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Asset Management

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Portfolio Managers Outlook

Portfolio Managers Outlook 2013

Fixed Income Outlook

After a tremendously successful year 2012 with the fixed income asset class providing double digits returns and all of our funds at the top end of performance expectations, we see a normalization of returns in 2013.

Two factors that were supportive in 2012 will be unlikely to provide the same lift again, namely unprecedented tightening in US treasury yields and the spread tightening of risky bonds from highly attractive yield levels at the beginning of 2012. Also coupons and Sukuk profit rates will contribute less to the performance, as we are starting from a much lower yield environment in 2013.

US Treasuries are largely expected to trade wider towards the end of 2013 which would create a slight headwind. This will largely depend on further recovery of the US economy, inflation and employment numbers which will be more closely watched now since the FED changed its wording. It made its policy subject to attaining certain levels, whereas previously it reiterated to keep interest rates low without conditionality.

Due to still high liquidity in the market, improving fundamentals for global growth and removal of tail risks especially in Europe, spreads are likely to tighten further on the back of risk-on attitude of markets throughout 2013. This will be the main driver for returns.

This strong liquidity will also be the primary driver of returns in the MENA fixed income market. While we expect robust supply in 2013, (up from a very strong new issue year in 2012) we believe that the region has enough liquidity to absorb this new supply. The region still trades a little cheaper that global EM bonds but this spread differential has narrowed a lot in 2012. We expect returns of about 5-7% with the region and about 4-6% globally for the fixed income market.

The continued hunt for yield will benefit High Yield corporate bonds, Emerging Markets and new structures that provide higher returns, e.g. Conditional Convertibles or perpetuals that will mainly be issued from financial institutions in order to reorganize their capital structures to comply with capital requirements.

During the first quarter resolving the Fiscal Cliff will be an overlaying theme in the market which might induce some volatility. This can create buying opportunities as we expect that the Fiscal Cliff will ultimately be resolved.

Risks to our base case are stronger than expected growth in the US with a change in FED policy sooner than currently expected, a prolonged or badly solved Fiscal Cliff, geopolitical risk and growth disappointments in Emerging Markets - especially in China.

Equity Outlook

Despite the prevailing uncertainty caused by the Fiscal Cliff issues, geopolitical risk in the region and Europe's continued troubles, we see 2013 as a good year for equities given the tightening in credit market and the improvement in global financial conditions following the strong policy measure introduced by FED (QE3) and the ECB (OMT). The recovery in the global economy continues, but it has weakened. In advanced economies, growth is now too low to make a substantial dent in unemployment. In major emerging market economies, growth that had been strong earlier has also decreased. The forces at work are, for the most part, familiar. The forces pulling growth down in advanced economies are fiscal consolidation and a still-weak financial system especially in the Euro-zone. In most countries, fiscal consolidation is proceeding according to plan. While this consolidation is needed, there is no question that it is weighing on demand and the evidence increasingly suggests that in the current environment, the fiscal multipliers are large. The financial system is still not functioning efficiently. In many countries, banks are still weak and their positions are made worse by low growth. As a result, many borrowers still face tight borrowing conditions.

The main force pulling growth up is accommodative monetary policy. Central banks continue not only to maintain very low policy rates but also to experiment with programs aimed at decreasing rates in particular markets at helping particular categories of borrowers or at helping financial intermediation in general. More seems to be at work, however, than these mechanical forces-namely, a general feeling of uncertainty. Assessing the precise nature and effects of this uncertainty is essential, but it is not easy.

Back in the regional markets, the overall MENA GDP growth outlook in 2012-13 is generally better than in 2011. Continued solid growth in the GCC is supported by a gradual recovery in countries that saw political turmoil last year, with these trends likely to continue in the medium term. The average forecasts for GDP growth rate in GCC is 4.9% in 2013, a slowdown relative to last year's 5.6% growth, on the back of slowing growth in government spending and a flat oil price forecast, while medium term growth of 4% is expected. Saudi Arabia's GDP is expected to increase 6% in 2012, slightly below the 7.1% rate achieved in 2011, and is expected to continue growing at 4% in 2014-17. Elsewhere in MENA, continued political challenges combined with high soft commodity prices, an unfavorable global economic environment for exports and weakened tourism revenues, are expected to translate into slow growth in 2012-13, particularly in Egypt, where it is nonetheless expected to accelerate to above 6% from 2015.

Government spending is expected to increase by 12% Y-o-Y on average in GCC countries compared to 14% a year earlier. The Saudi spending is expected to increase by 13% in 2013 after the slowdown in 2012. Despite current account balances more than doubling in the GCC over the past two years, the high government spending levels mean that the breakeven oil price for fiscal balance has edged higher for most countries.

As the majority of GCC markets offer strong demographics and rising disposable income, supported by an oil price above USD 100 /bbl in the medium term, we believe consumer confidence will continue to translate into growth and returns; as a result consumer stocks comprise the bulk of the top quartile of our preferred names. Telecommunications are the second best preferred stocks in our model portfolio given the sustainability in their dividends and the potential growth in data revenue. Smart phone penetration in GCC is still under 15% of addressable market despite the high affordability.

On the other hand and while the 2013 revision has led to cuts in petrochemicals price targets, we continue to expect high returns in petrochemicals and fertilizer names and see value in stocks that are able to grow capacity. GCC banks especially Qatari and Saudi banks are offering good value as they are trading at discount to emerging markets peers. Banks should enjoy higher credit growth given the high level of government expenditure and we expect deleveraging to decline due to the significant improvement in business and consumer confidence.

We are expecting average return of 25% for MENA markets in 2013, and volatility is expected to continue to be high, however it should be lower than last year giving the improvement in political and business environment. That would position MENA as one of the best places in terms of risk-adjusted return. For the first quarter of the year, we are expecting high dividends yields and visible growth names to continue outperforming underpinned by good year end results and dividends announcement. Our strategy is to overweight in retail, telecommunications and banks and shy away from cyclical names that are exposed to high volatility in global markets.

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