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INVESTING PROFESSIONALLY IN THE MIDDLE EAST

Monthly Outlook – October 2019

1. Global and Regional Asset Allocation

Global Asset Allocation

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Asset Class	Tactical View (3m horizon)
Equities	Global cyclical slowdown and a lack of clarity on the protectionism stance undertaken by developed economies coupled with overbought market conditions and deteriorating corporate fundamentals drives our cautious tactical stance on equities. The positives witnessed encompass trend-like growth and a collective central bank dovish stance which could support the markets in the near term.
Fixed Income	Poor economic data, ongoing political drama in the UK and a technical recession looming over the European economy will continue to drive investor sentiments in the markets. While world central banks are loosening their monetary policy pockets to revive sluggishness in global growth, risk-off mode driven by flight to quality is expected to weigh on global yields.
Commodities	World GDP growth slowdown backed by the trade wars, expanding shale oil production and intensifying geopolitical risks 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 taken by the OPEC+. Gold is expected to continue to be a preferred asset on the back of its safe haven status and a decreasing 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 fair 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 temporarily averted, albeit remains a risk selectively (for example, Bahrain and Oman).
 North Africa	→ Long-dated sovereign bonds provide value for carry positions while we witness fundamentally improving economies.	↑ Earnings growth is positive and the market is cheap. Also, it should benefit from the rate cuts.	→ EGP to remain in a band.
 Turkey	↓ Ongoing policy stimulus, improving economic data provides support for the sovereign although geo-political, sanctions and policy risks remain a key challenge.	↑ It could be the main beneficiary from the monetary easing in the US.	→ We expect continued volatility with the lira in 2H2019.

*Downgrade in MC rating from last month.

Mashreq Capital View: ↑ Positive → Neutral ↓ Negative

2. Global Portfolios

Global Assets – Monthly Commentary

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Overview

DM Equities (+2.1%)

Optimistic trade comments between the US and China along with positive surprise revisions in key economic data led to a risk-on market sentiment driving the returns in the equity markets.

EM Equities (+1.90%)

EM stock markets rallied on the back of improving structural characteristics of EM economies supported by expansive fiscal and monetary stimulus measures. The return was driven by major markets like India, Russia and Brazil.

DM Fixed Income (-1.02%)

Treasuries saw a sell-off with major sovereign bonds correcting sharply, driving yields upwards amid improving trade talks and easing protectionism stance taken by the US.

EM Fixed Income (-0.46%)

EM bonds witnessed a mild downturn supported by less sensitivity to interest rate risks as opposed to spread risks compared to DM bonds with support coming from widespread central bank dovishness and lower global yields.

+ Positive Returns / – Negative Returns

Outlook

DM Equities: Neutral

Global growth continues to face headwinds from a downturn in the economic cycle aided by recurrent trade frictions. Muted inflation trends and poor core economic data should continue to drive the economic policy. Expensive valuations and reducing corporate profitability leads to our neutral stance.

EM Equities: Neutral

Dovish EM central banks and fiscal policy stimulus in varying degrees witnessed in EM economies are appealing attributes for EMs, though the trade uncertainty, soft data releases leading to the slowing EM growth momentum leads us to maintain our cautious view on the asset class.

DM Fixed Income: Positive

Safe havens should be sought after amid a combination of continuing trade uncertainty, consistent weak macro Euro data, Brexit related ambiguity and the fact that the global pool of perceived safe assets are limited. Central banks are expected to continue to try to boost the benign growth witnessed in the core economic data.

EM Fixed Income: Positive

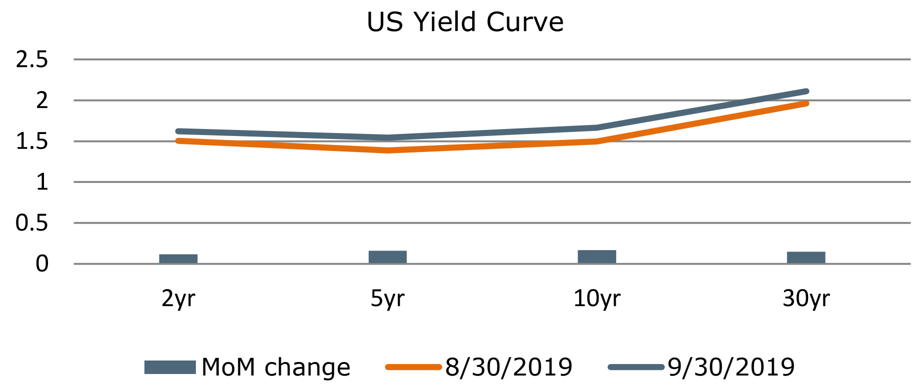
Despite the volatility in EM fixed income, the asset class should be supported by central banks maintaining their easing cycles on the back of disappointing manufacturing data and compressing global growth outlook.

