

Monthly Newsletter

April 4th, 2019

"I come from no country, from no city, no tribe. I am the son of the road... all tongues and all prayers belong to me. But I belong to none of them" — Amin Maalouf

"You cannot build reputation on what you are going to do" — Henry Ford

Clues from Recent Asset Classes' Behavior

Macro: Timid Recovery So Far

Oil: Market Set to Tighten into Q2 2019

MENA: Market Positioning into Q2 2019

Introduction

A combination of poor economic activity globally and tight financial conditions pushed global Central Banks, led by the US Fed and the ECB, to shift their hawkish policy stance to a more accommodative approach.

The Fed decided to be patient on interest rate hikes and to stop the quantitative tightening, or the run-off, of its balance sheet by October 2019. The ECB shifted any potential interest rate hike into 2020 and decided to resume extending cheap loans to banks by September 2019 to promote credit expansion in the system.

The reversal of Central Banks' policies aims at easing financial conditions and preventing the world economy from sliding into an unexpected recession after the warning signs sent by the inversion of the US yield curve.

As a result, the world substituted a potential economic collapse with a decelerating path. The US and China are following two different narratives through which the US economy is decelerating as the effect of the tax cuts fades and Chinese economy is recovering slowly on the back of target stimulus measures. Europe has been stagnating since Q4 2018 and is waiting for a recovery in China to pull it up. Emerging economies appear to be geared for a recovery after a tough 2018 and amid stability in their currencies, yields, inflation, fiscal and trade balances, and relaxed Central Banks' policies.

Dovish Central Banks' actions have reduced market risk and thus helped in easing financial conditions. Volatility across asset classes was compressed as indicated by the VIX and MOVE indices (a gauge for volatility in equities and US treasuries, respectively). Equity markets were in a rebounding mode since the beginning of the year, the reach for yield resumed as the size of negative yielding assets climbed from USD 6.3trn to around USD 10.4trn since last year, while the 5-year Markit CDX Index, which is a gauge of credit risk, narrowed dramatically from 95 to 62.

This compression of volatility is obscuring many vulnerabilities as fundamentals have not improved yet, which explains why markets are moving sideways looking for direction after their significant rebound since the beginning of the year.

Investors will pay attention to trade negotiations between the US and China, and to outcomes and trajectories regarding Brexit due to their impact on business confidence and the revival in investment spending by corporates. Market participants will be keen to see if global economic data will improve and whether earnings will start to rebound in Q2 given a weak guidance for Q1 2019.

Meanwhile, investors are aware that inflation did not drop dramatically and thus inflation expectations, as indicated through breakeven rates in the fixed income market, are not falling, and thus Central Banks will not go on full easing mode in the medium term. As a result, the yield curve may avoid inversion but would stay flat for a while before we see true bullish steepness at the long end. In this context, investors are advised to look at thematic plays- we are looking at China, India and a potential recovery in Germany in Q2 2019. In the MENA region, we are being selective while taking global index inclusions into consideration as major drivers for markets. We are content with companies that have capacities to generate generous cash flows amid low bond yields, or capabilities to grow sales while maintaining their profit margins and dividend payouts.

Asset Management Team:

Wassim Jomaa, CFA

VP, Head of Asset Management

Wassim.Jomaa@Capitalinv.com

Raed Al Momani

Portfolio Manager

Raed.Momani@Capitalinv.com

Sarah Elawi

Financial Analyst

Sarah.Elawi@Capitalinv.com

Zina Rajjal

Financial Analyst

Zina.Rajjal@Capitalinv.com

Ghaleb Mihyar

Financial Analyst

Ghaleb.Mihyar@Capitalinv.com

For further information and to discuss possible investment opportunities, please contact:

