

Monthly Outlook - February 2017

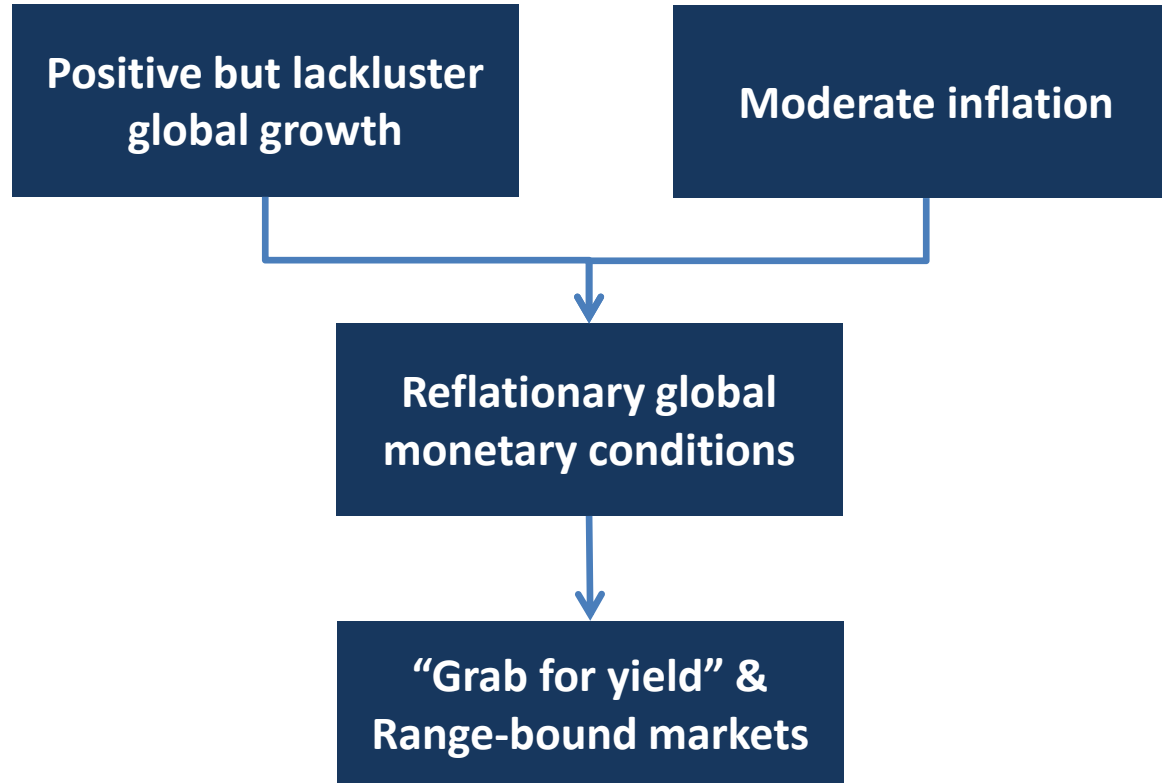


mashreq capital  المشرق كابيتال
Investing Professionally in the Middle East

8 February 2017







Overview

Global Investment Themes



- US only major economy close to full capacity. Divergence in cycle pushes upward pressure on USD, a reason for the Fed to tighten gradually
- Challenging outlook for the oil-importing countries which are exposed to a rising USD




Global Asset Allocation













Asset Class	Tactical View (3m horizon):	End-2017 Horizon:
Equities	 Expectations about US and global growth have probably become too optimistic and a mild correction is overdue	 We expect equities in general to deliver decent returns in 2017. Easy monetary policy and relatively sound fundamentals mean that selloffs in risky assets are likely to be limited and crises country-specific rather than global
Fixed Income	 The rebound since end-December has been strong. January has delivered total returns that we expected to materialize over a longer period. We take some profits with the plan to add on any weakness	 We expect US yields to increase broadly in line with forwards in 2017. Spreads to Treasuries should decline moderately as investors look for yield
Commodities	 Commodity prices appear set to move sideways since the main factors are well known and in the price	 We expect decent global growth to be favorable for commodities in general, but prices already reflect this

Regional Asset Allocation

Expected return February-December 2017:

