

Monthly Newsletter

November 7th, 2019

"No man will ever bring out of the presidency the reputation which carries him into it" — Thomas Jefferson

"Leadership is based on inspiration, not domination, on cooperation, not intimidation" — William Arthur Wood

Clues from Recent Asset Classes' Behavior

Macro: Some Signs of Potential Stability

Oil: Slowing Shale Boom

MENA: One Year Ahead of Expo 2020...UAE Stocks are at an Attractive Valuation

Introduction

During last month, notable institutions such as the IMF and the World Bank lowered their global economic growth forecast and warned about a potential recession amid rising uncertainties.

Although we continue to be tactically bullish, we raised our investment participation in the market during the past month despite the rhetoric of a dim outlook as we have received three pieces of news that alleviated uncertainty around key policy making issues.

First, in Europe, the odds for a chaotic Brexit receded as the UK and Brussels have agreed on a withdrawal agreement that is awaiting ratification.

Second, and more importantly, the trade war between the US and China seems to be heading towards a truce through an interim deal that appears to be supported by both economic and electoral arguments for both parties. Moreover, trade issues between the EU and the US are on a de-escalation path as the US indicated that it will refrain from imposing tariffs on European automakers after encouraging discussions with their counterparts across the Atlantic.

Third, the US Fed continued its contribution to the easing of global financial conditions by cutting interest rates for the third time this year and re-introducing a program to expand its balance sheet through buying USD 60bn in T-bills for the coming two quarters. This will increase excess reserves in the banking system and is contributing to the steepness in the US yield curve by lowering its front end. It is worth mentioning that the pendulum of global monetary policy swung towards easing with around forty central banks globally cutting rates or injecting liquidity. As a result, we are witnessing a net cut in the interest rate cycle led by both developed and emerging economies' central banks.

Based on the global monetary easing stance, we think that central banks have voted against a recession albeit a slowdown is still in the horizon. However, we think that central banks are engineering a comeback in global manufacturing PMIs which started to exhibit signs of stabilization. This means that easing works with a lag and is modestly bearing some fruit amid trade tensions.

This encouraging environment allowed us to cautiously get out from our defensive positioning and deploy our cash into different venues in emerging markets such as Brazil and Pakistan, while we approached cyclicity by investing selectively in European ETFs, and maintaining our exposure to gold. In the MENA region, the drop in the Saudi equity market provided many opportunities related to companies involved in the domestic economies while we continue to see that the UAE is offering selective and attractive opportunities. Trades in GCC are supported by a de-escalating trend in the Yemen war.

Although we removed the discussion of recession off the table, we continue to subscribe to a slowdown thesis for the medium term and thus we are keeping our cautious approach. We prefer to tactically trade the market and avoid having a deep plunge while seeking to diversify across many plays. Valuations continue to play an important role to guide us so we do not get dragged by the waves of greed and fear that influence equity markets over the short run.

