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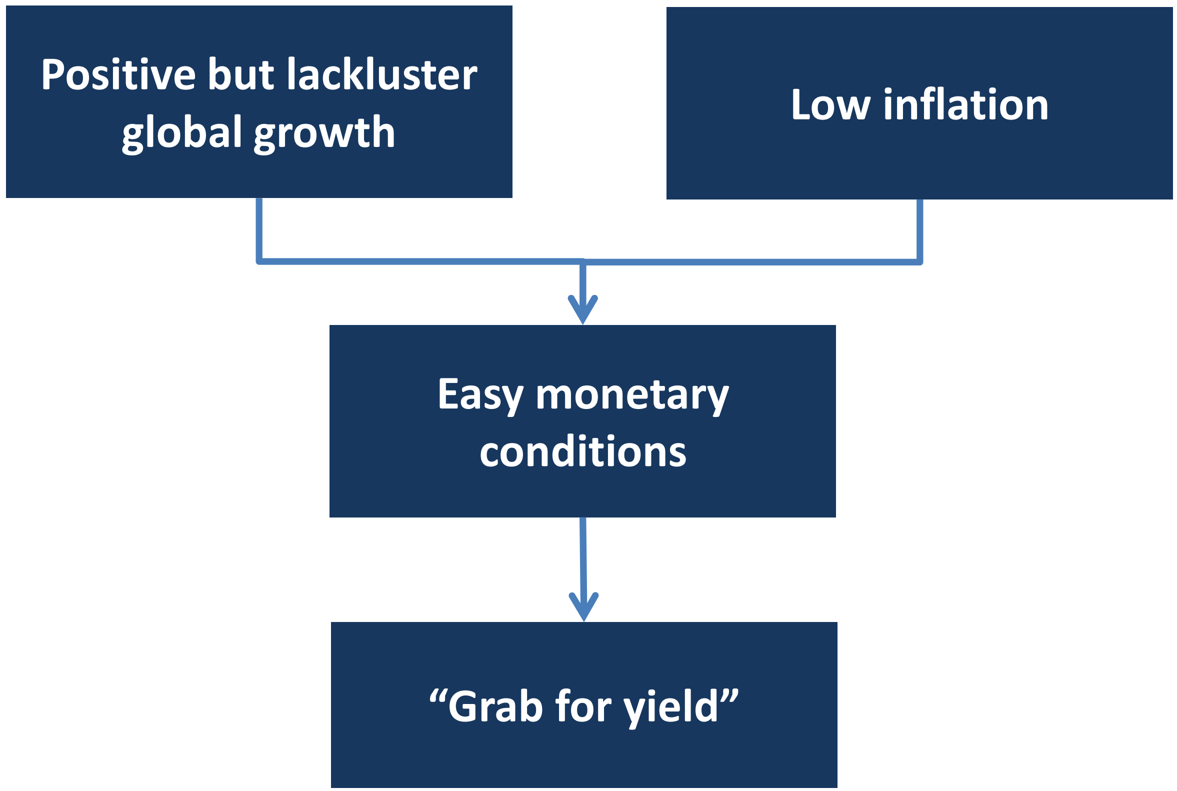
Asset Management

Investing Professionally in the Middle East

Investment Themes

Our fundamental research highlights the following investment themes on a 3 months horizon:



Investment Themes - Details

Positive but lackluster global growth without inflationary pressures (yet):

- Global trade growth subdued with ongoing overcapacity in certain sectors.
- Range-bound oil price: shale-gas caps the upside at around US$50-55 and demand growth supports prices at around US$35-40. Potential OPEC agreement could move the range slightly up though.
- In the context of rising commodity prices we monitor potential feedback into higher inflation expectations very closely.

Major central banks will only tighten very cautiously (USA) or not at all :

- Episodes of financial volatility likely to be short-lived. Investors are pushed towards riskier assets.

GCC: economies adjusting to the lower oil prices:

- Tighter fiscal policy with capital spending slashed, subsidy cuts and introduction of new taxes.
- Demand growth under pressure, especially discretionary items.
- Budget deficits to be financed partially by debt issuance. This will offer opportunities to capture new issue premia.