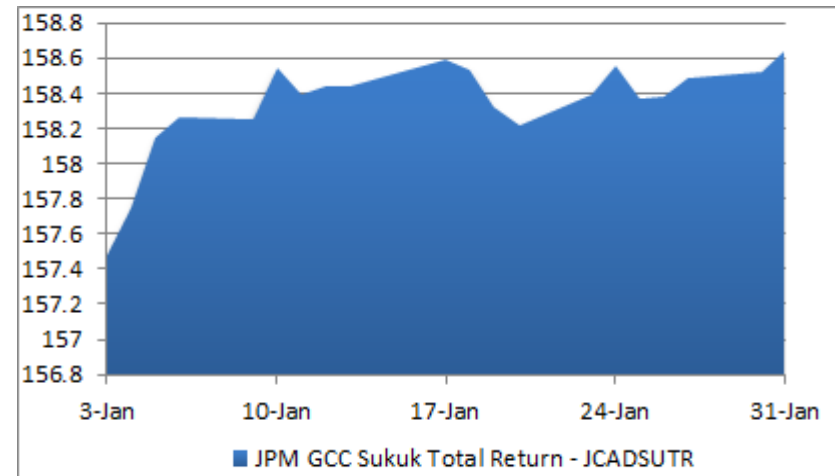
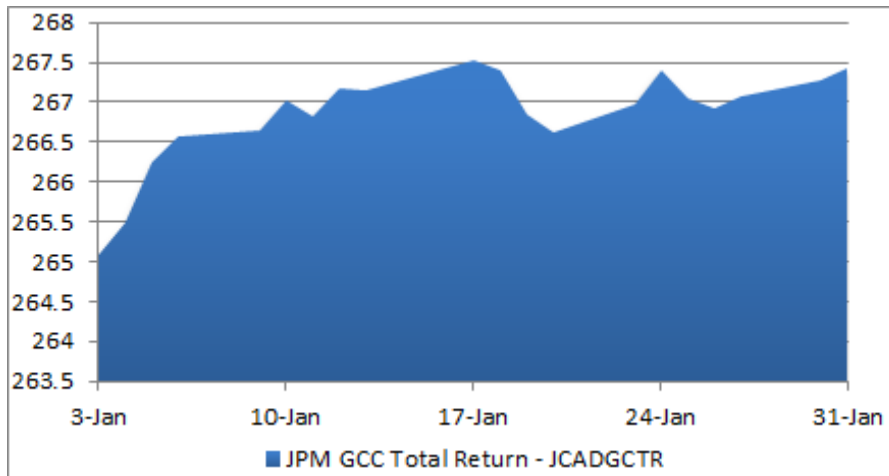
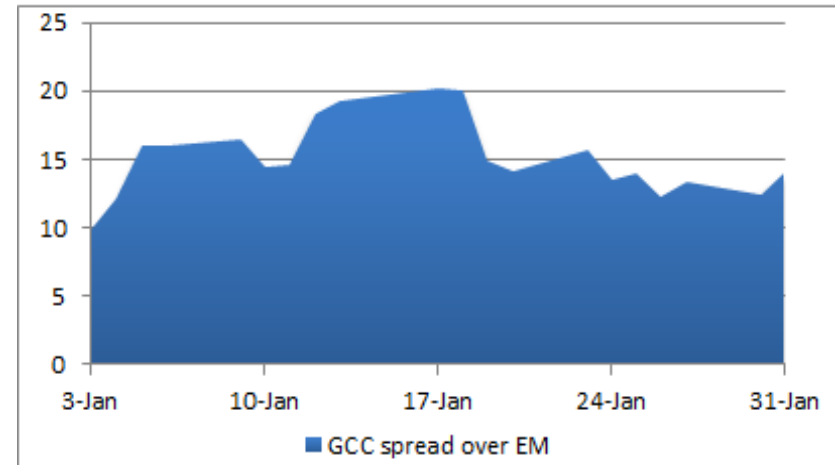
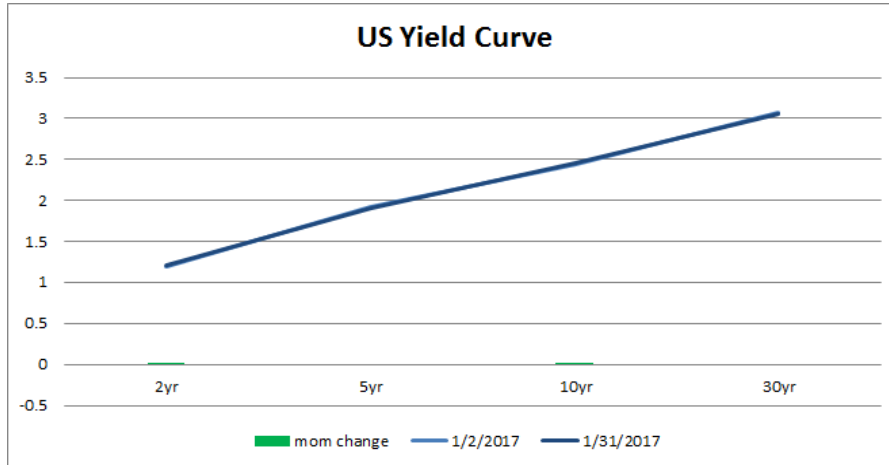
- Equities: 10% for the S&P MENA (7% earnings, 3% PE ratio)
- Bonds: 2% (Middle East Investment Grade) to 5% (Middle East High Yield)

