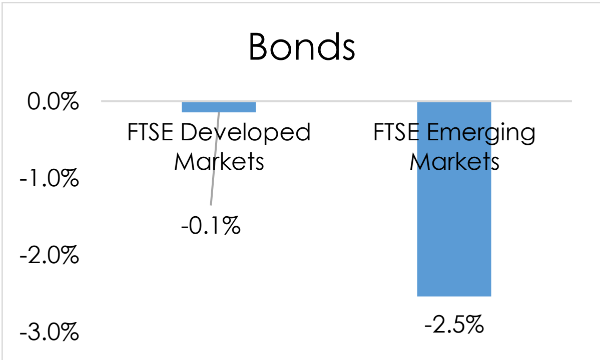
50bps May 2022 hike

The US Fed hiked the benchmark interest rate by 0.5%, bringing the federal funds rate to a range of 0.75%-1%. Fed's move was in line with market expectation.

Going forward we expect the rate hikes to be sustained in the subsequent meetings as the policy maker continues to deal with high inflation and low unemployment statistics. We are pricing a 50bps hike in June 2022 meeting.

How did the markets react to the hike? See below performance in May 2022





Source: Bloomberg, NCBA

Inflation

US inflation remained elevated in 8.3% in April with the main drivers being food and energy indices which rose by 7.2% and 30.3% respectively year on year.

Continued lock downs in China have led to a slowdown in economic activity, which has offered some reprieve in global crude oil prices. This was reflected in a 2.7% decline in the US energy index month on month.

Supply side inflation continues to be a headwind to economic growth. IMF revised the inflation outlook upwards with developed countries expected to average at 5.7% while emerging and developing economies are expected to average at 8.7% in 2022.

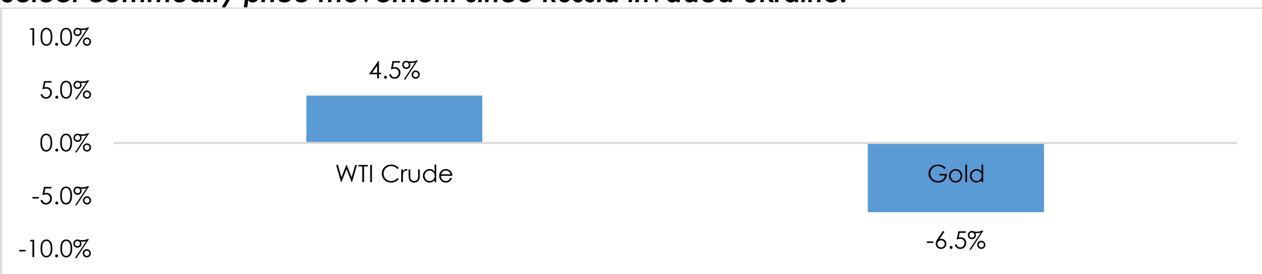
Ukraine Russia war

The conflict has been going on for approximately 79days. During a speech on Victory Day celebration, the Russian president reiterated his country's justification for invading Ukraine. Tracking the war from media sources, it appears that Russia has gained control of eastern and southern regions of Ukraine.

The war has continued to disrupt supply of commodities to the rest of the world, effectively maintaining the high commodity prices. Recently, Russia required European countries to pay for gas supplies in Russian Rubles, a move that has seen selective compliance by some companies while countries such as Poland and Bulgaria have openly rejected the move.

Russia has not defaulted on any external debt obligations since the start of the war despite sanctions which were aimed at rendering their forex reserves unusable. We see Russia capable of sustaining the war for longer on account of its ability to negotiate new economic terms with different countries. This will effectively translate to elevated commodity prices, especially crude oil and natural gas in 2022.

Select commodity price movement since Russia invaded Ukraine.



Source: Bloomberg, NCBA

Economic Growth statistics

US posted a decline in Q1 2022 GDP by 1.4%. Inflation remains the key threat to economic growth in US economy. The Fed admitted to the conflicting interest between taming inflation and stimulating economic growth, with the policy maker focusing on the prior. The possibility of a recession in the US cannot be ruled out.

