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Asset Management

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Portfolio Managers Outlook

Outlook

We are all monetarists now. The anticipated policy action from Central Bankers and/or European Politicians seems to the only variable driving day to day fluctuations in asset prices across the entire spectrum from equity to commodities to fixed income. Market participants appear to be focusing on a policy response from the Fed and European Politicians. This belief in the ability of policy makers to ignite a rally in risk assets appears to be the most significant underpinning of most risky asset valuations. Ultimately, investors need to worry about whether this belief is justified over the long run, though the immediate concern is admittedly guessing the timing of policy action and the market reaction.

Source: Bloomberg

As Spanish bond yields bottomed in March 2012, MSCI World and S&P Pan Arab Index posted their highs a fortnight later. Since March 2012, Spanish 10 year bond yields are up 150 bps or so, while the MXWO and S&P Pan Arab are off 12.5% and 10.7%, respectively. Crude Oil futures are down 22% for the same period. Make no mistake, it's a global world and investors choosing to ignore the macro backdrop do so at their peril. It is a safe bet to assume some policy action will be forthcoming over the next few weeks. It is not so clear how similar the reaction of the markets will be in response. Some strength is probably very likely, but how much and for how long? For MENA investors this debate is relevant, as the outcome is the most significant short term driver at present.

The investment implications are quite clear; investors have a choice of going long beta in the hope of capturing upside following policy action or they can use the strength to re-position portfolios and rotate into less cyclical, more domestically oriented sectors. The beta capture option would also require exposure to the most cyclical, higher beta counters. This is a high risk strategy and is suitable for investors with the requisite risk appetite. In our opinion, fundamentals in developed markets remain weak, with emerging signs of slower economic growth, if not outright contraction. This is precisely why there is anticipation of policy action. The fundamental story is not supportive for commodities and is likely to slowly get reflected all along the energy value chain. Needless to say, that is overall quite relevant to the MENA region. The profitability cycle for petro chemicals appears to be peaking and portfolios need to be positioned accordingly.

Not all is doom and gloom. Domestic demand stories are on fire in most markets in MENA (Saudi Arabia, Dubai) and corporate results have by and large been good in this space. Jarir, Al Hokair, Emaar, Rajhi, Du, and Mobily have all been examples of robust domestic demand feeding through to good operating performance. Banks have been flattish, with pretty distinct market specific trends. Saudi banks show some growth momentum finally, Egyptian banks are recovering sequentially, Dubai names continue consolidating and Abu Dhabi names are doing the same.

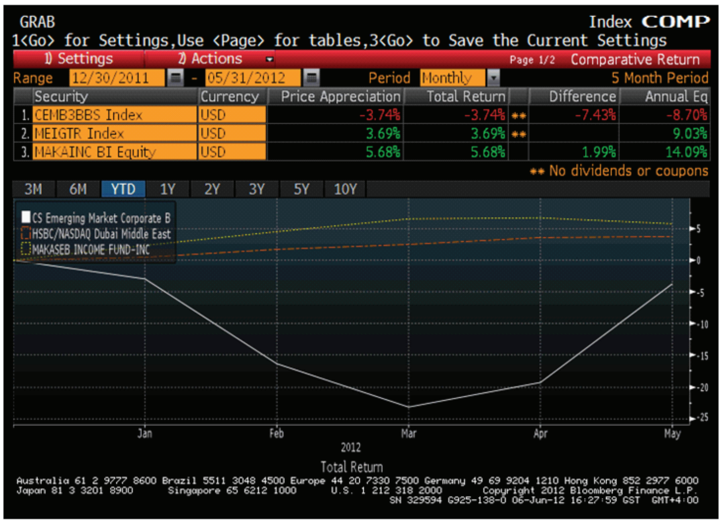
QNB led the pack in Qatar, while the rest of the sector lagged a bit. Telecom names with significant exposure to growth areas like mobile broadband continue to do well (Mobily in Saudi Arabia and Du in the UAE being the star performers). Emaar posted excellent numbers, with rising recurring revenue streams and significant traction in their Dubai assets. The Egyptian political process is also moving forward and regardless of the outcome, a successful conclusion to the presidential elections should provide some relief to the market.

We remain quite bullish on the internal fundamentals of the region and expect to do reasonably well over the medium to long term. It is the global backdrop that remains weak with no particular signs of strength, which is a concern in the short term. We plan on using any strength in the near future to further align our investment stance with our preference for domestic plays at the expense of cyclicals exposed to global demand.

Fixed Income

All's quiet on the "middle-eastern" front!

It has been a relatively stable and solid first 5 months of the year. While the middle-eastern bond markets did give back some of the gain of the first 3 months in April and May, performance overall has been quite satisfactory. The chart below shows that the regional HSBC index has outperformed the CS Emerging Market BBB index quite handily and our Makaseb Income Fund has outperformed both! So where do go from here? As mentioned above, the world stands at the edge of a precipice in search of a soft landing pad/trampoline to be provided by the global central banks. Far be it from us to hazard a guess as to whether or not this trampoline will be provided or more importantly how robust a rebounding platform this may form. Our investing philosophy for the 2nd quarter and into the 2nd half of the year is based on the following principles.



Source: Bloomberg

1. Liquidity: Stay in the most liquid bond issues in the market, because in the event a turn comes, you need to be able to exit.

2. In the region we like Dubai: The economic fundamentals are improving, refinancing/repayment of debt continues apace with the repayment of the JAFZA and DIFC sukuk a practical certainty now.

3. Prefer Sukuks over conventional bonds: Sukuk tend to have better technical characteristics, declining less in periods on panic and rising faster in strong markets. One of the main reasons for this is the strong liquidity in Islamic banks and also the large amount of repayments that have occurred or are occurring in the sukuk market.

4. Extend Duration: We think rates stay benign for the foreseeable future so we prefer extending duration where we can.

The main risk as far as we are concerned is not Europe but BRIC countries, China in particular. A weaker than expected growth picture here would result in oil price weakness, which clearly will have negative connotations not only for the equity markets but also for the bonds markets.

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