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INVESTING PROFESSIONALLY IN THE MIDDLE EAST

Monthly Outlook – March 2020

1. Global and Regional Asset Allocation

Global Asset Allocation

Asset Class	Tactical View (3m horizon)
Equities	Creation of new epicenters for the novel coronavirus (Covid-19) globally, even as containment measures are being ramped up in scale, could create a very depressing scenario for global stock markets. Robust growth projections seem like a distant memory in this pandemic-like situation which is expected to drive investor sentiments and behavior in the near future, but a coordinated response from key policymakers could reflate equities in Q2.
Fixed Income	Every risk-off signal is on high alert due to increased signs of instability in the global growth outlook added by the significant risk of more extensive spreading of the Covid-19 virus worsening the supply shock situation in the market. Central banks across the world stand ready to take "appropriate action" by cutting rates aggressively to support market sentiments. We believe good economic data may struggle to support sentiments leading to central banks coming up with strong monetary easing measures.
Commodities	Oil consumption is expected to significantly contract globally, led by China in Q1 2020 due to the Covid-19 outbreak. The containment measures undertaken by the authorities have been unable to avoid the "communal spreading" of the virus globally which will lead to a further deterioration of demand. OPEC+ meeting will be an important global event watched by investors to gage the measures taken by the alliance countries to cut supply. Although, Russia's resistance for supply curtailments will be crucial for the prices. Gold is expected to continue to be a preferred asset on the back of its safe haven status and the diversification benefits derived amidst an uncertain global environment.

Mashreq Capital View: Positive Neutral Negative

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Regional Asset Allocation

Region / Country	Fixed Income	Equities	FX
 **GCC**	Increased volatility in oil prices will impact oil-exporting economies. Cheap valuations relative to similar rated EM peers.	We are very selective in Saudi due to high political risk coupled with expansive valuation for Saudi stocks. The UAE is our preferred market.	De-pegging risk has been averted, albeit remains a risk selectively (for example Oman).
 **North Africa**	Improving fundamentals provide value in long-dated sovereign and quasi bonds for carry positions while global risk-off could lead to exacerbated outflows.	Sluggish private sector activity will curb earnings growth momentum. We are very selective in Egypt.	EGP to remain relatively strong.
 **Turkey**	Limited ability for central bank to ease policy rates which is expected to drive local yields. Rising inflation and geopolitical risks remain a key concern.	The market will continue to be volatile giving the high tension between US and Iran	We expect continued volatility with the lira in 1Q20.

Mashreq Capital View: Positive Neutral Negative

2. Global Portfolios

Global Assets – Markets Go Viral!

Overview

DM Equities (-8.45%)

Stock markets began the month by shrugging off concerns over the Covid-19 outbreak with the S&P 500 making new all-time highs as the markets believed that the virus would be contained within China. By the end of the month we saw the sharpest decline in history as the virus spread across to the US and Europe showcasing limited signs of abatement globally.

Outlook: Negative

Global equity markets still have room for further downside in the short term due to the negative sentiments in the market caused by the increased uncertainty in the global growth outlook. Companies are expected to take a hit in their earnings due to the now pandemic-like situation in the world which will drive investor behavior. We expect a rebound once we view a coordinated action by policymakers in the world.

EM Equities (-5.27%)

The spread of Covid-19 and its potential spill over into 2Q20 caused concerns over EM growth resulting in a market sell-off during the month. Although EM outperformed DM markets, cyclical sectors and banks were at the forefront of casualties. We expect negative macro data throughout 1H20.

Outlook: Neutral

EM asset valuations have further cheapened due to the recent sell-off but still we maintain our stance to be cautious as the Covid-19 uncertainty is likely to cap EM risk markets in the short term. Growth downgrades for EM economies may need further revisions as more incoming data gets processed. Although, it has stayed resilient so far the markets could be on edge and very sensitive to negative headlines.

DM Fixed Income (+0.67%)

Economic data across regions continued to show signs of improvement, but that did little to support market sentiments as the Covid-19 contagion continued to dominate headlines, leading investors to dump risk assets in favor of safe havens. US 10 year and 30 year treasury yields touched their new all-time lows.

