

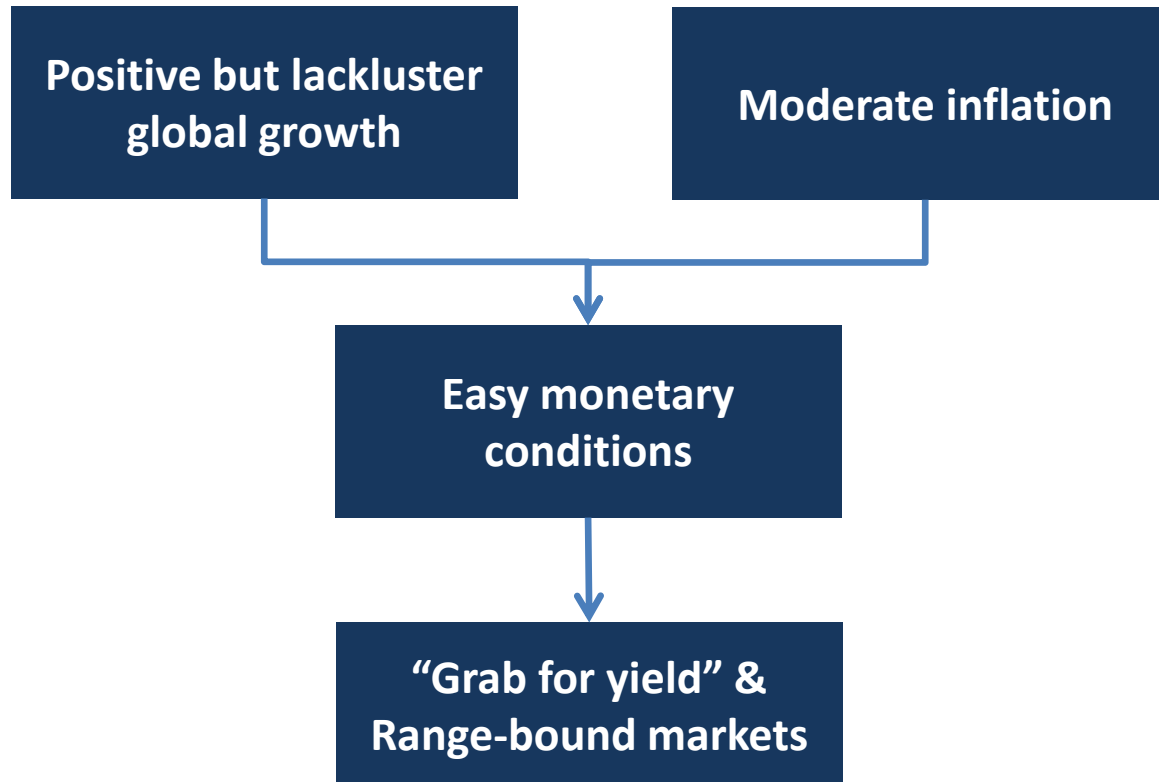
## Monthly Outlook Dec 2016





mashreq capital  المشرق كابيتال  
Investing Professionally in the Middle East

## Overview

## Global Investment Themes


















## Global Asset Allocation

Asset Class	Tactical View (3-m horizon):
Equities	 <p>We take some profits after the recent strong gains. Expectations about US and global growth may have become too optimistic</p>
Fixed Income	 <p>The bond market has delivered one of its typical corrections: sharp and short-lived. We expect yields to remain broadly stable in the coming months</p>
Commodities	 <p>We expect commodity prices to move sideways after their recent rebound</p>

