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Mashreq Capital

Market Outlook and Strategy

Q1 2023

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CAPITAL

Fixed Income

MARKET OVERVIEW

BULLS OR BEARS

2022 was one of the biggest bear-market years for bonds on record. All the major bond benchmarks were down from safe-haven US treasuries to EM bonds. The year was a perfect bear-market storm of surging inflation, supersized rate rises & QT.

DEVELOPED MARKET FIXED INCOME

The world's supposed safe-haven bonds including US treasuries endured heavy losses as central banks triggered jumbo-sized rate hikes to curb out-of-control inflation. Bond prices plummeted & 10-year US treasury yields surged from 1.51% to 3.87%, an unprecedented sell-off in 10-year treasuries.

EMERGING MARKET FIXED INCOME

Rising US treasury yields & a strong dollar sucked capital out of EMs, leaving EM bonds with nowhere to hide. JP Morgan's EM government bond index fell 17.8%, its worst performance since its launch in the 1990s.

GCC FIXED INCOME

GCC fixed income was the best of a bad bunch of global bonds in 2022. JP Morgan's Middle East index shed 10.5% & the sukuk version only 6.5% due to the latter's resilient investor base. International investors are starting to appreciate GCC bonds' sturdy characteristics of high credit ratings, low debt loads & budget surpluses resulting from high hydrocarbon prices & fiscal reforms.

NORTH AFRICA AND TURKEY

Oil-importers such as Egypt, Tunisia & Turkey struggled amid surging oil prices & weak currencies.

MARKET WATCH

Yields (%)	12/30/22	12/31/21
3-Month USD Libor	4.77	0.21
US Treasuries 2-Year	4.43	0.73
US Treasuries 10-Year	3.87	1.51
US Treasuries 30-Year	3.96	1.90
German Bunds 10-Year	2.57	(0.18)
Spreads (bps)	**12/30/22**	**31/12/21**
DM IG Corporates	130	92
DM HY Corporates	468	283
EM USD Sovereigns	453	369
EM USD Corporates	322	272
Returns (%)	**QTD**	**YTD**
EM USD Sovereigns	8.11%	(17.78%)
EM Local Sovereigns	7.84%	(10.18%)
EM USD Corporates	4.72%	(12.26%)
Middle East Composite	3.96%	(10.51%)
Sukuk	1.96%	(6.47%)

*EM USD Sovereigns= JPM EMBI Global Diversified Index, EM Local Sovereigns= JPM GBI- EM Global Diversified Index, EM USD Corporates= JPM CEMBI Diversified Index, Middle East Composite= JPM MECI Index, Sukuk= FTSE Sukuk Index

MARKET OUTLOOK

SUMMARY

2023 could be a year of two halves for bonds: First-half recession risks imply overweighting investment grade; A second half recovery in high yield could be triggered by a bottoming of growth data, allowing a Fed pause & a broad bond market recovery in the final months of 2023.

GROWTH

Last year's jumbo-sized rate hikes should end up hurting economies this year. Much of the world is forecasted to fall into recession including the US & Europe, with below-trend growth in China. The GCC should avoid recession due to high hydrocarbon prices helping to keep the region's economy flush with cash.

MONETARY POLICY

The lower for longer mantra is gone. Higher for longer is the new central bank playbook. We don't expect central banks to cut rates this year.

SENTIMENT

Waiting for the Fed to finish hiking or inflation to hit 2% risks missing the bond-market rebound. We think the inflection point in data & sentiment is already here via falling inflation, slower rate hikes & a hot pipeline of new issuance.

VALUATIONS

Higher yields are a gift to investors that have been starved of income for many years. For example, this year's starting yield for JP Morgan's MENA Bond index 5.9%, compared to 3.6% last year. We're taking advantage of the higher yields by being fully invested this year.

ASSET CLASS VIEWS

	Under Weight	Neutral	Over Weight
DM Sovereigns	○	○ →	●
DM IG Corporates	○	○ →	●
DM HY Corporates	●	○	○
EM USD Sovereigns	○	○ →	●
EM Local Sovereigns	○	●	○
EM USD Corporates	○	●	○
GCC	○	●	○
North Africa & Turkey	●	○	○

Equity

MARKET OVERVIEW

Recessionary fears continued to weigh on markets in 2023. Against recession fears, developed market equities showed an improvement in performance in Q4 vs. a weak performance in Q322. S&P 500 Index gained +7.08% during Q422. However, in MENA, the SPACPUX Index was down -5.87% during the quarter.