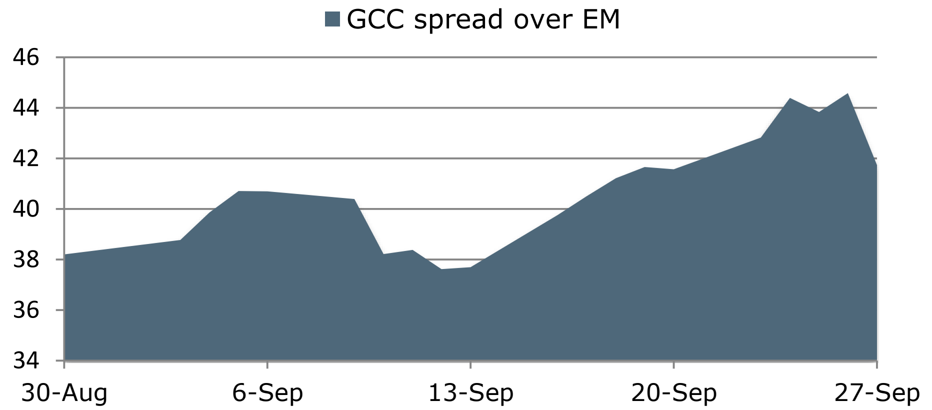
Positive Neutral Negative

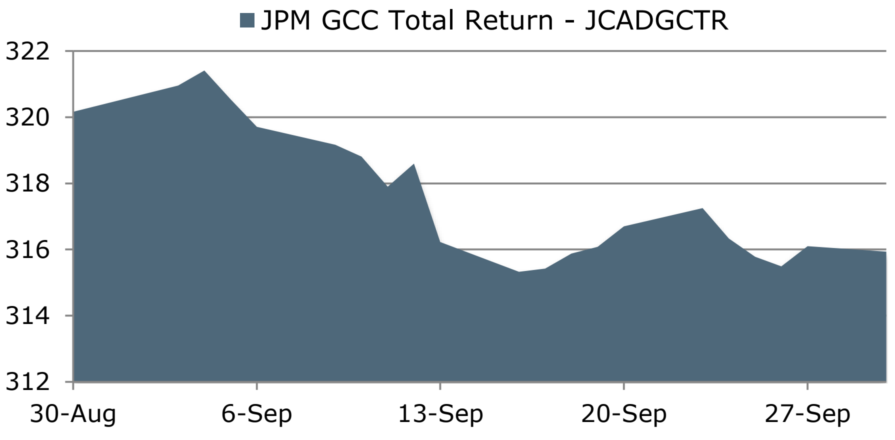
Source Morningstar: DM Equities = MSCI World Index; EM Equities = MSCI Emerging Markets Index; DM Fixed Income = Bloomberg Global Aggregate Index; EM Fixed Income = JP Morgan Emerging Market Bond Index. Overview figures are monthly, unhedged US dollar returns. Outlook forecasts are based on a 3-6 month timeframe.

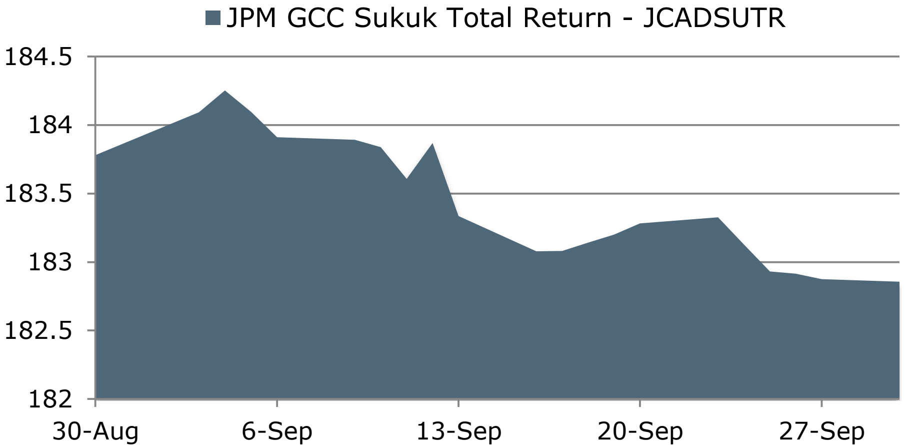
3. MENA Fixed Income

MENA Fixed Income - Markets









Sources: Mashreq Capital, Bloomberg

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Overview

EMD stalled its positive performance in September with the global EMBI down by 0.46%. The global benchmark's return was relatively better compared to the Middle East Index's loss of 1.85%.