## Strategic Biases – Major Asset Classes

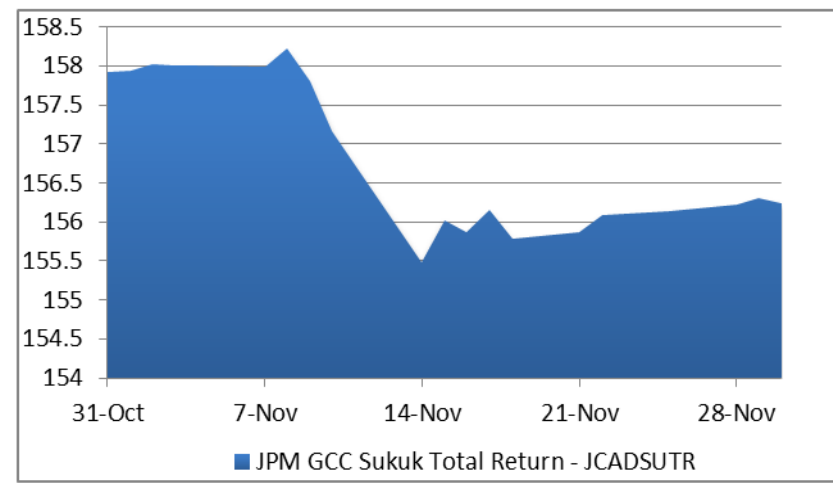
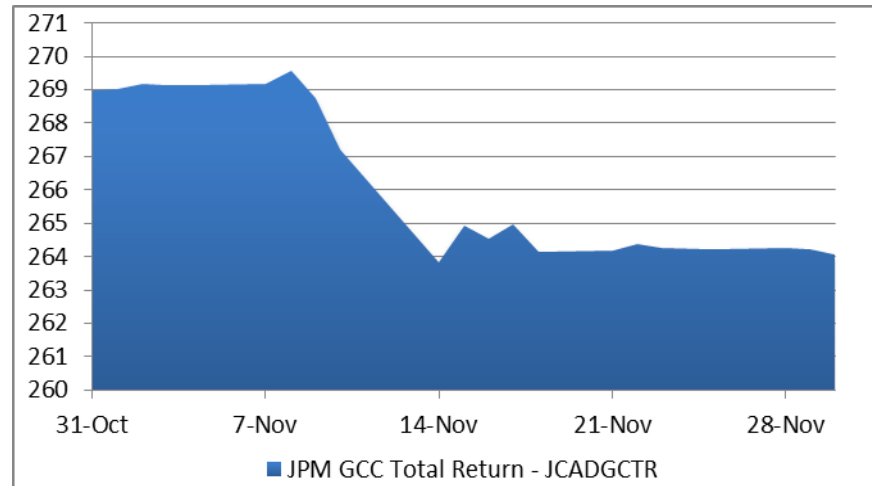
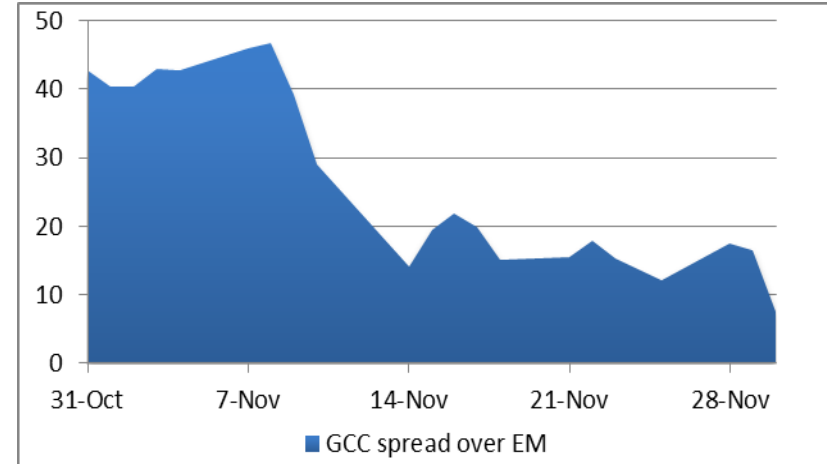
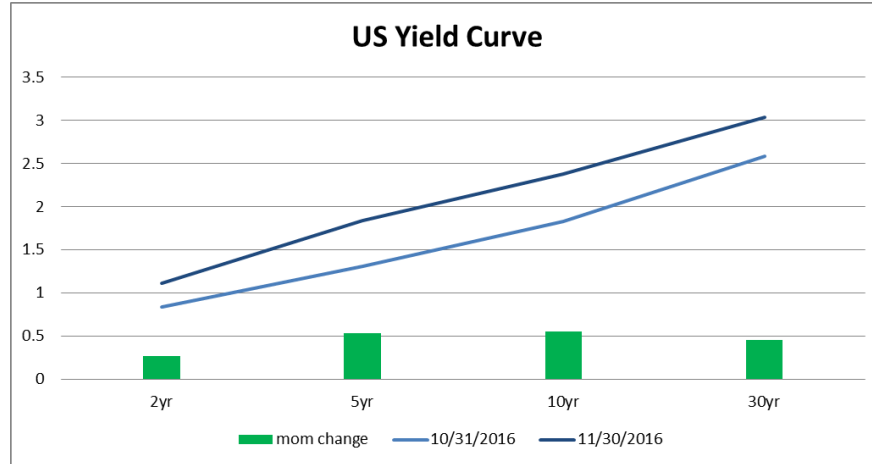
Our strategic top-down views on a 3 month horizon:

Region / Country	Credit Spreads	Equities	Currency
GCC	 Potential to tighten further on attractive absolute yields within a stable oil environment	 KSA & UAE to outperform rest of GCC	 Speculation on de-pegging unwarranted
North Africa	 Rebalancing opportunity into higher yielding less US treasury sensitive bonds	 Egypt to perform inline after big move QTD	 EGP to strengthen from portfolio inflows
Turkey	 Challenging political situation will cap potential for spread tightening but absolute yield levels should attract demand	 Sensitive to US hikes & political risks	 Carry trade to pressure currency
India & SE Asia	 Selective buying opportunities at belly of curve		

 positive     neutral     negative

## Fixed Income

## Fixed Income - Markets



Sources: Mashreq Capital, Bloomberg Dec. 2016

## Fixed Income - Monthly Comment

### Where we stand

The month of November has been a very challenging month for the fixed income universe in reaction to the US election results. The dramatic move is largely attributed to the expected expansionary fiscal policy, tax cuts and possible inflation driving tariffs on imports. Essentially the Trump victory has amplified existing market expectations of rising inflation, a shift from monetary to fiscal policy as well as rising global growth which hence accelerated the market adjustment.

While these developments justify a higher risk premium in the bond markets, the question remains how much will the real impact be and how much has already been discounted by the markets. Expected policy cannot be taken at face value alone but has to be assessed as a whole with all of its consequences.

The feedback loop of recent market activity into the real economy constitutes a tightening of financial conditions for US corporates, which have increased leverage over the last several years. A higher US dollar makes US production less competitive. Also US debt is expected to hit the ceiling once again by the end of the first quarter 2017.

