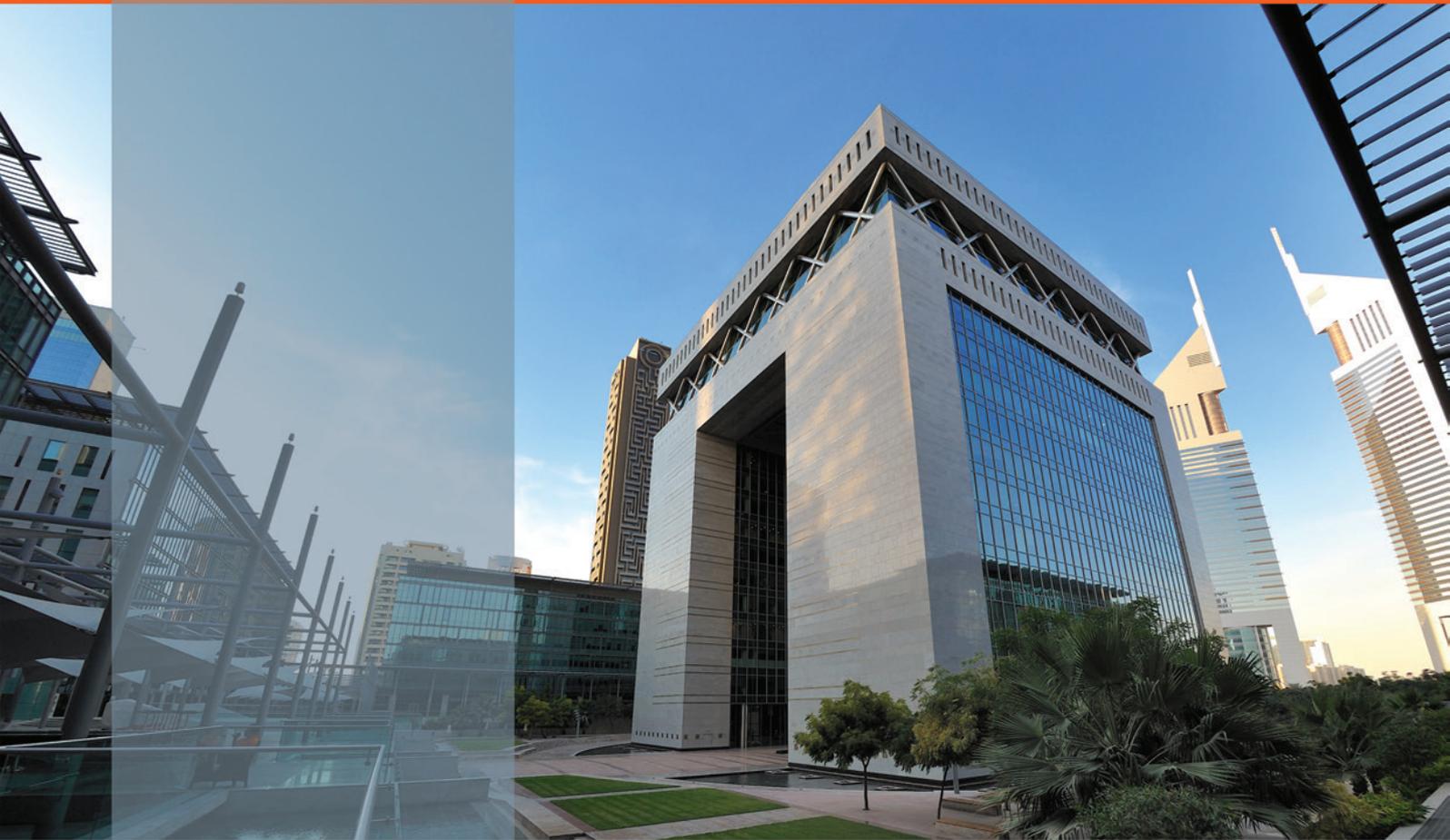




Mashreq Capital

Market Outlook and Strategy

Q3 2023



Fixed Income

MARKET OVERVIEW

BULLS OR BEARS

Better-than-expected economic data in the US and stability of the banking system dispelled concerns of 'hard landing' or a financial crisis, leading to higher US Treasury (UST) yield in 2Q23.