 positive  neutral  negative

Region / Country	Credit	Equities	Currency
GCC	 Potential to tighten further on attractive absolute yields within a stable oil environment	 Qatar & UAE to outperform rest of GCC	 Speculation on de-pegging unwarranted
North Africa	 Rebalancing opportunity into higher yielding less US treasury sensitive bonds	 Egypt to underperform	 EGP to strengthen from portfolio inflows
Turkey	 Challenging political situation will cap potential for spread tightening but absolute yield levels should attract demand	 Sensitive to US hikes & political risks	 Carry trade to pressure currency
India & SE Asia	 No particular opportunity currently		

Fixed Income

Fixed Income - Markets



Source: Bloomberg

Fixed Income - Monthly Comment

Where we stand

While many market participants were still debating the broader implications of the US elections and the potential harm to our fixed income market, the market was able to rally. We were always of the opinion that the November weakness was overdone and stayed positioned for a recovery and therefore managed to fully benefit from the strong markets.

The positive market momentum allowed for an increase in primary issuance. Particularly EM issuers found eager buyers. Regionally we have seen Gulf International Bank, ICD and of course the long anticipated Egypt issuance, with Bank of Sharjah, Dubai Islamic Bank, Equate and Tunisia issuing next.

Looking back the month has been dominated by news surrounding Trump and his appointment of staff. Only towards the turn of the month we had some interesting data points for US 4Q GDP, FOMC and employment data, which all pointed towards a continuation of a gradual improvement which was appreciated by risk markets.

Outlook

Within the next 30 days we have Janet Yellen speaking to Congress, FED minutes and PCE numbers for inflation. While this could taper the bond rally, one also has to keep in mind that there are plenty of events lined up which could cause some risk off, like the debt ceiling, elections in Europe or US politics.

Our strategy for 2017 will more dynamic in order to avoid headwinds that might come from rising yields as well as to take advantage of likely overreactions that the market will experience throughout the year.

In our base case we continue to see a supportive environment for fixed income especially after the market adjustment. We think that 2017 will see positive total returns with the chance to create decent alpha along the way.

Equities

Regional Equity Strategy

Sector	GCC	North Africa	Turkey
Banks	→	↗	↘
Consumer Goods	→	→	↘
Real Estate	↗	↗	↘
Telecommunications	↘	↘	↗
Materials	→	→	↗
Utilities	↗	→	↗

