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CAPITAL

INVESTING PROFESSIONALLY IN THE MIDDLE EAST

Monthly Outlook – February 2020

1. Global and Regional Asset Allocation

Global Asset Allocation

Asset Class	Tactical View (3m horizon)
Equities	Mixed global economic data and increasing concerns over the spreading of the novel coronavirus (nCoV) in China is expected to create a bumpy ride for global growth projections which will keep the stock market optimism in check in the near future. Although, with the earnings season for 4Q2019 in the US now underway with companies doing better than expected, we believe this ambiguity could drive tactical buy decisions.
Fixed Income	Signs of instability in the growth backdrop and cautious financial markets may mean many central banks will be vigilant in their monetary policy approach in the near future. Although, with the economy currently evolving broadly in line with the Fed's outlook of moderate economic growth, a strong labor market and better than expected wage growth we expect rates to continue to be unchanged in 2020. Bond yields are expected to gyrate within a range to reflect market risk-on and risk-off sentiments.
Commodities	Increasing geopolitical risks in the Middle East, unexpected build up in US shale inventories and potential shocks in global demand due to the outbreak of the nCoV in China is expected to apply pressure on oil prices. However, existing supply-side disruptions and the prospects of deeper output cuts by OPEC+ in a timely manner can possibly limit the impact to oil balances. We continue to believe that oil should maintain its average price range of USD 60 to USD 70. 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

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Regional Asset Allocation

Region / Country	Fixed Income	Equities	FX
 GCC	Strong fundamentals in some economies and cheap valuations relative to similar rated EM peers. Geopolitical risks increased.	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 debt levels and refinancing risks still remain elevated.	Sluggish private sector activity will curb earnings growth momentum. We are very selective in Egypt.	EGP to remain relatively strong.
 Turkey	Low ability to further expand policy measures which is expected to drive local yields. Rising inflation and potential US sanctions remain key risks.	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 – Safety First!!

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Overview

DM Equities (-0.61%)

Stock markets began the new decade in a buoyant mood with the signing of the US-China trade deal, before volatility picked up during the end of the month. The breakout of the nCoV in China drove global equities to move to a de-risking mode as the number of infected cases keeps rising rapidly causing growth concerns.

Outlook: Global equity markets are past their prime however improving sentiments due to reduced trade tensions, aided by the lagged impact of the global 'dovish' wave, and possible fiscal stimulus measures could lead to mid-single digit returns. The novel coronavirus impact could have a short-term damaging impact on global growth projections impacting risk sentiments and investor behavior.

EM Equities (-4.66%)

Improving economic data from EM economies was overshadowed by the nCoV outbreak which created heightened uncertainty whilst posing downside risks to growth and effectively capping EM risk market sentiments.

Outlook: EM asset valuations have cheapened due to the recent sell-off but still have more room until they reach oversold territory. The spread of the nCoV is likely to continue to weigh on emerging markets, and is beginning to present downside risks to Q1 economic activity in China, and potentially the wider region.

DM Fixed Income (+1.28%)

Economic data across regions continued to show signs of improvement while major central banks continued to echo their dovish rhetoric. Safe havens performed extremely well during the second half of the month due to the increasing concerns over the coronavirus outbreak. Risk-on/Risk-off market sentiments caused increased volatility.

Outlook: The markets are dismissing the risk of higher inflation while there is positive economic data flow as the US economy remains in a "Goldilocks" scenario, which effectively caps major moves in bonds. Although, the severity of the nCoV outbreak remains uncertain and can lead to risk-off moves in treasuries.

EM Fixed Income (+1.52%)

EM bonds rallied during the month on the back of the risk-off move, following the breakout of the coronavirus in China. Long duration, Investment Grade bonds drove the major positive rally while High Yield witnessed a sell-off amidst an uncertain growth outlook in EM.

Outlook: EM growth is expected to be hit by the nCoV outbreak which can open more room for policy easing within EM economies. 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. Event risks due to credit specific negative news can cause a migration of capital.