Asset Management Department

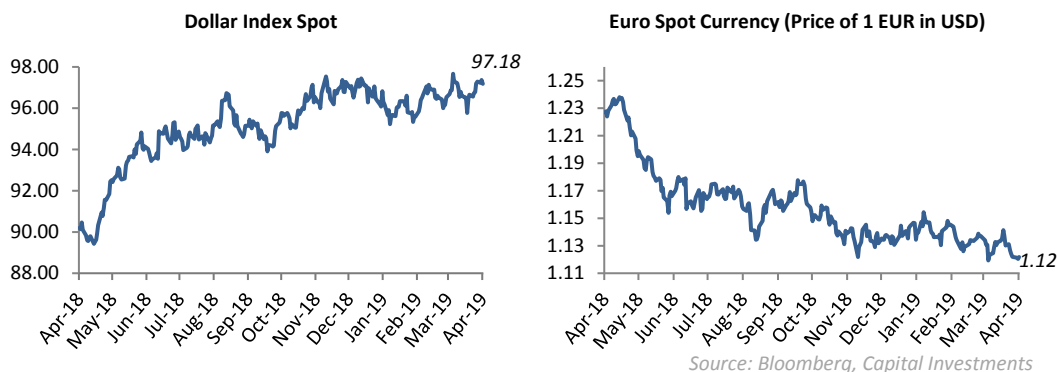
Tel: +962 6 5200330

Ext. 2494 and 2373

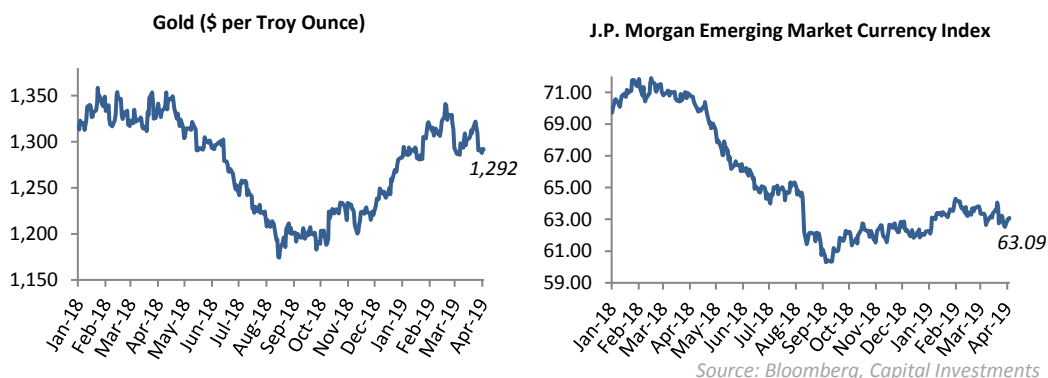
AssetManagement@Capitalinv.com

This report must be read with the disclaimer at the end of the report.

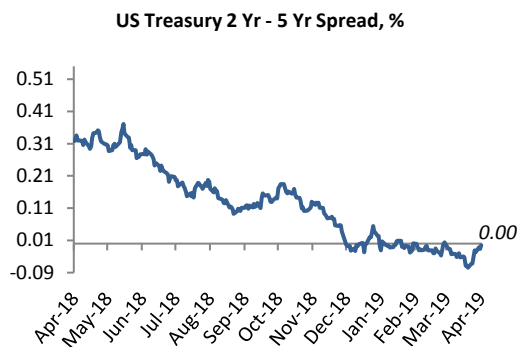
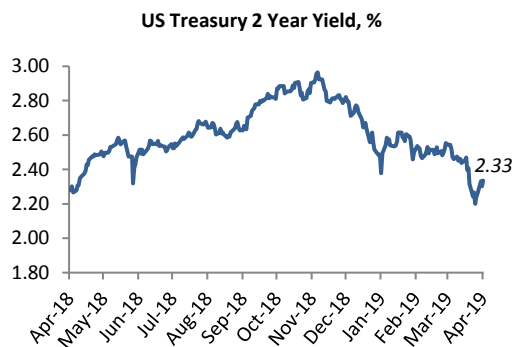
Clues from Recent Asset Classes' Behavior



The USD continues to trade in a stubbornly strong range as illustrated by the Dollar Index (DXY) chart above. We think that the USD will continue to outperform over the medium term as other Central Banks are following the Fed’s neutral stance given their limited toolkits should global growth deteriorate. Given yields on US treasuries are the highest among developed countries, they will lend support to the USD until economic activity in other regions picks up. The ECB’s accommodative stance coupled with its declared intention to shift any interest rate hikes till 2020, in addition to its countercyclical measure of providing cheap loans to the banks will not provide support to the Euro. This is in addition to the dovish commentary from key Central Banks in the world, notably the Bank of Japan and the Bank of Canada, while many emerging economies’ Central Banks are cutting interest rates such as Egypt.

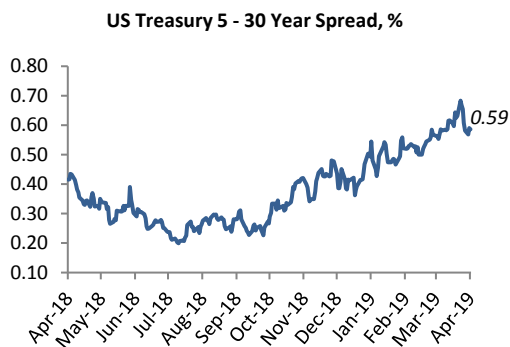
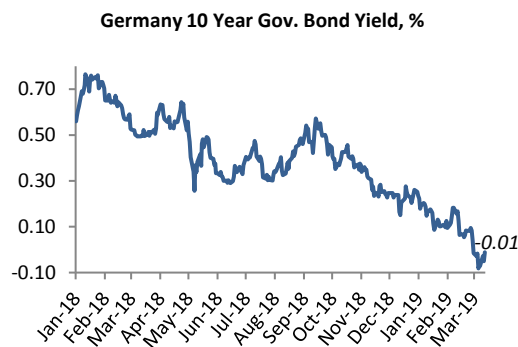


Amid a strong USD and a revival in risk appetite, gold lost its allure and the rally in the yellow metal pared its gains, while gains in emerging market currencies are being capped and the rally since the Fed turned dovish in January lost its momentum.



Source: Bloomberg, Capital Investments

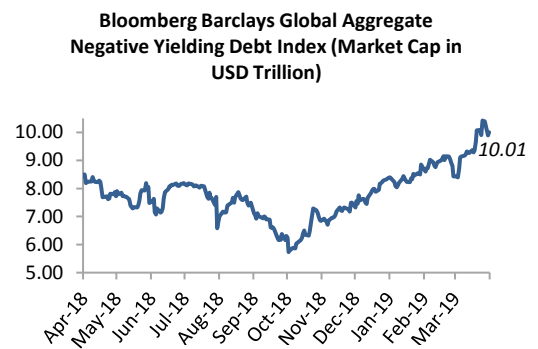
A significant drop in the 2-year yield in the US by around 70bps from its recent peak along with an inversion in the yield curve did not save the moment for the USD, which has not factored in the potential easing in monetary policy, signaled by the yield curve.