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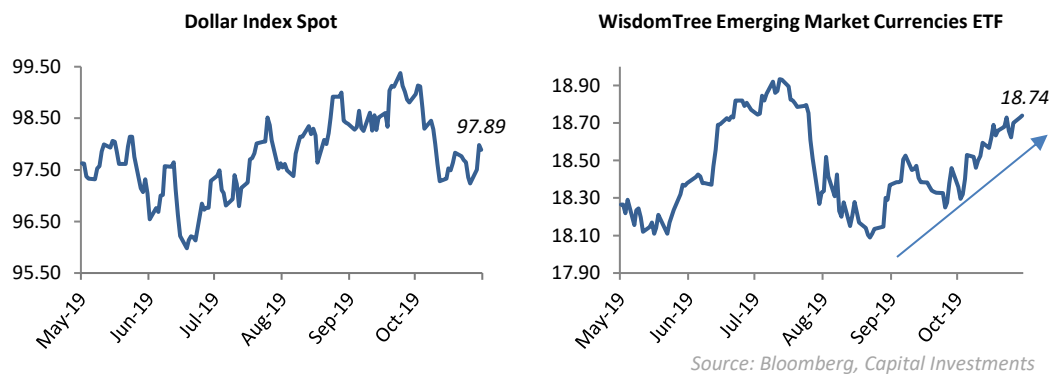
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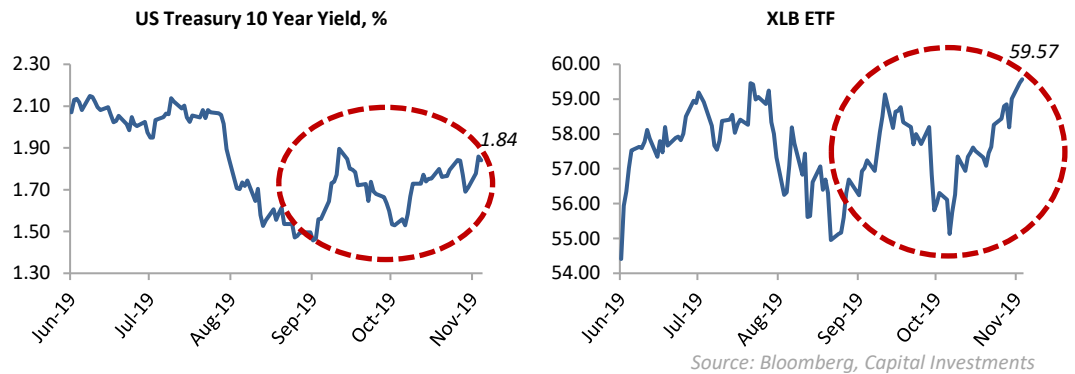
This report must be read with the disclaimer at the end of the report.

Key factors that we are monitoring include trends in profit margins in the US, and their continuous decline is not a positive sign. Amid a shaky global trade environment, we need to get confirmation that the business investment will be revived, and private consumption will not stall and thus aggregate demand is supported given the global monetary easing. On the trade negotiations front, it is important to see if the agreement over agriculture, waivers related to Huawei suppliers, and tariff increase halts will pave the way for more concrete and positive steps especially that issues related to capital flows, stiffness in supply chains and China's industrial policy are still on the table. Last but not least, we should keep in mind that the US presidential election season has officially started and will stay with us for a year. The election season may include the nomination of Elizabeth Warren, which may have repercussions across markets along with Trump's impeachment process, not to mention that the spending stopgap to fund the US government will expire on November 21.

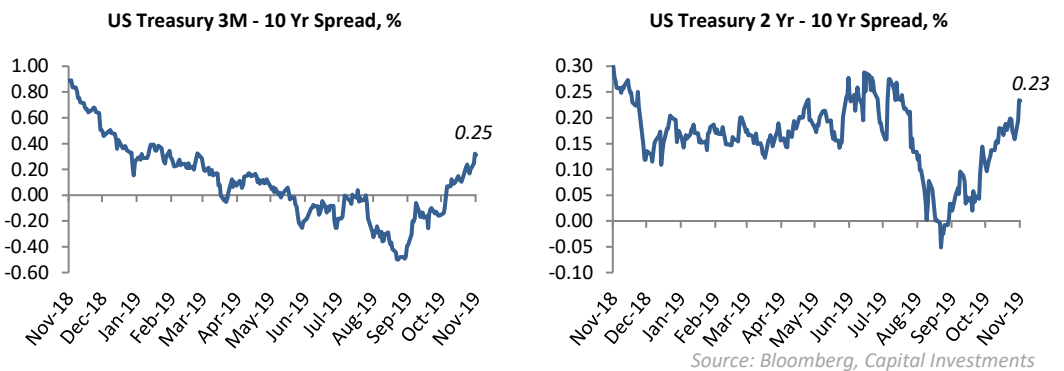
Clues from Recent Asset Classes' Behavior