Asset Allocation Views:

- Environment beneficial for fixed income in general while sector selection is key for equites.
- Assets which still offer some yield in a low –return environment will benefit. EM, GCC fixed income and dividend return strategies will probably do well.
- We seek to extend duration in UAE and Qatar and, opportunistically, in Kuwait and Saudi Arabia.
- In equities, subdued consumer demand in GCC countries drives us to underweight this sector.
- We are underweight growth stocks and overweight high-dividend stocks.

Strategic Biases – Major Asset Classes

Our strategic top-down views on a 3 months horizon:

Region / Country	Credit Spreads	Equities	Currency
GCC	positive New issuance a buying opportunity, RV in global context	neutral SA to outperform rest of GCC	neutral
North Africa	positive Benefit from high yield in EM context	positive Egypt to outperform after FX devaluation	negative EGP devaluation expected
Turkey	neutral Challenging political situation will cap potential for spread tightening	negative Sensitive to US hikes & political risks	negative
India & SE Asia	neutral	neutral	neutral

positive neutral negative

Strategic Biases – MENA Equities

Our strategic top-down views on a 3 months horizon:

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

↗ positive → neutral ↘ negative

Fixed Income - Monthly Comment

Where we stand

Markets consolidated during September and were relatively uneventful apart from the second half in which we had the FOMC and OPEC meetings. While the FED refrained from hiking and guided towards a lower adjustment path, the OPEC meeting resulted in a preliminary agreement to cut production but details still need to be confirmed during their next meeting in November as well as any potential co-operation with non-OPEC members.

We continue to see very strong interest from issuers to tap the market which keeps a lid on price performance at the tight end of this year's valuation levels.