\+ 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

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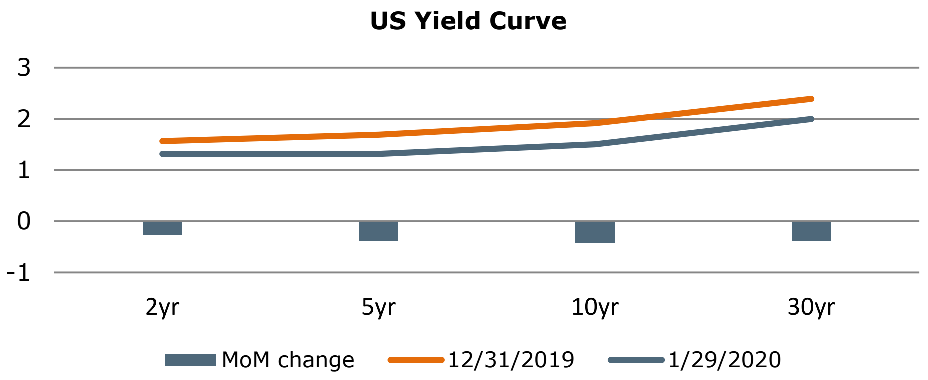

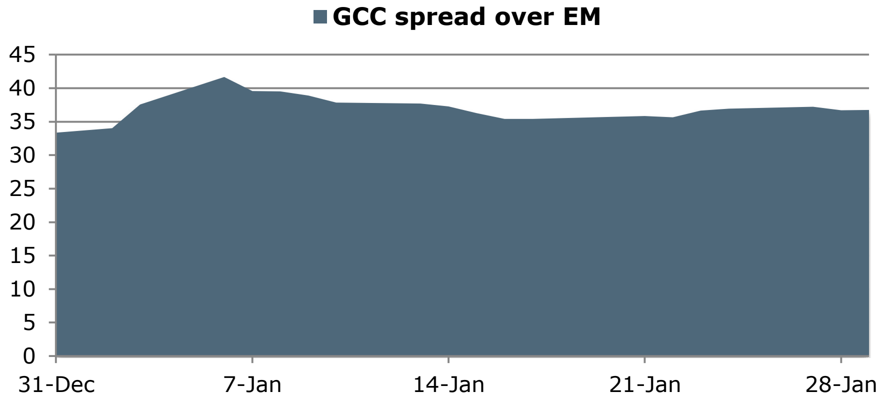

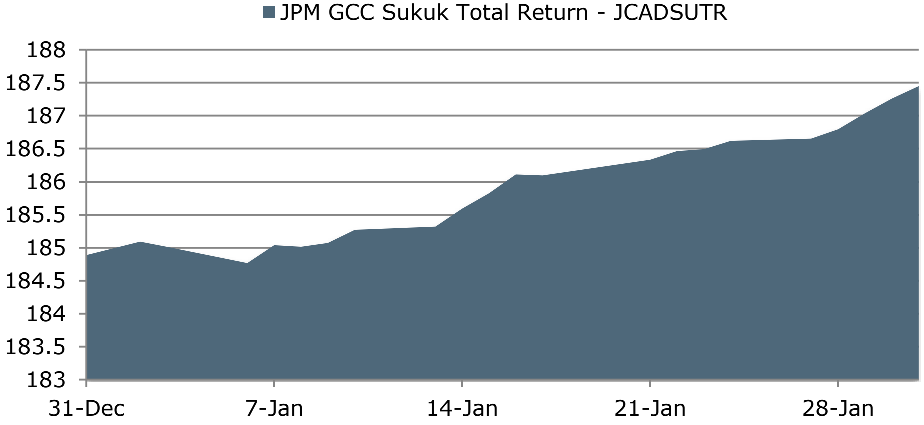

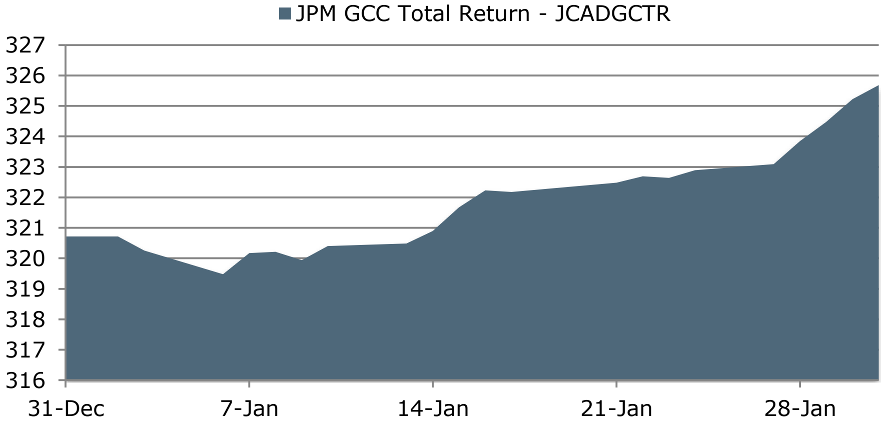

Sources: Mashreq Capital, Bloomberg

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Overview

EMD ended the month with positive performance with the Global EMBI at 1.52%. The global benchmark's performance outperformed the Middle East Index's gain of 1.19% which faced price pressure, majorly due to the increasing geopolitical risks in the region and continued unrests in Lebanon with no clear closure in sight.

January started with a tense week due to a spike in geopolitical tensions following the US airstrike in Iraq which killed Iranian Major General Soleimani and rattled financial markets, effectively overshadowing the positive impact of the PBOC reserve ratio cut which was expected to boost Chinese growth. The optimism powered by the signing of the Phase I of the US-China trade deal, positive economic data in the US and a very strong earnings season led to a risk-on move, driving markets higher in the second week.

We witnessed a massive exogenous shock hitting markets in the second half of the month due to the anxiety created by the nCoV epidemic. The early signs of exuberance were diminished very rapidly as EM Asian growth forecasts for Q1 were reduced drastically to effectively reflect the demand shocks and supply disruptions caused by this pandemic in China.

With the economy evolving broadly in line with the Fed's outlook of moderate economic growth and a strong labor market, the decision to keep the key interest rate unchanged at the January meeting came as no surprise to markets. Christine Lagarde's second meeting in charge of the ECB was a low-key affair as policy rates were left unchanged. In Japan, BOJ kept its policy rate unchanged.