China is also facing growth challenges, more recently posed by a resurgence of Covid cases. China's export sharply slowed down to 3.9% in April from 14.7% in March- reflecting the impact of lockdowns while imports remained flat-reflecting weak demand. As such, growth in China is expected to slow down to 4.4% in 2022 according to IMF.

Sub-Saharan Africa

Official 2021 GDP growth for Kenya came in at 7.2%. The recovery was premised on a general recovery of all sectors post- Covid height days. IMF projects that real GDP growth will slow down to 5.7% in 2022 driven by a higher inflation and high comparable base year on year.

The Government of Kenya is on course to meet its local domestic borrowing target having raised approximately 90% of the target amount, KES 616.8bn.

Plans are underway to float a USD 1billion Eurobond before the end of the financial year FY21/22. We expect the issue to come in at a premium to existing Eurobonds on account of rising global interest rates.

Nigeria is the most recent sovereign to issue a 7-year, USD 1.25billion Eurobond in March 2022 at a coupon rate of 8.37%. The issue was oversubscribed attracting USD 3.67bn.

Trading the inflation wave

Inflation is perhaps going to be the riding theme in 2022. Supply chain constraints have been the main driver since the Covid induced disruption. The Russia-Ukraine ongoing crisis has exacerbated commodity price inflation.

Our view is that it will take longer to solve the supply side constraints, at least not in 2022. At best level, we expect re-positioning by different nations and companies with a view to reduce reliance on key sources of raw materials and finished goods. It will however most likely result in higher costs associated with entering into new contractual agreements and deployment of capital expenditures.

The response to inflation by policy makers is juxtaposed. On one hand, the ghost of immoderate stimulus which spurred growth recovery from the Covid pandemic is haunting them. On the other hand, inflation is no longer a "classic transitory' narrative. The risk of plunging economies into recession through knee jerk rate hikes is evident. Global fixed income assets have sharply adjusted upwards in response to the rate hikes. This will undoubtedly result in higher borrowing costs and slower economic growth partly driven by reduced purchasing power.

It is not all doom and gloom as we see opportunities for investments in the emerging market debt opportunities and Kenya local currency bonds.

In this issue we focus on Ghana, Egypt and Kenyan Eurobonds which are trading at discounts and yielding satisfactory incomes.

Ghana has seen a sell-off on its Eurobonds for the better part of 2022, following credit rating downgrades by Moody's from B3 to Caa1 with a stable outlook and Fitch Group from B to B- with a negative outlook. Kenya and Egypt have retained their previous credit ratings from Fitch at B+ with a negative outlook and B+ with a stable outlook respectively. The Kenyan and Egyptian Eurobonds have however been negatively affected by the global risk off sentiment by investors. Our fact check makes us believe that the bonds are oversold.

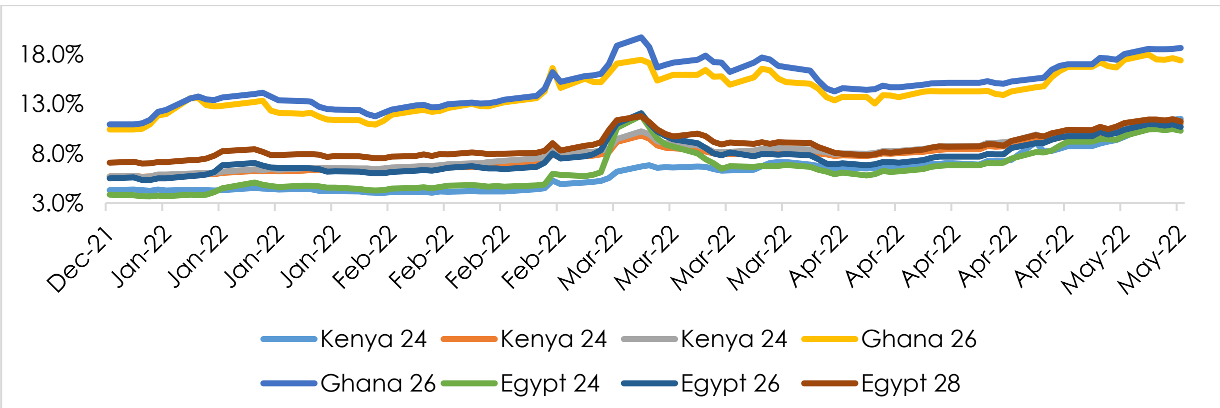
Our bias is towards short-tenor Eurobonds, those maturing in 5years. We opine that the bonds are less sensitive to volatility compared to long tenor Eurobonds. We are of the view that the current discounts to face value are huge and this offers an attractive entry point.