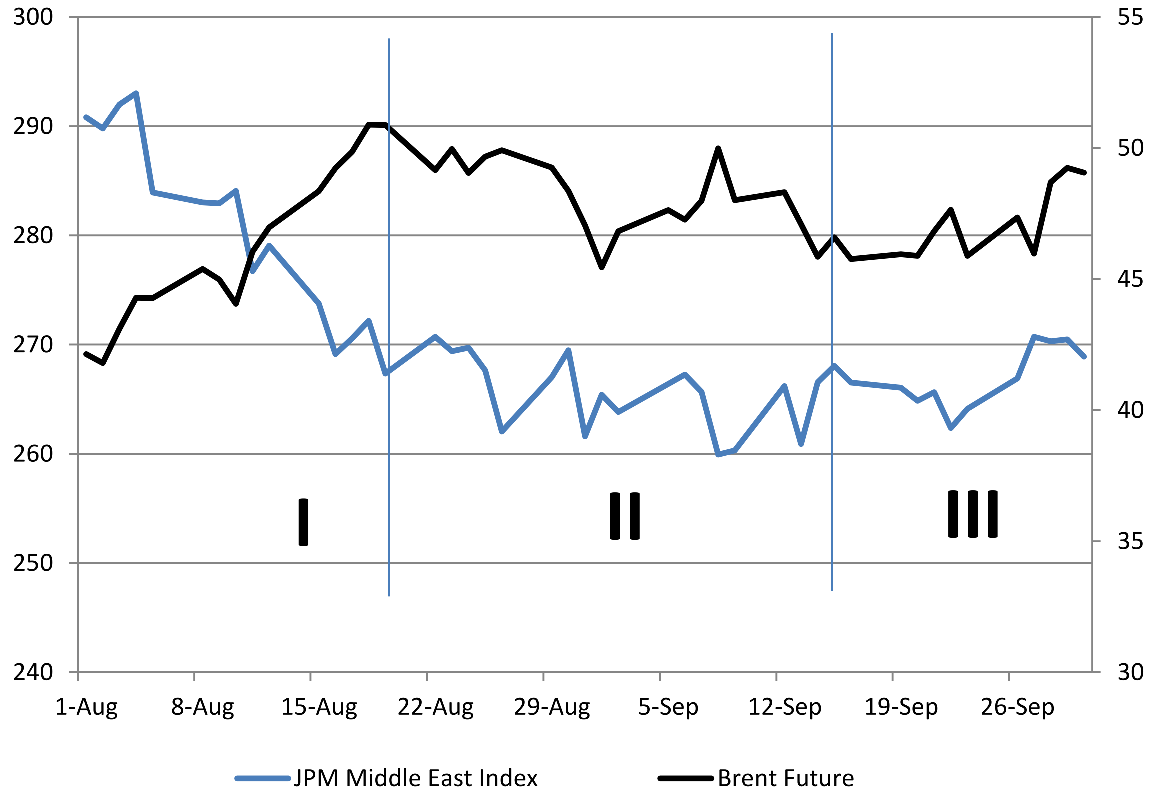
Outlook

The market is still waiting for the Saudi issuance which keeps many investors on the sideline and playing it safe. Entering October, as well as the last quarter of the year, we expect that the market will be dominated by three issues – apart from the technical supply and demand situation:

a) the continuing recovery of oil prices,
b) the likelihood of a rate hike at the end of the year,
c) inflation expectations driven by higher commodity prices.

In our base case we continue to see a supportive environment for fixed income, however we could enter into a transitional period in which the future path is very much data dependent and might warrant a change in portfolio allocation towards less interest rate sensitivity.

Fixed Income Chart of the month – oil correlation to regional spreads



Over the last two months we have noticed a very significant change in the correlation between regional spreads and the oil price. While there is normally a solid inverse relationship - oil prices and spreads moving into opposite directions (Sector I) due to the macro effect of higher oil prices, we have entered into a period in which the relationship was more diffuse (Sector II) and finally started to turn into slight positive correlation (Sector III).

We believe that the regional bond and Sukuk market has reached a valuation level at which the incremental change in oil price is not sufficient to automatically translate into tighter spreads. Going forward the market will need a higher conviction that oil prices will remain in the upper trading range until we see further spread tightening (ceteris paribus).