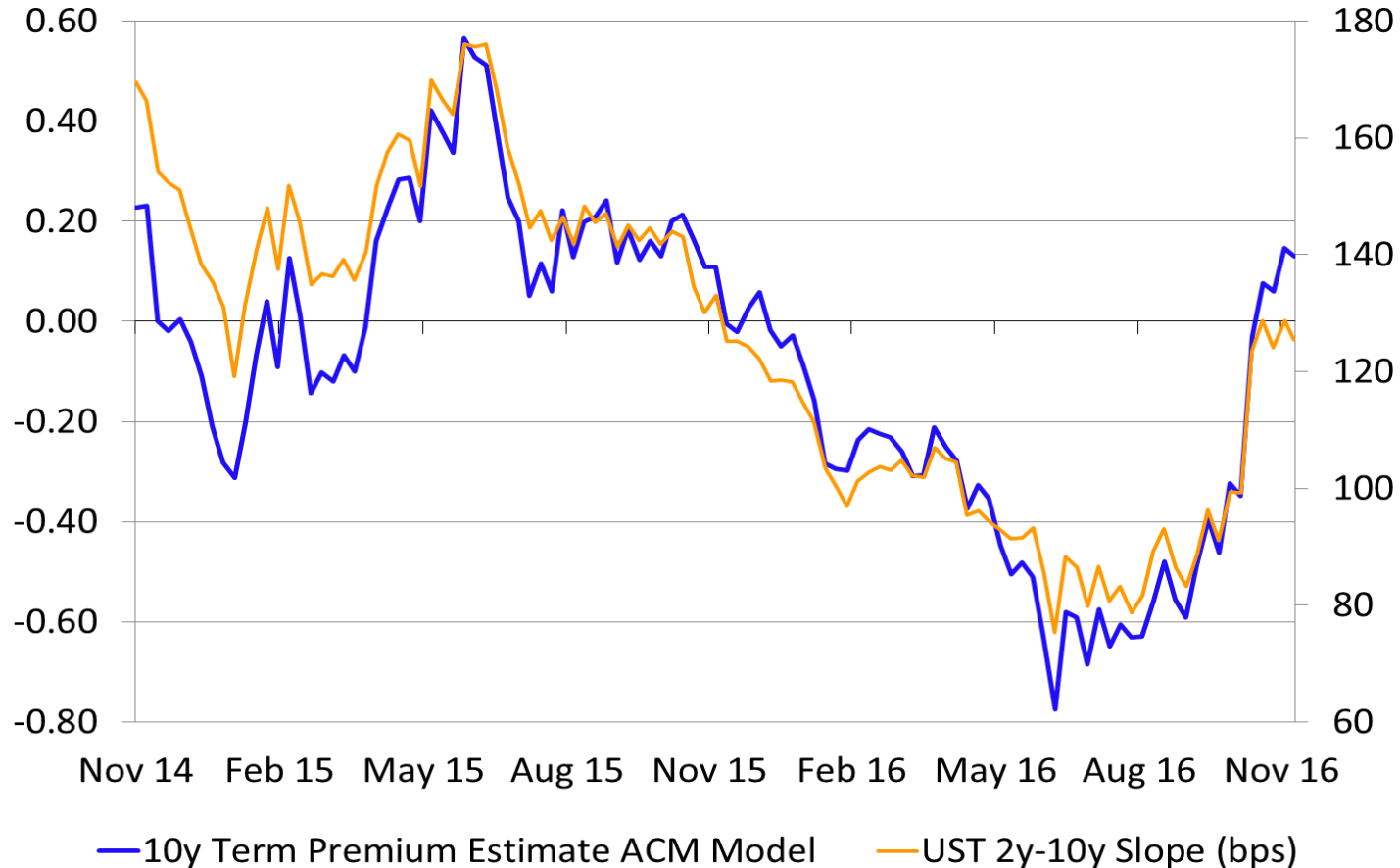
### Outlook

In our base case, we see a supportive environment for fixed income after the recent market adjustment. We think current yields embed a positive risk premium for bond investors. In the meantime we see higher yields as an opportunity for higher total returns. Still we acknowledge that the main risk scenario for rates is that of faster Fed hikes because of easier fiscal policy and/or a faster pickup in wage growth.

We expect MENA credit spreads to remain relatively tight.



## Fixed Income Chart of the Month: Rising Risk Premium



The bear steepening of the US Treasury curve is consistent with investors requesting a higher risk premium. Going forward, we expect yield to be broadly stable. The main risk to our benign view is a bear flattening on the back of faster-than-expected Fed hikes

## Equities

## Regional Equity Strategy

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

↗ positive    → neutral    ↘ negative

## Regional Equities - Monthly Comment

### Where we stand

- Saudi was up 16% in November as positive momentum spilled over from October when the index rallied 7% post the \$17.5bn bond issue and enjoyed its best monthly return since April 2009. With 2016 being marked as a transitional year, expectations of an OPEC production cut served as the impetus for investors to upgrade their growth expectations for KSA.
- The move by the Egyptian CB on Nov 2<sup>nd</sup> to float the EGP, raise key interest rates by 3% and the approval of the \$12bn IMF loan helped to ignite the strongest rally (in EGP terms) in a decade with the EGX +33% over the month. Foreign inflows of \$220mn since the float compares to the year to float inflows of \$95mn (which includes 2 IPO's). Please see two slides ahead for more on the EGP devaluation.
- Qatar continued underperforming during the month, losing close to 5% and is now down close to 7% YTD meaning Saudi is no longer the worst performing market. We believe, like Saudi in the summer, Qatar is suffering from liquidity issues shown from increasing interbank offer rates.
- EM outflows post the US election and subsequent passive selling weighed on the on-benchmark UAE and Qatar markets mid-month. Significant retail churn in UAE mid and small caps drove volumes 2x recent averages over the month as margin trading hit highs not seen since March.

