

Monthly Newsletter

August 6th, 2019

"There is nothing permanent except change" - Heraclitus

*"To think is easy, to act is difficult, to act as one thinks is the most difficult" —
John Wolfgang Von Goethe*

Clues from Recent Asset Classes Behavior

Macro: Escalating Trade Tensions May Distort Recent Green Shoots of Stabilization

Oil: Supply is Already Tight but Demand Will Confirm Price Strengthening

MENA: A Few Words on the UAE

Introduction

Risk aversion dominated the markets again on the back of rising trade war temperature. The trade truce reached between the US and China during the G20 meeting back in June was broken by a single tweet from Mr. Trump stating that a 10% tariff will be imposed on the extra USD 300bn goods (not yet subject to tariffs) imported from China starting September 1st, as the Chinese authorities did not accelerate the purchase of US agriculture products.

This reignited fears, raised uncertainties and amplified volatility. It exacerbated an already downgraded path of global growth by the IMF and sent shock waves across risky assets as investors flew to quality, notably developed markets sovereign bonds, the USD, and gold.

Because of rising trade protectionism and a deteriorating global economic outlook, monetary policy came to the rescue. The Fed cut interest rates for the first time in a decade and stopped reducing the size of its balance sheet since August 1st. The Fed's actions were taken with a grain of salt from markets participants.

On the positive side, this shift will lend support to financial conditions by alleviating any tightening pressures. It will offer some relief to emerging markets as they can ease their policies to cushion their economies after they were tightening last year because of the Fed although their economic performance was weakening.

On a less encouraging note, the Fed stated that its recent action is just a "mid-cycle policy adjustment" which means that they do not intend to start an easing round. By doing so, the Fed is further deviating from global central banks which have shifted towards an easing mode. This is lending support to the USD and raising the prospect of currencies volatility through competitive currency devaluations.

In principle, the central banks' easing should support asset valuation as it lowers the discount rate and provides more liquidity into the system. However, as bond markets are reflecting a darker global economic picture and pricing in further easing, we think that other conditions should be met for us to assume more risk and deploy cash, i.e. to move from a tactically bullish mode to a strategically bullish mode.

For instance, although the weakness in the manufacturing sector has not filtered through to the services sector, aggregate demand is weak in general. Deteriorating business confidence due to trade protectionism, populist movements or potential events with unexpected consequences such as a no deal Brexit are distorting supply chains, weakening business investments as capital expenditures are declining while share buybacks funded either through junk bond or triple BBB rated bonds (which are the worst in investment grade) are gaining track. This, in absence of meaningful synchronized global fiscal stimulus notably in Europe, is raising further uncertainty around the weak global economic outlook. In turn, it is weighing negatively on margin expansion and earnings growth.

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:

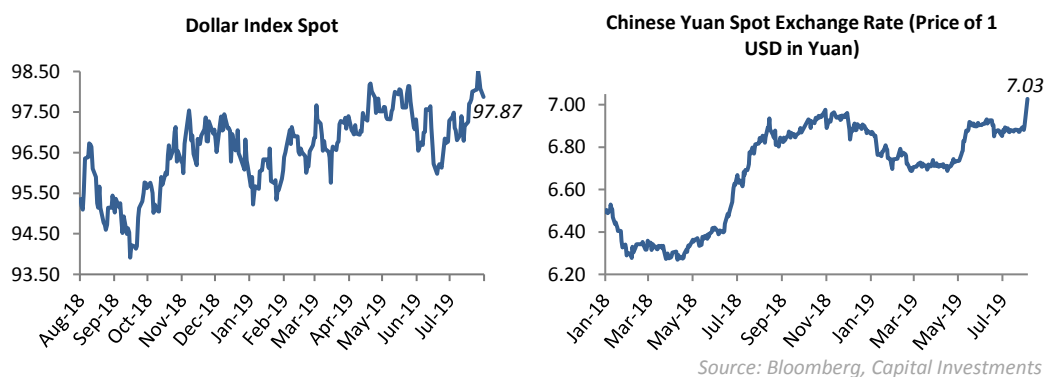
Asset Management Department
Tel: +962 6 5200330
Ext. 2494 and 2373
AssetManagement@Capitalinv.com

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

For H2 2019, we continue to hold a portion in cash which would provide us protection and optionality. We added short term high quality fixed income papers and are holding our position in proxies to gold and to a less extent in some other commodities. We also started to buy gradually again into emerging markets, while in the MENA region we are looking at high dividend yield stocks and into selective thematic plays that include index inclusions.

