INVESTING PROFESSIONALLY IN THE MIDDLE EAST

Monthly Outlook – December 2019

1. Global and Regional Asset Allocation

Global Asset Allocation

Asset Class	Tactical View (3m horizon)
Equities (Neutral)	Global cyclical slowdown driven by the protectionism stance undertaken by the Trump administration coupled with overbought market conditions drives our cautious tactical stance on equities. The positives witnessed encompass trend-like growth, ebbing geopolitical risks and the collective central bank dovish stance which could help offset the headwinds.
Fixed Income (Positive)	Markets are expected to continue being hostage to the lingering risks from the US-China trade war, the Brexit uncertainty and the political noise from the major economies in the world. The pivot towards an activist dovishness by the major central banks to resuscitate global growth amidst late cycle concerns this year is expected to drive down global yields.
Commodities (Neutral)	Slowdown in global growth, US shale oil production levels and geopolitical tensions are expected to apply pressure on oil prices. However, we think oil should stay within the $60-$70 range due to the expected supply control measures to be undertaken by the OPEC+ in their meeting in December. Gold is expected to continue to be a preferred asset on the back of its safe haven status and the diversification benefits derived amidst a dovish interest rate environment.

Mashreq Capital View: Positive Neutral Negative

Regional Asset Allocation

Region / Country	Fixed Income	Equities	FX
 GCC	GCC Bonds are currently trading at cheaper valuations relative to similar EM rated peers. Longer duration IG continues to be in focus	The Saudi story has come to an end. The UAE and Kuwait are our top markets.	De-pegging risk has been averted, albeit remains a risk selectively (for example Oman).
 North Africa	Long-dated sovereign bonds provide value for carry positions while we witness some fundamentally improving economies.	Earnings growth is positive and the market is cheap. Also, it should benefit from the rate cuts.	EGP to remain relatively strong.
 Turkey	Low ability to further expand policy measures along with increased supply expectations to drive local yields. Pro-growth policies risks exacerbating imbalances.	It could be the main beneficiary from the monetary easing in the US, however high political risk still remains.	We expect continued volatility with the lira in 1Q20.

Mashreq Capital View: Positive Neutral Negative

2. Global Portfolios

Global Assets – Monthly Commentary

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Overview

DM Equities (+2.8%)

"Phase One" mini trade deal negotiations between the US and China along with positive surprise revisions in key economic data increased the confidence for a growth rebound which led to a risk-on market sentiment driving the returns in the markets.

EM Equities (-0.14%)

EM stock markets were driven by the benign backdrop of poor economic data amidst increasing fiscal and monetary stimulus measures. The marginal negative return was mainly driven by LatAm equities, due to their currency weakness.

DM Fixed Income (-0.76%)

Treasuries whipsawed during the month with major sovereign bonds ending relatively negative amid uncertain trade war dynamics between the US and China added by ambiguity on the UK elections. Global business sentiment was seen bottoming due to positive surprises in the global growth data.

EM Fixed Income (-0.5%)

EM bonds sold during the month despite widespread central bank dovishness as they are facing intensifying fiscal risks in major economies, and this was exacerbated by the sell-off in Lebanon which is in the midst of a major geopolitical and economic risks environment.

+ Positive Returns / – Negative Returns

Outlook

Softening global growth due to a downturn in the economic cycle added by recurrent trade frictions will drive investor sentiments. Although, the lagged impact of the global 'dovish' wave and the fiscal stimulus measures could drive the stabilization of the world economic outlook.

Discounted valuations compared to DMs and monetary and fiscal policy stimulus in varying degrees witnessed in EM economies are appealing attributes for this asset class, although the ongoing trade war ambiguity, soft data releases and the slowing growth momentum leads us to maintain our cautious view on the asset class.

The likelihood of a US-China trade deal, even if it fails to resolve longer term bilateral issues could be a key turning point driving the yields globally. The lack of clarity on the 'material reassessment' of the US economic outlook and signs of encouragement from manufacturing in the Euro area, leads to a stable outlook on yields in the near term.

The backdrop for EM rates is likely to be less directional following aggressive monetary easing by several economies. Although, subdued inflation/ growth outlook and prospects of robust capital flows due to stable G3 yields favors EM debt. Event risks due to negative credit migration instances should drive positional decisions .

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.