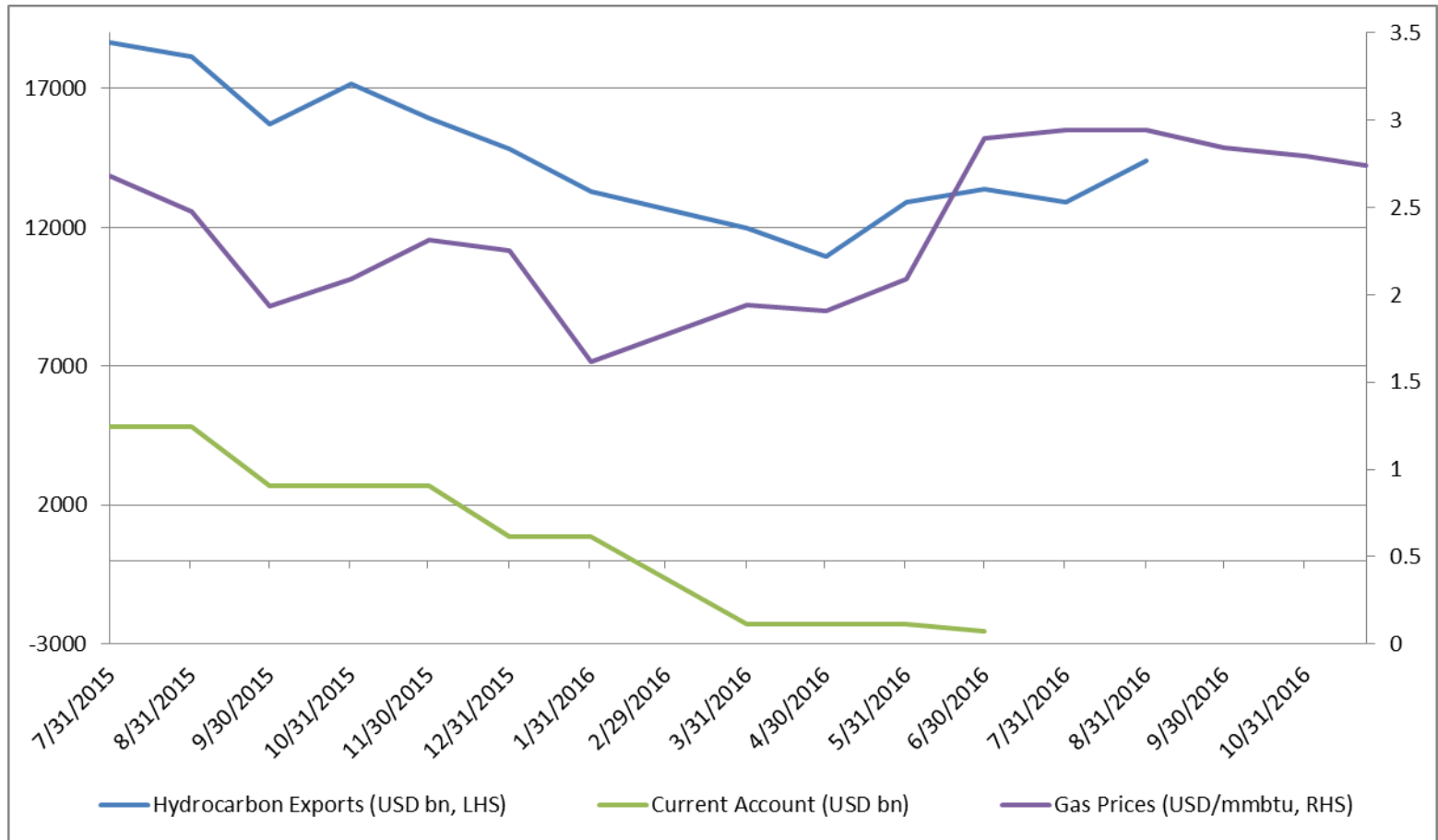
### Outlook

- OPEC decided to cut oil production by 1.2mn barrel /day which we think will support oil price to stay above \$50 for 2017. As the majority of domestic investors sit on more than 20% cash levels and internationals retaining a minority interest (c1% mkt ownership), the scope for further upside is significant.
- Despite Egypt having been in their own world in November despite weakness from EMs, we believe the pressure will be on as liquidity tightens as USD strengthens. Additionally, Egypt sovereign has pushed back their USD 3bn Eurobond offering as a result of higher treasury yields.
- Qatar continues to be pressured by liquidity concerns from ever increasing interbank rates. This could be structural in nature or window dressing for the end of the year. One thing remains certain, government can't afford a non functioning banking system with FIFA World Cup related spending. We expect, higher hydrocarbon exports, potential bond offering to support liquidity at the margin.
- UAE markets are well positioned compared to other markets as the economy and financial markets offer relative stability. We believe investors are not rewarding the market for this characteristic as there have been pressure on EM equity flows since Trump was elected US president. We believe this is temporary in nature.