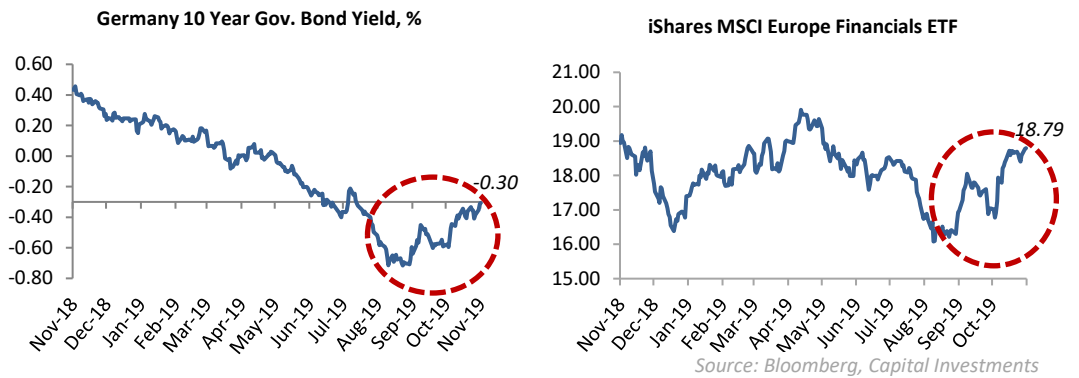
As uncertainties around key global issues in the world such as Brexit and trade negotiations between the US and China have receded, the USD has lost its allure as a safe haven and tested its 200-day moving average. The weakness in the USD is gaining a tailwind through the expansion of the Fed's balance sheet. It will take time for the USD to break down decisively, but we continue to favor the GBP and we are considering emerging market currencies which seem to be on a positive reversal trend.



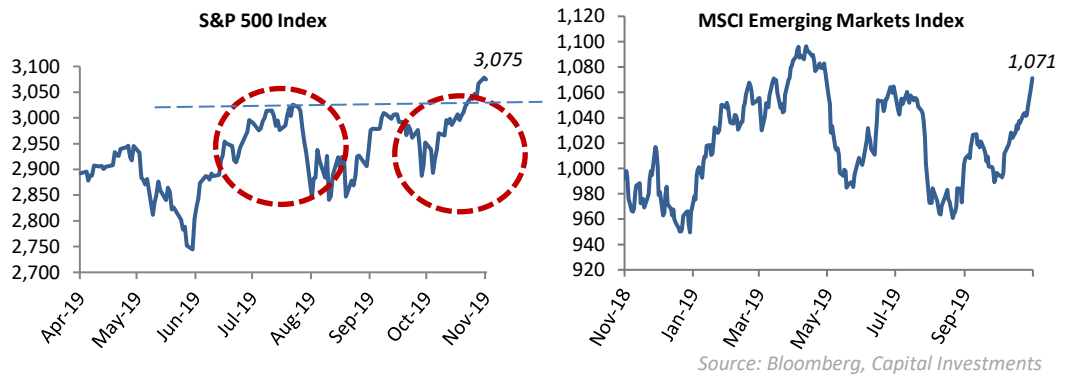
Since the Fed started easing during the summer, we have noticed that cyclical ETFs were dancing tango with the US 10-year yield as they were swinging in a synchronized manner supported by optimism around trade negotiations.



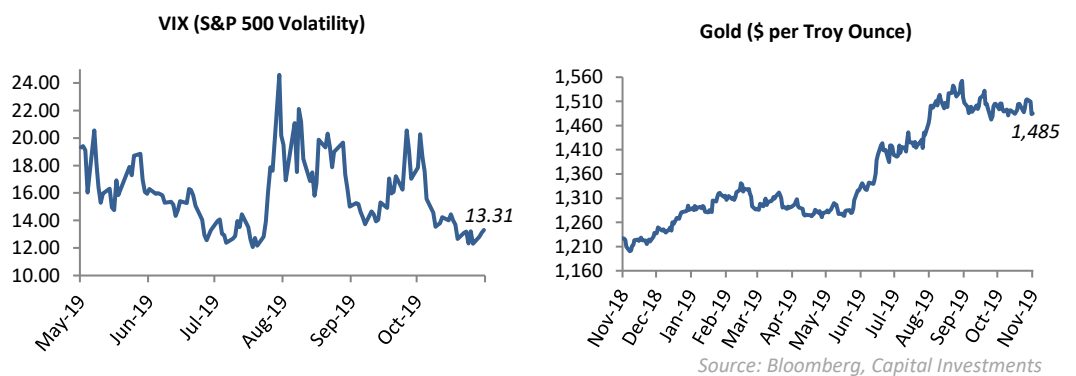
This volatility and the lack of a decisive move are explained by spreads' steepness along the US yield curve. Both the 3 month-10 year and the 2-year-10-year spreads confirmed that on one hand a recession is not imminent anymore, but clearly indicated that the steepness is not due to a change in market expectations regarding growth or inflation but due to the Fed's intervention at the short end of the curve. In all cases, the rally exhibited in developed markets' sovereign bonds over the past year is showing some signs of fatigue, but yields are failing to breakout higher so far due to macro and fundamental hurdles that are yet to be cleared. On a separate note, our fixed income asset allocation is becoming more tactical focusing on relative plays within and across the curve along with potential spread tightening opportunities.