DEVELOPED MARKET FIXED INCOME

Higher US treasury yield was offset by spread compression of corporate credits as concern of a recession receded. High-yield (HY) bonds outperformed investment-grade (IG). Sovereign bond yields also increased in other major developed economies, driven mainly by higher-than-expected inflation readings, particularly in the UK and Australia.

EMERGING MARKET FIXED INCOME

EM bonds defied higher Treasury rates in 2Q23, delivering positive returns as spreads over Treasury bonds narrowed. HY bonds outperformed IG here as well on the back of positive developments in weaker-rated sovereigns such as Egypt, Nigeria, and Turkey. JP Morgan's Emerging Market sovereign and corporate bond index saw gains of 4.09% and 3.64% respectively during the quarter.

GCC FIXED INCOME

After strong outperformance of GCC bonds in 2022, it lagged rest of the EM space in 2Q23 as investors flocked towards select distressed EM names as they staged strong comeback. Nevertheless, JPM's GCC Index posted +0.41% return in 2Q23 and 2.18% YTD supported by fiscal strength and lower financing needs.

NORTH AFRICA AND TURKEY

Investor's increased appetite for the credit risk and series of positive news in these countries helped them outperform.

MARKET OUTLOOK

SUMMARY

We do not expect an imminent respite from volatility in US treasury yields as investors would be focused on tight labor market conditions in the US. However, we forecast growth to slowdown towards end of the year which can trigger a rally in USD bonds towards 4Q23. On EM USD bond spread, we consider them as tight by historical standards and therefore, any positive return will likely come through compression in the US treasury yields.

GROWTH

We expect global growth to continue to slowdown as major DM economies are struggling to contain inflation which would keep interest rates high. Besides, China's economic recovery has been slower than expected which shall keep EM growth in check.

MONETARY POLICY

A divergence in monetary policies of DM and EM is expected to become more prominent as US looks set to further tighten while some EM central banks are looking towards cuts and may accelerate once there is a pause by US.

SENTIMENT

Sentiment remains negative as rising US treasury yields are making investors nervous. However, we expect it to reverse rapidly as US economic data will likely show signs of softness in response to higher rates.

VALUATIONS

Despite relatively tighter EM spreads, we consider overall valuations as attractive owing to higher absolute yields. While return in the first half of 2023 were primarily driven by spread compression, we expect returns in the 2nd half to be contributed by UST yield compression.

MARKET WATCH

Yields (%)	06/30/23	12/30/22
3-Month USD Libor	5.55 %	4.77%
US Treasuries 2-Year	4.90%	4.43 %
US Treasuries 10-Year	3.84 %	3.87%
US Treasuries 30-Year	3.86 %	3.96%
German Bunds 10-Year	2.39 %	2.57%
Spreads (bps)	06/30/23	12/30/22
DM IG Corporates	122	130
DM HY Corporates	392	468
EM USD Sovereigns	432	453
EM USD Corporates	344	346
Returns (%)	QTD	YTD
EM USD Sovereigns	2.19%	4.09%
EM Local Sovereigns	2.69%	7.65%
EM USD Corporates	1.37%	3.64%
Middle East Composite	0.44%	2.25%
Sukuk	0.57%	2.40%

*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

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

Investor focus remained on central bank policy actions during the quarter. Developed markets continued to run far ahead of Emerging markets, with the S&P500 Index returning 8.74%, the Nasdaq 100 Index returning 15.39%, the Euro Stoxx 50 Index posting a return of 4.25%, while the MSCI Emerging Markets Index posted a total return of 0.97%. The SPACPUX Index posted a total return of 3.92% for the quarter.

