Mashreq Capital

Outlook on MENA Fixed Income and Equity Markets

Q1 2025

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Fixed Income

MARKET OVERVIEW

US TREASURY MARKET

2024 was a tumultuous year for US Treasuries. The year began with treasury yields anchored by a dovish Federal Reserve, which anticipated a significant slowdown in the US economy. However, robust labor force growth bolstered by foreign immigration and sustained productivity gains maintained economic momentum. This delayed the expected disinflation trend in the US economy and led to a volatile treasury market. Towards the end of the year, the market's focus shifted to the US elections, where Donald Trump secured a sweeping victory, contrary to most election surveys. As the potential policy changes came into focus, treasury yields surged, with volatility reaching levels last seen during the banking crisis of 2023. The year concluded with the US 10-year Treasury yield up 69 basis points year-on-year, closing at 4.57%.

EMERGING MARKET FIXED INCOME

Emerging Markets performed positively over the year 2024, with the Bloomberg Emerging Markets USD Aggregate Bond Index returning 6.6%, driven mainly by spread tightening and positive carry. As a result, the High Yield section of the market outperformed, returning 14.9% for the full year as measured by the Bloomberg Emerging Markets High Yield Total Return Index. Since their latest peak in 2022, emerging markets bond spreads have been moving tighter due to steadily improving credit fundamentals and a stable default outlook. Among emerging market corporates, net leverage is near a decade low and EBITDA growth has been recovering against a backdrop of cooling inflation. Default rates for Emerging Markets high yield for 2024 were 3.5%, down from double-digit levels in 2022. Rating agencies have been taking note of these positive factors, resulting in the net rating action volume for 2024 turning positive for the first time since 2012.

MENA FIXED INCOME

The MENA Fixed Income market generated positive returns for the year 2024, returning 3.6%, as measured by the Bloomberg Emerging Markets USD Aggregate: MENA index. Returns for the year were primarily driven by spread effects as the long end of the US treasury yield curve moved upwards over the course of the year. In terms of countries, Egypt was the biggest contributor to total returns, driven by significant outperformance following the UAE's $35bn Foreign Direct Investment, which helped the near-term borrowing requirements for the country to fall sharply. Positive idiosyncratic events also took place in Jordan, Morocco, and Oman, helping move credit spreads for these countries lower. Rating actions within MENA were largely positive over the year, helped by improving credit fundamentals, economic diversification, and fiscal discipline in the case of regional governments. Oman achieved its first Investment Grade rating in September from S&P since 2017 following a period of balance sheet deleveraging, marking it a likely rising star for 2025. Overall, the MENA region remains characterized by its high credit quality within broader emerging markets, supportive oil price environment, and attractive valuations versus similarly rated sovereigns within Emerging Markets. This favors the longer-term positive outlook on the MENA fixed income asset class.

MARKET WATCH

Yields (%)	December 31, 2024	December 29, 2023
SOFR 3-Month	4.31%	5.33%
US Treasuries 2-Year	4.24%	4.25%
US Treasuries 10-Year	4.57%	3.88%
US Treasuries 30-Year	4.78%	4.03%
German Bunds 10-Year	2.37%	2.02%
Spreads (bps)	**December 31, 2024**	**December 29, 2023**
US IG	80	99
US HY	287	323
Emerging Markets	220	297
Emerging Markets: MENA	149	185
Global Agg Sukuk	69	77
Returns (%)	**QTD**	**YTD**
US IG	(3.04%)	2.13%
US HY	0.17%	8.19%
Emerging Markets	(1.47%)	6.58%
Emerging Markets: MENA	(2.60%)	3.64%
Global Agg Sukuk	(1.60%)	3.34%

US IG = Bloomberg US Corporate IG Index
US HY = Bloomberg U.S. Corporate High Yield Index
Emerging Markets = Bloomberg Emerging Market USD Aggregate Index
Emerging Markets MENA = Bloomberg Emerging Market USD MENA Aggregate Index
Global Agg Sukuk Index = Bloomberg Global Agg USD Sukuk Index.