3. MENA Fixed Income

MENA Fixed Income - Markets

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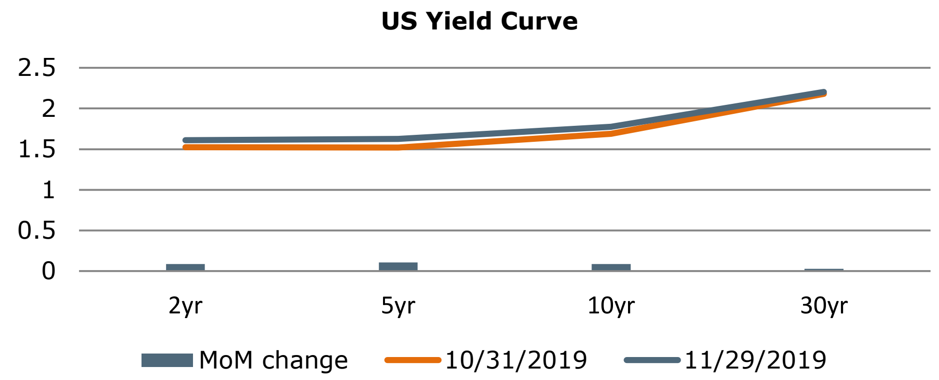

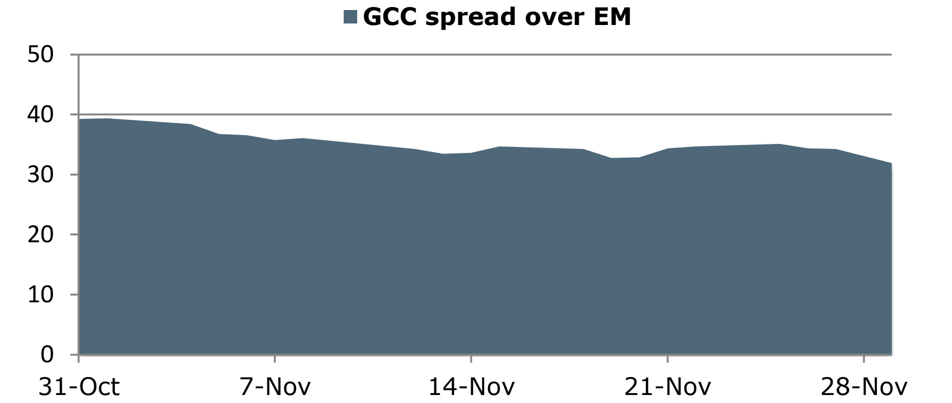

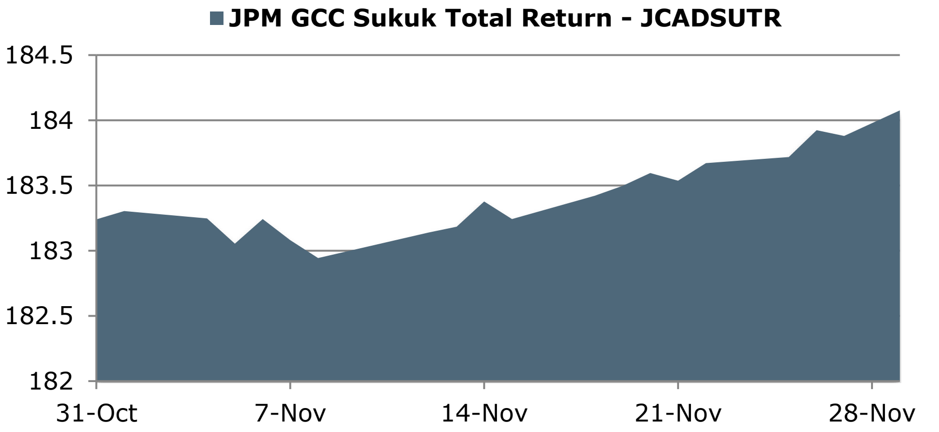

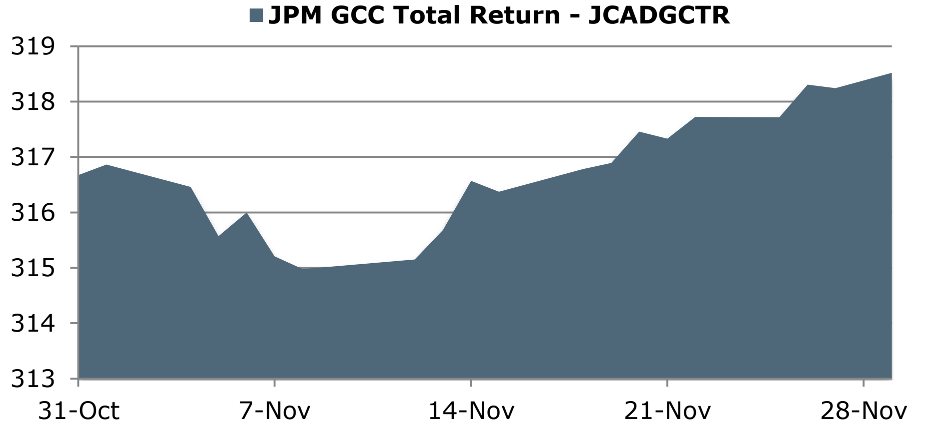

Sources: Mashreq Capital, Bloomberg

EM Fixed Income – Monthly Commentary

Overview

EMD ended the month with a negative performance as the global EMBI was down by 0.50%. The global benchmark’s downturn was worse when compared to the Middle East Index’s loss of 0.15% which faced downward price pressure majorly due to the geopolitical situation and unrest in Lebanon.

PMI data in the G3 economies namely the US, Euro area and Japan during the month confirmed that global manufacturing is bottoming out even if broader activities like services and composite PMIs are still struggling. Doubts that the US and China will reach a Phase 1 trade deal have risen partly on mixed messages around the issue of the tariff rollback and the Hong Kong bill.

The FOMC minutes contained little detail on what counted as a “material reassessment” of the outlook that would be required to change the view that policy would be “well calibrated” after October’s rate cut. Following the changeover in leadership, the ECB has also been notably quiet about the near-term outlook. President Lagarde did not comment on monetary policy in her first official appearance. In Japan, post the downbeat data releases signaling poor growth, the government signaled a large fiscal stimulus package as opposed to monetary easing.

Rising idiosyncratic EM risks accompanied by repayment capacity concerns emphasized the need for greater differentiation with DM economies. Risk sentiment had been lifted since early October, but a series of escalating stories in EM, coupled with a technical overhang, has led to widening in EMBIGD spreads. The increase in EM government and private sector debt to all-time highs remains a structural concern as the cycle ages.