## Equities – Chart of the Month

### Qatar's Current Account Deficit at an Inflection Point

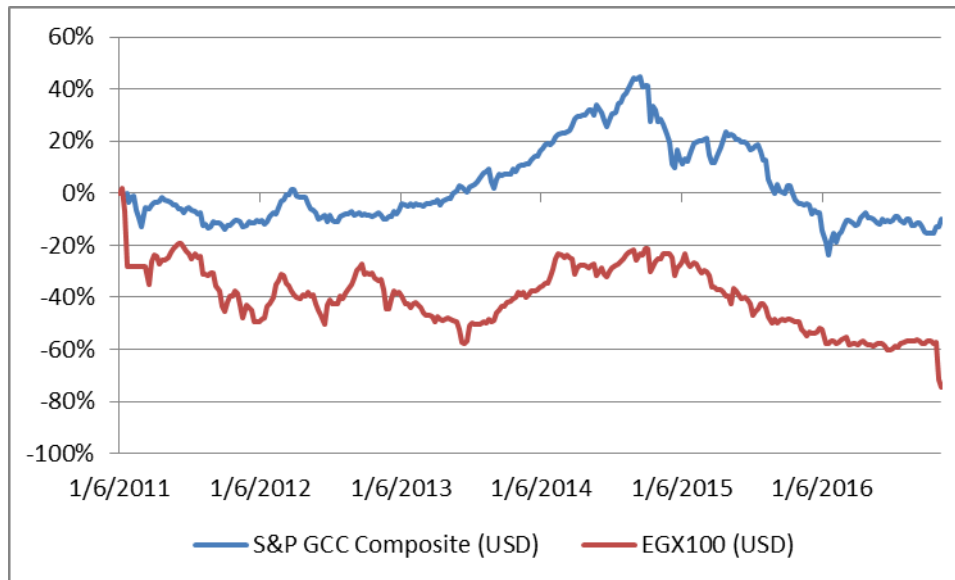
With oil and gas prices on the upswing, which is also seen from higher hydrocarbon exports QoQ, we expect current account to improve in the 2H16.



Source: Bloomberg

## EGP Floatation – The Right Step for Economic Reform (1/3)

- On November 3<sup>rd</sup>, the Central Bank of Egypt (CBE) left the Egyptian pound to float, contrary to expectations of a managed devaluation. They also raised interest rates by 300bps. Within a few days, the EGP saw offers around 17 to 18 versus the US Dollar.
- While this was a widely anticipated event, the magnitude of the currency move in such a short time period was a shock to all stakeholders. Having said that, it was a much needed move as the market attempts to find an equilibrium level at which we'll begin seeing dollars flowing in, import backlog clearing and the economic growth beginning to accelerate after years of economic inactivity.
- This is the reason we have seen equities rally over 30% since the floatation and will continue to see the market rally as investors position themselves to benefit from a secular bull market that is about to resume course after being halted following the ousting of former President Hosni Mubarak. However, the latter move won't come without a painful adjustment period for Egyptian corporates and households.



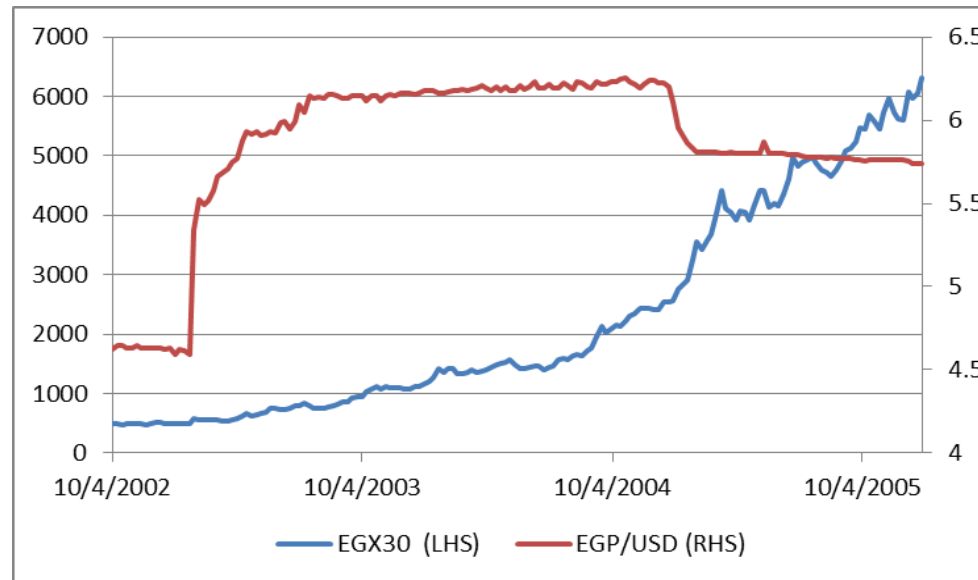
The EGX100 has underperformed by 64% in USD terms since the Arab Spring

Source: Bloomberg, as of November 9<sup>th</sup> 2016

## EGP Floatation – The Right Step for Economic Reform (2/3)

- As investors in Egypt we are bullish as ever following the floatation. However, the massive devaluation in the currency has resulted in portfolio valuations dropping by a rather large amount. We have underestimated the magnitude of the devaluation as we expected an intervention by the CBE to 'smooth' the floatation process. Nevertheless, the long-term story of Egypt is intact and equity returns will eventually far exceed the EGP's devaluation. In 2003, for example, equity returns exceeded 1000% within 3 years. While we're not expecting such returns, we think that nominal equity returns will far exceed the devaluation over the long-term.