President Trump and China had some optimistic trade talks, which calmed the negative rhetoric witnessed by the market during the quarter. The tariff increases are affecting about three quarters of China exports to the US and the majority of US exports to China. Elsewhere, JP Morgan announced that it will start a phased inclusion of Chinese government debt into its Government Bond - Emerging Markets Index. China's weight will be capped at 10% with the inclusion starting in February 2020.

Widespread easing of monetary policy by EM central banks was observed to combat the continued soft growth environment. In India, the Ministry of Finance announced a reduction in the corporate tax rate to 22% from 30%.

September saw the highest monthly issuance of EM sovereign, quasi-sovereigns and corporate debt on record at USD 88bn with South Africa, Abu Dhabi, Bahrain and Ecuador coming to the capital markets to raise debt.

Oil prices were under pressure due to intensifying geopolitical tensions, concerns over the demand outlook and strong US supply. In September, oil prices spiked sharply higher following an attack on key Saudi Arabia production facilities that wiped out 5% of global supply.

Outlook

EM bonds should continue to be one of the biggest beneficiaries of DM central bank policy easing stance. Investors are likely to flock to EMD given the increasing number of negative-yielding sovereigns from Germany to Japan as a result of dovish rhetoric from the Fed to the ECB. Global growth has now slowed to the slowest pace since the Eurozone crisis and ongoing trade tensions and other geopolitical uncertainties leave it poised to slow further.

The ECB's well-flagged package of a lower deposit rate, open-ended QE and more forward guidance was duly delivered in September while China also stepped up its monetary easing as the economy slowed further. We believe on the back of poor economic data and as recession fears are growing again among investors, ECB could further open up their wallets through increased QE or fiscal stimulus to support the flagging economy.

EM growth is slowing and is below its potential rate much like in the developed markets. EM economies will be majorly driven by the headline noise as we anticipate deteriorating data from the US, as well as another round of US- China trade talks. Central banks look likely to continue following the dovish path laid by the Fed. EM policymakers have become more active in cushioning their economies against intensifying headwinds to growth.

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

4. MENA Equities

MENA Equity View

Sector	GCC	North Africa	Turkey
Banks	Negative	Neutral	Neutral
Consumer Goods	Neutral	Neutral	Negative
Real Estate	Neutral	Neutral	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 neutral.
- Real Estate: Falling interest rates will positively benefit interest rates hence we upgrade to neutral from negative.
- Telecommunications: 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 continued their struggle in September down by 1.3% on the back of trade war and geopolitical tension. Oil prices also declined by 0.5% over global growth concerns. MENA markets are up 3.3% for the year underperforming Emerging markets, which are up 3.6% YTD.

In Saudi, the market gained 0.9% as the government announced a USD3bn boost for businesses in the form of easing of expat worker fees having positive impact on industrial names. The market is up 3.4% YTD.

Egyptian shares (Hermes Stock Market Index) traded weak and fell as low as c.10% during the month due to anti-government protests which impacted investor sentiments. However, rate cuts (100bps) and no further escalation in socio-political events led the markets to recover and finally closed down by 4.7% for the month (-3.09% in USD terms). The market is up 2.6% YTD.

The Qatari market gained by 1.3% on the back of passive flows mainly in banking stocks and was also supported by local investor interest in some of the industrial names. The market is up by 0.7% YTD.

The UAE finished down 3.3%, led by weakness in real estate names which on an average fell by 7%. The weakness in real estate was offset by strong rally in banking names after Emirates NBD announced an increase in FOL to 20% and led to believe this should be followed by peers. The UAE overall index is flat YTD.

In Kuwait, the market continued it’s weakness for the second month down by 5.4% on the back of geopolitics. The market is up 17.2% YTD.

Outlook

In Saudi, 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.

In Egypt, inflation has reached single digits despite additional utility and fuel subsidy cuts, due to high base effects and a stable currency. The CBE after cutting 350bps interest rates in YTD 2019, we expect further 50-100bps cut for the remainder of 2019 which should help sustain the rally.

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 15x 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.