Sources: JPM, Mashreq Capital, Bloomberg Oct. 2016

Equities - Monthly Comment

Where we stand

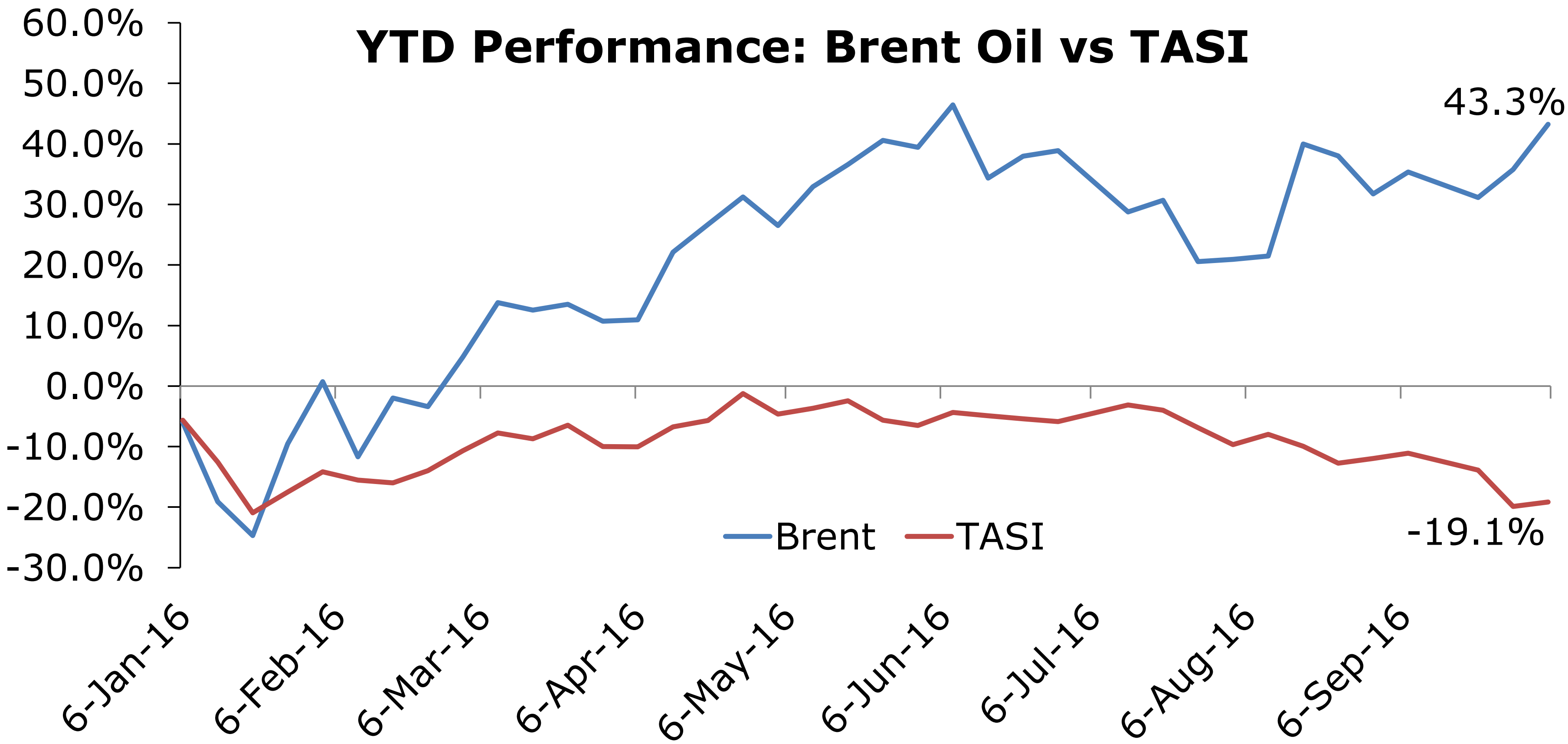
- OPEC met in Algiers on September 28th and decided to freeze production at 32.5 to 33mbpd versus where the cartel stands at under 34mbpd. Details on who halts/cuts/increases production will be ironed out in the November OPEC meeting. The headline is definitely positive and oil has reacted positively over the following several days, however, historically OPEC has rarely abided to production quotas. Nevertheless, this is the first time OPEC acts as a cartel in the past two years, which should put a floor on prices. We don't expect oil to rally above USD 55-60/bbl over the next 3 months as shale oil producers will enter the market.
- In Saudi, liquidity continues to hurt the economy and financial markets. To add insult to injury, the government cut wages on the public sector sending the market tumbling down to January 2016 levels. No sector was spared in the panic sell-off that ensued, however, petrochemicals have outperformed as demand is not correlated to domestic demand. Over in the UAE, the market was stable as EM flows trickle in. Qatari started the month on a negative note tumbling as much as 11% from their August highs and have since not recovered despite being included in FTSE EM Index. In Egypt, the market went into a mild correction mode in September as the market awaits the EGP floatation.

Outlook

- Saudi anecdotally seems to be trying to repair their targeted fiscal austerity by instructing banks to restructure loans with no additional cost, supporting Saudi citizens with direct cash support earnings less than SAR 13k/month paying Saudi Bin Laden USD 1bn, Saudi agreeing to cut oil production on paper promoting oil price stability. Additionally, a bond issue for the sovereign would big a boost to liquidity and sentiment.
- The Central Bank of Egypt is expected to float their currency in October. This is a widely anticipated event that will be taken positively by the market. However, following such a move, economic reforms will need to be properly enforced for the investor community to continue to be positive on the economy and financial markets.
- Despite Qatar being added to the FTSE EM index, the market corrected 10%+. Nevertheless, passive index followers have a leeway to enter the market and we believe this correction offers a good buying opportunity.
- UAE markets have been benefitting from EM flows. However, UAE markets are the only markets that have not corrected unlike Qatar, Saudi and Oman. We are cautious on the market but believe a correction will be a good opportunity to accumulate positions.

Equities - Monthly Chart

Saudi Arabia has underperformed oil by 62% year-to-date



Source: Bloomberg, September 2016

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