Oil tumbled in the last week of the month as US crude oil inventories rose strongly. In addition, the risky demand expectations given intensifying fears of a global growth slowdown due to the nCoV epidemic in China are effectively capping the prices. OPEC+ members mentioned that they are closely watching the virus impact and would possibly extend production cuts to support prices.

Outlook

EM growth is expected to be moderate due to the impact of nCoV which will cap risk markets in the near future. The largest economic impact is expected to be in Q1 2020, which can be exacerbated if there is a prolonged outbreak and Chinese factory shutdowns with no vaccine in sight. Although, Chinese import demand is now expected to remain weaker throughout 2020 and a number of EM countries are likely to see a negative impact on full-year growth too.

Impact on Middle East EM growth from the nCoV comes mostly through two channels: direct exposure to China and lower oil prices which will be a double whammy for these economies, hurting growth.

Headlines on the severity of the virus, US-China trade relations, the Brexit trade deal, and geopolitical developments in the Middle East and LatAm economies are expected to constrain investor risk appetite and drive sentiments.

Our base-case scenario remains that the Fed would maintain their neutral monetary policy in 2020, providing a tailwind for many EM economies (especially the high-yielding ones) to continue monetary policy easing this year. Rising global growth concerns and a disinflationary impulse has opened much room for more fiscal and monetary policy easing. The pressure to ease will be greatest in EM Asia given that it is expected to suffer the largest growth hit and we believe there will be added rate cuts in Malaysia, Korea and the Philippines. In terms of timing, central banks in the most severely affected countries are unlikely to wait for the hard activity data to reveal the true extent of the damage. Whilst not our base case, a more protracted outbreak could also compel DM central banks to deliver more easing too.