Source: Bloomberg, Capital Investments

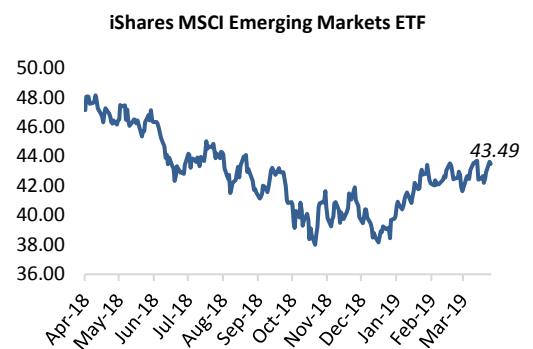
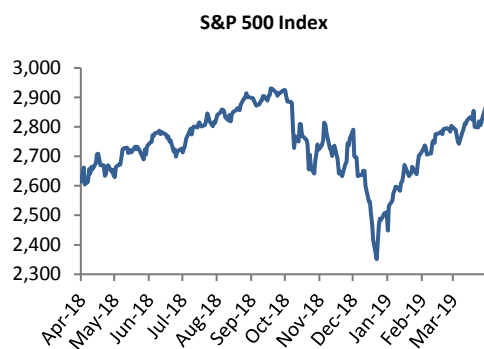
We think that the Fed will not allow the yield inversion to be persistent due to its negative implications on economic activity and sentiment. However, the Fed’s efforts to engineer a steepness in the long end of the yield curve would require expectations about inflation to rise and would require the Fed to extend its patience regarding a pause in rate hikes. Simultaneously, the Fed will seek to keep banks’ excess reserve at a comfortable level for financial conditions to stay relaxed which explains its decision to stop its balance sheet shrinking process by end of October 2019.

A dovish stance by other major central bank to counter weak global economic activity means that long-term bond yields of key countries such as Germany are in a negative territory. In this context, a flat yield curve would be the norm across the board for the time being and would command a barbell strategy for fixed income while giving the flexibility to adjust the composition of the portfolio should the curve shape adjust.



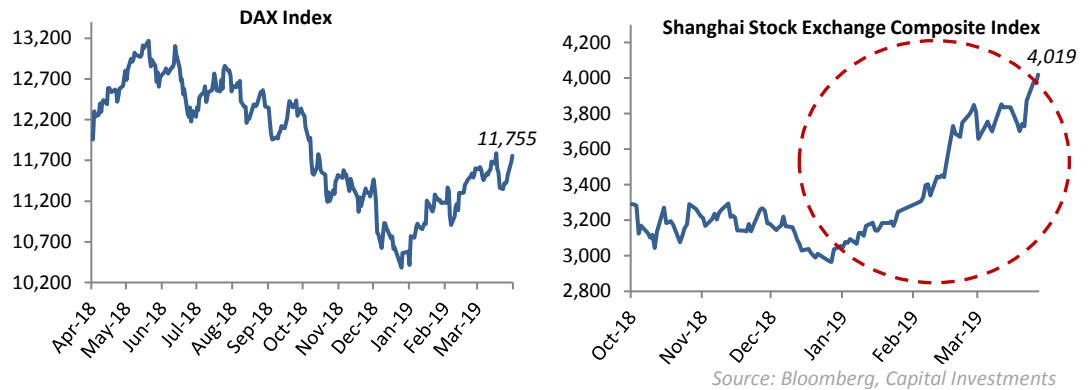
Source: Bloomberg, Capital Investments

The chart of the VIX index above illustrates the compression in volatility since the Fed adopted a dovish stance while the rise in the size of negative yielding assets from around USD 6trn in October of last year to USD 10trn now stipulates the reach for yield wave that reigned over the market. The most striking issue about these charts is that investors are assuming that the world has shifted again to “a lower for longer interest rate regime”.