↗ positive → neutral ↘ negative

Regional Equities - Monthly Comment

Where we stand

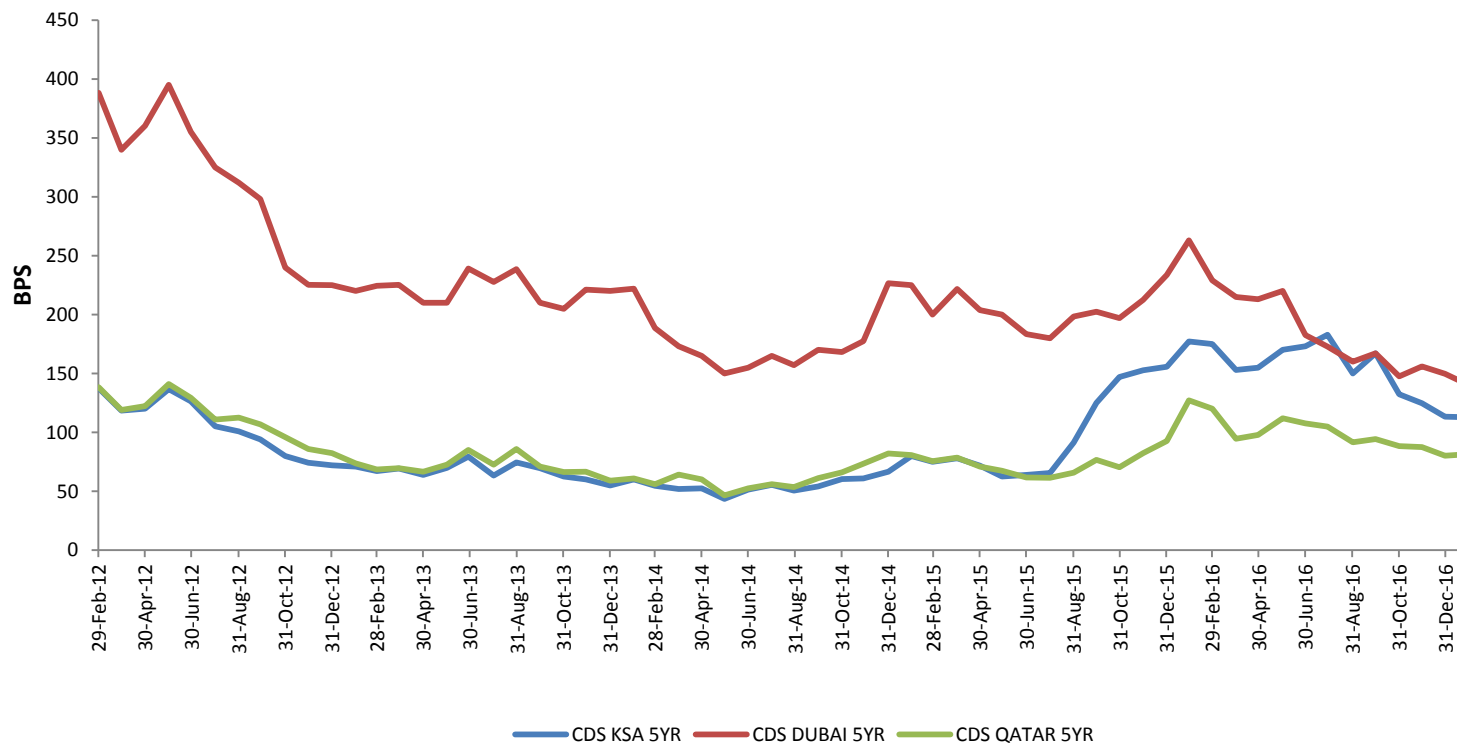
- While MENA markets finished up 1%, they were up as much as 3% during the month before profit-taking led the market down to finish the month.
- Saudi wrapped up earnings seasons in January with aggregate earnings dropping 13% YoY led by consumers and building materials as a result of negative consumer sentiment and projects that have been suspended. Petrochemicals and telecommunications were the only sectors that reported positive numbers. Despite negative fundamentals, the index finished down just over 1% being down as much as 5% during the month.
- Egypt had yet another strong month up almost 6% as the index was encouraged by Egypt's Eurobond, which was finally issued with success. The issue was oversubscribed by 7-8x, which led the government to increase the size from the planned USD 2.5bn to USD 4.5bn.
- Qatar had a solid month up 1.5% as MENA investors position themselves in the market for the annual dividends. Additionally, MSCI EM flows provided support to the market.
- While ADX was flat, DFM finished up strongly up 3.3% as led by Emaar and DIB, foreign favorites as the economic situation improves and markets begin to realize the safe haven status of the UAE relative to peers.
- The Kuwait market cap weighted index finished up over 12% being the best performing market in the world as it will have a large weight in the MSCI Frontier Market Index as Pakistan has been upgraded to Emerging market status.

