




## Monthly Outlook: January 2018















mashreq capital  المشرق كابيتال  
Investing Professionally in the Middle East

## Global Asset Allocation

Asset Class	Tactical View (3m horizon):
Equities	 <p>The fundamental backdrop for equities remains solid given the still-decent growth numbers coming out of the US, Europe and Asia. In contrast, valuations are unattractive following recent record stock market highs, low volatility and lofty price-to-earnings ratios. Therefore; overall a neutral stance to equities seems appropriate.</p>
Fixed Income	 <p>We expect the yield curve to continue bear flatten over time, i.e. short term rates to increase faster than long term rates on the back of a continuation of good momentum in the US economy which would usher the Fed to proceed with rate hikes while at the same time inflation is only slowly creeping up.</p>
Commodities	 <p>Oil is still in center stage with OPEC and non OPEC countries maintaining production cuts. Brent closed the year at \$ 66.87/barrel on the back of potential supply disruption from Iran. Our base case is that this is a temporary spike which will not persist and oil will eventually drop to our range of \$55-60 range, with potential for upside surprise.</p>

## Regional Asset Allocation

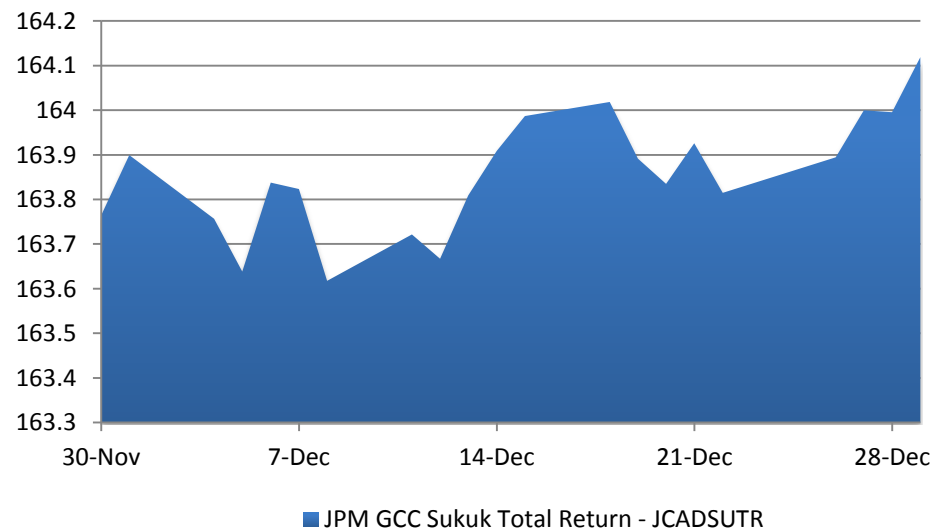
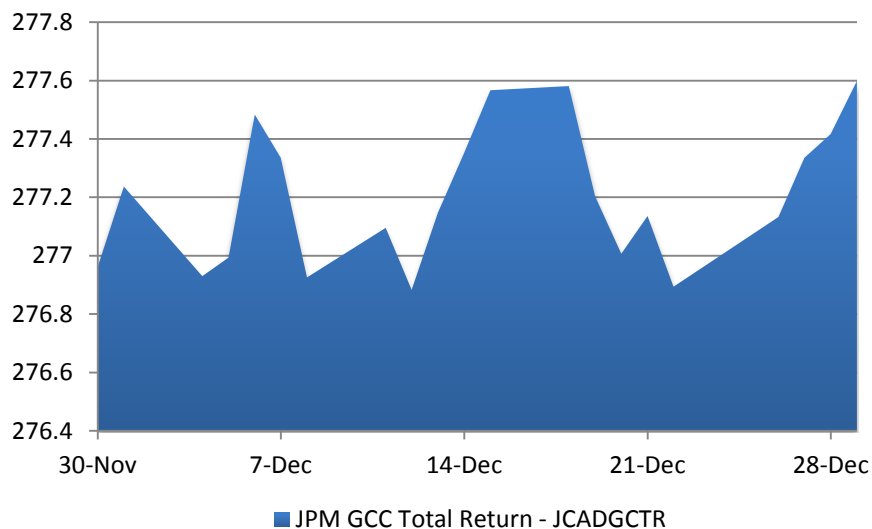
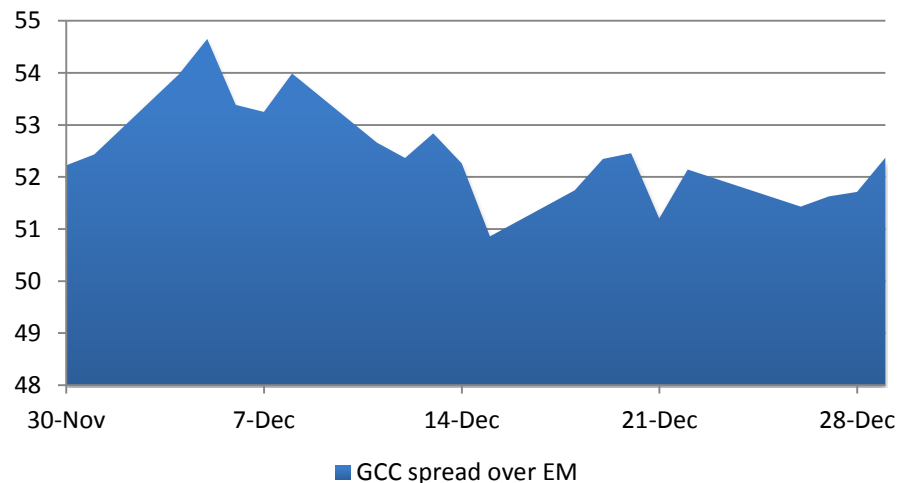
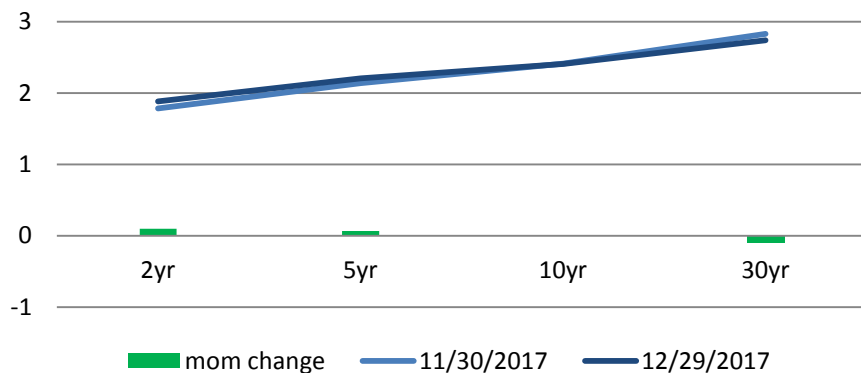
Region / Country	Credit	Equities	Currency
GCC	 Tight spreads supported by stability in oil prices and rallying UST has resulted in overall low yield levels. Still looks attractive versus other EM markets	 Expansionary budget announcements & strong oil prices should result in stable to up markets	 De-pegging risk has been selectively revived (example: Bahrain and Oman)
North Africa	 Tight spreads continues to provide some value for carry positions and varying degrees of improving economies	 Seasonally speaking, Egypt tends to underperform near the end of January as well as for the remaining Q1	 EGP to remain in a band
Turkey	 Tight spreads continues to provide some value for carry positions, prefer corps over sovereign	 Sensitive to US hikes & political risks	 Carry trade, outflows and inflation continue to pressure currency

 positive
  neutral
  negative

## Fixed Income

## Fixed Income - Markets

### US Yield Curve



Sources: Mashreq Capital, Bloomberg January 2018

## Fixed Income - Monthly Comment

### Where we stand

We have seen the UST curve flattening month on month (this is further magnified if we look at the UST curve from a year on year perspective). The amendment to the debt ceiling is being delayed and a decision is only expected on January 19<sup>th</sup> 2018 in order to avoid a government shutdown as the US Government hits its borrowing limit again. Another rate hike has come and gone without much of a blip in the market.