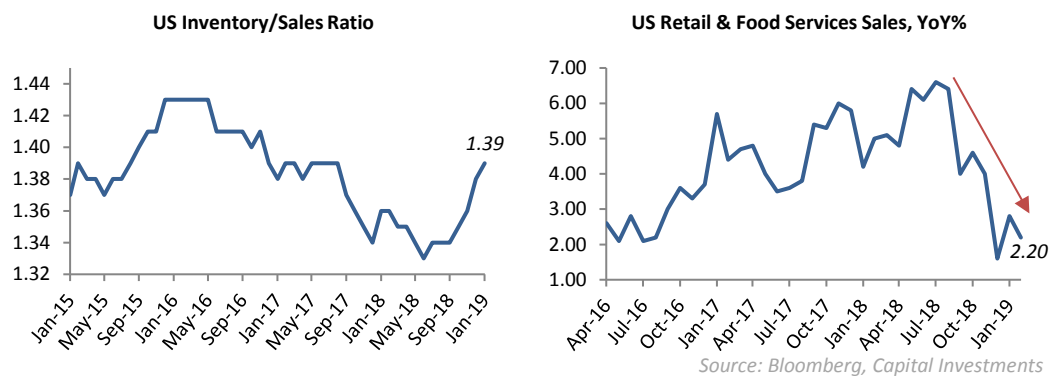
Source: Bloomberg, Capital Investments

The compression in volatility and the Fed’s “put” explain the rebound in equity markets since the beginning of the year which have rallied substantially and reached a ceiling as they await further data to guide their direction. A positive outcome from the trade negotiations and more upbeat economic data will help the market run higher although any improvement in economic activity will lead to a rise in yields which will cap the rally as valuations will be in check. On the other hand, any negative outcome from the trade negotiations or Brexit will hit the markets negatively, while any weaker than expected economic data or earnings releases for Q1 may present fundamental reasons to sell. All in all, we continue to prefer emerging markets over the US as the economic activity in the latter is decelerating while the former bloc will benefit from a recovery in China and a drop in the USD at a later stage, assuming mild global inflation and US 10-year yield in the range of 2.5%- 2.7%.

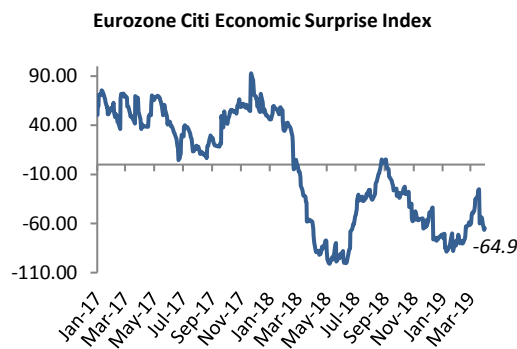


We continue to think that Chinese equities will benefit from the stimulus measures enacted by the authorities there while the weight increase into the MSCI Emerging Market indices would provide much-needed support, and a trade deal, if materialized, will give a boost and a tailwind. We expect the German economy to recover in Q2 2019, and as such the DAX index would warrant continuous assessment for gradual positioning.

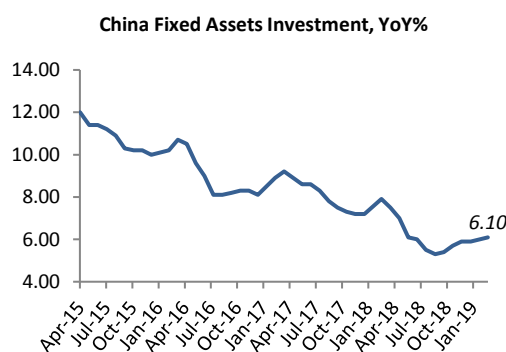
Macro: Timid Recovery So Far



We are cautious about the prospects of the US economy over the medium term although most analysts are expecting a weak H1 2019 and a rebound in the second half. However, inventory accumulation and weakness in spending and income growth does not bode well for the economy which explains the reversal of policy by the US Fed.



Despite a slight improvement in business sentiment in Germany, the index is still below the levels of Q4 2018 which means that the weakness will continue into Q1 2019 with a potential recovery in Q2. We focus on Germany as we think that the weakness is related to domestic factors, such as policies that have curtailed the auto industry’s production, along with mild weather conditions, in addition to global factors such as the trade war and China’s economic activity. While issues related to the auto industry seem to be resolved, and as the German authority adopts targeted stimulus measures to boost private consumption, the economy should recover in Q2 helped by the expected recovery in China. This would stabilize the Eurozone’s growth, if the US does not initiate any trade skirmishes with Europe once a deal is finalized with China.



Recovery signs in China are emerging despite a rise in the unemployment rate from a low of 4.7% to 5.3%. Fixed assets investment is picking up and new order Purchasing Managers’ Index rebounded sharply. The Chinese authorities enacted a 2trn Yuan stimulus package in terms of tax cuts and fee reduction to take effect on April 1st and May 1st, respectively. This includes a reduction in VAT for manufacturers from 16% to 13% and for the transport sector from 10% to 9%. The government will boost spending in areas including infrastructure and technology.

Purchasing Managers Indices (PMI) (2017-2018):											
	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
Global Manufacturing	53.0	52.9	52.7	52.5	52.1	52.0	51.9	51.4	50.8	50.6	50.6
Global Services	54.3	54.6	54.0	53.5	52.9	53.4	53.7	53.0	52.6	53.3	53.7
Global Composite	54.0	54.2	53.7	53.4	52.8	53.0	53.1	52.7	52.1	52.6	52.8
US Manufacturing	58.7	60.0	58.4	60.8	59.5	57.5	58.8	54.3	56.6	54.2	55.3
US Services	58.9	58.7	56.7	58.8	60.8	60.0	60.4	58.0	56.7	59.7	56.1
US Manuf. New Orders	62.9	63.0	60.8	64.5	61.5	58.0	61.8	51.3	58.2	55.5	57.4
EU Manufacturing	55.5	54.9	55.1	54.6	53.2	52.0	51.8	51.4	50.5	49.3	47.5
EU Services	53.8	55.2	54.2	54.4	54.7	53.7	53.4	51.2	51.2	52.8	53.3
EU Composite	54.1	54.9	54.3	54.5	54.1	53.1	52.7	51.1	51.0	51.9	51.6
China Manufacturing	51.9	51.5	51.2	51.3	50.8	50.2	50.0	49.4	49.5	49.2	50.5
China Services	54.9	55.0	54.0	54.2	54.9	53.9	53.4	53.8	54.7	54.3	54.8
China Manuf. New Orders	53.8	53.2	52.3	52.2	52.0	50.8	50.4	49.7	49.6	50.6	51.6