In line with the above thoughts on yields, it is worth noting the correlation between the rise in Germany’s 10-year yield and the European Banking ETF which shows that banks are thirsty for a steepness in the yield curve.



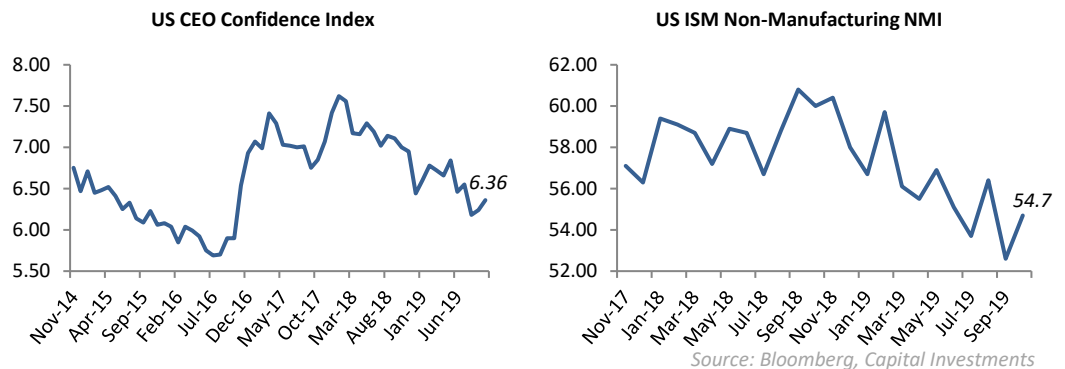
As illustrated in the charts above, equity markets rallied over the past 6 months in anticipation of a potential easing by the Fed. The upward trade then dwindled but the most recent break out in the market came on the back of the Fed dovish coupled with optimism around trade, and was supported by some encouraging data. We believe, however, that we are approaching an overbought territory after the recent rally from October lows.



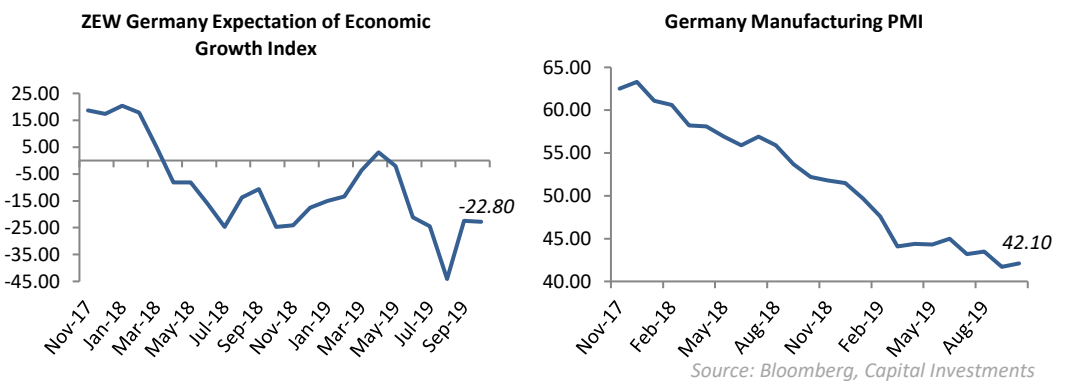
A looser monetary policy has benefited gold which rallied significantly this year. Safe- haven flow due to geopolitical risks and trade negotiations along with Brexit uncertainties also offered support to

gold. Some of these factors are discounted by the market but we think that gold prices are consolidating and are set to benefit from a weaker USD and from low interest rates which will reduce the opportunity cost of owning gold. As for the VIX index, which is a gauge of fear and a reflection of volatility in markets, its uptick is indicating that some investors may be buying some protections amid the recent rally in markets.

