

Portfolio Managers Outlook

Portfolio Managers Outlook Quarter III 2013

MENA Equity outlook for remainder of 2013

Equities have outperformed in the first half of 2013 and we believe that in a low interest rate environment, equities will continue to outperform. There has been talk that the US Federal Reserve's recent tapering rhetoric i.e. reducing bond purchases will have an impact on the US economy. We believe this not to be the case for the following reasons. Should the Central Bank begin to decrease liquidity injections, firstly, they will still be purchasing bonds but at a slower pace – additionally, there will still be the FED backstop should the economy weaken. In any case, despite the rhetoric to decrease bond purchases, US data remains strong, specifically housing data. Monthly supply of homes is at 4 month, levels synonymous with periods of significant house appreciation. Additionally, various consumer confidence indicators are at levels not seen since the 2008 crisis, which is a positive for the economy (consumers represent two-thirds of the economy).

Over in Europe, while they are mildly in recessionary territory, the continent's overall economy is stable and unlikely to have negative surprises in the short term following the European Central Bank's statement on July 4th to extend low interest rates for an extended period of time. In China, the weakening data is a cause for slight concern. Sequential growth for second quarter GDP numbers came in at an annualized reading of 6.8% versus 6.4% in the first quarter. A sequential improvement, but a weak GDP figure nonetheless. Government officials have stated that a consistently weak GDP growth figure below 7% is their pain threshold. Therefore, should the data continue to weaken, we would come to expect some sort of monetary or fiscal stimulus. Although granted, the People's Bank of China has proven the market wrong again and again.

In MENA, despite political concerns, economic numbers have been encouraging. Government spending has been the theme since the 'Arab Spring' and has supported MENA economic growth in the face of a weak global economy. The magnitude of spending has been quite large – for example, Saudi Arabia's cement consumption/capita in 2011 was 1.7x (1.9x as of 2012) versus China's 1.5x. Moreover, Oman's slated 2013 spending is 47% of their GDP. Consequently, it's no surprise to see the differential in real GDP growth between MENA and Emerging Markets narrowing to 1.4% in 2012, which is down from 2.6% in 2010. To note, real GDP growth in MENA finished at 4.2% in 2012. We expect the narrowing trend to continue despite increased breakeven oil levels for GCC countries, now at USD 80/bbl as a result of increased spending. In the past few years, oil prices have comfortably averaged above USD 100/bbl years.

Having global and regional factors into consideration, our portfolio allocation will continue to overweight sectors that benefit from increasing domestic demand and underweight ones that depend on export demand. As a result, we are and have been underweight petrochemical and are and have been overweight consumer names since the beginning of 2011. We are selectively overweight additional sectors including real estate where there are housing shortages, banks of whom have exposure to the retail segment, and industrials who will benefit from spending. We will continue to use telecommunication names as a safe haven for dividends. We expect a 6% return for MENA for the remainder of 2013.

Fixed Income Outlook for second half of 2013

The main theme for the second half of 2013 for traditional investments will be the FED's monetary policy going forward which is path dependent on the recovery of the US economy. Although

monetary policy is guided to be loose for the foreseeable future, which is a supportive factor for assets, certain aspects of the overall policy will be faded out, i.e. the so called tapering which describes the reduction of purchases made under the FED's Quantitative Easing program. This means that the amount of currently USD 85 bn of monthly asset purchases in the market will slowly be reduced. Half of economists expect the reduction to start as early as September this year.

Europe seems to be on a path to recovery with encouraging economic data out of Germany recently, but the government debt of the periphery (Portugal, Spain, Greece, Italy, Cyprus) might become a topic again as well as their economic performances and structural problems, like high unemployment. But the ECB has perhaps gained some problem solving credibility so that they will be better capable of containing a positive market sentiment.

In China, it has to be watched how the reduction of GDP growth rates plays out and how the economy can make a transition from being export oriented to strengthen their domestic demand. Also their financial sector needs some attention to curb the excessive "shadow banking" which could pose a systematic problem.

For Fixed Income as an asset class, it is crucial that expected interest rate increases in the US Treasury benchmark curve will happen in an orderly fashion over time in order that portfolios can be adjusted and positioned without causing disturbances in the market as we have experienced over the last two months. Also the FED has certainly now a better idea of how markets react to changes in their policy and how careful they have in communicating any change in strategy. This will hopefully result in more controlled market dynamics in the second half of the year.

As for the GCC market, we expect it to generally perform well and outperform other Emerging Markets due to better market technicalities, e.g. a financially strong and dedicated investor base which is supportive to market prices. Also the nature of the GCC economies as having higher growth rate than the world average and a positive outlook will be supportive factors. Nevertheless rising US interest rates are a drag on fixed income performance and can only be overcome by shorter maturities, higher yielding debt or hedging strategies.

Alternative asset classes which are less dependent on the general economic and monetary trends will pretty much perform independently and their success will be determined by their investment theme and the quality of their management teams. It is therefore quite difficult to make a general statement about how they will perform in the second half. But as a share of any portfolio in a long-term strategy they certainly make sense due to their low correlation to other asset classes.

Contact Us: Tel: +9714 207 8811, **Email:** assetmanagement@mashreqbank.com, **Web:** www.mashreqassetmanagement.com

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 any of its 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. Mashreq Asset Management does not warrant the accuracy of the information provided herein and views expressed in this note reflect 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, nor any of its related parties accept any liability whatsoever for any direct, indirect, consequential or other loss arising from any use of this memorandum and/or further communication in relation thereto. Mashreq Asset Management does not accept any obligation to correct or update the information or opinions in it; however, opinions expressed are subject to change without notice. This note is disseminated primarily electronically, and, in some cases, in printed form. 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