Outlook

- As it relates to Saudi, while the headline economic data is improving, liquidity is improving, FX reserves burn is easing, the market has priced a large part of this into the market. As a result, we don't see the market moving up till 1Q17 earnings come in - unless we see a strong increase oil prices, which should see petrochemicals lead the rally.
- Pressure on EGP has fully abated in January and we believe this will be the case for the coming months. The Eurobond issue in addition to the coming second IMF tranche will offer a sentiment boost to the currency as reserves have reached USD 27bn. We believe economic data will continue to be poor in the short-term, which will limit market gains, however, we remain bullish over the medium to long-term.
- Qatar's phase 2 FTSE upgrade will bring in USD 390mn in passive flows. We believe strong oil prices and dividend season will result in a strong performing market in the first quarter of 2017.
- We continue to believe UAE markets are well positioned compared to other markets as the economy and financial markets offer relative stability and investors are not appropriately rewarding the market for this characteristic. We've seen banks come to market which will aid liquidity as well as a strong increase in real estate transaction in December and January.
- We believe the Kuwait market may have more room to go, however, the fundamentals have yet to change and we believe the rally will be limited. We will, nevertheless, be looking at this market selectively and the investment manager may choose to buy shares in companies should they be fundamentally attractive.

Benign Environment on the Sovereign Front

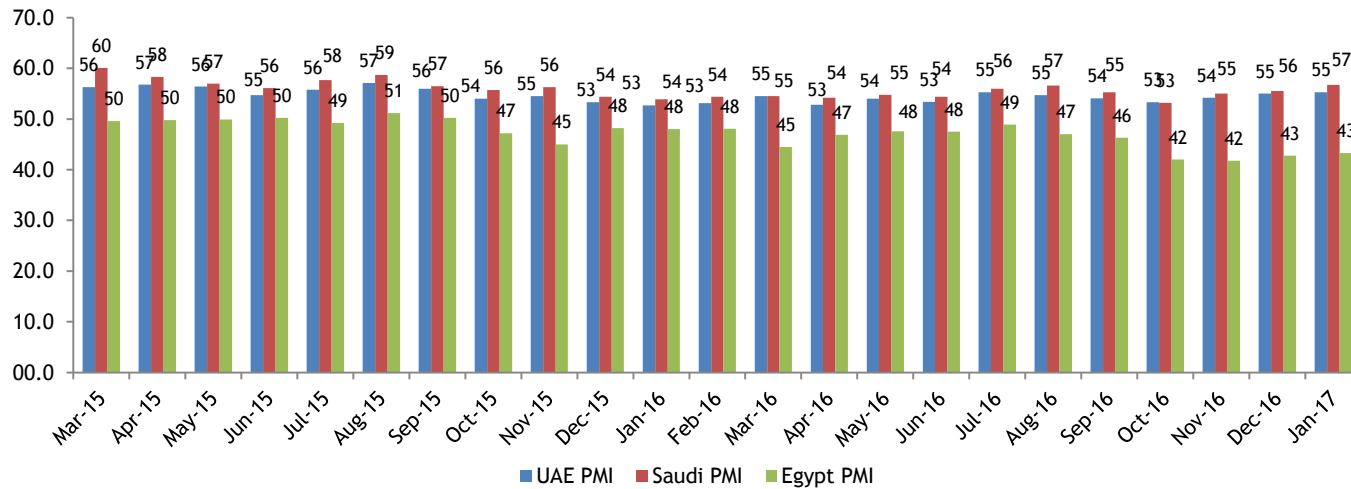
Credit Default Swaps – KSA, Dubai & Qatar



Drop in Credit Default Swaps across the GCC reflects a declining risk premium in financial markets following KSA's bond offering in October as well as rally in oil prices

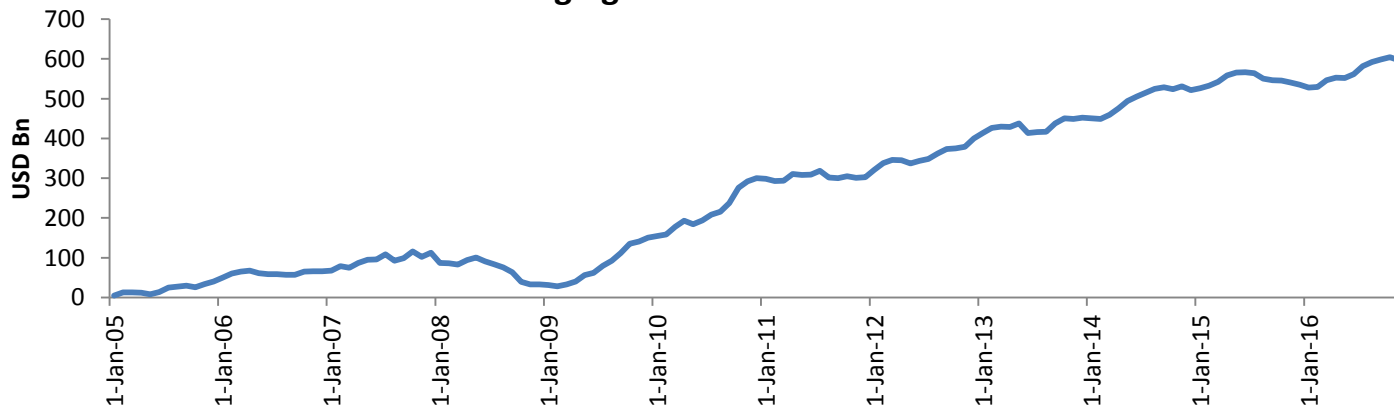
Fundamentals and Sentiment Are Mildly Supportive