Outlook: Neutral

The direct impact on the US from weaker global growth stays modest, although the significant risk in the event of a more extensive spreading of the virus could steepen the US curve further as markets are expecting aggressive easing measures by the Fed. Markets are pricing two-three rate cuts in 2020 whilst awaiting a central bank action.

EM Fixed Income (-0.97%)

EM bonds sold-off during the month on the back of the risk-off move, following the global breakout of Covid-19. Long duration, Investment Grade bonds supported the markets due to flight to quality while High Yield witnessed a massive sell-off amidst an uncertain growth outlook in EM. Lebanon, Argentina and Ecuador posted the most negative returns.

Outlook: Neutral

The economic impact of the virus outbreak globally is expected to lead to further downgrade revisions in EM growth. Central banks in the most severely affected countries specifically in Asia are not expected to wait for activity data to the reveal the true extent of the damage and take aggressive action in terms of stimulus measures to support the market sentiments and to avoid extensive damage.

\+ Positive Returns / – Negative Returns

Positive Neutral Negative

Source Morningstar: DM Equities = MSCI World Index; EM Equities = MSCI Emerging Markets Index; DM Fixed Income = Bloomberg Global Aggregate Index; EM Fixed Income = JP Morgan Emerging Market Bond Index. Overview figures are monthly, unhedged US dollar returns. Outlook forecasts are based on a 3-6 month timeframe.

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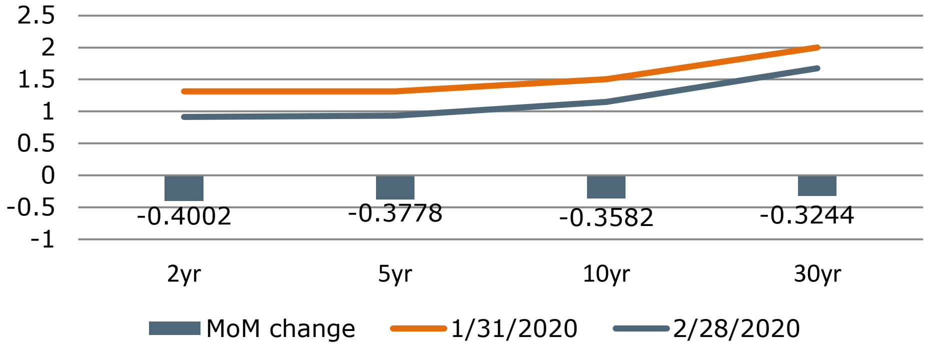
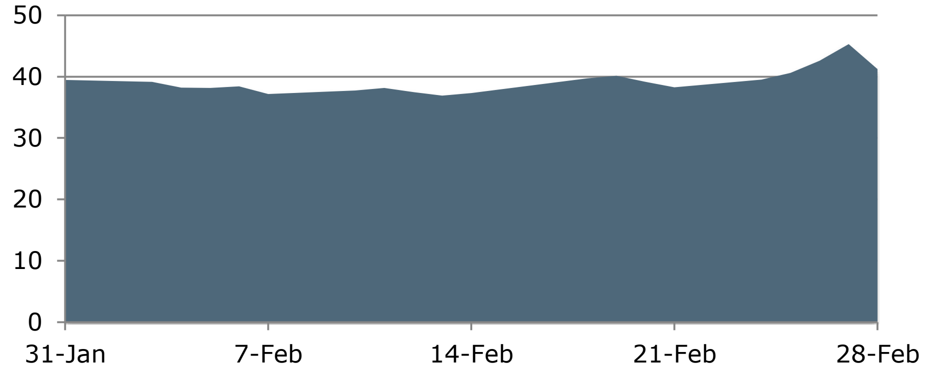
3. MENA Fixed Income