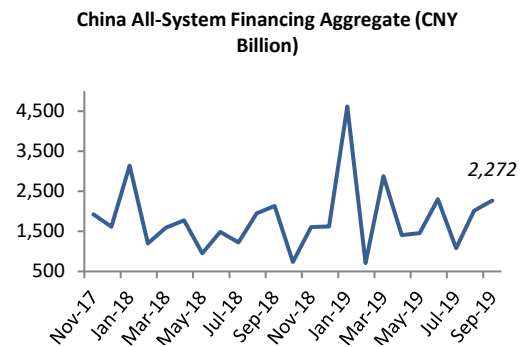
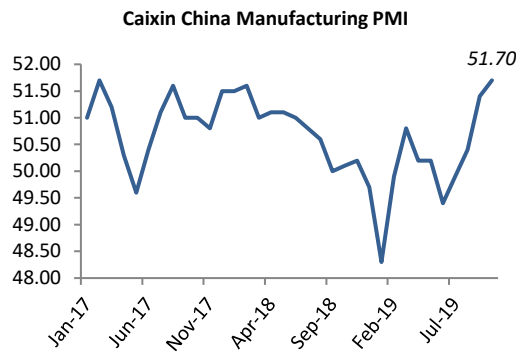
Macro: Some Signs of Potential Stability



The recent uptick in the US CEO Confidence Index along with the ISM non-manufacturing index indicate that the slowdown in manufacturing has not spread to the broader economy despite the recent deceleration in retail sales. The upcoming data releases will show whether stability is under way or not.



This time seems to be different in Europe as the core of the old continent, France and Germany, are leading the slowdown amid an ECB stimulus. We are expecting an easier monetary policy to be complemented by looser fiscal policy, and given that purchasing manager indices are at a record low it is only a matter of time before we see a pick up.



Source: Bloomberg, Capital Investments

In China, we would like to highlight that the PMI data is showing some signs of stability while credit growth is expanding again. This will lead to a recovery with a lag. Weakness may persist for the coming two quarters, but monetary easing should start to bear fruit after, not only in China but around the world.

Purchasing Managers Indices (PMI) (2017-2018):											
	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct
Global Manufacturing	51.4	50.7	50.6	50.5	50.4	49.8	49.4	49.3	49.5	49.7	49.8
Global Services	53.0	52.6	53.3	53.7	52.7	51.6	51.9	52.5	51.8	51.4	51.0
Global Composite	52.7	52.1	52.6	52.8	52.1	51.2	51.2	51.7	51.3	51.1	50.8
US Manufacturing	54.3	56.6	54.2	55.3	52.8	52.1	51.7	51.2	49.1	47.8	48.3
US Services	58.0	56.7	59.7	56.1	55.5	56.9	55.1	53.7	56.4	52.6	54.7
US Manuf. New Orders	51.3	58.2	55.5	57.4	51.7	52.7	50.0	50.8	47.2	47.3	49.1
EU Manufacturing	51.4	50.5	49.3	47.5	47.9	47.7	47.6	46.5	47.0	45.7	45.9
EU Services	51.2	51.2	52.8	53.3	52.8	52.9	53.6	53.2	53.5	51.6	52.2
EU Composite	51.1	51.0	51.9	51.6	51.5	51.8	52.2	51.5	51.9	50.1	50.6
China Manufacturing	49.4	49.5	49.2	50.5	50.1	49.4	49.4	49.7	49.5	49.8	49.3
China Services	53.8	54.7	54.3	54.8	54.3	54.3	54.2	53.7	53.8	53.7	52.8
China Manuf. New Orders	49.7	49.6	50.6	51.6	51.4	49.8	49.6	49.8	49.7	50.5	49.6

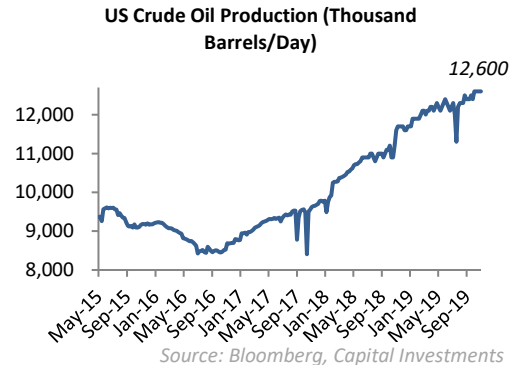
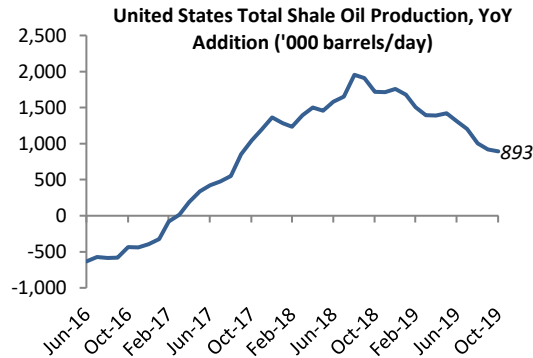
* PMI reading above 50 indicates economy expansion