Purchasing Managers Index



PMIs have shown improvement MoM across the board in January for KSA, UAE and Egypt with a big jump coming from KSA on the back of new orders. The increase in Egypt, while an improvement, was tepid.

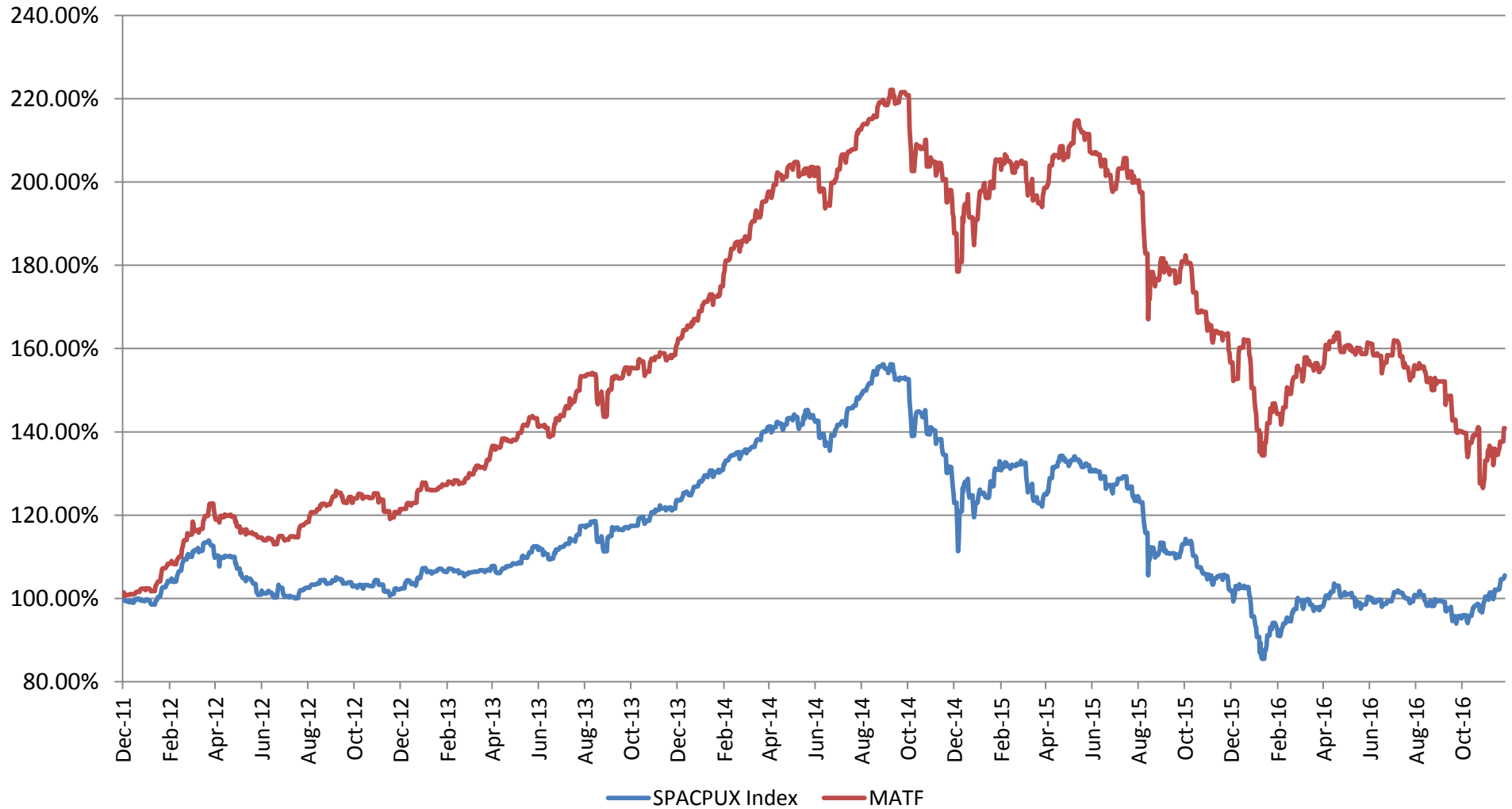
Emerging Markets Portfolio Flows



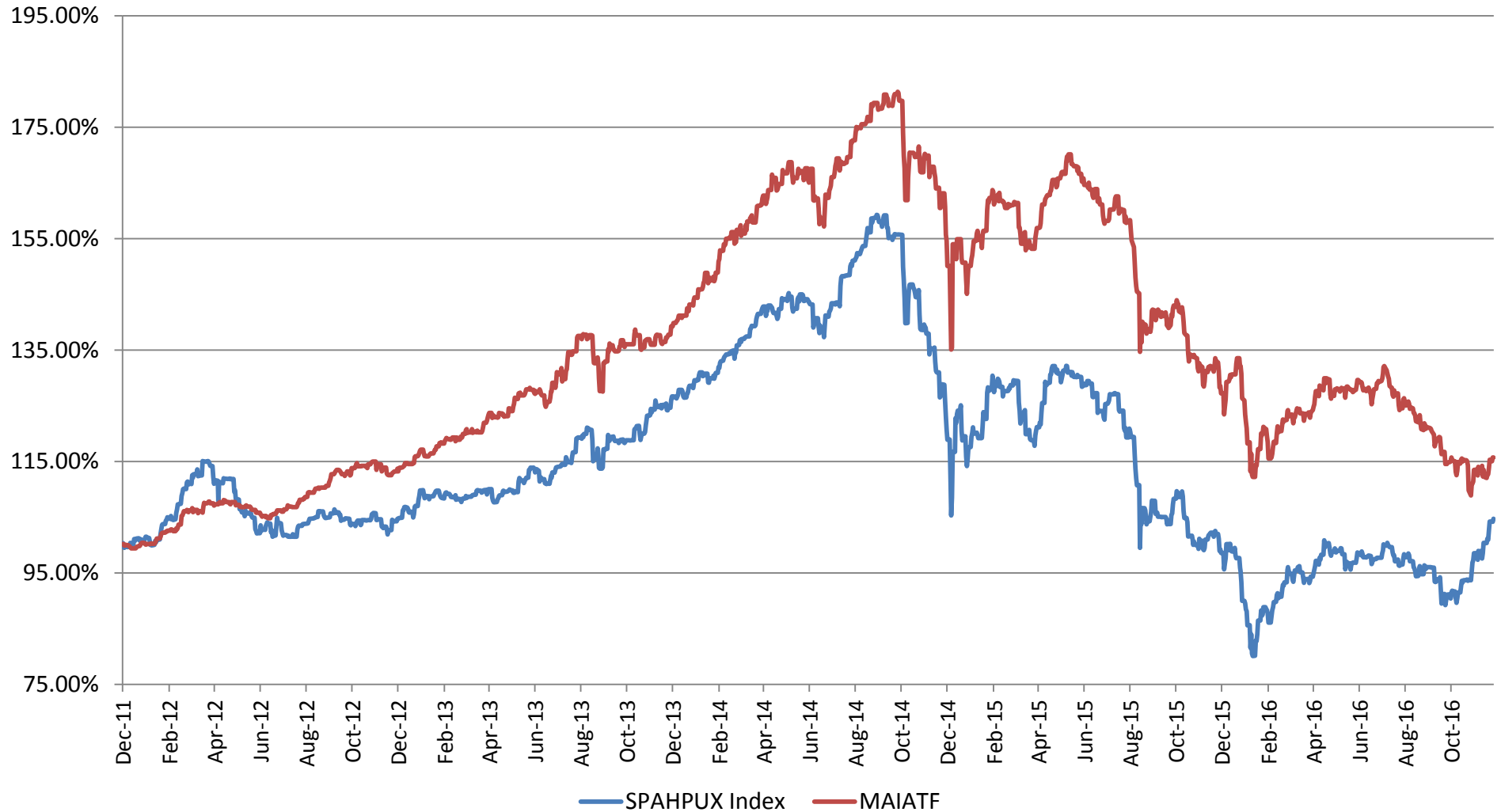
Emerging Market portfolio flows have been positive throughout 2016, up by USD 60.0 bn but some outflows were seen in the last 2 months of the year.