MENA Fixed Income - Markets

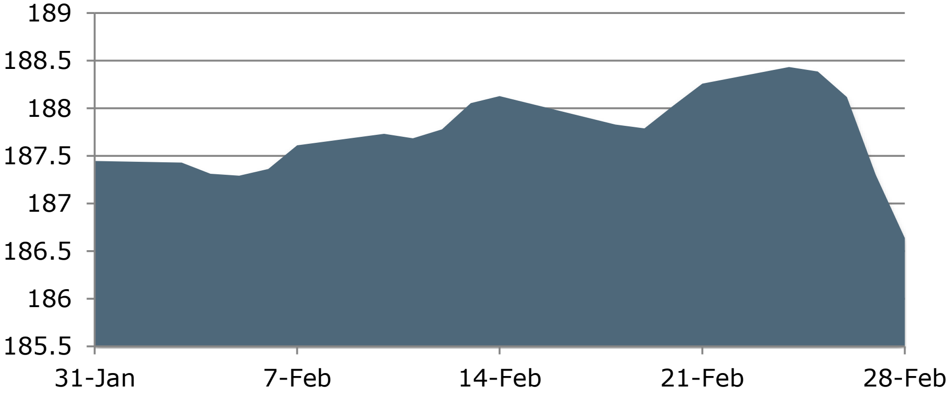
US Yield Curve



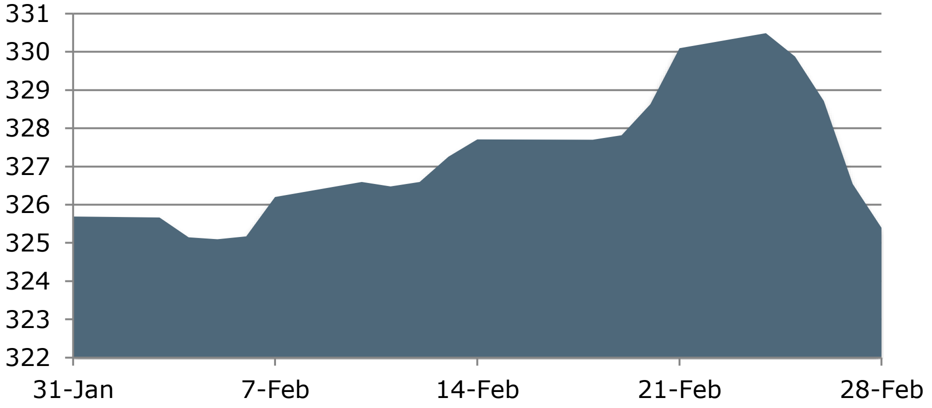
GCC spread over EM



JPM GCC Sukuk Total Return - JCADSUTR



JPM GCC Total Return - JCADGCTR



Sources: Mashreq Capital, Bloomberg

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EM Fixed Income – Monthly Commentary

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Overview

EMD ended the month with a negative performance as the Global EMBI was down by 0.97% which was primarily due its exposure in Argentina and Ecuador due to their debt, liquidity and geopolitical concerns. The Middle East Index fared slightly better losing only 0.86% with the main detractor being Lebanon.

We started the month with the markets shrugging off the mixed developments for the coronavirus outbreak. The positive news post China's announcement of tariff cuts and a potential cure for the virus led to a risk-on sentiments across the capital markets. The drag on the global economy was expected to be short-lived and growth was expected to rebound as soon as 2Q20. The optimism was very short-lived as the last week of the month saw the biggest correction in the markets since the Global Financial Crisis as the virus was giving no signs of containment and was spreading rapidly all over the world infecting more than 70 countries. Positive economic data from DM economies could not provide any support to the markets as risk sentiments deteriorated rapidly.

Increased uncertainty in the global economy capped risk sentiments and effectively increased pressure on central banks to take action as the markets priced in two-three rate cuts in the near future added by coordinated action by policymakers to provide support to the economy.

EM central banks cut interest rates in-line with market expectations. We saw rate cuts from Thailand, Brazil, Philippines, Mexico, Indonesia and Turkey amongst others.

Oil tumbled again in the month of February as risk aversion spread into commodities. The biggest headwinds came from concerns about the first decline in global oil demand since 2009, due to the economic disruptions caused by the Covid-19 outbreak, together with stalling negotiations between Russia and OPEC on the implementation of further supply cuts.

Outlook

EM growth is expected to take a hit due to the impact of Covid-19 which will cap risk markets in the near future. The largest economic impact is expected to be in 1Q20, while it can roll over to 2Q20 too as the virus is becoming a contagion and showing no signs of abatement. EM credit returns have stayed resilient so far and should remain so unless the coronavirus impact goes towards the more severe scenarios.

