

**INVESTING PROFESSIONALLY IN  
THE MIDDLE EAST**

# 1. Global and Regional Asset Allocation



## Asset Class



**Equities**



**Fixed Income**



**Commodities**

## Tactical View (3m horizon)

Global growth is expected to edge slightly higher in 2020, aided by the diminishing US-China trade tensions and gradually improving data releases which provide a favorable backdrop for risk assets limiting recession risks. Although, we believe that we remain in an uncertain environment due to persistent geopolitical risks driving market sentiments. This leaves us with a modestly pro-risk stance for 2020.

Signs of stabilization in the growth backdrop and buoyant financial markets mean many central banks may not need to deliver further easing in 2020 as they seek to achieve a delicate balance between trying to meet their inflation objectives while not adding to growing signs of financial excess. Due to a lack of triggers and a strong year in 2019, yields are expected to stay range bound this year.

Expansion in US shale oil production levels and increasing geopolitical risks in the Middle East are expected to apply pressure on oil prices. However, we think oil should stay within the \$60-\$70 range due to the supply control measures undertaken by the OPEC+ last month. 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



GCC



North Africa



Turkey

## Fixed Income



Strong fundamentals and cheap valuations relative to similar rated EM peers. Geopolitical risks are high.



Long-dated sovereign bonds provide value for carry positions while debt levels and refinancing risks are high.



Low ability to further expand policy measures along with increased supply expectations to drive local yields. Rising inflation remains a concern.

## Equities



We are very selective in Saudi due to high political risk coupled with expansive valuation for Saudi stocks. The UAE is our preferred market



Sluggish private sector activity will curb earnings growth momentum. We are very selective in Egypt.



The market will continue to be volatile giving the high tension between US and Iran

## FX



De-pegging risk has been averted, albeit remains a risk selectively (for example Oman).



EGP to remain relatively strong.



We expect continued volatility with the lira in 1Q20.

## 2. Global Portfolios



## Overview

### DM Equities (+3.0%)

“Phase One” mini trade deal negotiations between the US and China along with bottoming of business sentiment and stabilization in consumer confidence laid a foundation for an eventual rebound in growth leading to a risk-on market sentiment driving the returns.

### EM Equities (+7.5%)

EM stock markets ended the year on a buoyant note mainly driven by the improving backdrop of economic data amidst increasing fiscal and monetary stimulus measures. The structural characteristics of EM economies are significantly better than market expectations supported by reducing global risks.

### DM Fixed Income (+0.6%)

Treasuries were volatile during the month with major sovereign bonds ending negative driving yields higher amid improving trade war negotiations between the US and China added by increased clarity on the Brexit saga. Global business sentiment was seen improving due to positive surprises in economic data.

### EM Fixed Income (2.0%)

EM bonds rallied during the month on the back of the stabilizing growth outlook, this was aided by the dovishness wave that swept the markets during 2019. The index saw most of the returns during the month from their High Yield exposure reinstating the risk-on market stance.

+ Positive Returns / – Negative Returns

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.

## Outlook



Trade policy in the coming year will continue to reflect currents of economic nationalism and protectionism. Global markets are past their prime but improving market sentiment aided by the lagged impact of the global ‘dovish’ wave and the possible fiscal stimulus measures could lead to mid-single digit returns.



Stabilizing global cycle, dovish interest rates and rising liquidity lead to increasing allocation to EM risk. Although geopolitical tensions, poor corporate earnings, high levels of debt and low levels of real interest rates drives a modest selective stance on the asset class.



The conclusion of the first phase of the 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 markets are no longer pricing in immediate rate cuts from the Fed. Although, the dovish environment witnessed in all major economies of the world is expected to stay in 2020.