Fixed Income

MARKET OUTLOOK

US TREASURY MARKET

The US economy is entering 2025 from a strong position, with unemployment remaining low at 4.1%, inflation close to the Federal Reserve's target, and GDP estimates for Q4 2024 coming in at a robust 2.5-3% Quarter on Quarter. Under our baseline scenario, we expect US inflation to further ease during the first half of 2025, enabling the Federal Reserve to cut policy rates by 50 basis points during the year. Despite the potential rate cuts, we expect the 10-year Treasury yield to remain high and fluctuate within a 4-5% range due to uncertainties surrounding the incoming Trump administration's economic policies, such as broad-based tariffs, potential tax cuts, and restrictive immigration measures. These policies could exert inflationary pressure during 2025. Additionally, we anticipate adverse changes in demand-supply dynamics of US Treasury securities to further steepen the US yield curve. As the supply of US Treasury securities increases due to a higher fiscal deficit and demand shifts from price-insensitive buyers (such as the Federal Reserve, US banks, and foreign official accounts) to price-sensitive buyers (institutional investors), we expect the long-end parts of the yield curve to remain elevated. Meanwhile, the short end of the curve is likely to be anchored by Fed rate cuts, at least in the first half of 2025. Consequently, we anticipate the yield curve to remain steep and see the best value in the front end and belly of the curve as opposed to the long end.

EMERGING MARKET FIXED INCOME

The first quarter of 2025 looks to be challenging for Emerging Markets, as trade-related policies from the new US administration are set to lower the growth outlook and reduce the scope for US policy easing. That being said, we still see pockets of opportunities within High Yield corporates, where default rates are easing as well as sovereigns that are going through structural reforms. In our view, the key themes for 2025 are (1) the US policy implementation surrounding tariffs and Ukraine, (2) supply chain shifts, and (3) rating upgrades. The new US administration starts this month, and we expect tariffs will feature prominently within their economic policy agenda. China will bear the biggest brunt of this, but negative spillovers across Emerging Markets are likely given trade dynamics. China's global manufacturing dominance is therefore likely set to gradually recede from here, providing opportunities for others to make inroads. Latam, Emerging Markets Europe, and India could all be beneficiaries given they benefit from their proximity to large end-markets. As a result, we have an underweight view on China and an overweight view on Turkey, Mexico, and Uzbekistan.

MENA FIXED INCOME

Given the high-quality nature of the MENA Fixed Income universe, we expect the first quarter to be challenging on an index level given the current tight credit spreads and potentially elevated US treasury yields during early 2025. Although we expect to see returns in the highest quality segments of the MENA market, such as Qatar and Abu Dhabi, closely follow movements in the US Treasury yields, there are several High Yield names that offer attractive potential upside given their elevated spread cushion. Both Oman and Morocco could be investment-grade names in the next few months given rating agencies have placed them on a positive outlook, with the former the more likely of the two given it received its first BBB- rating from S&P in 2024. A ceasefire between Israel and Hamas is undoubtedly positive for the region. It will reduce the risk premium for neighboring countries such as Jordan and Egypt, offering potential for spreads to tighten for these sovereigns. We believe that high carry short-to-intermediate duration names offer the best risk-reward for the MENA fixed income market for the first quarter of 2025.

GLOSSARY

- **EBITDA:** Earnings Before Interest, Taxes, Depreciation, and Amortization
- **MENA:** Middle East and North Africa

ASSET CLASS VIEWS

	Under Weight	Neutral	Over Weight
US Treasuries	○	○	●
US IG	○	●	○
US HY	○	●	○
Emerging Markets: USD	○	●	○
MENA: USD	○	●	○
Global Sukuk: USD	○	●	○

*No change in the asset class views from Q4 2024

Equity

MARKET OVERVIEW

DEVELOPED MARKET EQUITIES

The US had a very strong 2024, underpinned by expectations of a soft landing, backed by easing inflation, a strong labor market, and falling interest rates. There were some hiccups in late 3Q24 and in 4Q24 as policy uncertainty post-US elections and a hawkish cut by the US Fed in Dec'24 dampened sentiment. The rally post-US election in anticipation of business-friendly policies of the incoming administration offset this impact. Overall, the S&P 500 posted a return of +25.0%, and the NASDAQ 100 returned +25.8% for 2024. The Eurozone rose 4.7% in 2024. The bulk of this advance took place in 1Q24 (+10.2%) on the back of easing inflation and expectations of higher rate cuts. However, post-1Q24, markets remained range-bound for the rest of the year as growth concerns emerged. Japan also had a strong year, posting a return of 8.7%. Overall, the Bloomberg Developed Markets Index was up 18.8% for 2024.