* PMI reading above 50 indicates economy expansion

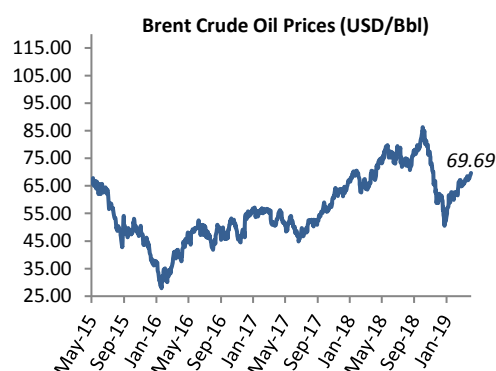
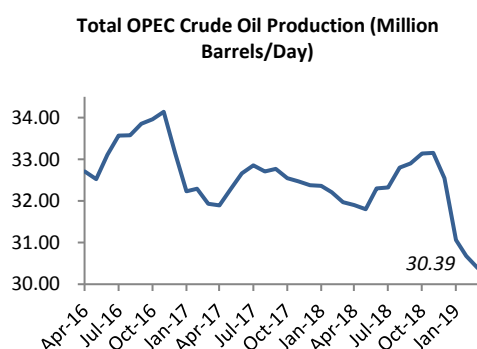
* Red points displayed within the lines above indicate highest point in the range

* Figures in green indicate acceleration from previous month, while red indicate deceleration

Source: Bloomberg, Capital Investments

Oil: Market Set to Tighten into Q2 2019

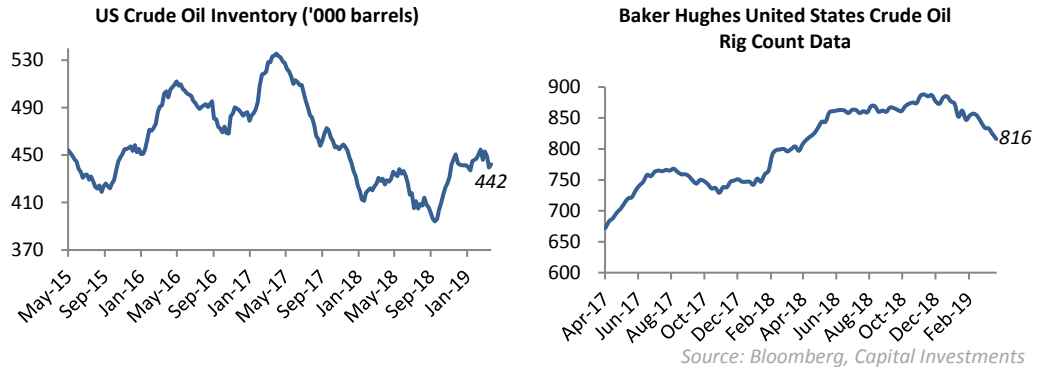
OPEC, once again, has stood its ground with regards to its production cuts. Saudi Arabia has decided to deepen its cuts further in April, and Russia is said to be accelerating the pace of its oil production cuts. Saudi Arabia has also signaled that OPEC may need to extend its cuts till the end of 2019, and the OPEC meeting with Russia in April has been postponed till June to get clarity with regards to the US sanctions in Iran. Meanwhile, geopolitical tensions across the globe have led to further supply disruptions emerging from Libya, Venezuela, and Iran. The IEA has warned of a sharp decline in crude supplies from Venezuela, while waivers for Iranian exports are set to expire at the beginning of May.



Source: Bloomberg, Capital Investments

The EIA (Energy Information Administration in US) has cut its US production forecasts for 2019 and 2020 by 110k barrels and 170K barrels respectively, while US crude and gasoline inventories are on a downward trend, with gasoline inventory within its 5-year range. Moreover, rising interest rates

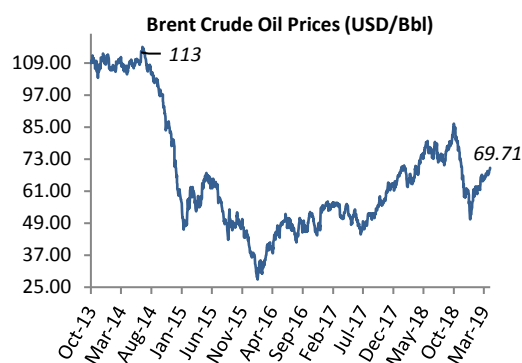
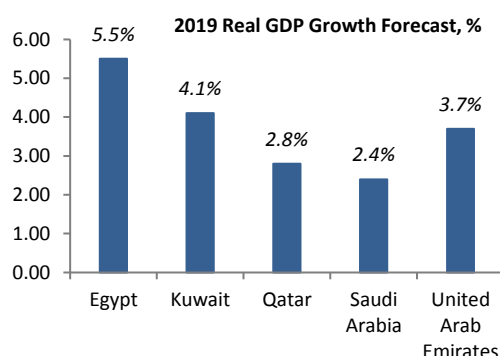
will slow US production down as operators can survive at current WTI price levels but are not very profitable, and are therefore in need of credit lines to expand.