A more protracted outbreak and prolonged Chinese factory shutdowns in particular would pose further downside risks. For commodity exporters, this drag comes on top of potential negative spillovers from the US-China Phase One deal and raises further doubts about the feasibility of the deal and argues for more policy support.

Impact on Middle East growth from Covid-19 comes mostly primarily through two channels: direct exposure to China and lower oil prices which will be a double whammy for such economies.

Headlines on the severity of the virus contagion, OPEC+ responses to control supply, Brexit trade deal, and geopolitical developments in the Middle East and US elections are expected to constrain investor risk appetite and drive sentiments.

Our base-case scenario has changed following the recent developments and we expect that the Fed would take appropriate action and cut rates in their policy meeting in March followed by more in 2020 to support deteriorating sentiments. We expect this to usher EM economies (especially the high-yielding ones) to continue monetary policy easing this year. Rising global growth concerns and a disinflationary impulse has opened a window of opportunity for more fiscal and monetary easing. The pressure to ease will be greatest in EM Asia given that it is expected to suffer the largest growth impact. In terms of timing, central banks of the most severely affected countries are unlikely to wait for the hard activity data to reveal the true extent of the damage.

4. MENA Equities

MENA Sector Allocation

Sector	GCC	North Africa	Turkey
Banks	↓	→	→
Insurance	→	→	→
Consumer Goods	→	→	↓
Real Estate	↓	↓	↓
Health Care	↑	↑	→
Telecommunications	↑	↑	↑
Materials	↓	↓	↓
Utilities	↑	↑	↑

- **GCC Banks:** Falling interest rates to negatively impact profitability hence we remain negative.
- **GCC Consumer Goods:** The decline in Saudi consumer spending has reached its bottom and a decline in expat exodus should help turnaround hence we remain neutral.
- **Real Estate:** Falling interest rates will positively benefit interest rates hence we remain negative. In Egypt, we are negative for Real Estate as we believe purchasing power remains low.
- **Telecommunications:** The high leveraged sector should positively benefit from interest rate cuts leading us to remain positive.
- **Materials:** Negatively impacted from weaker demand due to US-China trade war hence we remain negative.
- **Utilities:** Resilient to global volatility due to its defensive business nature resulting positively hence we remain positive.

Mashreq Capital View: ↑ Positive → Neutral ↓ Negative

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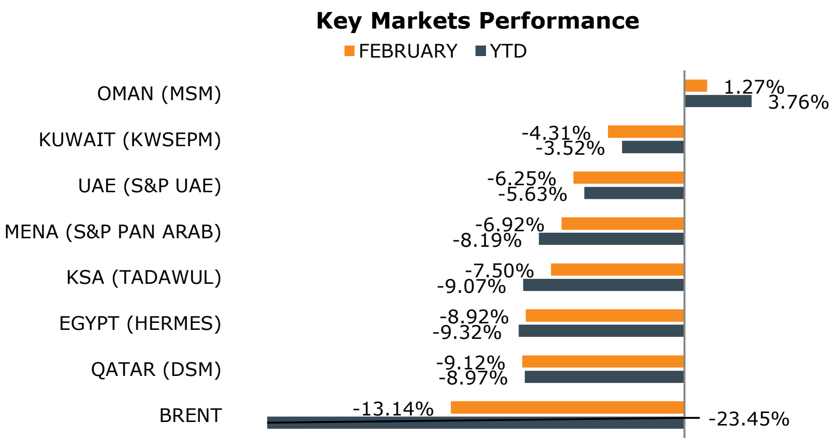
MENA Equities – Monthly Commentary

Overview

Global equity markets continued to shake because of coronavirus spreading from China to the rest of the world. The equity markets witnessed a sell-off towards the end of month due to the difficulty of containment of the virus, S&P 500 plunged by 8.41% and Emerging markets fell by 5.1%.

Brent fell by 13.14% in February dragged down by a lackluster demand from China; for which MENA markets responded very negatively and finished the month with a loss of 6.92%.

The news headlines were mostly negative throughout the month and impacted sentiment, with some panic selling witnessed towards the end of the month. Business activity shrank globally and MENA has not been immune to that. PMI numbers in Saudi Arabia, UAE and Egypt showed contraction in business activity.