Fund Performance

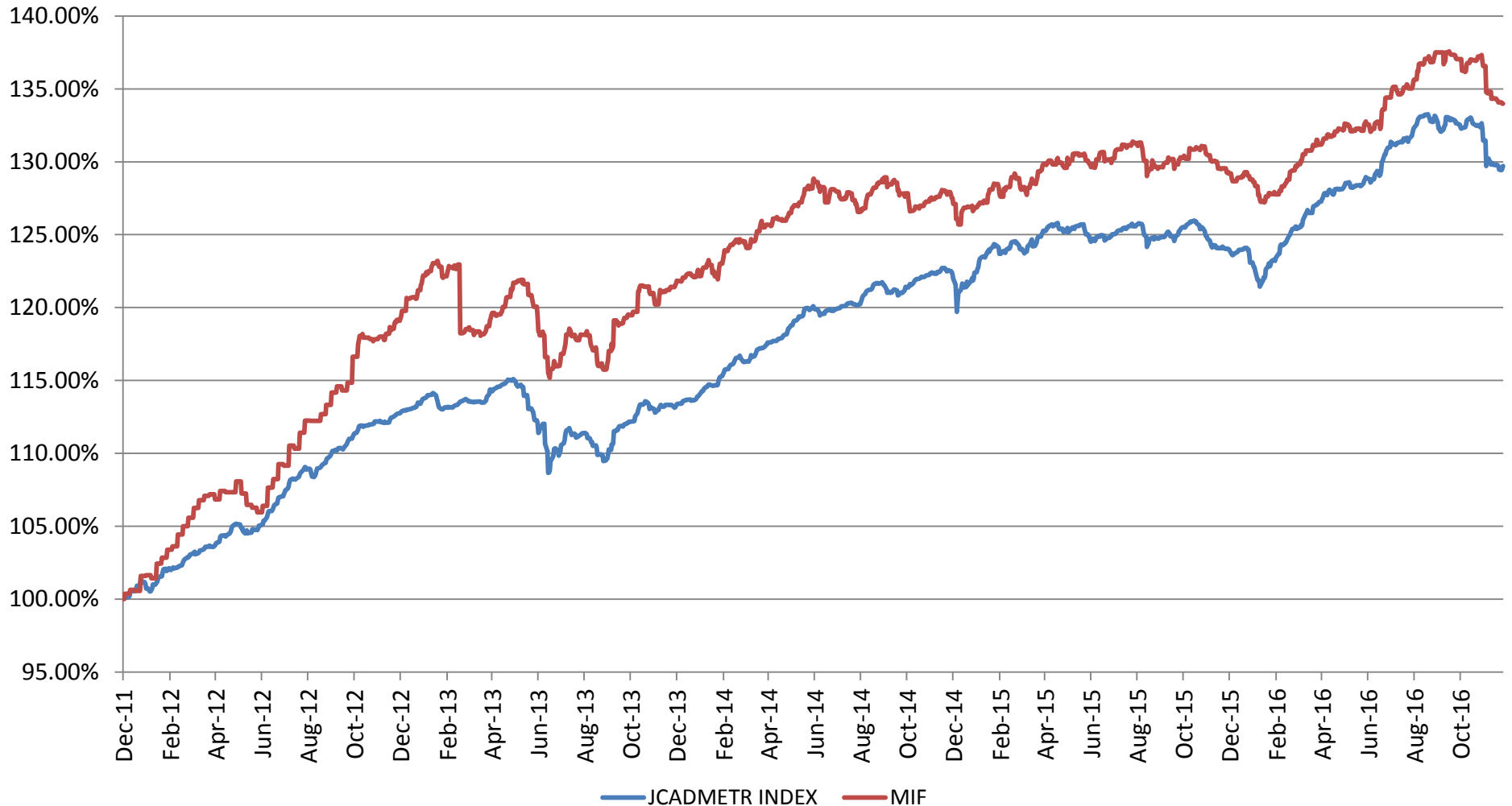
Makaseb Arab Tigers Fund vs. Index



Mashreq Al Islami Arab Tigers Fund vs. Index



Makaseb Income Fund vs. Index



Mashreq Al Islami Income Fund 5 yr Cumulative Performance



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