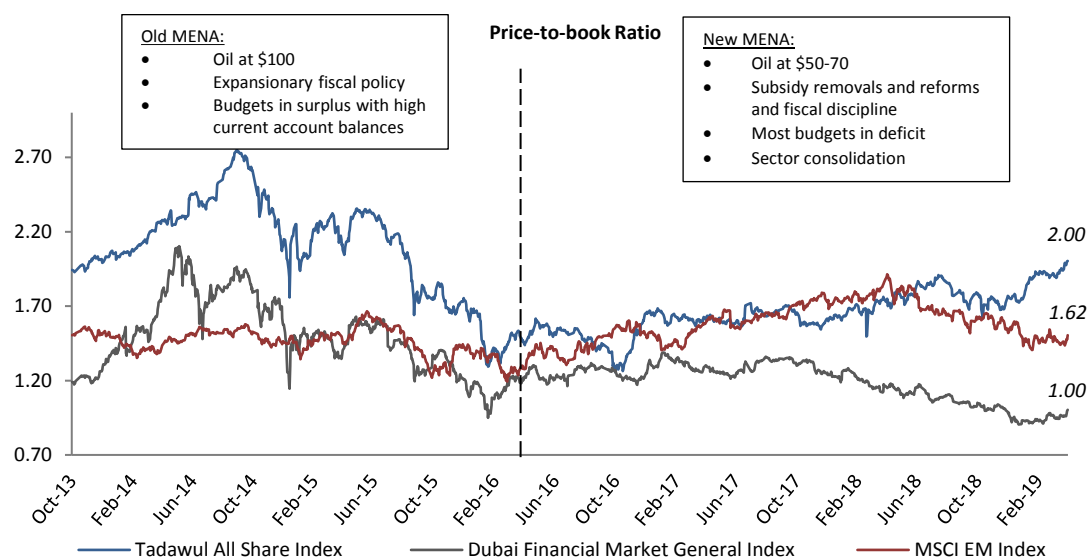
The IEA has kept its 2019 global oil demand forecast unchanged at 100m b/d at a growth rate of 1.4% YoY and sees the oil market turning into a deficit in Q2 2019. The main downside risk for oil prices is the increased output from Libya after the country resumed production at its biggest oil field, with production on track to hit its 6-year high.

MENA: Market Positioning into Q2 2019

Following the recent rally in their equities, the MENA’s stock markets seem to be overstretched. Valuations are relatively high vis-à-vis the current macro backdrop and earnings outlook. As such, we do not recommend taking the MENA and GCC markets as a bundle, but to look for selective opportunities within each market instead.