Eurobond returns and yields to maturity

	Month to Date		
	Price Return	Income Return	Total Return
Kenya 24	-5.02%	0.25%	**-4.77%**
Kenya 24	-4.88%	0.27%	**-4.61%**
Kenya 24	-5.24%	0.29%	**-4.95%**
Ghana 26	-2.99%	0.37%	**-2.62%**
Ghana 26	-5.15%	0.39%	**-4.76%**
Egypt 24	-2.03%	0.22%	**-1.81%**
Egypt 26	-2.81%	0.20%	**-2.61%**
Egypt 28	-4.32%	0.28%	**-4.04%**

	Year to Date		
	Price Return	Income Return	Total Return
Kenya 24	-13.6%	2.0%	**-11.58%**
Kenya 24	-19.8%	1.7%	**-18.07%**
Kenya 24	-22.7%	2.4%	**-20.28%**
Ghana 26	-18.6%	3.3%	**-15.33%**
Ghana 26	-24.5%	3.3%	**-21.14%**
Egypt 24	-12.0%	2.0%	**-10.02%**
Egypt 26	-15.6%	1.7%	**-13.84%**
Egypt 28	-18.3%	2.4%	**-15.85%**

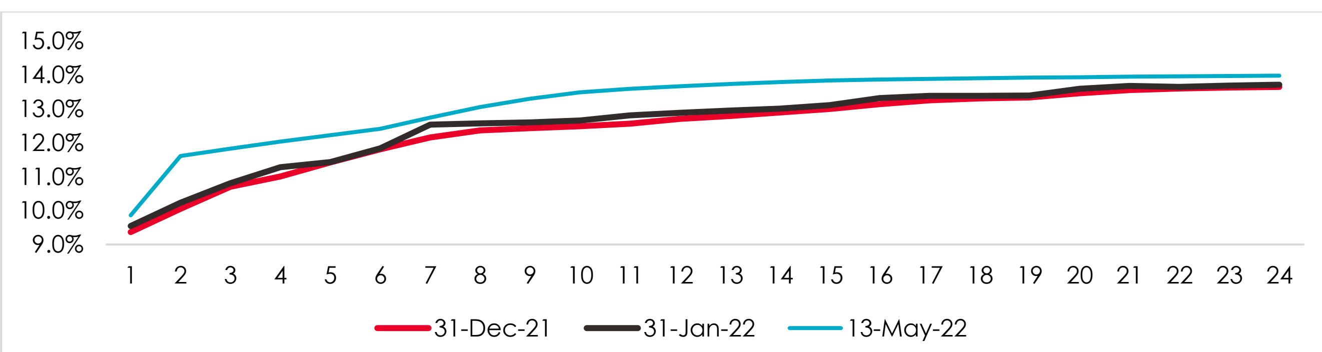
Source: Bloomberg, NCBA



Source: Bloomberg, NCBA

Our recommendation for local currency Kenya bonds is to invest in new short tenor (10 years and below) issues. We expect these tenors to command attractive coupon rates driven by investor sentiment surrounding interest rates. Liquidity conditions will influence how fast interest rates rise, but we are of the view that this will be a secondary theme if the global interest rates rise, persists.