The backdrop for EM is likely to be less directional following aggressive monetary easing in 2019 by several economies. Although, asubdued 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



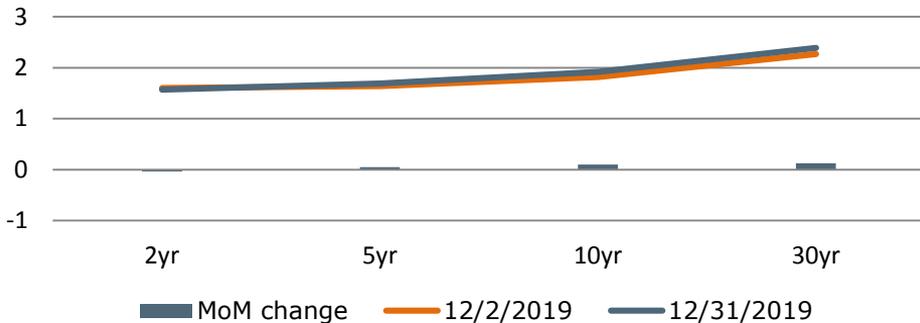
Negative

## 3. MENA Fixed Income

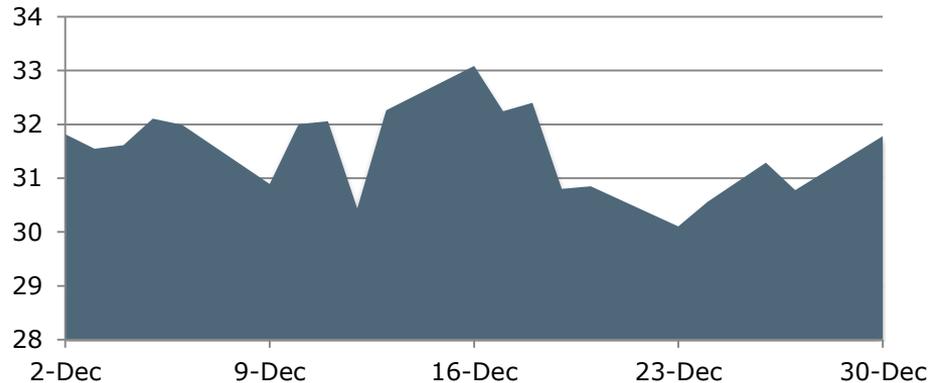


# MENA Fixed Income - Markets

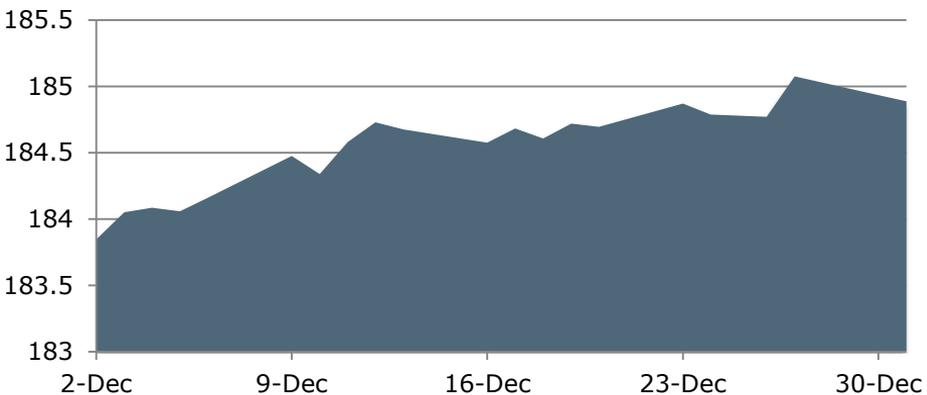
### US Yield Curve



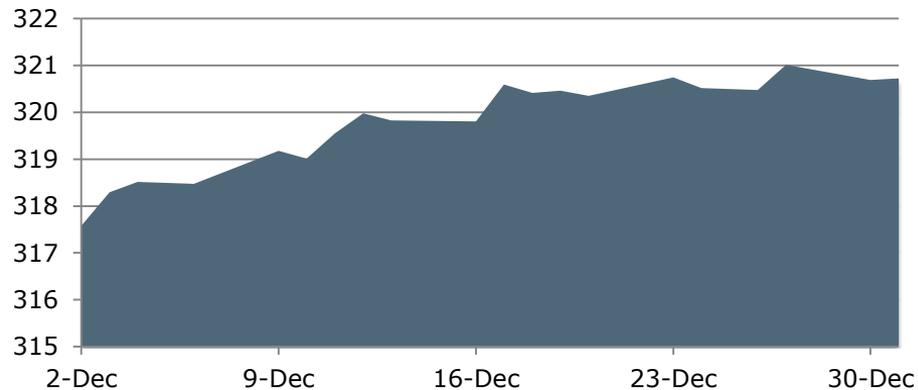
### GCC spread over EM



### JPM GCC Sukuk Total Return - JCADSUTR



### JPM GCC Total Return - JCADGCTR



## Overview

EMD ended the month with a strong positive performance as the global EMBI was up 2.0%. The global benchmark's performance outperformed the Middle East Index's gain of 0.8% which faced price pressure majorly due to the increasing geopolitical risks in the region.

President Trump announced last month that he would formally sign the phase one trade deal with Chinese officials on 15th January 2020 and would travel to Beijing shortly after for the next round of negotiations effectively providing clarity on the most important overhang driving market sentiments during the year 2019. In terms of data, global release at the turn of the year has been the global manufacturing PMI at 50.4, whose message was mixed but distorted by idiosyncratic issues.

The Fed meeting minutes broke little new ground and maintained a broadly dovish tone. Policymakers left the rate unchanged last month while adding that the ongoing review of the strategy will continue until mid-2020. While the ECB has also been notably quiet about the near-term outlook on rates, President Lagarde mentioned that a year long ECB review will begin and her presidency is expected to be consensus driven. In Japan, there were signs of labor market softness added by weakness in the retail and manufacturing sectors.

Rising idiosyncratic EM risks accompanied by rising debt levels emphasized the need for greater differentiation with DM economies. EM ended 2019 on an improving path in terms of growth indicators pointing to a bottoming, valuations slightly cheap, and steady inflow momentum.