The highlight of December was the downgrade of Bahrain and Oman sovereigns which brought a wave of downgrades to the quasi sovereign complex (Bahrain: Mumtalakat, Oman: Mazoon, Oman Grid and Bank Muscat). We have also started positioning for next year by extending duration as we see the belly of the curve as the most stable in the coming months.

**In 2017 the Makaseb Income Fund is the best performing fund against its peers while Mashreq Al-Islami Income Fund is the second best performer amongst its peers. Both remain at the top for 3 year and 5 year performance comparisons as well.**

### Outlook

We expect a similar pattern of bear flattening during this year aided by: a) The Fed rolling down short term maturities and b) low inflation which reduces term premium. However, this may be mitigated if inflation filters through, getting closer to the Fed's long term target of 2%.



















We think that the US tax bill may potentially spike inflation, however, we expect this to be short lived if it happens. Majority of the tax benefits are expected to be realized in 2018 for corporates and we do not see this trickling down to the middle class via an increase in wage growth. Also a higher budget deficit on the back of lower tax collection and an increase in spending (via the infrastructure bill) could amount to an increase across the UST yield curve.




The greatest known unknown for bond spreads is the ETF flows which could potentially swing the market either way, which we will be keeping a very close eye on.

We tactically favor medium to long duration high yield which is a change from our previous short duration strategy towards the end of 2017.

# 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

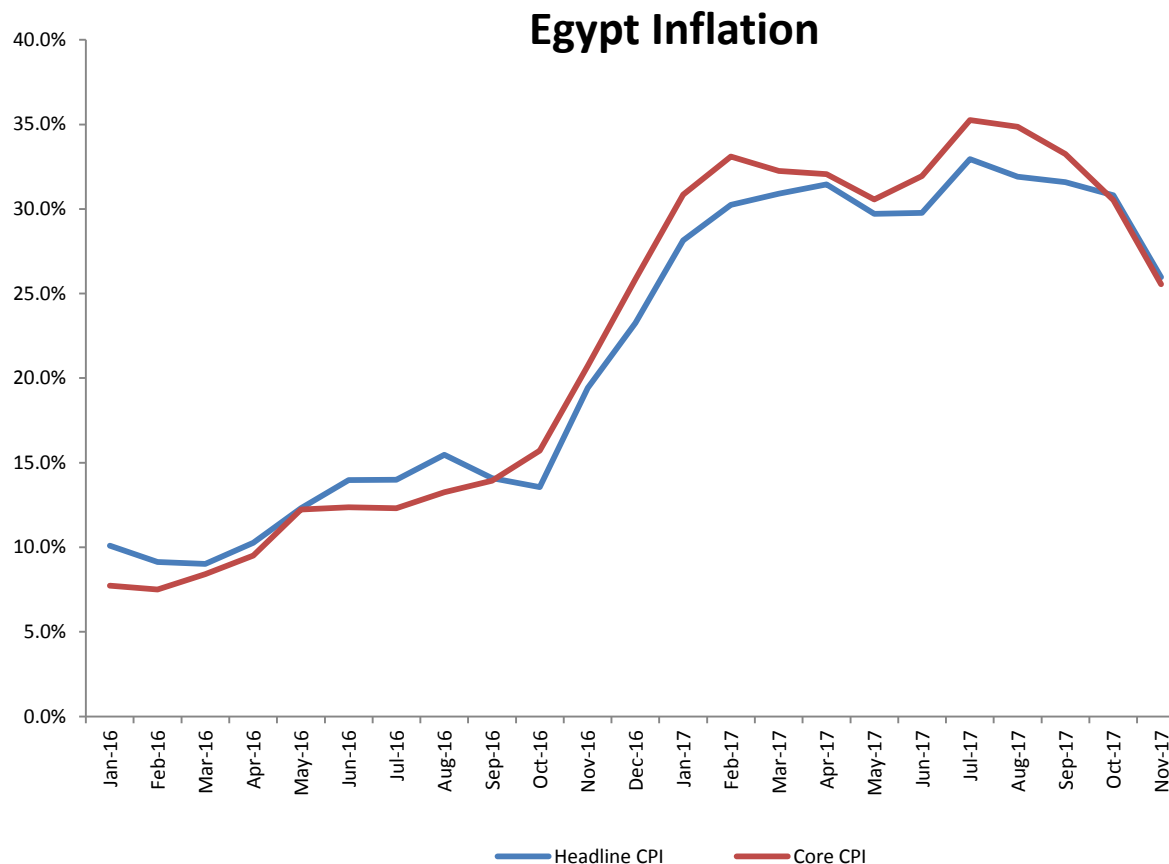
- MENA markets finished up 2.8% in December led by Qatar, Saudi and Egypt. Oil prices continued their upward ascent remaining above USD 60/bbl finishing up 21% for the year. MENA markets finished the year up 0.8% underperforming Emerging Markets, which finished up 34.4%.
- In Saudi, the market rose by 3.7% in the month led by the non-oil sector. Banks continued to catch a bid as the Fed hiked rates again while cement names saw a big rally on the anticipation of a positive budget announcement, which came through more or less. The market finished the year flat just up 0.3%.
- Egyptian shares (Hermes Stock Market Index) were up 2.9% for the month (up 2.5% in USD terms). The market continues to price in an easier monetary policy, lower inflation and a strengthening economy. The market finished 2017 up 31.9% YTD (34.6% in USD terms).
- Qatar also rose strongly up 9.6% in December as Central Bank data showed a big up tick in public sector deposits after a couple months of no 'liquidity injections'. Also, investors are positioning themselves for FY17 dividends. The market finished the year down 18.3% YTD.
- Despite Emaar Properties dropping close to 10% in December, as a result of announced planned dividends (proceeds from their Emaar Developments spin-off) underwhelming the market, UAE markets rose 0.4%. The market is down 1.5% for 2017.
- The Kuwait market cap weighted index finished up 0.7%. The market is up 5.6% YTD.