Kenya local currency bonds yield curve



Source: NSE, NCBA

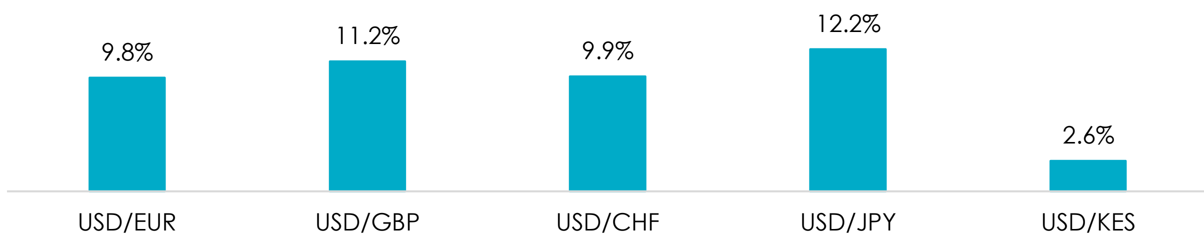
Is climate investing going to take a backseat?

Prior to Covid-19 outbreak, investors had increasingly become cognizant of responsible investing. Specifically, we saw a good deal of investments channeled towards responsible climate investing in line with the sustainable development goals. In Kenya, the first green bond, worth USD 40mn & issued by Acorn Holdings, was listed on the exchange

The past three years have however been disrupted by the pandemic, geopolitics and inflation conversations. Going forward, we opine that investors will hold managers and corporates more accountable towards responsible investing.

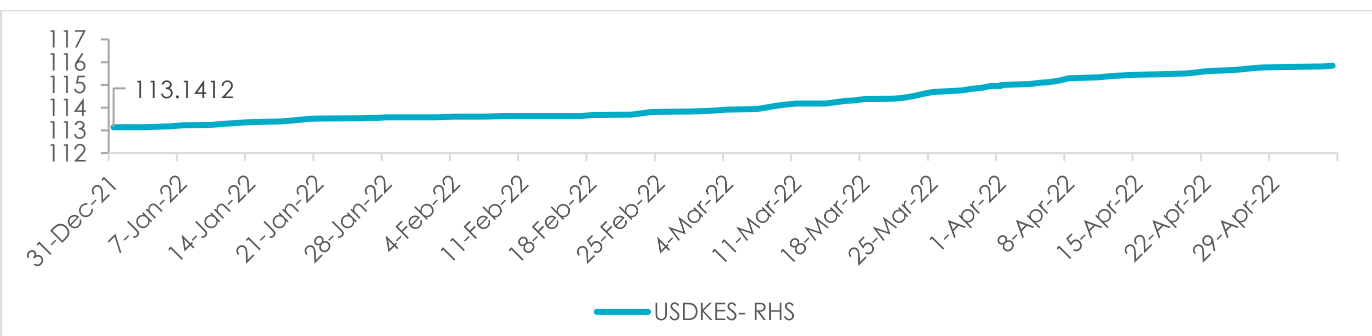
Currency

The Kenya Shilling (KES) continues to weaken against the US dollar (USD). USD strength can be attributed to higher interest rates following US Fed rate hikes. To be sure, the dollar has strengthened against major currencies across the globe. ***See illustration below***:



Source: Bloomberg, NCBA, Central Bank of Kenya

USD/KES trend line YTD



Source: NCBA, Central Bank of Kenya

We expect the KES to sustain a weakening bias against the dollar, mainly on account of the dollar being supported by the Fed hikes. Fed is expected to hike interest rates in each of its subsequent 5 meetings in 2022. On average, we expect the KES to depreciate to KES 116-117 per USD in Q2, 2022.

We wish you a happy investing week!

About NCBA Investment Bank

NCBA Investment Bank is a subsidiary of NCBA Group. The services offered by the brokerage department include equities trading for listed securities, fixed income trading for both corporate and government bonds, Over the Counter (OTC) equity transactions as well as execution of equities transactions across the East African countries. Additionally, NCBA Investment Bank backs these activities with solid advice from the research team to enable investors meet their return objectives. NCBA Investment Bank deploys simple and convenient client driven technologies, robust risk management, highly competent and experienced staff and has the backing of robust research capabilities to differentiate itself from other players in the market.

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The following analyst(s) who prepared this research report: Benjamin Gitonga & Victoria Mututu hereby certifies(y) that:

(i) all of the views and opinions expressed in this research report accurately reflect the research analyst's(s') personal views about the subject investment(s) and companies (y) and

(ii) No part of the analyst's(s') compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed by the analyst(s) in this research report.

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