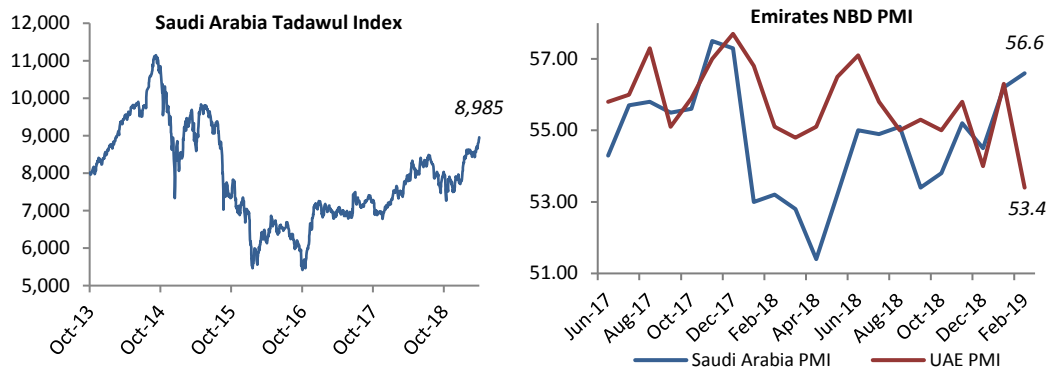


Source: Bloomberg, IMF, Capital Investments



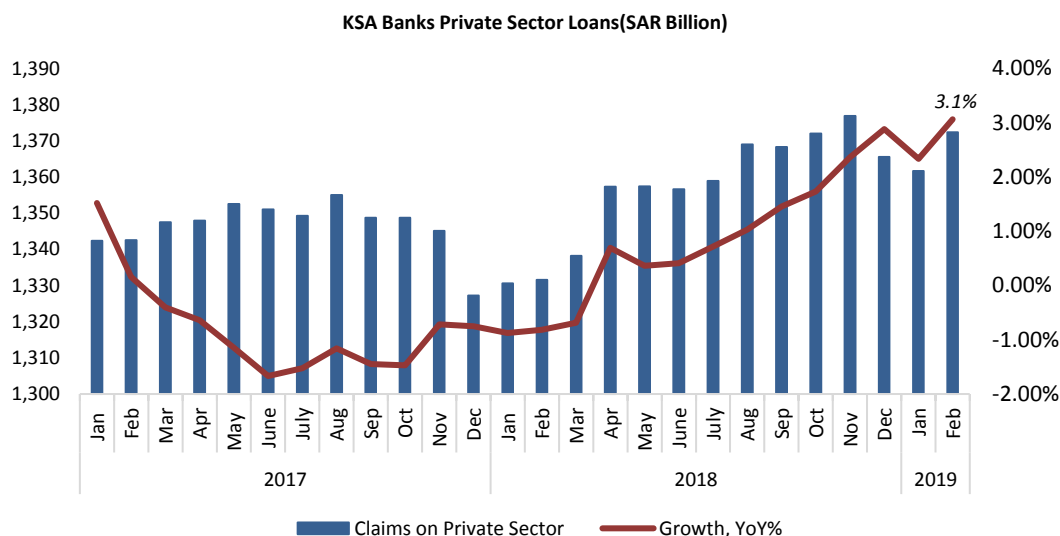
Source: Bloomberg, Capital Investments

We see three potential investment routes in Saudi Arabia. The main track, which seems to be currently driving the momentum in the market is Saudi Arabia’s inclusion in the MSCI and FTSE emerging market indices. Beyond FTSE and MSCI, we believe investors should focus on discretionary retailers which are set to benefit from consolidation in the market as well as growth in disposable income and avoid food staple names as they continue to be under pressure due to the expat exodus.



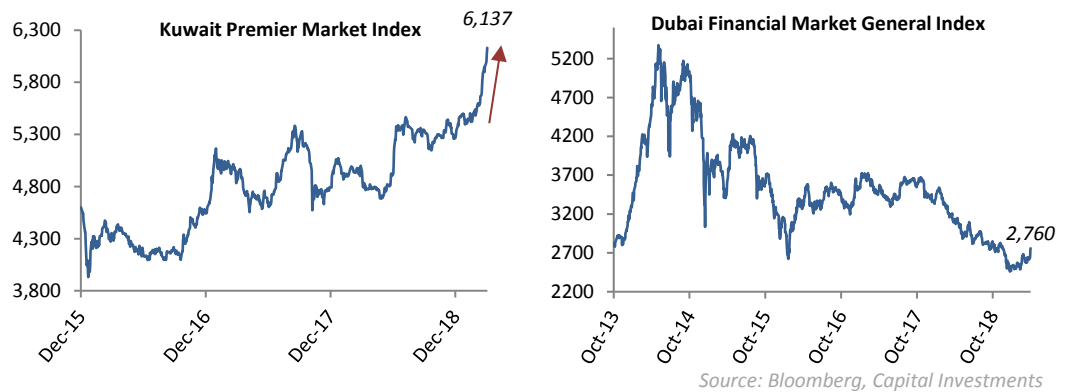
Source: Bloomberg, Capital Investments

We have also noticed an uptick in KSA banks loan growth to the private sector, which could mean that the government’s housing scheme, Sakani, is gaining track. Stocks related to infrastructure and project spending, namely in the cement sector, have reacted positively to the Saudi Government’s mega-projects-related news and announcements. However, based on our analysis of the country’s cement data, we believe that the fundamentals have not turned the corner yet, so we prefer to keep monitoring plays related to infrastructure spending for further confirmation.



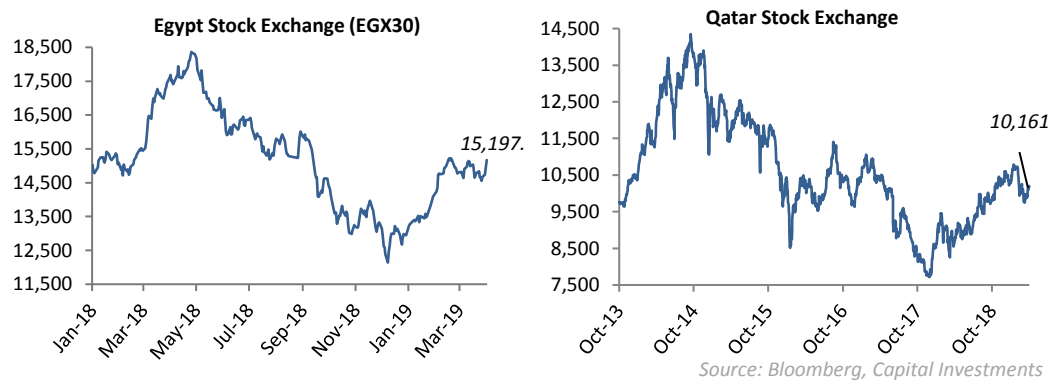
Source: Bloomberg, SAMA, Capital Investments

Like Saudi Arabia, the Kuwaiti market is set to benefit from increased liquidity due to its inclusion in the FTSE and MSCI emerging market indices. As seen below, however, we believe this is already reflected in the Kuwaiti stock market, namely in Banks, and we therefore anticipate a correction in the near-term that would allow for re-positioning. Increased government spending as well as a pickup in loan growth should drive the key plays in the Kuwaiti market.



As for the UAE, economic growth is expected to pick up on the back of the government’s stimulus measures. Moreover, the Real-Estate sector seems to be stabilizing, and we believe that, as the EXPO 2020 approaches, any excesses in the economy should shrink. The UAE market offers selective plays, mostly in the Banking, Real-Estate and Non-Cyclical Consumer sectors.