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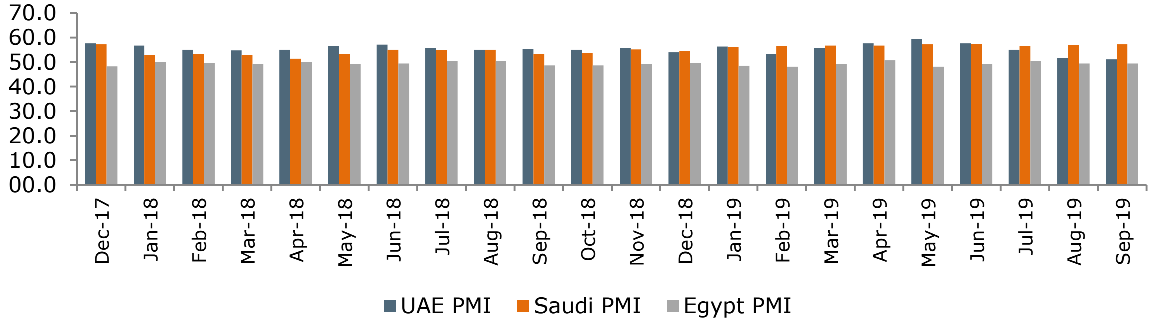
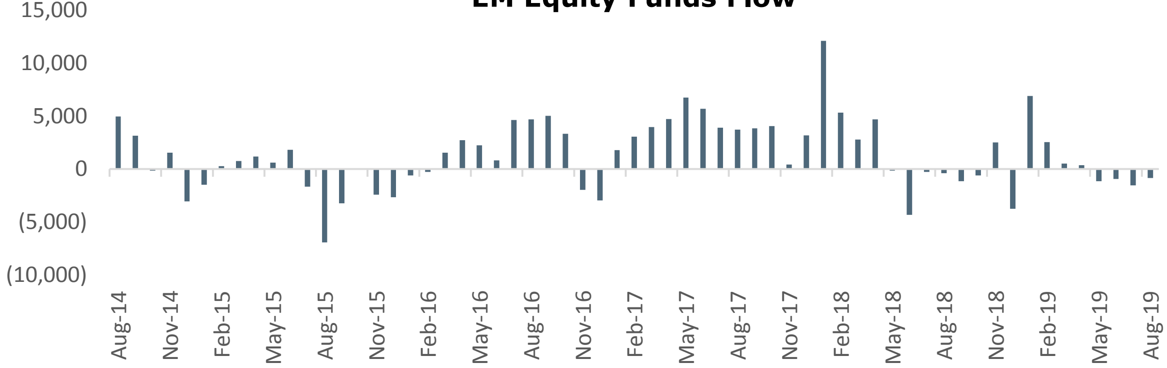
Purchasing Managers Index



Saudi PMIs increased to 57.3 on the back of strong orders while Egypt PMIs remained flat at 49.5. UAE PMIs fell to lowest of 51.1 in September on the back of weaker new orders.

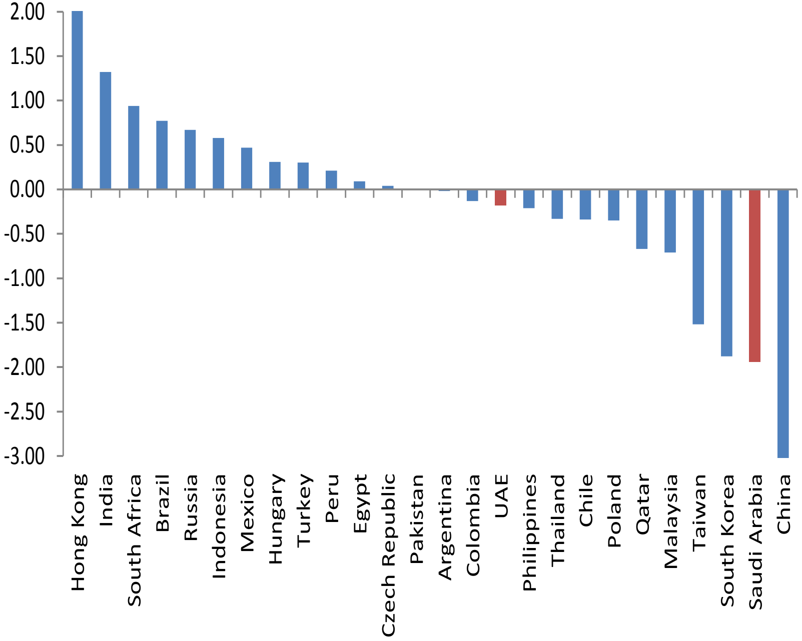
EM Equity Funds Flow



August saw a net outflow of USD0.9bn vs. net outflows of USD1.5bn in July, in Emerging Market Equity Funds.

MENA Equities – Chart of the Month

Active Fund Managers: Actual vs. Benchmark Positioning (MSCI EM INDEX)



Global active managers are underweight in Saudi and China on the back of geopolitics, expensive valuations and trade war while overweight India and South Africa due to easing policy to benefit equity story.

Sources: Mashreq Capital, Morningstar

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