### EGX30 Appreciated by more than 1000% following the 2003 devaluation

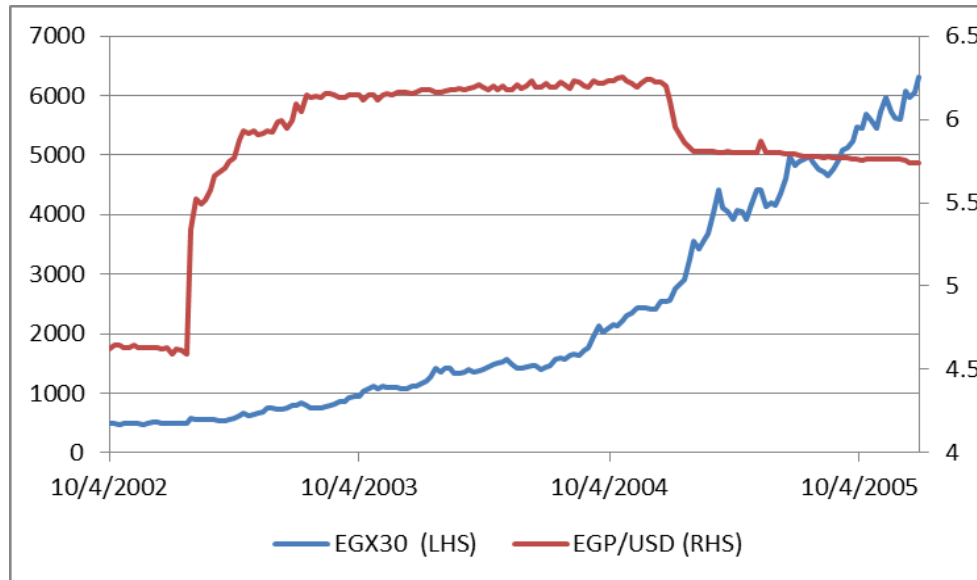


Source: Bloomberg, as of November 9<sup>th</sup> 2016

## EGP Floatation – The Right Step for Economic Reform (3/3)

- We expect the EGP/USD to be between 12-13 to the USD over the medium to long-term based on the real effective exchange rates. In the short to medium-term, we expect the FX rate to reach 14-15 to the USD based on where most interbank transactions have been taking place.

### Real Effective Exchange Rate has dropped to Multi-Year Lows after EGP Floatation



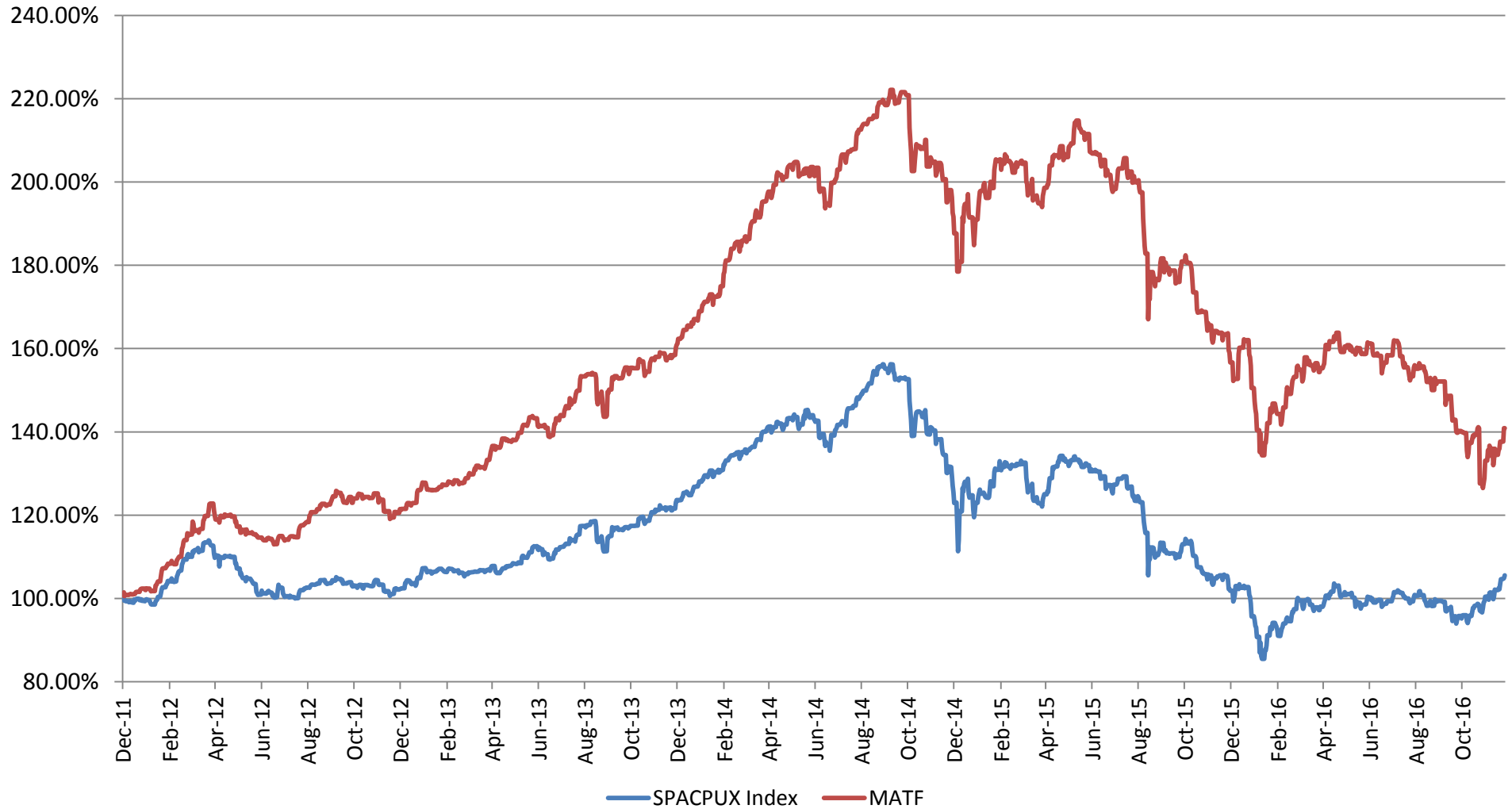
Source: Bloomberg, as of November 9<sup>th</sup> 2016

- The biggest tail risks we see to our investment case on Egypt is risks of a social uprising due to less subsidies being put in place as well as higher prices from importing inflation. Having said that, the government is well aware of these risks specifically after going through various uprisings since 2010. We believe they will be targeting subsidies using ration cards. The inability for Egypt to stick to IMF reforms will also result in a loss of confidence from the IMF and consequent retraction of funds as well as a massive loss of investor confidence in Egypt. This is also something that the government will keep a very close eye on. Lastly, the inability of Egypt to attract portfolio inflows is the only major risk that is arguably out of Egypt's control. Having said that, with treasury bills with various tenors north of 15% (after raising interest rates by 3%) and a currency that has devalued by close to 50%, we believe this risk is a low probability event.