* 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

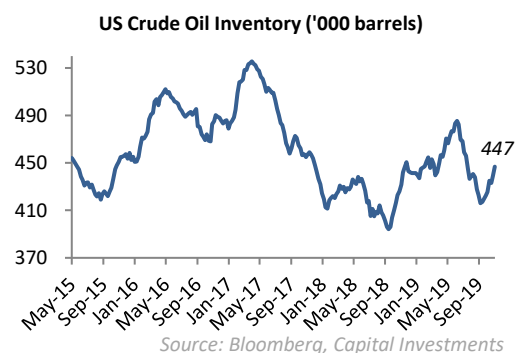
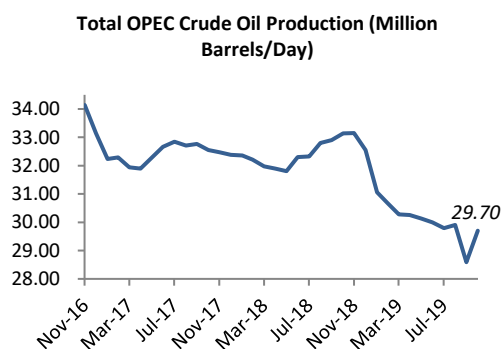
Source: Bloomberg, Capital Investments

Oil: Slowing Shale Boom



Source: Bloomberg, Capital Investments

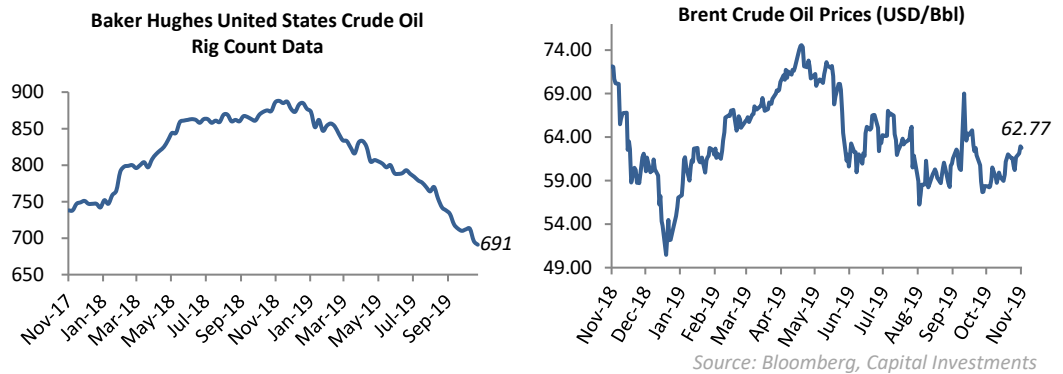
Underneath the buzz of the Aramco attacks and its IPO lies a major shift in the oil market that we would like to highlight. The American shale boom is slowing, and it's expected that production is getting closer to its peak. While shale production has been affected by the collapse of oil prices in the past, the slowdown this year has been driven by operational issues such as wells producing less than expected. US oil production is still increasing, but at a lower rate and below levels seen earlier this decade. According to the EIA, production growth has been at around 3% in 2019 versus a 21% growth from 2017 to 2018, and Goldman Sachs have cut their 2020 US oil production forecasts by 30% as shale drillers struggle to extract crude. Moreover, shale producers, especially small and midsize ones, are facing pressure from investors to show some restraint after delivering poor financial results and spending excessively, whilst financial support from Wall Street is tightening. This is making it more challenging for the companies to drill new wells as rapidly as they previously did.