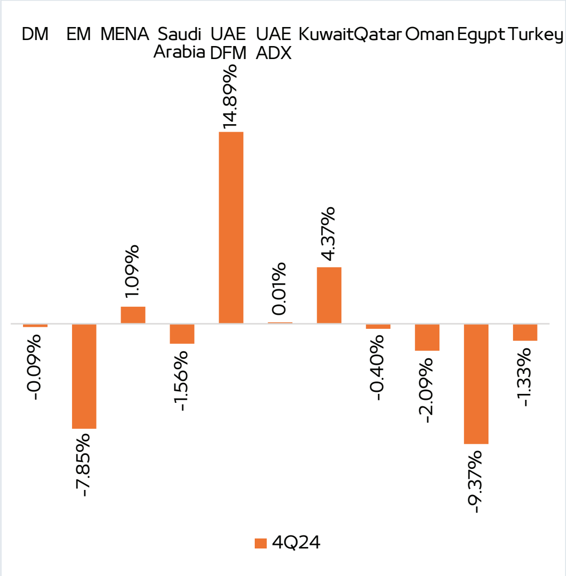
EMERGING MARKETS EQUITIES

Emerging markets equities underperformed developed market equities by 1133bps and posted a return of 7.98% for 2024. China (+13.02%) was the biggest contributor to the return, on the back of stimulus provided by the government. India (+6.5%) was the second-largest contributor, backed by ongoing structural growth. Political turmoil in South Korea (-18.9%) resulted in the market being the largest detractor in Emerging Markets. Brazil was the second biggest laggard with a 29.5% loss due to the worsening fiscal situation, currency depreciation, and overall adverse macroeconomic environment. The Emerging Markets Index was up 7.98% for 2024.

MENA EQUITIES

MENA Equities posted a return of 5.1% for 2024. The UAE led the way with ongoing reforms and a buoyant real estate sector driving the index higher. Saudi Arabia had a muted 2024 (+3.1%), as energy names underperformed due to soft oil prices. The healthcare sector was also a detractor, where high valuations kept investors at bay. Utilities and Industrials did well for 2024, led by index-heavy names like Acwa Power, while the technology sector also contributed positively. Egypt was down 25.4% as ongoing reforms fell short of investor expectations.

PERFORMANCE OF KEY MARKETS



Figures in USD - Total return basis, actual returns.
Date: 31st December 2024

UAE DFM (Dubai Financial Market)
UAE ADX (Abu Dhabi Securities Exchange)

MARKET OUTLOOK

DEVELOPED MARKET EQUITIES

We remain constructive on equity markets for 2025. A strong US economy is likely to underpin earnings growth. Post-US elections, policies of the new administration are expected to be business-friendly and benefit the corporate sector. Although less than previously expected, rates are still likely to come down in the US. This can potentially favor equities. A potential de-escalation between Russia and Ukraine could also provide a boost to equities. This possible improvement in geopolitical tensions should result in lower oil prices and inflation expectations. In the near term, equity markets may consolidate as market participants await further clarity on the Trump administration's policies.

EMERGING MARKETS EQUITIES

The outlook for emerging markets remains clouded by expectations of tariffs and a stronger dollar. This would not bode well for most of the region. Tariffs can work against growth in markets like Latam. Increasing yields can lead to the dollar becoming stronger against local currencies and will mount pressure across the region, but more specifically on import-dependent economies. Another China stimulus can provide a bout of optimism. It will have to compete against the negative sentiment around expected tariffs. The Gulf Cooperation Council remains attractively positioned, a beneficiary of a stronger dollar and relatively shielded from the impact of tariffs.

MENA EQUITIES

We are constructive about the MENA region. A booming consumer sector and rising income per capita support the region, particularly the Gulf Cooperation Council. Real estate remains strong in the UAE. The tourism sector remains strong, requiring investment in capacity and underpinning infrastructure plays. A growing population will be beneficial for domestic demand plays. We like domestic demand and infrastructure names in Kingdom of Saudi Arabia. Employment growth remains firm, and the government has ample fiscal buffers to finance ongoing projects. Headline valuations obscure attractive bottom-up opportunities leveraged to growing consumption and infrastructure development, in our opinion. Current energy prices should support the appetite for risk assets in the region by improving the outlook for fiscal outcomes for the major energy exporters in the region.

GLOSSARY:

- **MENA:** Middle East and North Africa
- **Latam:** Latin America

ASSET CLASS VIEWS

	Under Weight	Neutral	Over Weight
DM Equities	○	●	○
EM Equities	○	●	○
MENA Equities	○	○	●

*No change in the asset class views from Q4 2024 mashreq CAPITAL | mashreq AL ISLAMI

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