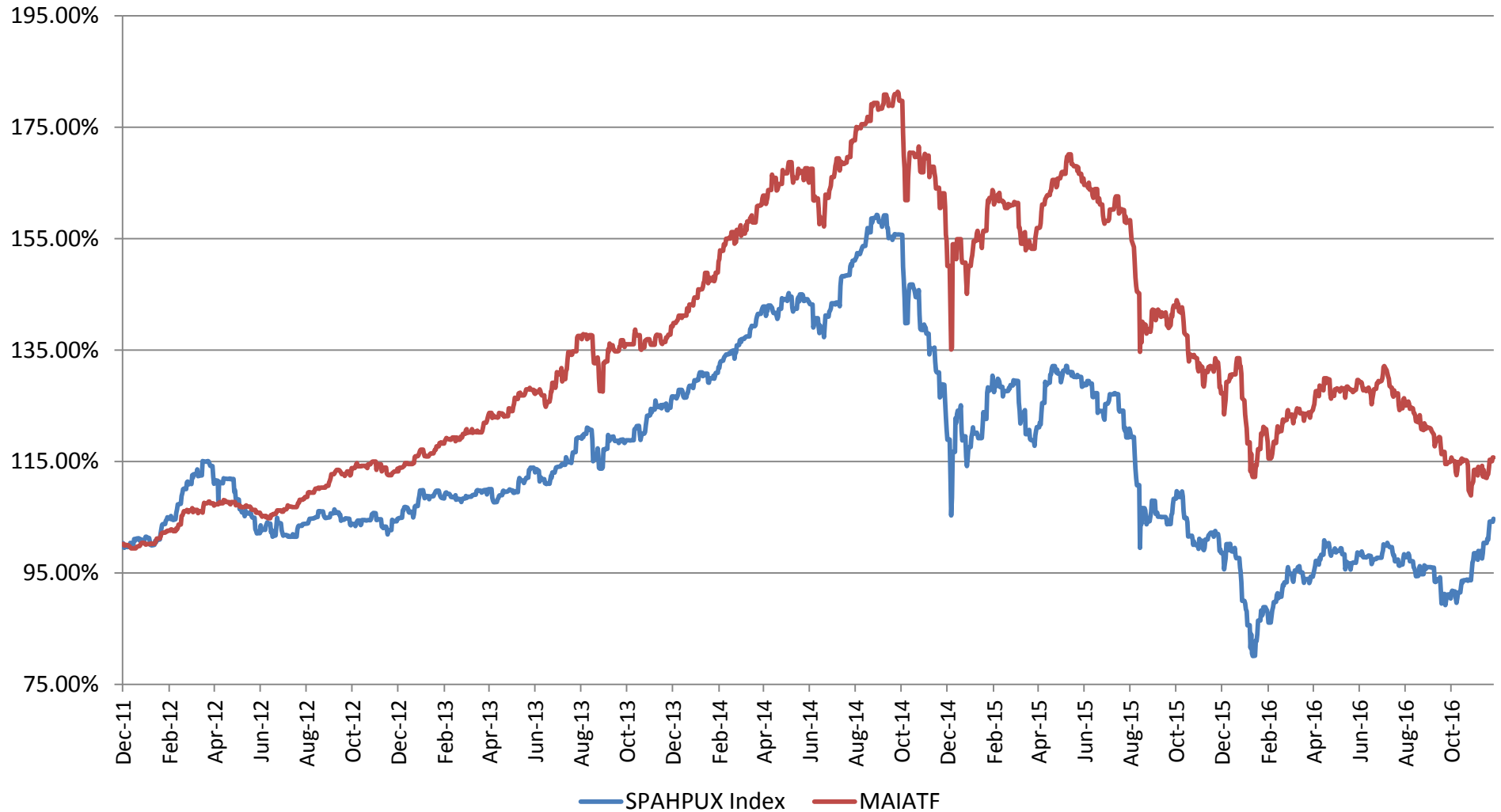


## Fund Performance

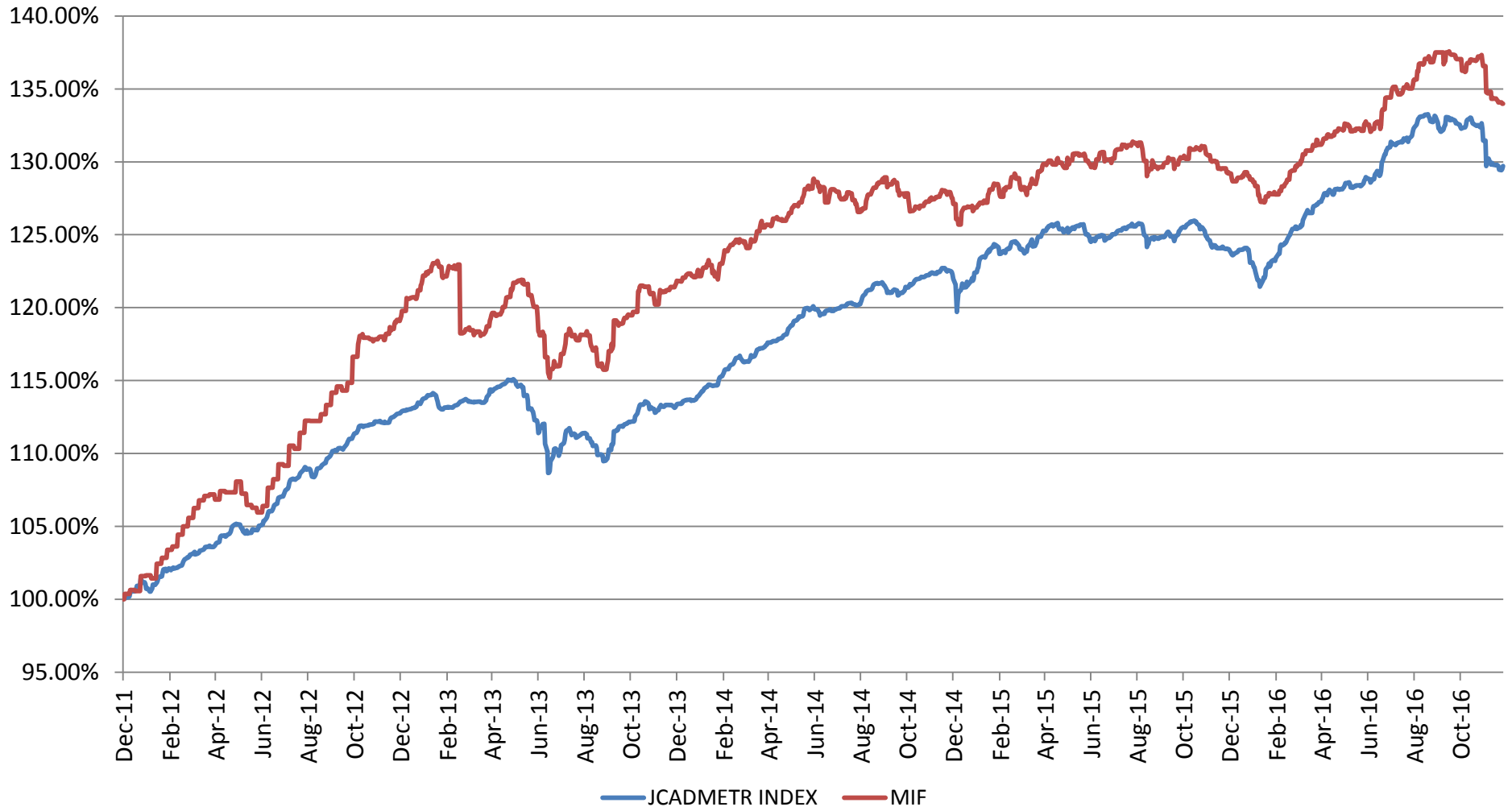
## Makaseb Arab Tigers Fund vs. Index



## Mashreq Al Islami Arab Tigers Fund vs. Index



## Makaseb Income Fund vs. Index



## Mashreq Al Islami Income Fund 5 yr Cumulative Performance



## Contact Us:

- Mail:** Asset Management,  
Treasury and Capital Markets,  
Mashreq  
P.O Box 1250  
Dubai, UAE
- Tel:** +9714 207 8811
- Email:** [assetmanagement@mashreqbank.com](mailto:assetmanagement@mashreqbank.com)
- Website:** [www.mashreqassetmanagement.com](http://www.mashreqassetmanagement.com)

## Disclaimer:

This note has been prepared solely for information purposes. It does not constitute an investment advice, solicitation, offer or personal recommendation by Mashreq Asset Management or Mashreq Capital (DIFC) Limited ("MC"), or any of their related parties to buy or sell any securities, product, service or investment or to engage in or refrain from engaging in any transaction, particularly, in any jurisdiction where such an offer or solicitation would be illegal. Certain assumptions may have been made in the analysis that resulted in any information and results/returns detailed therein. No representation is made that any returns/results indicated would be achieved or that all assumptions in achieving these returns/results have been considered. Past performance is not necessarily indicative of future results. Neither Mashreq Asset Management nor MC warrant the accuracy of the information provided herein and views expressed in this document reflect the personal views of the analyst(s) which does not take account of individual clients' objectives, financial situations or needs. Investors are required to undertake their own assessment and seek appropriate financial, legal, tax and regulatory advice to determine whether this investment is appropriate for them in light of their experience, objectives, financial resources and other relevant circumstances. Mashreq Asset Management, MC nor any of their related parties accept any liability whatsoever for any direct, indirect, consequential or other loss arising from any use of this document and/or further communication in relation thereto. Mashreq Asset Management and MC do not accept any obligation to correct or update the information or opinions in this document; opinions expressed are subject to change without notice.

*FOR THE DIFC-BASED FUND COVERED IN THIS NOTE, THE MATERIAL IS INTENDED ONLY FOR PROFESSIONAL CLIENTS, AND NOT FOR RETAIL CLIENTS, AS DEFINED BY THE DFSA RULES AND SHOULD NOT BE PROVIDED TO OR RELIED UPON BY ANY SUCH PERSON.*

The above terms are indicative and do not constitute solicitation or an offer to sell to the public. This document is not intended to identify, represent or notify the conclusive terms and conditions of any transaction, other material considerations and any possible risks, direct or indirect, that would be involved in undertaking such a transaction.