Source: Bloomberg, Capital Investments

For OPEC and its allies, such developments could offer them some relief as they attempt to reduce a worldwide supply glut- the extent and timing of such relief is still unknown. Nonetheless, OPEC has reiterated its commitment to continue curbing production, which is expected to decline to 32.8 million barrels per day by 2024, while the protests in Ecuador should also disrupt production.

Meanwhile, according to the EIA, U.S crude inventories rose by 7.9 million barrels in the week to November 1, versus an analyst expectation of 1.5 million barrels.



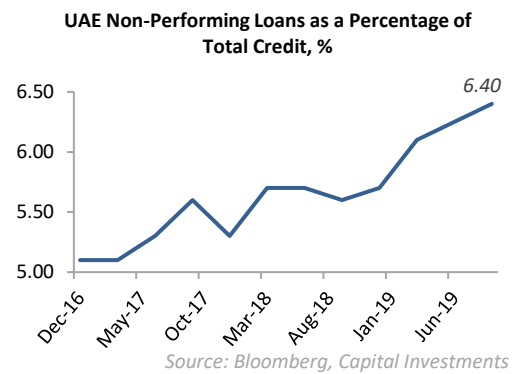
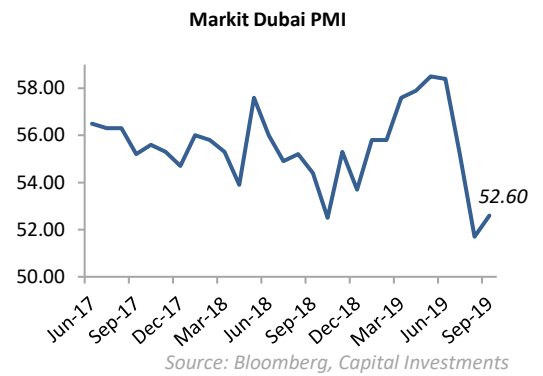
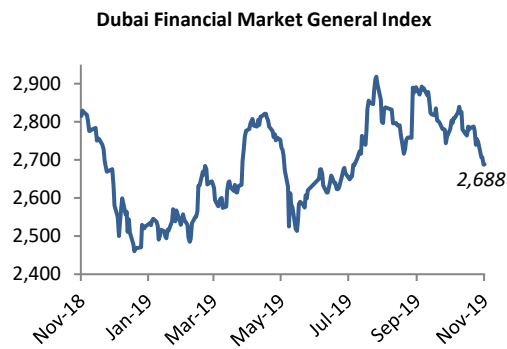
As for global oil demand, both OPEC and the IEA have expressed their concerns over its outlook. The IEA has cut its demand forecast for the remainder of 2019 and for 2020 by 100,000 bpd due to mounting fears of an economic slowdown. OPEC has lowered its outlook numbers for global oil demand growth, to 104.8 million bpd by 2024, and 110.6 million bpd by 2040.

MENA: One Year Ahead of Expo 2020...UAE Stocks are at an Attractive Valuation

Expo 2020, the first Expo to be held in Middle East, Africa and South Asia, will take place in Dubai from 20 October 2020 to 10 April 2021, welcoming 190 participating countries and millions of visitors from around the world. According to Arqaam Capital, Expo 2020 could lead to up to USD9bn of incremental tourist spending which is equivalent to around 7.5% of Dubai's GDP and 2% of UAE's GDP. Furthermore, it will enhance employment by adding jobs, and according to the latest Monster employment index the hospitality and travel related occupation in the UAE has increased by 37% since Q3 2018.

Expo 2020 should create a legacy- 80% of the Expo's buildings are expected to be a part of District 2020 which is a new zone that will expand into a community of over 400,000 square meters. District 2020 will be a new mixed-use development that includes sectors such as communication, logistics, transport, tourism, real estate and education. Thus, the economic impact will continue after the exposition from the operations and activities of District 2020.

In light of the above, we should look at thematic and domestic plays benefiting from Expo 2020, such as the logistics sector which is in for a boom and the retail sector where we are already seeing a pickup in some metrics such as fuel consumption. In addition, the real estate sector should be reaching its bottom following the decision to balance out supply and demand in the property market as there are some signs that the regulator will curtail the expansion of new supply, while the central bank in the UAE will ease mortgage loan requirements. All these factors are positive for the UAE economy and we see an opportunity to selectively accumulate ahead of the Expo 2020 given attractive valuations and generous dividend yields as we think that we are around the peak of pessimism.