Oil remained volatile despite supportive geopolitical headlines which raised prospects of deeper output cuts next year. Uncertainty over the trade deal and mixed macro data kept crude anchored though a lower build up in US crude inventories compared to expectations acted as a catalyst for improved prices.

Outlook

EM is ending 2019 on an improving path in terms of growth indicators pointing to a bottoming, valuations slightly cheap, and steady inflow momentum. Although the broadening of the softness in DM activity data and business cycle implications is expected to weigh on the emerging market economies. In a few major economies, including India, Brazil, Mexico, Russia, and South Africa, growth in 2019 is sharply lower for idiosyncratic reasons and this is expected to continue to remain benign in 2020.

Headlines on US impeachment risk, Brexit, unrests in LatAm economies and geopolitical developments in the Middle East are expected to constrain investor risk appetite.

A rebound in China in response to policy supports and better export performance should result in a stronger start to 2020. The US-China possibility of a trade truce and accompanying lift in global business sentiment and capex spending should improve EM growth prospects broadly. Manufacturing exporters, especially EM Asia economies tied to the China supply chain, are likely to benefit the most from this lift. The lagged effect of the substantial 2H19 monetary easing, should provide added support to activity throughout 2020.

EM central banks have room to continue easing. As long as the Fed remains on an easy-to-neutral bias, we expect many EM economies to continue monetary policy easing in 2020 albeit at a slower pace than in 2019, as economic fundamentals continue to justify further rate cuts.

EM-dedicated bond fund inflows are expected to slow to +$30bn in 2020, from +$65bn in 2019. Despite the global search-for-yield, EM country risks and late-cycle concerns could be a major factor contributing to flows.

Favorite overweight's remain GCC ex-Oman, China, India, Brazil, Mexico, Russia, Egypt and Ukraine, while key underweights are Turkey, Argentina and Lebanon.

