

Portfolio Managers Outlook

Quarter 1, 2010

Overview:

Welcome to the first edition of what we hope will be a quarterly presentation on our views for the regional equity and debt markets. While the detailed fund performances can be found on our website, www.mashreqassetmanagement.com and in our monthly fund fact sheets, this document will endeavor to provide you with a more strategic outlook for the coming quarter and beyond. We will also discuss our view on asset allocation from a regional perspective using three main categories of assets, regional equities, regional bonds and cash.

As you will read below we have a generally bullish view of both the equity and debt markets in this region as such we would recommend a relatively fully invested view at this point. While we believe that both debt and equity offer great value here, we feel that regional equity markets are slightly better positioned versus regional debt markets that have seen strong gains following the positive developments in Dubai. As such, within a regional allocation we would be allocated as follows:



For our view on asset allocation within each category (debt and equities) please see the individual sections below.

Equities

All systems go.

The first quarter has been a rather pleasant contrast to the same period last year; up about 13% so far this year, against a drop of 11% last year (in the first quarter). Interestingly, the move thus far has been very strong, where staying uninvested has negatively impacted performance.

The trick thus far has been to get the asset allocation call right; individual markets as well as sectors have behaved well in following the pecking order of size. The four largest markets in the MSCI Arabian Markets Index at the beginning of the year (Saudi Arabia, Kuwait, Egypt, and Qatar; we count the UAE as two markets) account for 92% of the total return thus far. On a sector basis, the top three sectors by size account for 78% of total return. Admittedly, size has a big influence here; Saudi Arabia at half the benchmark, accounted for half the return. So there were no prizes to be won for being bullish on Saudi Arabia. Kuwait and Egypt were value accretive bets relative to size, while the UAE was the single biggest detractor of performance during the quarter. While Egypt and Kuwait accounted for 38% of the quarterly performance (as against a combined size of 26%), the UAE accounted for 2.8% of

regional returns while making up 7.5% of the benchmark. So, the country bet clearly was to be significantly overweight Kuwait and Egypt, while being underweight the UAE. Saudi at 50% to begin with does not offer a lot of room for being overweight.

On the sector side, commercial banks made a big comeback across the board in the region, but still only matched returns and size (both at 32% of the benchmark). Chemicals and Wireless Telecoms were the big winners, accounting for 46% of regional returns compared to a size of 29%. The performance of Chemicals was on the back of improving prospects for global growth and demand from Emerging Markets (read China). Commercial banks recovered from depressed valuations as some semblance of normalcy returned to interbank markets in the region. Wireless telecoms also benefited from recovering valuations and improving prospects for domestic demand.

Although the nice pick up in the first quarter is a welcome continuation of the recovery in risk appetite from last year, the medium term outlook (3 years or so) is becoming something of a dilemma. The strong performance of risk assets from the lows of March last year seem to have discounted most of the good news out there; the world is not coming to an end, the Chinese miracle continues, and the developed world is not in the midst of another great depression. These are big worries to get out of the way and hence the market response has been understandable, but has wiped out any semblance of cheapness in Equities, globally. It is perhaps some comfort that emerging equities still appear to offer value, if only due to the more modest long term growth outlook for their developed brethren. The point here is that there is no longer a valuation driver for even medium term returns; it is the heady mix of low interest rates, strong growth in China (more on that in a moment) and ever improving sentiment that will drive returns from here. Here it is important to note that with unemployment in the US still elevated it is premature to speculate about rising rates in the short term. In China, the government needs an engine of growth while the hitherto successful model of export led growth takes a breather; the domestic property market has proved a reasonable substitute, which would suggest that any hint of significant weakness in property values will bring forth a quick policy response.

In this global backdrop, the preferences for regional markets become quite clear. Overall, we expect equities (read risk assets) to remain well bid. Our favorite market in the region at the moment is the UAE, on the back of sluggish relative performance and modest valuations on normalized earnings. Among the larger markets, Egypt has been a strong performer so far this year as it has benefitted from strong fund flows into GEMs funds. Though individual names still look interesting in Egypt, we are happy being neutral/underweight the market. Qatar is a good infrastructure spend story that is one of our preferred markets, though some of the market heavy weights appear stretched. Kuwait's rally was interesting; Zain was understandable and was one we missed, but the cheer in the financial sector appears premature. We remain underweight. Any exposure to the smaller markets in Jordan, Lebanon, Tunisia, and Bahrain would be on a purely bottom up basis if the opportunity presents itself.

Market	Relative to Benchmark*
Saudi Arabia	Neutral
Kuwait	Underweight
Qatar	Overweight
UAE	Overweight
Egypt	Neutral
Oman	Neutral

*MSCI Arabian Markets Index

So with the ingredients of increasing risk appetite still in place, and likely to remain in place for the short term, risk assets will continue to remain well bid. As the first quarter has shown quite clearly, markets do not tend to be discriminating between quality and junk in the short term; there is no reason to

believe that this will change any time soon. Investors are well aware that valuation has a significant role to play in determining realized long term returns but is impotent in determining the path or level of short term returns. So although the long term outlook for returns is getting poorer as markets continue to rally, risk assets are still likely to get much dearer in the emerging world before taking a significant breather; long and strong is the name of the game for now.

Debt

Time to Look Beyond Dubai World

There are 2 stories to tell here. The first is the global risk appetite story. Even though there has been a strong recovery in risk appetite since the disastrous days of the Lehman collapse in the fall of 2008, we believe risk appetite will continue to be stable/ strong the remainder of 2010. A strong earnings recovery is underway in the US, this will eventually lead to stability and a recovery in the job market also, China while putting on some brakes, continues to grow impressively and the rest of the emerging market space is well positioned. The only cloud on the horizon is the sovereign risk situation in Europe. While there are no easy answers there and that will continue to be a source of volatility for global markets, we do not believe that it will derail the recovery that has been on-going in risk assets, both in stocks and in emerging market debt.

So having established our view that emerging market debt should continue to perform well for the remainder of the year we now focus on our belief that Regional debt should actually outperform global Emerging Market debt for the rest of 2010.

Since the 25th of November 2009 (the date of the first announcement by the Dubai Government that it intends to restructure Dubai World debts) the HSBC Middle East Index has returned 0.12% during the same time period the Credit Suisse Emerging Market US Dollar BBB index has returned 5.7%. While this underperformance has started to correct itself slightly since March 25th 2010, (the date of the Dubai World restructuring proposal), we believe that there is still a lot of ground to cover. Regional bonds still trade at a discount to similarly rated bonds in the Emerging Market space. There are 3 main catalysts for outperformance in our view.

1. The Catch up effect: As mentioned above this region has lagged and is bound to catch now that there is some clarity around the restructuring of Dubai World. While headline risk remains until an actual agreement is signed we believe the initial moves have been very positive for the regional debt markets.
2. The broadening and deepening of regional debt markets: New issues have already started to make an impact in the regional market space. DEWA launched a successful issue and Egypt followed shortly thereafter, we believe the pipeline is healthy and will provide good momentum to the regional bond space.
3. Regional Demand: The one thing that the Dubai debt crises did is that, it focused attention on the regional bond and sukuk markets. This has resulted in good investor interest from both individuals and institutions. It seems to us that a new fixed income fund crops up almost every week! And while there is still a long way to go before this becomes an asset class of note in this region, we believe that the process has already started. Some regulation, and the development of broader and deeper local currency markets can only help the process, but we are clearly on the way.

Given our bullish view, it is no surprise that we tend to favor the riskier part of the regional bond market. We would be overweight Dubai and we would also be overweight duration (i.e. we like longer dated bonds at the current time).

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