As a result, easing monetary policy would help us navigate volatility by taming any tightness in global financial conditions. However, as explained earlier, uncertainty around global economic growth, muted inflation and a soft earnings outlook will slow the needed decrease in equity risk premiums. This requires the portfolio manager to maneuver volatility and keep rotating or rebalancing the investment portfolio. If economic indicators continue their stabilization as indicated through the PMI data from China and Europe, coupled with clarity regarding trade negotiations, then low bond yields may encourage investors to move aggressively from cash and bonds into equity especially that markets are pricing in further easing from the Fed.

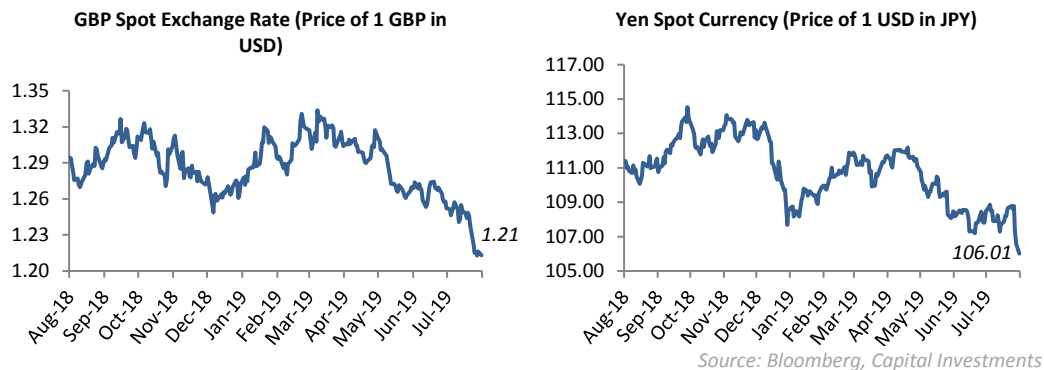
Clues from Recent Asset Classes' Behavior



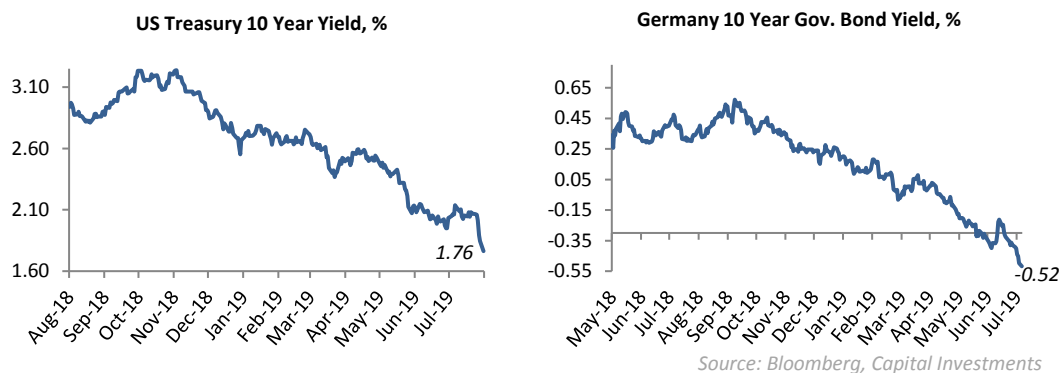
Source: Bloomberg, Capital Investments

A series of relatively encouraging macro-economic data following the trade truce reached between the US and China during the G20 meeting in June contributed to the strengthening of the USD as illustrated in the graph above. This appreciation got a boost towards the end of July after the Fed delivered a “hawkish” interest rate cut. The USD then lost some steam as traders priced in another interest rate cut in September, coupled with deteriorating PMI data in the US and an in-line jobs report. In contrast, the Chinese Yuan which was enjoying a period of stability due to the positive G20 meeting outcome, deteriorated sharply in the aftermath of Mr. Trump’s recent tweet in which he imposed additional tariffs on Chinese goods. The Yuan crossed the key psychological barrier of 7 to the USD and amplified the negative momentum although China’s central bank interfered and fixed

