NEWS BUSINESS

COMMODITIES REVIEW
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What to expect in 2018 money markets

"As a macro investor, my job for 30 years was to anticipate changes in the economic trends that were not expected by others - and therefore not yet reflected in securities prices" Stanley Druckenmiller said.

Druckenmiller (who with his partner George Soros) is a man worth listening to. He has made a lot of money for more than three decades. My most vivid memory was around the time I finally arrived on the trading floor at Credit Suisse First Boston in the 1990s and watched Soros and Druckenmiller lift a billion pounds off the Bank of England on Black Wednesday in 1992. I admire folks who can spot the anomaly, seize the opportunity and make away with their profits. To do all three is not an easy thing. I also discovered that Stanley had shorted (short selling is where an investor sells as asset and profits if the asset price subsequently falls) Christo Wiese's Steinhoff at a time when practically every South African commentator and Asset Manager was long up the "wazoo".

So in this article, as promised, I would like to anticipate what might happen in 2018 and where we might seek to profit. The caveat to this article is that the markets are not static, markets are in fact incredibly fluid and I for one believe in an active strategy, which means the portfolio can pivot at any time.

Last year, I made bitcoin my number one choice and it rallied close to 20-fold before correcting and ending the year +1,300%. I am no longer bullish bitcoin, in fact, I am bearish. The structure of bitcoin is, however, one that lends it to being "short-squeezed" and being "short-squeezed" is not a pleasant sensation, let me assure you. For 2018, the portfolio will look to be short bitcoin on a tactical basis. Against that bitcoin short, I will hold a small long in ripple, which is another crypto-currency, which looks like it might become a serious payments platform. This component of the portfolio will be capped at a 7.5% ceiling of the total value notwithstanding that the millennials have become a serious player in the Global Economy. Look at Avocados if you want further confirmation.

Commodity markets ended 2017 real hot, The Bloomberg Commodity Index, which measures returns on 22 raw materials, closed up 11 days in a row, resulting in the longest run in records dating back to 1991. WTI Crude traded above $60 a barrel near its highest level in two years. In November, I turned bullish on Oil and am forecasting a further run higher towards $65 a barrel in New York. The portfolio will therefore look to bag that gain in 2018. Once we strike that level the portfolio will switch to flat. I expect this gain to be booked in the first quarter which gives us a substantial gain when you annualise it. This component is capped at 12.5%.

Western economies have been experimenting with lashings of Quantitative Easing. This "money-printing" experiment has suppressed Government Bond Yields. The centre of this monetary experiment has held since 2009. I propose the portfolio bets about 2.5% of its value on deep out of the money put options on a basket of 10-year bonds. This is an insurance policy with a high payout.

The Currency Markets remain the most liquid markets in the world. Over five trillion dollars trade daily. In 2017, The Euro rallied about 12% against the Dollar. The Mozambique Metical rallied about 20% and was the best performing currency in the world against the Dollar. It is proposed that 30% of the value of the portfolio is allocated to FX. The portfolio will own the Euro (I look for 1.3000+ versus the Dollar in 2018), will own the Rand (as its main long-term holding) as I believe the Rand has been savaged by President Zuma and that a President Ramaphosa will mean an erosion in the Zuma haircut and a substantial re-price in the value of the Rand. I also propose we hold some Meticals. The portfolio will also keep funds aside to be traded on a tactical and short-term basis. Opportunities abound in the FX markets. The frequency of flash-crashes in the early hours has been unprecedented. The FX markets are a 24-hour market and whilst I propose to get some shut-eye, I propose the portfolio allocates one human resource to monitoring things, whilst the world sleeps.

Equity markets have been in a Golden "Goldilocks" era. We have seen prices rise, almost in a straight line throughout 2017. President Trump has cloaked his administration in the righteousness of the markets, for example. The FANG stocks like Amazon, Facebook, Ali Baba led the charge as they remade the world and its economy in their image. Valuations are now rich. I prefer to look for opportunities below the headliners. I like Twitter at $24.00. We can also play TENCENT through Naspers. I am keen on looking for purely digital based Banks that can seriously apply Artificial Intelligence across billions like Facebook have done. Upto 30% of the portfolio will be applied to the Equity Markets.

The residual balance of the portfolio will be applied to the Frontier markets. One of the reasons I returned home to Kenya was because I believed that someone like myself should be able to create an "Edge".