Major Indices	Status as of end		Performance	
	December. 2018	October. 2019	October.2019	YTD (31 October. 2019)
MENA				
Abu Dhabi	4,915.07	5,107.76	1.00%	3.92%
Bahrain	1,337.26	1,523.27	0.44%	13.91%
Dubai	2,529.75	2,746.93	-1.23%	8.59%
Egypt	13,035.77	14,558.02	2.11%	11.68%
Jordan	1,908.81	1,800.29	-1.50%	-5.69%
Kuwait	5,267.36	6,211.13	0.59%	17.92%
Lebanon	976.75	763.81	-4.01%	-21.80%
Morocco	11,364.31	11,484.30	-0.67%	1.06%
Oman	4,323.74	3,999.88	-0.44%	-7.49%
Palestine	529.35	519.51	0.36%	-1.86%
Qatar	10,299.01	10,188.97	-1.72%	-1.07%
Saudi Arabia	7,826.73	7,744.08	-4.30%	-1.06%
Tunisia	7,271.65	6,989.69	-0.87%	-3.88%
S&P Pan Arab Composite	728.72	738.39	-2.30%	1.33%
Dow Jones MENA	556.65	568.61	-1.89%	2.15%
Americas				
Dow Jones Industrial	23,327.46	27,046.23	0.48%	15.94%
S&P 500	2,506.85	3,037.56	2.04%	21.17%
NASDAQ Composite	6,635.28	8,292.36	3.66%	24.97%
S&P/Toronto Composite	14,322.86	16,483.16	-1.05%	15.08%
Europe				
EURO Stoxx 50	3,001.42	3,604.41	0.98%	20.09%
S&P Europe 350 Index	1,367.94	1,602.76	0.92%	17.17%
FTSE 100 Index/ London	6,728.13	7,248.38	-2.16%	7.73%
FTSE MIB Index/ Italy	18,324.03	22,693.77	2.65%	23.85%
DAX Index/ Germany	10,558.96	12,866.79	3.53%	21.86%
ASIA/Pacific				
NIKKEI 225/ Japan	20,014.77	22,927.04	5.38%	14.55%
S&P/ASX 200/ Australia	5,646.40	6,663.37	-0.37%	18.01%
BRIC				
Brazil/ Bovespa	87,887.30	107,219.80	2.36%	22.00%
Russia/ RTS	1,066.13	1,422.92	6.67%	33.47%
India/ Bombay Sensitive	36,068.33	40,129.05	3.78%	11.26%
China/ Shanghai Composite	2,493.90	2,929.06	0.82%	17.45%
Hong Kong/ Hang Seng	25,845.70	26,906.72	3.12%	4.11%

Source: Bloomberg, Capital Investments

Description	Closing Prices as of end		Performance	
	December. 2018	October. 2019	October.2019	YTD (31 October. 2019)
Commodities (in USD)				
Brent Spot (Barrel)	53.17	59.55	-0.50%	12.00%
WTI Cushing Spot (Barrel)	45.41	54.18	0.20%	19.31%
Natural Gas NYMEX (MMBtu)	2.95	2.63	5.15%	-10.62%
Gold Spot (OZ)	1,282.45	1,512.93	2.75%	17.97%
Silver Spot (OZ)	15.50	18.11	6.55%	16.86%
Copper LME Spot (MT)	5,949.00	5,769.50	1.30%	-3.02%
Corn CBOT Active Month (Bushel)	3.98	3.90	0.52%	-1.89%
Wheat CBOT Active Month (Bushel)	5.43	5.09	2.62%	-6.22%
Soybean CBOT Active Month (Bushel)	9.46	9.32	1.39%	-1.43%
Rough Rice Futures (USD/cwt)	10.10	11.73	-2.37%	16.20%
Currencies Spot Exchange Rates Against US Dollar				
Euro	1.15	1.12	2.32%	-2.75%
GBP	1.28	1.29	5.31%	1.47%
CAD	0.73	0.76	0.58%	3.61%
Yen	0.01	0.01	0.04%	1.47%
CNY	0.15	0.14	1.56%	-2.28%

Source: Bloomberg, Capital Investments

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