4. MENA Equities

MENA Equity View

Sector	GCC	North Africa	Turkey
Banks	Negative	Neutral	Neutral
Insurance	Positive	Positive	Neutral
Consumer Goods	Positive	Neutral	Negative
Real Estate	Neutral	Negative	Neutral
Health Care	Positive	Positive	Neutral
Telecommunications	Positive	Positive	Positive
Materials	Negative	Negative	Negative
Utilities	Positive	Positive	Positive

- **GCC Banks:** Falling interest rates to negatively impact profitability hence we downgrade to negative from neutral.
- **GCC Consumer Goods:** The decline in Saudi consumer spending has reached its bottom and a decline in expat exodus should help turnaround hence upgrade to Positive from Neutral.
- **Real Estate:** Falling interest rates will positively benefit interest rates hence we upgrade to neutral from 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 upgrade to positive from neutral.
- **Materials:** Negatively impacted from weaker demand due to US-China trade war hence we downgrade to negative from neutral.
- **Utilities:** Resilient to global volatility due to its defensive business nature resulting positively hence we upgrade to positive from neutral.

Mashreq Capital View: Positive Neutral Negative

MENA Equities – Monthly Commentary

Overview

MENA markets turned positive in November, mainly supported by trade optimism and an improved geopolitical risk environment. Markets were up 1.2% and this was mainly led by Kuwait and Saudi Arabia. Oil prices also gained a strong 6.0% over de-escalation in trade war between the US and China. MENA markets are up 2.0% for the year, underperforming emerging markets, which are up 8.8% YTD.

In Saudi Arabia, the market turned positive in November, up 1.5% as domestic investors returned after a spell of profit taking in October when Aramco IPO was announced. Investors focus was on banking sector as they believe the sector should benefit from providing leverage to Armco Investors. The market is up 0.4% YTD.

Egyptian shares (Hermes Stock Market Index) finished down 4.2% (4.1% in USD terms) in November as the investors remain in search of new catalysts to drive the market after CBE cut rates by 100bps which was largely in line with consensus and had little impact. The market is up 0.5% YTD.

The Qatari market finished down 0.4% as it lacks any catalyst coupled with uneventful earnings season. The market is down by 1.5% YTD.

The UAE finished down 1.9% in November, as Dubai's real estate stocks across all Emaar names weighed on the performance on the back of MSCI EM rebalancing, coupled with weakness in industrial names. The UAE overall index is down 1.8% YTD.

In Kuwait, the market finished positive up 5.0% for the month as the investors positioned ahead of the upcoming MSCI EM upgrade announcement in December. The market is up 23.8% YTD.

Outlook

In Saudi Arabia, we expect the weakness to continue after the final phase of inclusion in the MSCI EM index was made effective and valuations look expensive which could weigh on the performance. However we think the market will continue attracting flows next year as a result of listing the heavy weight Aramco.

In Egypt, inflation has reached single digits despite additional utility and fuel subsidy cuts, due to high base effects and a stable currency. After the CBE cutting 450bps interest rates in YTD 2019, we expect further cuts of 100-200bps in 2020E which should help strengthen the market.

Qatar does not have any catalysts or major risks on the horizon. In terms of valuation, the market is in line with its 5 year average P/E at 14.5x TTM – as a result we see limited upside in this market.

We expect the UAE market to trade positive on the back of FOL increase expectation and some relief in the real estate sector post incremental interest shown by Chinese investors in UAE market.

With Kuwait being added to MSCI EM's watch list, the market is likely to remain buoyant.

Main risks are still centered around high geopolitical tension in the MENA region and also the correlation with global equities, which we think should correct further as the global GDP growth is softening with no catalyst in the near future to improve the sentiments or productivity.