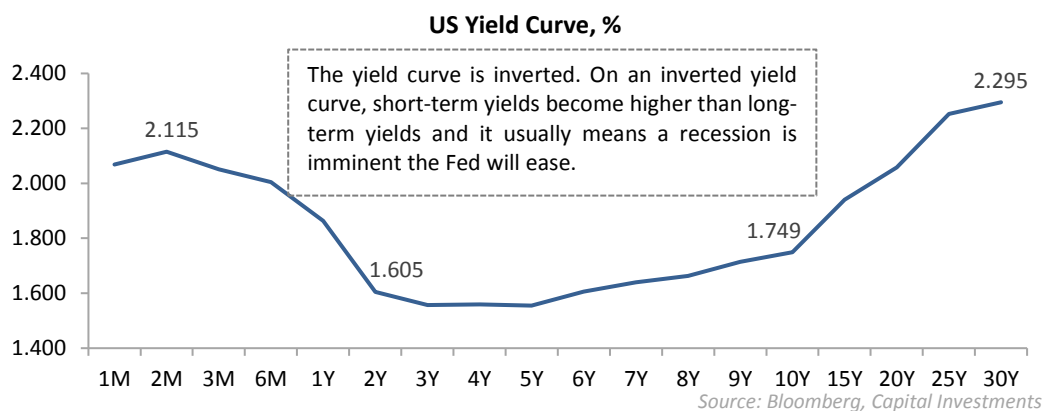
it at a stronger rate below 7. The US labelled China as a currency manipulator, a step that the former refrained from doing since 1994. A currency war is officially been declared.



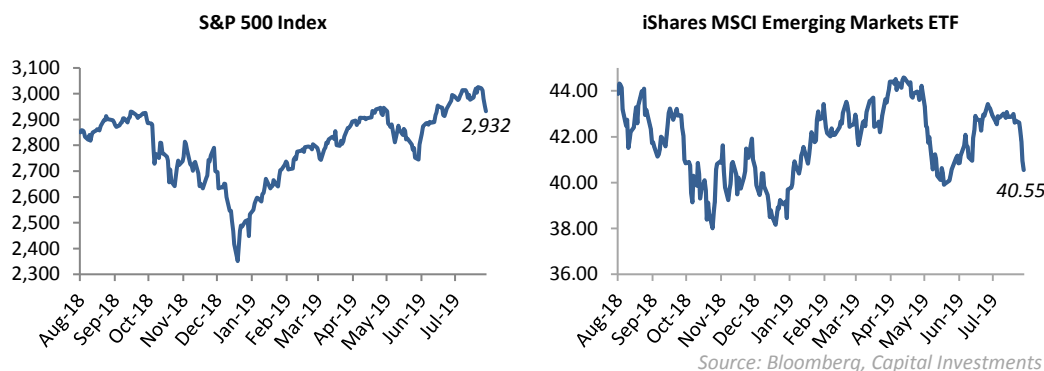
The Japanese Yen maintained its role as a safe haven when tensions rise, while the GBP declined sharply as investors are positioning themselves for the possibility of a No-Deal Brexit and are closely watching whether the GBP/Euro will go to parity. The emerging markets carry trade came into check amid a strong USD. We think that the Fed cannot continue with its divergence from global central banks in terms of easing magnitude and thus the USD’s strength will not be sustainable, especially since the money repatriations that took place upon the tax cut incentives initiated by Mr. Trump toward the end of 2017 are ebbing.



Developed markets’ sovereign bond yields suggest that the path for interest rates is still lower as the yields in key countries such as the US and Germany are below policy rates set by central banks, with the entire German yield curve going into negative territory before rebounding at its longer end. The initial reaction of the yield curve in the US after the Fed’s decision to cut interest rates was a bull flattener, whereby long dated yields fell at a much faster rate than the front end. This was followed by Mr. Trump’s tweet escalating the trade war with China, which shifted the whole US yield curve downwards.