### Outlook

- In Saudi, the market will most likely be awaiting data on a number of Saudi's recent initiatives. Firstly, how will the citizens account negate impact of higher fuel and electricity prices. Additionally, how soon will we see capex spending filtering through the economy as outlined in the 2018 budget, which was an expansionary budget.
- In Egypt, after a strong finish to the end of the year we're expecting a correction, which will present a good buying opportunity as inflation decelerates and the probability of the CBE cutting interest rates increase.
- Qatar could continue their December gains, however, unless a deal is struck or if the government pumps liquidity into the banking system (as seen in November), volatility will reign supreme and the market will underperform.
- With oil prices above USD 60/bbl and Expo 2020 investments beginning, we expect UAE markets to perform well. We think the recent listing of Emaar Developments and ADNOC Distribution increases the market depth and hence will attract more inflows.
- We believe the Kuwaiti market may have more room to go boosted by inclusion in FTSE EM, which will add USD 750Mn inflows into the market, as well as a possible MSCI EM watch list addition in June 2018.
- MENA equities are trading at cheap multiples of 12.1x 2018 P/E compared to its five years average of 13x. We think corporate earnings will pick up in 2018 as the recession, which hit GCC, is coming to an end. Therefore, we are advising our clients to position themselves for a good capital gains over the course of the next two years. Having said that, overall, due to regional politics becoming increasingly unstable, the risk premium in the region has increased. Thus, we remain cautious on regional equities in the near term over the next 3 to 6 months.