Egypt’s economy is expected to grow in 2019, driven by a pick-up in domestic demand and external recovery. However, the removal of subsidies remains a key risk for Egyptian names. As the EGX 30 bottomed in December 2018, investments into the Egyptian Stock Exchange should be made cautiously and selectively. We believe that the Qatari market is highly overvalued and should be monitored for any correction.



Major Indices	Status as of end		Performance	
	December, 2018	March, 2019	March, 2019	YTD (31 March, 2019)
MENA				
Abu Dhabi	4,915.07	5,074.65	-1.23%	3.25%
Bahrain	1,337.26	1,413.32	0.05%	5.69%
Dubai	2,529.75	2,634.86	-0.03%	4.15%
Egypt	13,035.77	14,737.88	-0.45%	13.06%
Jordan	1,908.81	1,914.28	-3.91%	0.29%
Kuwait	5,267.36	5,986.87	9.21%	13.66%
Lebanon	976.75	972.70	3.38%	-0.41%
Morocco	11,364.31	10,912.23	-2.01%	-3.98%
Oman	4,323.74	3,983.66	-3.88%	-7.87%
Palestine	529.35	530.45	-1.98%	0.21%
Qatar	10,299.01	10,107.42	-0.04%	-1.86%
Saudi Arabia	7,826.73	8,819.44	3.85%	12.68%
Tunisia	7,271.65	6,861.49	-3.54%	-5.64%
S&P Pan Arab Composite	728.72	787.45	2.31%	8.06%
Dow Jones MENA	556.65	599.32	2.13%	7.67%
Americas				
Dow Jones Industrial	23,327.46	25,928.68	0.05%	11.15%
S&P 500	2,506.85	2,834.40	1.79%	13.07%
NASDAQ Composite	6,635.28	7,729.32	2.61%	16.49%
S&P/Toronto Composite	14,322.86	16,102.09	0.64%	12.42%
Europe				
EURO Stoxx 50	3,001.42	3,351.71	1.62%	11.67%
S&P Europe 350 Index	1,367.94	1,534.77	1.81%	12.20%
FTSE 100 Index/ London	6,728.13	7,279.19	2.89%	8.19%
FTSE MIB Index/ Italy	18,324.03	21,286.13	3.03%	16.17%
DAX Index/ Germany	10,558.96	11,526.04	0.09%	9.16%
ASIA/Pacific				
NIKKEI 225/ Japan	20,014.77	21,205.81	-0.84%	5.95%
S&P/ASX 200/ Australia	5,646.40	6,180.73	0.19%	9.46%
BRIC				
Brazil/ Bovespa	87,887.26	95,414.55	-0.18%	8.56%
Russia/ RTS	1,066.13	1,198.11	0.83%	12.38%
India/ Bombay Sensitive	36,068.33	38,672.91	7.82%	7.22%
China/ Shanghai Composite	2,493.90	3,090.76	5.09%	23.93%
Hong Kong/ Hang Seng	25,845.70	29,051.36	1.46%	12.40%

Source: Bloomberg, Capital Investments

Description	Closing Prices as of end		Performance	
	December. 2018	March. 2019	March.2019	YTD (31 March. 2019)
Commodities (in USD)				
Brent Spot (Barrel)	53.17	67.51	2.61%	26.97%
WTI Cushing Spot (Barrel)	45.41	60.14	5.10%	32.44%
Natural Gas NYMEX (MMBtu)	2.67	2.66	-5.70%	-0.37%
Gold Spot (OZ)	1,282.45	1,292.30	-1.60%	0.77%
Silver Spot (OZ)	15.50	15.12	-3.12%	-2.40%
Copper LME Spot (MT)	5,949.00	6,486.50	-1.05%	9.04%
Corn CBOT Active Month (Bushel)	3.83	3.57	-3.84%	-6.92%
Wheat CBOT Active Month (Bushel)	5.11	4.58	-0.38%	-10.33%
Soybean CBOT Active Month (Bushel)	9.08	8.84	-2.86%	-2.59%
Rough Rice Futures (USD/cwt)	10.10	10.85	4.38%	7.48%
Currencies Spot Exchange Rates Against US Dollar				
Euro	1.15	1.12	-1.35%	-2.17%
GBP	1.28	1.30	-1.72%	2.20%
CAD	0.73	0.75	-1.29%	2.17%
Yen	0.01	0.01	0.48%	-1.12%
CNY	0.15	0.15	-0.27%	2.48%

Source: Bloomberg, Capital Investments

Capital Investments

Asset Management Department

Tel: +962 6 5200330 Ext. 2494 and 2373

AssetManagement@Capitalinv.com

Disclaimer

The information and opinions contained in this document have been compiled in good faith from sources believed to be reliable. Capital Investments makes no warranty as to the accuracy and completeness of the information contained herein. All opinions and estimates included in this report constitute and reflect our independent judgment as of the date published on the report and are subject to change without notice. Capital Investments accepts no liability whatsoever for any loss of any kind arising out of the use of all or any part of this report. Capital Investments and its related companies may have performed or seek to perform any financial or advisory services for the companies mentioned in this report. Capital Investments, its funds, or its employees may from time to time take positions or effect transactions in the securities issued by the companies mentioned in this report. This document may not be reproduced in any form without the expressed written permission of Capital Investments. The opinions contained within the report are based upon publicly available information at the time of publication and are subject to change without notice. Prior to investing, investors should seek independent financial, tax and legal advice.