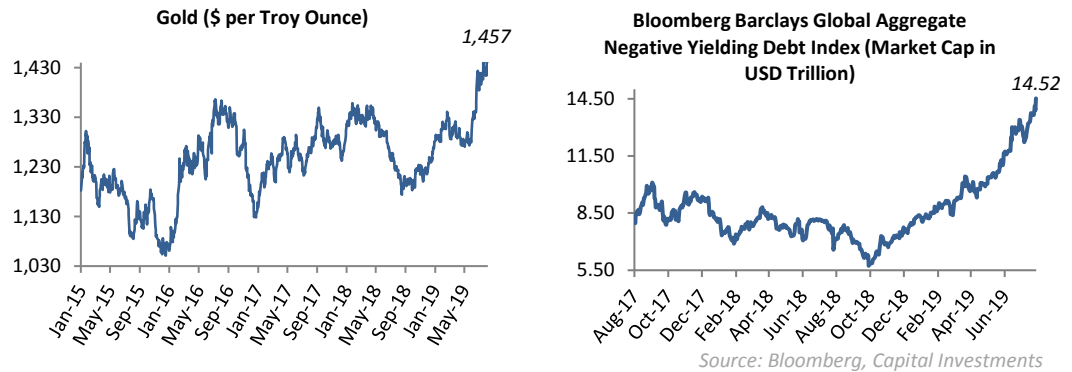


Amid the euphoria to reach out for yield, we continue to be cautious and selective in assuming credit risk while hunting for yields, and we have positioned ourselves in some short dated high-quality papers. Other factors that would affect yields and would require further assessment are the fact that both parties in the US have reached a deal regarding the budget and debt ceiling, which may affect the choice of the US Treasury when it comes to tenors (maturities) at which to borrow, and thus affecting the supply of papers along the curve. Another dimension is the fact that the Fed has stopped reducing its balance sheet since August 1st which will have implications as well on excess reserves in the US banking system and rates in general.



Expectations of an easing monetary policy by the Fed along with a trade truce between the US and China at the end of June supported equity markets over the past month. This journey will prove to be a bit challenging as the Fed failed to deliver the message expected by markets as trade tensions escalated again. Investors will be cautious with their trading until they get further clarity when the Fed holds its famous conference at the end of August in Jackson Hole. Valuation in the US market will be cheap if earnings growth is maintained and the Fed continues with its easing bias, and clarity regarding trade will support markets. As for emerging markets, although they are getting pressured by a stronger USD, most of them are on an easing monetary policy and in reforms mode, while China

is providing both fiscal and monetary stimulus to cushion any negative backdrop from trade. This makes any retreat in emerging markets a good entry point into selective plays.

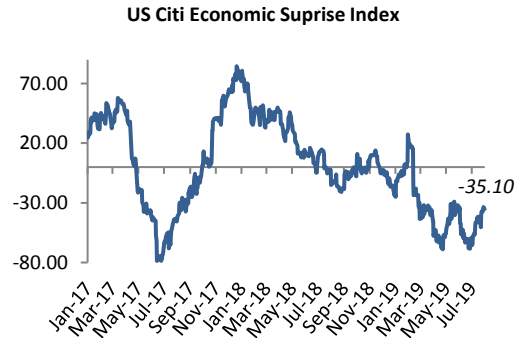
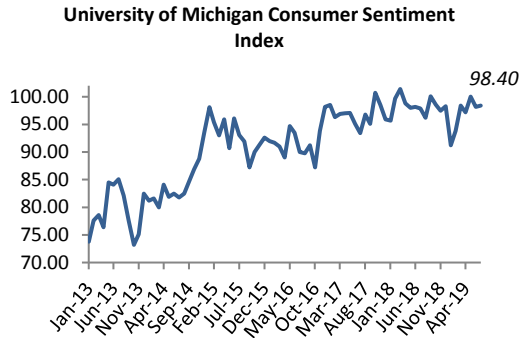


Amid declining yields and muted global growth and given that the size of negative yielding debt is increasing, finding relative value in most asset classes is becoming increasingly difficult. As such, we continue to prefer gold despite the recent volatility, while bearing in mind that it will get support from easing monetary policies, continued purchases by central banks, and trade tension escalation. A strong USD will continue to tame any rally in gold but with central banks following a reflation mode and bond markets pricing in further decline in yields despite the recent soft stability in macro data, gold will continue to find support.

Macro: Escalating Trade Tensions May Distort Recent Green Shoots of Stabilization