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

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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 neutral.
- **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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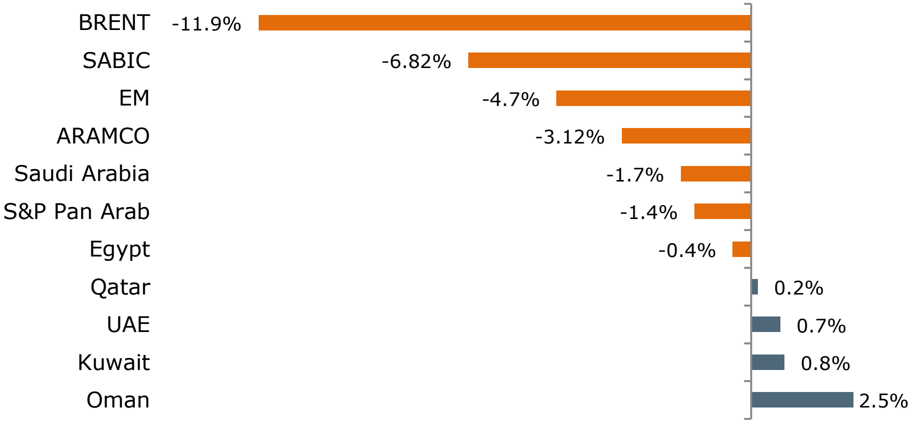
Overview

The coronavirus outbreak triggered bearish signals for oil investors as a result of a slowdown in demand by China. Although MENA markets have shown more resilience than Emerging Markets, the Saudi market has finished the month in the red with ARAMCO and SABIC plummeting significantly.

Although stating that the Egyptian market might be regaining some of its glow might be an overstatement, it is definitely coming back into MENA investors' radars as a result of a surge in M&A activity that might be unveiling a few compelling stories.

GCC ex-KSA has shown resilience lead by Oman where the elevation of Haitham bin Tariq al-Said as the country's new Sultan occurred uneventfully.

January (YTD) performance



Outlook

Saudi valuations look too high to us to be attractive in the long-term given that they are trading at a 24% premium to the 10-year average and a 21% premium to the 5-year average. That is a higher premium than EM, which is trading at a 16% premium to its 10-year average and a 9% premium to its 5-year average. The premium of the Saudi market remains wide in the wake of the index inclusion process. The PE premium versus EM is nearly 1SD expensive.

In Egypt, supported by positive sentiment, the economy has been performing strongly. Although PMI has eased off its highs, it is still hovering near its two-year averages, signaling that activity has remained robust. With rates reaching pre-2016 levels, we think the current multiples trading at discount is unjustified.

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 14.8x TTM. As a result we see limited upside in this market.

We expect the UAE market to trade positive on the back of an FOL increase expectation and some relief in the real estate sector. Also, the market is least expensive vs. regional peers triggering attractive entry points.

In Kuwait, our outlook for the next six months is positive as a result of the positive MSCI decision.

The main risks are still centered around high geopolitical tension in the MENA region and also the uncertainly around the coronavirus outbreak, which add sizable volatility and downward pressure for oil and commodities-related equities.

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MENA Equities

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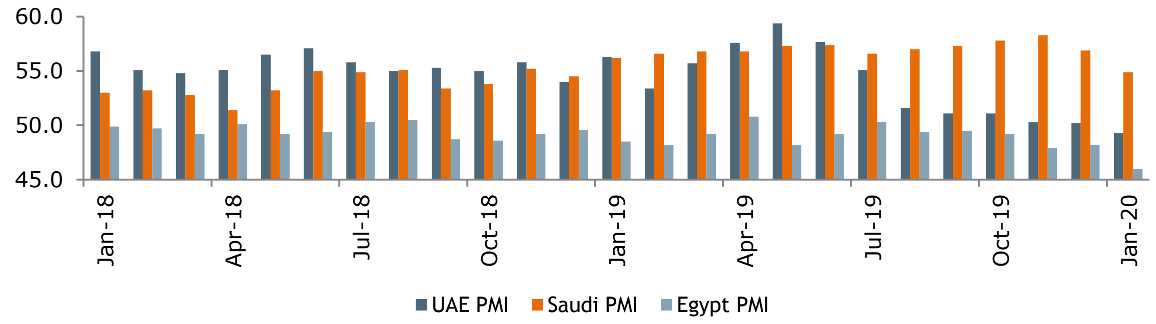
Purchasing Managers' Index