MENA Equities

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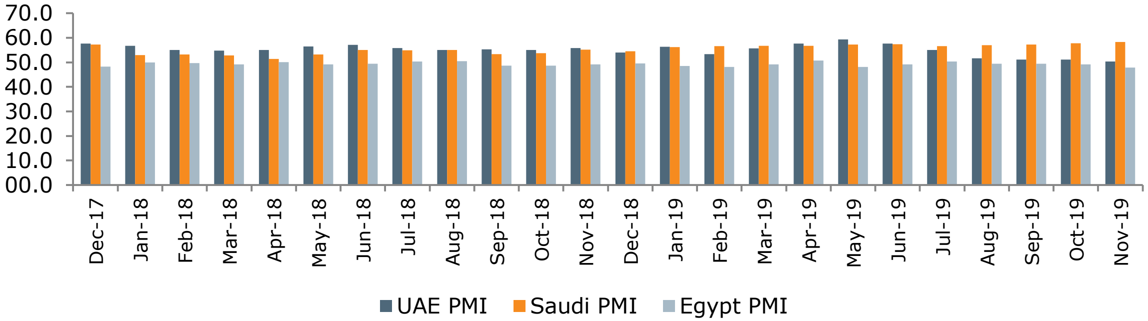
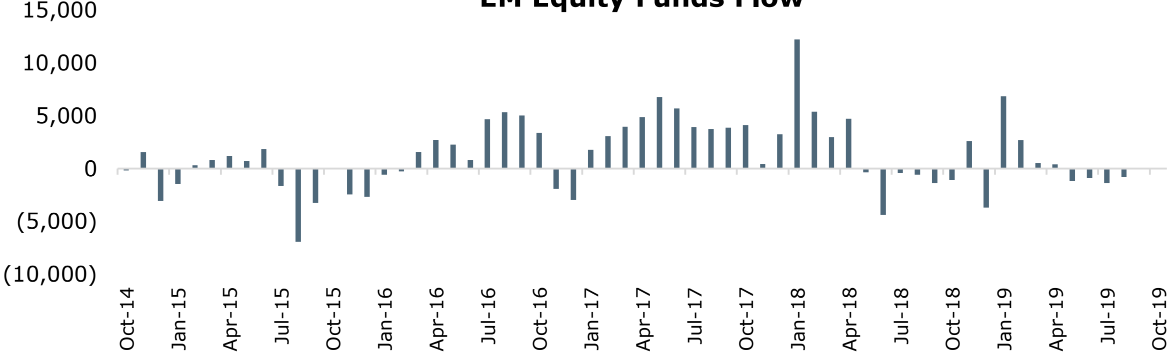
Purchasing Managers Index



Saudi Arabia's PMIs increased second time in 2 months and reached the highest level since August 2015 to 58.3 on the back of strong orders while UAE PMIs declined to 50.3. Egypt's PMIs fell to 47.9 in November (lowest since Sept 2017) on the back of weaker new orders.

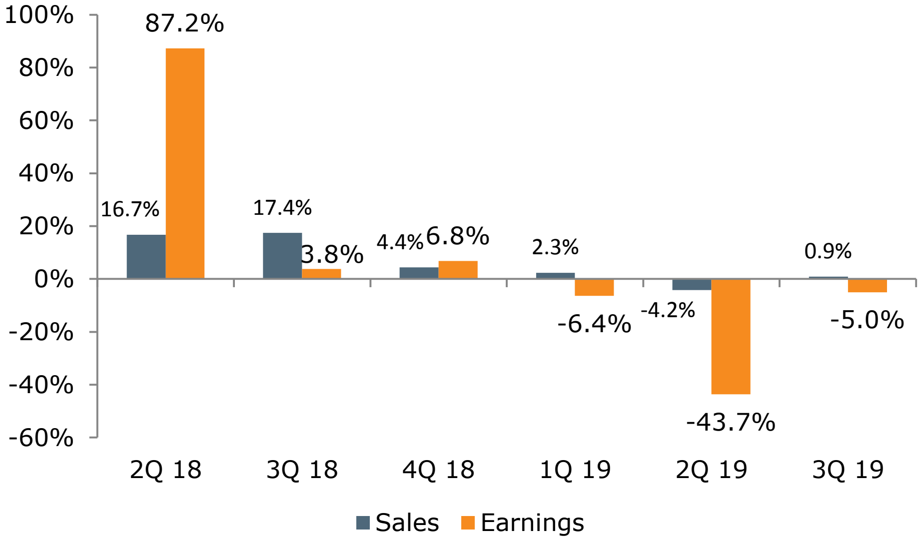
EM Equity Funds Flow



October saw a net inflow of USD12m vs. net outflows of USD17m in September, in Emerging Market Equity Funds.

MENA Equities – Chart of the Month

Earnings Analysis: S&P Pan Arab Composite Index



Negative growth: MENA earnings recorded negative growth for 3Q19 mainly due to weaker results from Material sector.

Sources: Bloomberg, Mashreq Capital

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