"In the business, a subtle but crucial informational advantage was called edge." Richard Holwell, a former federal judge in New York told me. He said that in order to evaluate a technology stock, hedge funds sent "people to China to sit in front of a factory and see whether it was doing one shift or two." He added, "An edge is the goal of every portfolio manager." (The New Yorker Article about SAC).

I like what I am seeing in Angola. I am keen on being long on Angolan risk. The devil is in the detail of the execution, however. I would probably look to be long Angola Eurobonds. African stocks had an alpha year in 2017. I like South African Banks, which I believe are steeply undervalued and still carry a Zuma haircut. So the portfolio will have some Standard Bank. Here in Kenya, the Portfolio will stay long Safaricom (I believe geographical expansion and the e-commerce opportunity have not yet been baked into the price - I look for 30%), KenGen (about 35% - dividend passes have weighed a little) and some Standard Chartered and Barclays Bank (more than 25%) and a small slice of higher beta via Uchumi.

I wish you all a profitable Year in 2018.

Aly-Khan is a financial analyst

SLOWDOWN

Kenya records lowest economic growth in five years

ABEL MUHATIA / Kenya's economy grew 4.4 per cent in the third quarter of 2017, the slowest growth in a period of five years, data by the Kenya National Bureau of Statistics show.

The quarterly Gross Domestic Product report attributed the reduced growth to uncertainty associated with the political environment coupled with effects of adverse weather conditions. The recorded growth is lower than World Bank's growth projection of 4.9 per cent announced last month.

In April 2017 the bank had estimated the growth at 5.5 per cent before reducing it to 4.9 per cent on sluggish credit growth and the prolonged electioneering period. In 2012, the economy grew by 5 per cent, went up to 6.4 per cent in 2013, dipped to 4.6 per cent in 2014, and went up again to 6.1 per cent in 2015. The third quarter of 2016 saw it record a growth of 5.6 per cent.

The poor weather conditions saw a rise in prices of food and non-alcoholic beverages that started in the second quarter of 2017 and continued into the period under review.

High food prices increased inflation to an average of 7.5 per cent, compared to 6.3 per cent during a similar quarter in 2016. Findings from the report indicate that suppressed performance in key sectors of the economy were key contributors of the economic dip. During the period under review, financial and insurance activities recorded the largest deceleration, from 7.1 per cent in third quarter of 2016 to 2.4 per cent.

Energy Regulatory Commission acting director general Pavel Oimeke during the launch of a study on the possibility of developing a shilling-denominated energy financing mechanism in Nairobi on July 11 **/FAITH MUTEGI**

POWER

Electricity costs likely to drop with new regulation

If the dollar moves from trading at Sh90 to Sh105, then it translates to a 15 per cent payment rise passed to consumers

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The Energy Regulatory Commission has hinted on possibilities to denominate power purchase agreements using the Kenyan shilling in small capacities from this year.

The move aimed at reducing the cost of power on the consumer end will see foreign investors inject cash into local power generation projects using the Kenyan shilling.

This means that despite a rise or fall in the value of the dollar to the shilling the Foreign Exchange fee will not be affected.

This is opposed to foreign currency which upon fluctuation ends up hiking electricity prices.

"For instance, if the dollar moves from trading at Sh90 to Sh105 then it will translate to a 15 per cent rise in payments, which is often passed to consumers," GuarantCo chief executive Samuel Chasia said.

This comes five months after the regulator commissioned a study on local currency tariff for Kenya Power Purchase Agreements.

Currently, the tariffs are denominated in US dollars, a situation that has led to consumers paying more for power.

According to the implementers of the study - GuarantCo - use of local currency financing will lead to productive recycling of savings within a country rather than increasing the country's external debt burden.

Chasia said use of local currency is also aimed at promoting local financing that will lead to reduction of power cost to consumers.

Consumers currently pay Sh1.25 per kilowatt as Foreign Exchange Rate Fluctuation Adjustment fee up, from Sh0.83 charged 10 years ago when the shilling was trading at Sh75.26.

This means that Kenyans are forced to pay higher power tariffs to repay mostly foreign investors who pump money into the sector when the shilling is more stable against the dollar. In 2017, the shilling traded at an average 103.41 against the dollar.

"We are looking at a situation where we can denominate small capacities of power purchase agreements to have a component of Kenya shillings. We are hoping that this is going to be done next year where we will start with small capacities and also test and see the challenges that come with it," ERC director general Pavel Oimeke said.

Apart from looking at lowering the cost of power for consumers, this move, if successful, will encourage locals to participate in long-term infrastructure financing that attracts high returns on investments.