Oil remained volatile despite supportive geopolitical headlines of deeper output cuts by OPEC+ in 2020. Increasing contentions between US-Iraq-Iran and increasing US crude inventories drove the returns in the asset class. Although, the positive conclusions of US-China trade deal helped in reducing demand concerns.

## Outlook

EM should start 2020 on an improving growth path, but with a modest cyclical lift and less monetary policy support which should constrain returns. The growth projections for EM economies in 2020 are slightly higher at 4.3% compared to 4.1% in 2019. A rebound in China in response to policy supports and better export performance should result in a stronger start to 2020.

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

Political risks in EM are never too far from focus. 2020 has a relatively calm election calendar, with only a handful of elections in larger EM countries. Although, geopolitical and domestic hotspots remain on the radar for next year, including the continued unrest in a number of Andean countries, the economic and financial crisis in Lebanon, and tensions in the Middle East spilling over into the global economy.

Our base-case scenario remains that 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 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. We expect issuance for EM hard currency sovereigns and corporates to decline in 2020 versus 2019, but to remain elevated given the rise in bond maturities.

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			
Insurance			
Consumer Goods			
Real Estate			
Health Care			
Telecommunications			
Materials			
Utilities			

- **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

## Overview

MENA markets ended up in December, supported by positive global sentiments, an improved geopolitical risk environment and a strong rally in oil prices on the back of partial US-China trade deal and weaker inventory data from the US. Markets were up 5.4% and oil prices up 5.7% in December. MENA markets are up 7.6% for the year, underperforming emerging markets, which are up 15.4% YTD.

In Saudi Arabia, the market remained positive in December, up 6.7% as domestic investors returned after a spell of profit taking ahead of Aramco IPO. Investor focus was on the banking sector as they believe that the sector should benefit from providing leverage to Aramco Investors. The market is up 7.2% YTD.