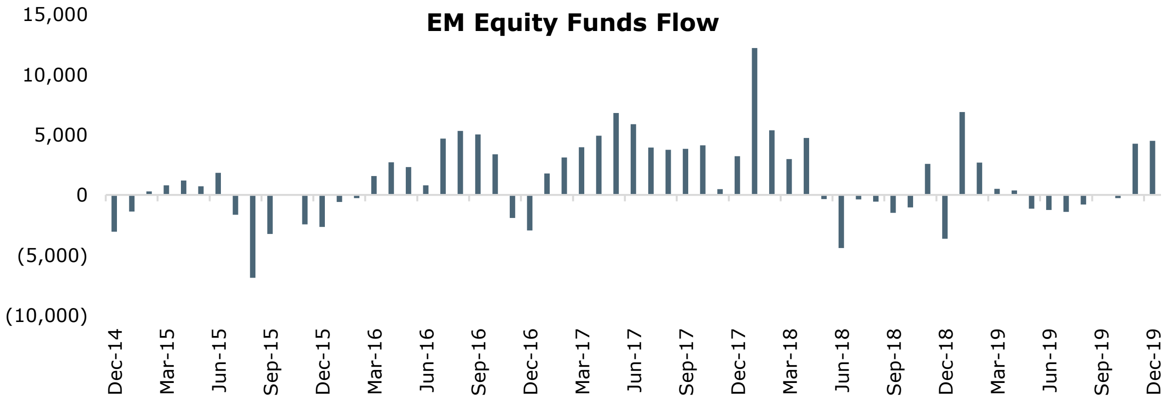


Purchasing Managers' Index for the UAE's whole economy in January fell to 49.3 from 50.2 in December; and 56.3 one year ago. It is the lowest reading since August 2009.

In KSA, the index fell to 54.9 from 56.9 in December. It is the lowest reading since December 2018.

In Egypt, the index fell to 46 from 48.2 in December, i.e. the sixth consecutive month of contraction.

EM Equity Funds Flow



December saw a net inflow of USD4.5Bn vs. net inflow of USD4.3Bn in November, in Emerging Market Equity Funds.

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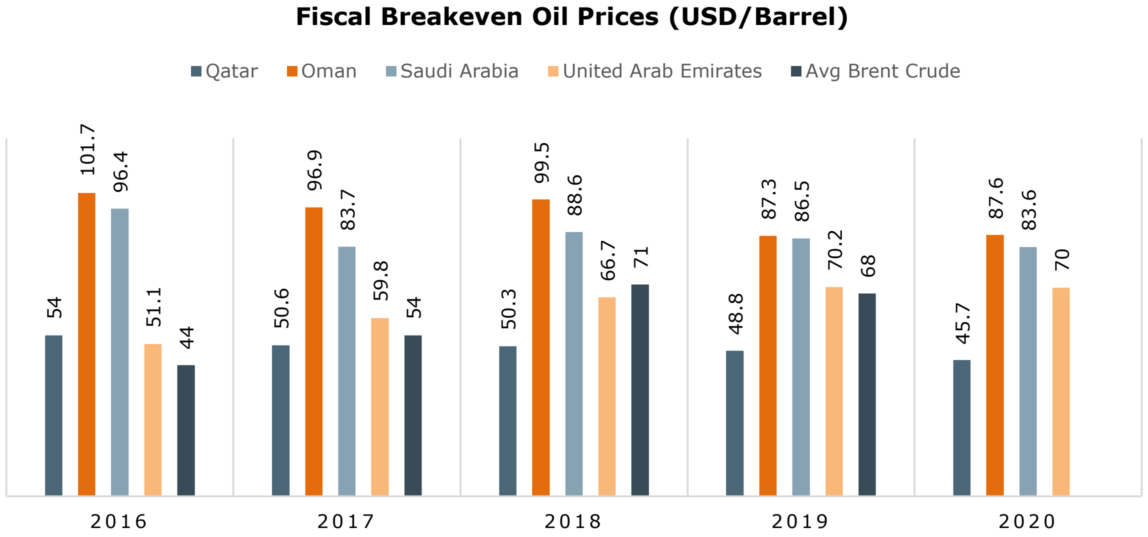
MENA Equities – Chart of the Month



In Saudi Arabia specifically, the government's commitment to fiscal stability is undoubted, the breakeven point declined sharply from around US$95 in 2016 to $85 in 2017 where it has remained in 2018 and 2019.

Sizable progress in the fiscal breakeven oil price for GCC countries, although still very much higher than the current.

Source: IMF, Mashreq Capital

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