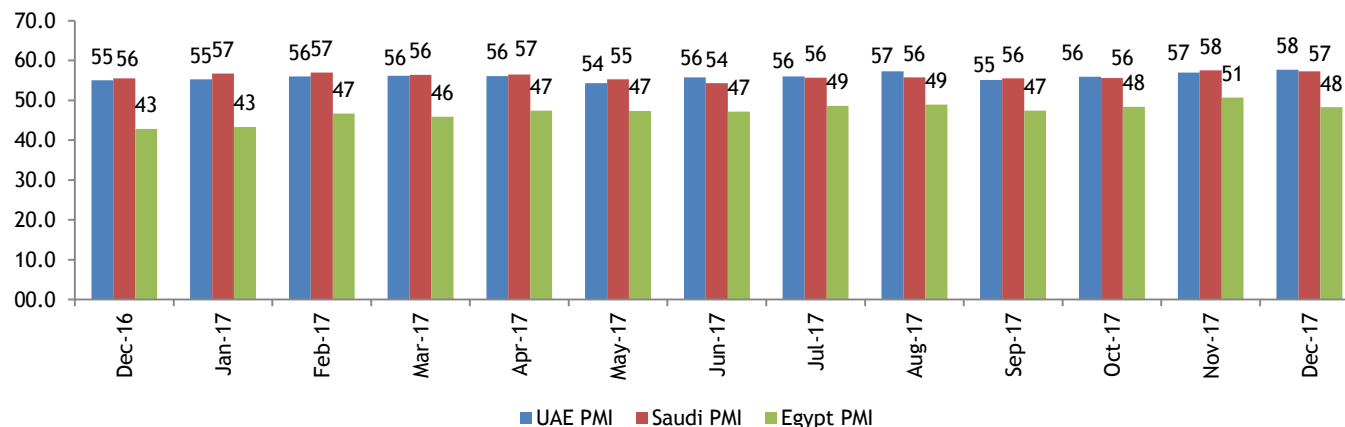
## Equities – Chart of the Month

Egypt inflation has been declining on a yearly basis since July 2017 with headline CPI falling by 4.8% in November to stand at 26.0%. Base effects have started to kick in and we expect inflation to fall further and the Central Bank to start cutting interest rates in the near future.



## Equities

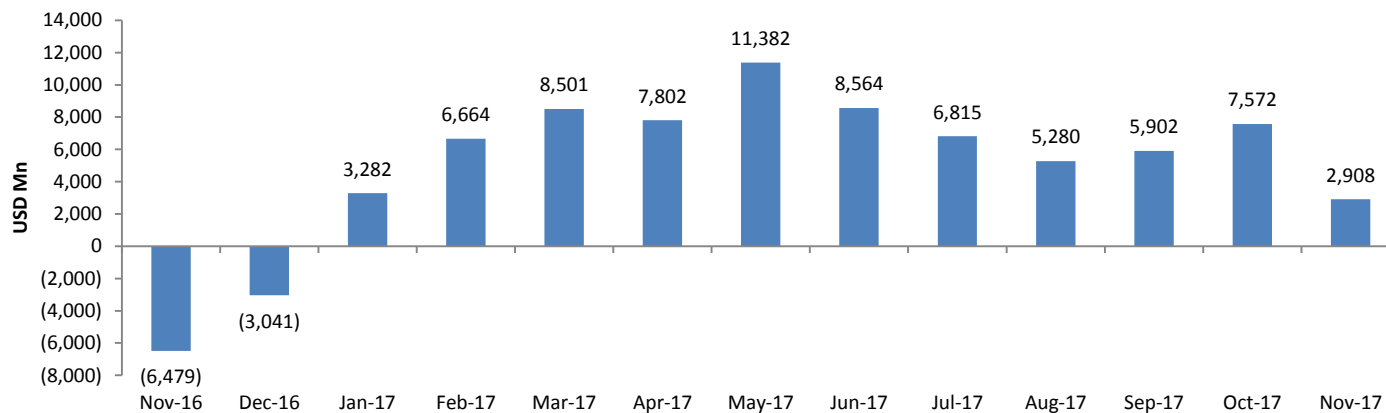
### Purchasing Managers Index



Source: Bloomberg

PMI readings were up YoY but retreated slightly on a monthly basis for Saudi Arabia and more significantly for Egypt, dropping by around 3 points to stand at 48 in December 2017.