DMEQUITIES

Developed markets continued to be strong during the quarter. The Nasdaq 100 Index posted one of the highest total returns for the first six months of the year, up 39.35% on a total return basis. The Euro Stoxx 50 Index was up 19.18%, with the S&P500 Index close behind with a 16.88% return. These numbers have brought valuations for Developed Markets well above historical averages and moderated the prospects for medium-term returns over the next 3-5 years.

EMEQUITIES

EM equities continued to lag DM equities by a wide margin. For the first six months of the year EM equities were up 5.02%. EM equities valuation, as measured by the MSCI Emerging Markets Index, was about a quarter standard deviation below the historical average, putting the asset class into slightly cheap territory.

MENA EQUITIES

MENA equities managed to turn the corner in the second quarter, rising 3.92% to finish the first half of the year up 2.42%. Saudi powered ahead 9.13% in the quarter, while Qatar fell 1.04%, Abu Dhabi was up just 0.94% and Dubai rose 12.49% (about 4.69% of this was due to Gulf Navigation alone). For the first six months Abu Dhabi is down 5.59%, with almost the entire decline accounted for by First Abu Dhabi Bank, Alpha Dubai, IHC, and Multiply.

MARKET OUTLOOK

The Fed delivered a further 25 basis points in rate hikes and followed that up with a pause in the June meeting. Investor focus now is whether this is a pause before rate cuts (bullish fixed income, neutral/bearish equities) or a skip before more hikes (neutral/bearish fixed income, neutral/bullish equities). We believe the path of inflation and unemployment will inform Fed actions going forward hence news around these topics will continue to drive markets. Core inflation remains at 4.6%, while unemployment is running at decade lows. Leading indicators continue to point to a weaker US economy, the only point of debate seems to be the timing and magnitude!

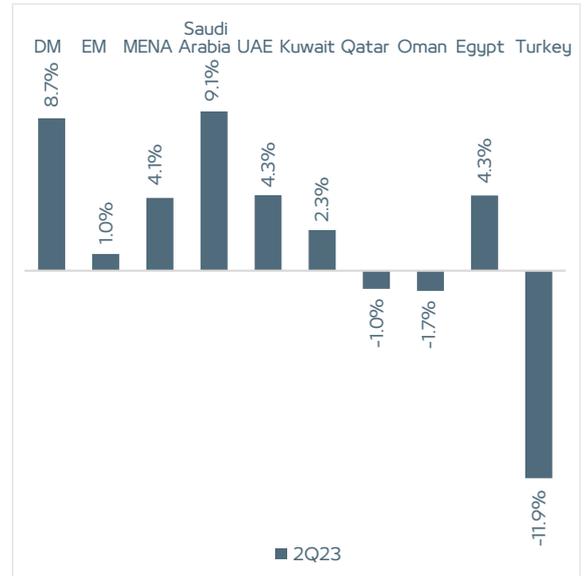
DM AND EMEQUITIES

DM equities have remained firm, as economic activity in the US has proven resilient for now. Inflation remains high in most DM economies, with only the USA running a positive real rate based on core inflation. It remains to be seen if the rest of DM will start cooling in line with the USA, without moving to positive or at least zero real rates. We expect equity market performance to evolve accordingly as well. EM equities are slightly cheap relative to history but are not likely to hold ground in absolute terms if DM equities start getting weaker. A generally conservative stance is appropriate for investors with a medium to long term horizon.

MENA EQUITIES

OPEC+ is being quite aggressive in cutting production, led by Saudi Arabia. Concerns around global economic growth have kept oil prices broadly in check, with any gains proving transitory. For now, the energy capacity addition story in Saudi Arabia, Qatar, and Abu Dhabi continues to play out. Being a dollar bull region, MENA overall should continue to outperform EM. Recent surveys indicate active fund managers remain underweight the core EM markets in the region (Saudi Arabia, Kuwait, Qatar, UAE) which in our opinion is a structural medium-term tailwind for the region. We continue to like bottom up domestic demand and infrastructure plays in our favored markets.

PERFORMANCE OF KEY MARKETS



*Figures in USD, Total Return basis, Actual returns.

ASSET CLASS VIEWS

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

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