Outlook

We think that the global economy will face very tough times in the next couple of quarters; as the numbers coming out of China and Europe should show severe weakness, and we might see a contraction in the global GDP for this time period.

We also believe that the policy makers will provide all required support to mitigate the adverse consequences of the crisis, and will protect the global financial system from having the same crash witnessed in 2008.

As a matter of fact, we believe that as long as the financial institutions do not crash; we anticipate that recovery should gradually happen in the second half of the year. Henceforth, and in spite of the fact that the current risk is very high, we believe that it is irrational to participate in the sell-offs.

A very close monitoring of work resumption rates in China should provide us with a clear idea about capacity utilization and hence the recovery of their oil demand.

The current oil price is very negative for GCC countries and should increase the budget deficit and by turn also the credit spread. Given, the higher breakeven oil price for most GCC countries, we think the current price war will not last for long and all parties should sit again and find a common ground.

Within MENA, we think the GCC countries will be able to weather the storm given their rich foreign reserve, however we think the risk is higher for the highly leveraged countries like Egypt, and UAE, for which we have changed our stance from overweight to underweight.

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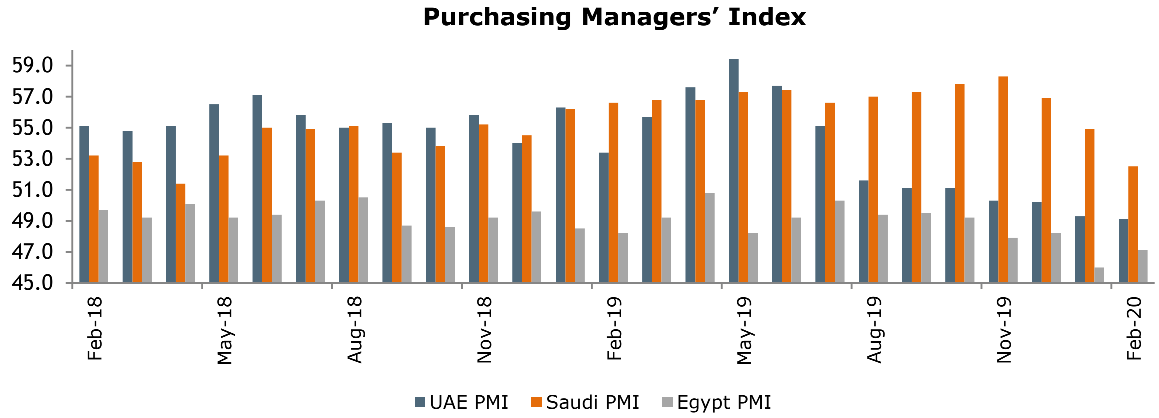
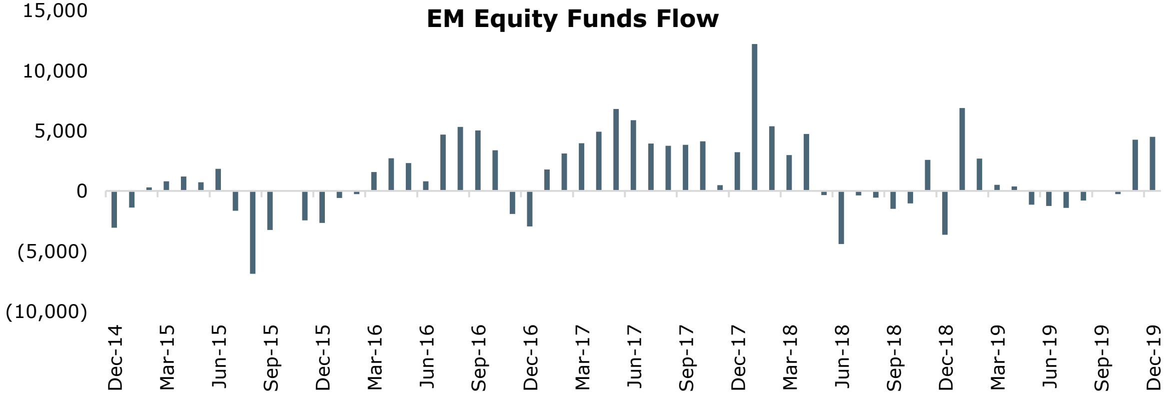
MENA Equities – PMI and Fund Flows



Saudi Arabia's PMI printed at 52.5, down 2.4pts m-o-m. The fall was the third successive m-o-m decline, and the largest drop since January 2018.