Egyptian shares (Hermes Stock Market Index) finished down 0.1% (+0.4% in USD terms) in December as investors remain in search of new catalysts. The market is up 0.4% YTD.

The Qatari market finished up 2.7% on the prospect of improvement in relations in the region. The market is up by 1.2% YTD.

The UAE finished up 2.1% in December, mainly supported by strong performance in the banking sector while the real estate sector continued to detract the performance. The UAE overall index is up 0.3% YTD.

In Kuwait, the market finished positive, up 7% for the month on the back of an announcement of MSCI upgrade to EM. The market is up 32.4% YTD.

## Outlook

In Saudi Arabia, we expect the weakness after the inclusion in the MSCI EM index and valuations looks expensive (higher end of the historical range). However we think the market will continue attracting flows (FTSE Phase 5 in March 20) as a result of listing the heavy weight Aramco.

In Egypt, after inflation reaching single digits, rate cuts and double digit EPS growth expectation should drive the markets. With rates reaching pre-2016 levels, we think the current multiples trading at discount is unjustified.

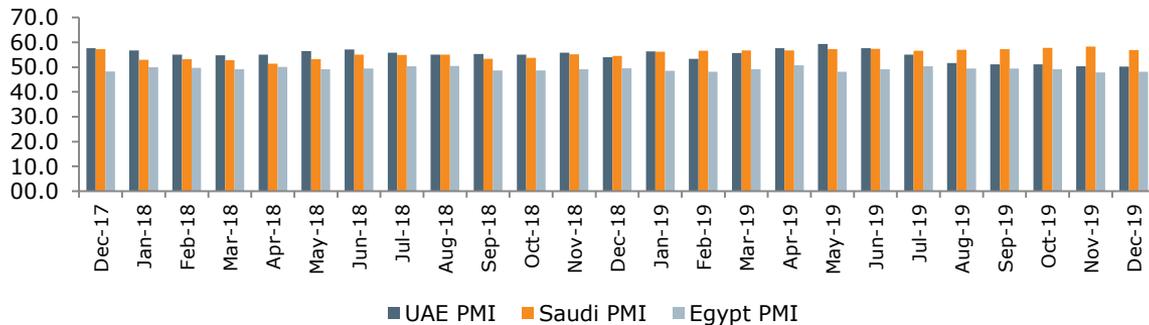
Qatar does not have any catalysts or major risks on the horizon. In terms of valuation, the market is in line with its 5 year average P/E at 14.8x TTM – as a result we see limited upside in this market.

We expect the UAE market to trade positive on the back of an FOL increase expectation and some relief in the real estate sector post incremental interest shown by Chinese investors in UAE market. Also, the market is least expensive vs. regional peers making it an attractive entry point.

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

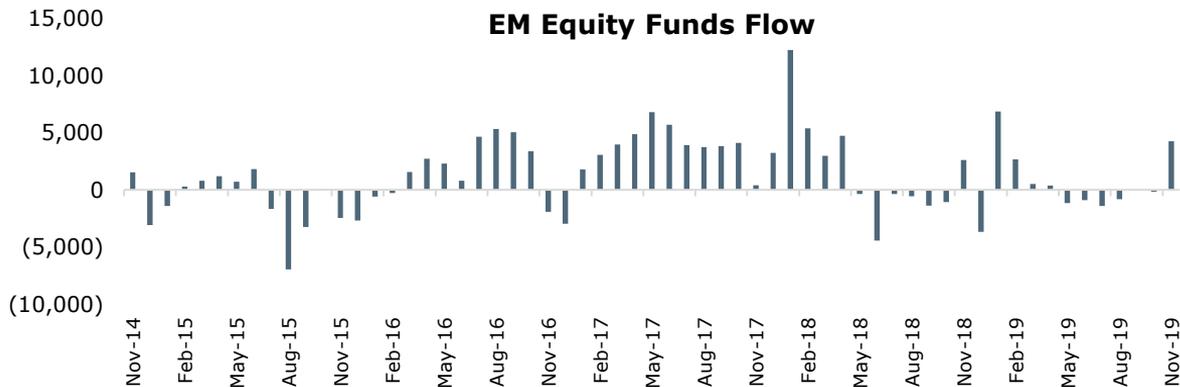
Main risks are still centered around high geopolitical tension in the MENA region and also the correlation with global equities, which we think should correct further as the global GDP growth is softening with no catalyst in the near future to improve the sentiments or productivity.