### EM Equity Funds Net Flows

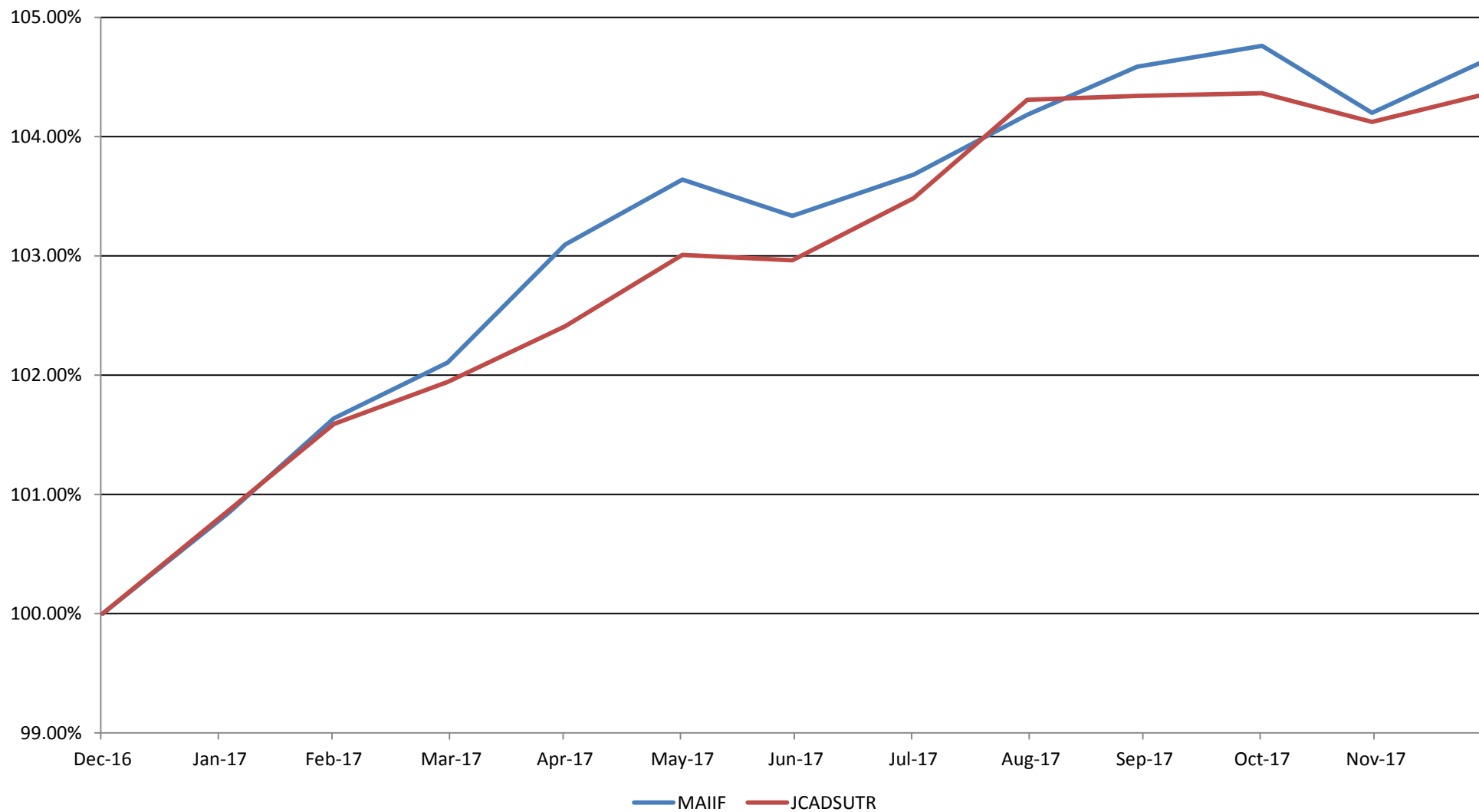


Source: Morningstar

After reversing the trend in October, Emerging Market Equity fund flows showed a significant drop in November to just below USD 3Bn but still significantly higher than the same period of 2016.

## Fund Performance

## Mashreq Al Islami Income Fund vs. Index



## Makaseb Income Fund vs. Index



## Makaseb Arab Tigers Fund vs. Index



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