The headline UAE reading fell by a more modest 0.2pts m-o-m, but at 49.1 stood 4.4pts below the 12m average and was under the 50pt breakeven level for the second month in a row.

The headline PMI in Egypt was below 50, but at 47.1 was up 1.1pts on the January print. The data show output rising 2.5pts m-o-m and new orders gaining but from a very low base.



Last available data as reported by Morningstar revealed EM equity flows were $4.5bn. According to IIF, Equity flows to EM stood at -$0.7bn.

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MENA Equities – Chart of the Month

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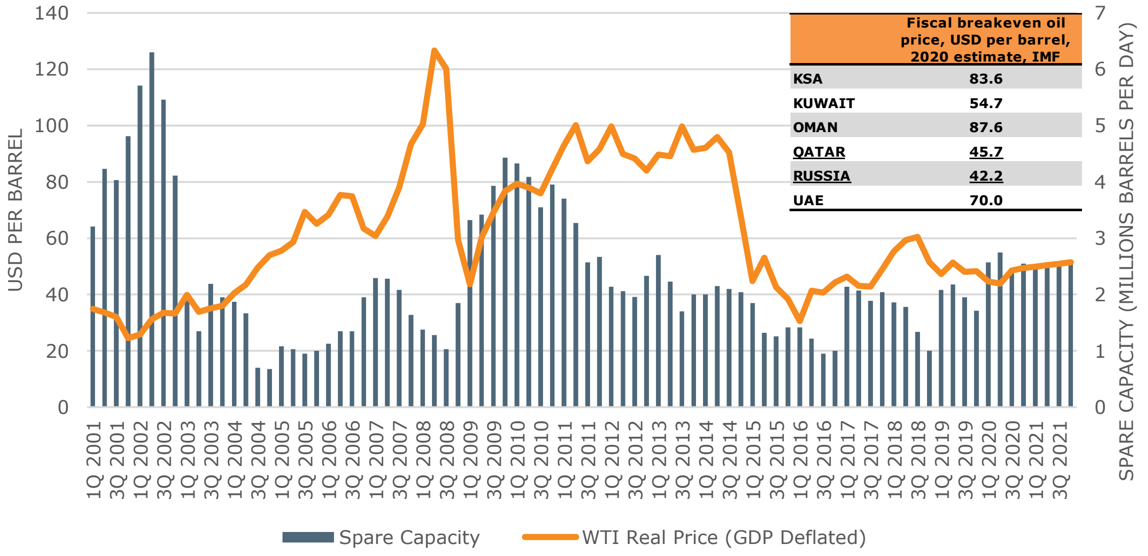
OPEC SPARE CAPACITY AND WTI PRICES



	Fiscal breakeven oil price, USD per barrel, 2020 estimate, IMF
KSA	83.6
KUWAIT	54.7
OMAN	87.6
QATAR	45.7
RUSSIA	42.2
UAE	70.0

Although OPEC countries and mainly Saudi Arabia have the spare capacity to ramp up production in the midst of the price war, a low price environment is not sustainable for Saudi Arabia as much as it is for Russia.

Source: EIA, IMF, Mashreq Capital

The oil price war – thoughts

According to the EIA, Saudi Arabia has usually kept more than 1.5-2 million barrels per day of spare capacity on hand for market management.
According to the Russian government, Russia holds spare capacity of 500,000 barrels per day.
In the current oil price war, and at least from a theoretical standpoint, Saudi Arabia has more additional spare capacity to ramp up production.

Nonetheless, a very high oil fiscal breakeven point for Saudi Arabia at USD 83.6 per barrel shows that the price war will not be sustainable for Saudi Arabia as much as it is for Russia (USD 42.4 per barrel).

Inevitably and should the price war be sustained, oil prices should dip back to US shale drillers cash costs.

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