DM EQUITIES

In the US, markets made a U-turn, and returned +7.08% during the 4th quarter of 2022. In Europe, we saw a similar narrative with the STOXX 600 gaining +9.55% during the quarter. In summary, the S&P 500 is down –19.40% for the year, and the STOXX 600 index is down -12.9% YTD, indicating a bleak period for equities during 2022.

EM EQUITIES

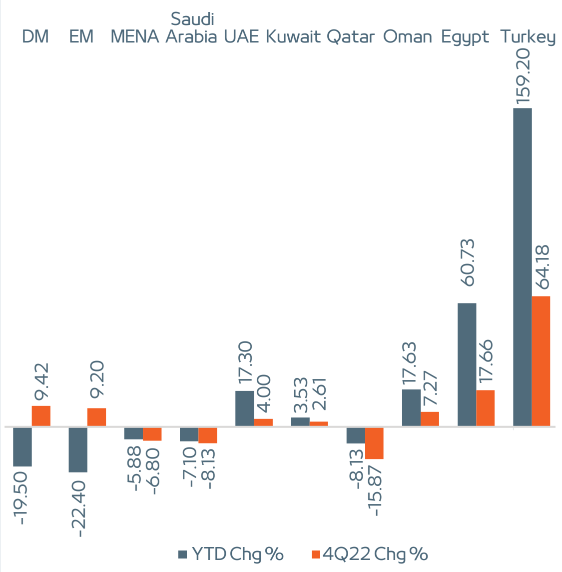
EM equities outperformed in Q4, as the pressure from the dollar eased. Oil prices moving towards the USD 75-80 handle, was an added tailwind for EMs – easing some of the pressure on current account balances. Thus, we saw the MSCI EM Index gaining +9.20% during Q422 cutting YTD losses to -22.4%.

The best performers in EM were Egypt and Turkey, returning >60% in Q42022. The biggest losers for the quarter were Qatar (-15.29%), Saudi Arabia (-7.64%).

MENA EQUITIES

MENA equities continued the weak performance we witnessed in Q3 2022, with the SPACPUX Index down -5.87% during Q422; which was largely a function of Saudi Arabia and Qatar, as a result of liquidity constraints, fund outflows on China re - opening and energy prices coming off. Full year 2022 performance for the SPACPUX Index was -6.81% outperformed both EM and DM equities.

PERFORMANCE OF KEY MARKETS



Equity Comment: GCC equities are acting as a safe haven amid higher oil and gas prices and potential interest rate hikes.

MARKET OUTLOOK

Bringing inflation under control remains the top priority for global Central Banks. However, the impact of the rate hikes are evident in the slowing US CPI print and the labor market on a MoM basis. The full impact of rate hikes is yet to be seen – and we believe will probably cause a material slowdown in economic growth in the next 12M, which could prompt a Fed pivot sooner than anticipated.

DM AND EM EQUITIES

US equities could weaken in 2023, as earnings take a hit. European equities view remains relatively negative, given the difficult macro backdrop, energy crisis and geopolitical risks.

We are neutral on EM equities and see value. Dollar weakness and declining commodity prices will help ease inflation and relieve pressure on the current account. The EM recovery story is still in its early stages, but we see value at current valuations, which are on par with "pandemic valuations".

MENA EQUITIES

Crude oil prices continue to help MENA economic growth, due to lower breakeven prices. Growth for the MENA region is expected to be robust in the medium term. We expect outperformance in banks, as banks benefit from improved profitability at this stage of the NIM cycle. We continue to favor value picks during this part of the cycle, as growth slows down. Our positioning will be limited to defensive counters with steady cashflow, and away from materials and other cyclical plays, in line with our view of a slowdown in the near term.

Valuations in the region drifted lower during Q4 2022, with the SPACPUX Index now trading at a 20-month low on a PBV basis. We see several factors driving the current decline in MENA markets; 1) lower crude oil prices and material prices vs. 3-6M ago 2) liquidity issues in KSA. During 2022, the SPACPUX Index P/E fell by -21.5% and is currently trading at 14.2x TTM earnings vs. 2Y average of 19.2x, thus presenting an excellent opportunity for value investing.

We are overweight in UAE, and Qatar, neutral on KSA and Oman, and underweight Egypt, Kuwait and Turkey.

ASSET CLASS VIEWS

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

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CONTACT US:

Mashreq Capital (DIFC) Ltd.
Al Fattan Currency House,
Tower 1, Floor 1, Office 111,
DIFC, Dubai, United Arab Emirates

Tel: **+971 4 424 4618**
Email: **MarketingTeam@mashreq.com**

www.mashreqcapital.ae