## Purchasing Managers Index



Saudi Arabia and UAE PMIs softened slightly on the back of weak orders reaching 56.9 and 50.2 respectively. Egypt's PMIs rose to 48.2 in December on the back of strong new orders.

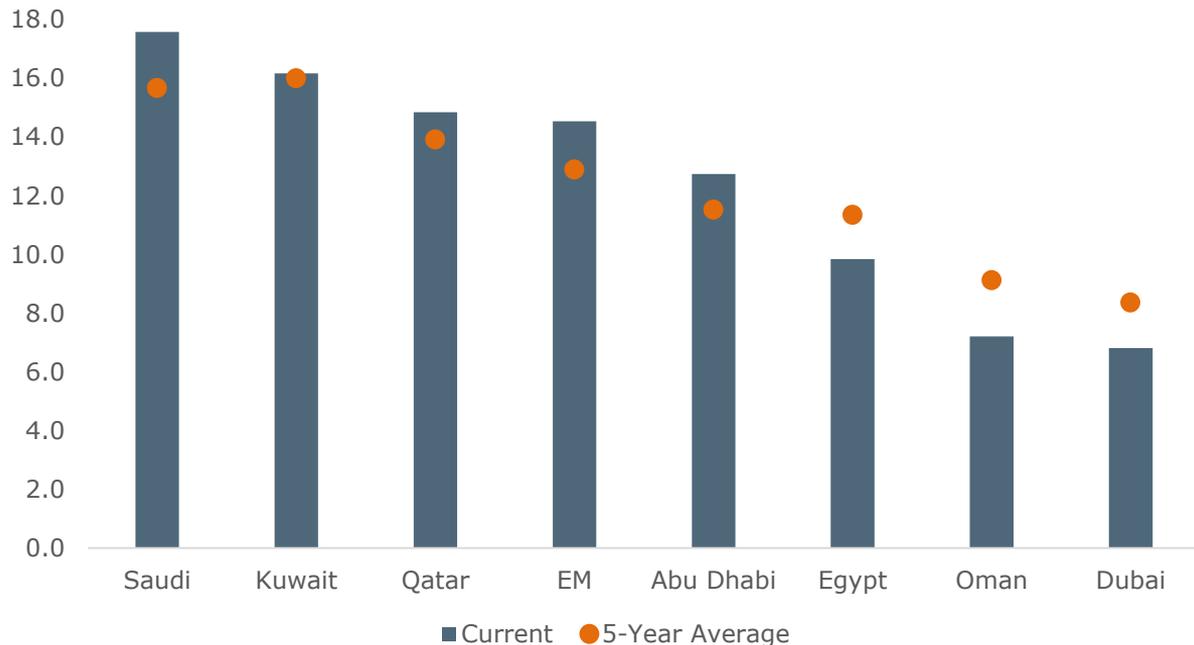
## EM Equity Funds Flow



November saw a net inflow of USD4.3Bn vs. net outflows of USD148M in October, in Emerging Market Equity Funds.

# MENA Equities – Chart of the Month

## P/E vs. Own 5 year Historical Average



**Valuation:** Dubai market trading at c.20% discount vs. own 5Y historical average while Saudi trading above the historical average.

Source: Bloomberg, Mashreq Capital



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