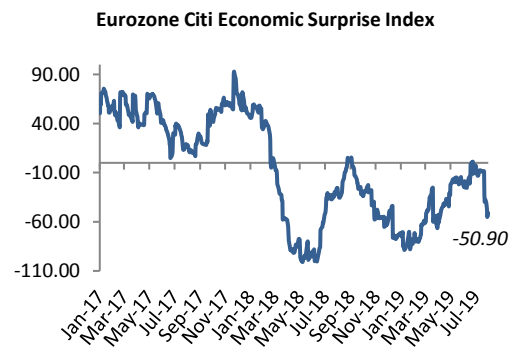
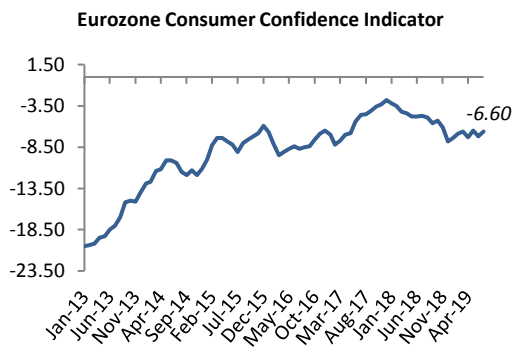
The series of charts below illustrate that the main players in the global economy, the US, EU and China, were showing signs of stabilization amid a slowing or decelerating trend. This was supported by the shift in monetary policy to an accommodative bias and several fiscal stimulus measures notably in China and to a less extent in Europe, although budget deficits are on the rise in both regions to sustain domestic demand as the export and manufacturing sectors have been struggling. Now that uncertainty is rising again due to escalating trade tensions between various players notably between the US-China, US-EU, and Japan-South Korea, and due to the impact of Brexit on business sentiment, we believe that more pressure will pile into the global economy. Therefore, we shall wait for further data to confirm that stabilization is a theme, but in all cases, we should expect more monetary stimulus globally and more fiscal measures by China to cushion the negative impact of the rising temperature of the trade war. However, competitive currency devaluation will continue to be a source of concern as it will only create a dislocation in aggregate demand rather than create any

meaningful incremental demand, not to mention that companies will refrain from adding new capital expenditures amid rising protectionism.



Source: Bloomberg, Capital Investments

US data showed signs of stability as consumer sentiment has been consolidating and consumer spending continued to be healthy despite obvious deterioration in the manufacturing sector, and lack of responsiveness of the housing sector to falling mortgage rates.



Source: Bloomberg, Capital Investments

Europe is once again haunted by the Brexit saga which weighed negatively on the region's economic surprise index, as illustrated in the graph above, despite some stability in Purchasing Managers Indices (PMIs).



Source: Bloomberg, Capital Investments

Despite the smell of weakness, it was obvious that the Chinese measures taken during the past quarter in terms of increasing infrastructure spending and reducing fees and VAT was contributing to the stability of the economy. The Chinese economy had been positioned for a consolidation mode but now that trade war is escalating, more confirmation is needed especially when it comes to export-oriented sectors. We continue to believe that the rotation from an export driven economy to a domestic consumption one is starting to bear fruit.

Purchasing Managers Indices (PMI) (2017-2018):											
	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul
Global Manufacturing	52.1	52.0	51.9	51.4	50.8	50.6	50.5	50.4	49.8	49.4	49.3
Global Services	52.9	53.4	53.7	53.0	52.7	53.3	53.7	52.7	51.6	51.9	52.5
Global Composite	52.8	53.0	53.1	52.7	52.1	52.6	52.8	52.2	51.2	51.2	51.7
US Manufacturing	59.5	57.5	58.8	54.3	56.6	54.2	55.3	52.8	52.1	51.7	51.2
US Services	60.8	60.0	60.4	58.0	56.7	59.7	56.1	55.5	56.9	55.1	53.7
US Manuf. New Orders	61.5	58.0	61.8	51.3	58.2	55.5	57.4	51.7	52.7	50.0	50.8
EU Manufacturing	53.2	52.0	51.8	51.4	50.5	49.3	47.5	47.9	47.7	47.6	46.5
EU Services	54.7	53.7	53.4	51.2	51.2	52.8	53.3	52.8	52.9	53.6	53.2
EU Composite	54.1	53.1	52.7	51.1	51.0	51.9	51.6	51.5	51.8	52.2	51.5
China Manufacturing	50.8	50.2	50.0	49.4	49.5	49.2	50.5	50.1	49.4	49.4	49.7
China Services	54.9	53.9	53.4	53.8	54.7	54.3	54.8	54.3	54.3	54.2	53.7
China Manuf. New Orders	52.0	50.8	50.4	49.7	49.6	50.6	51.6	51.4	49.8	49.6	49.8

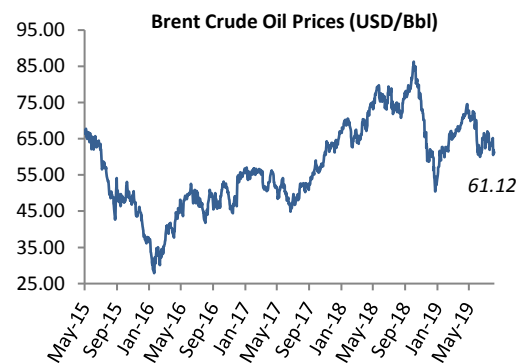
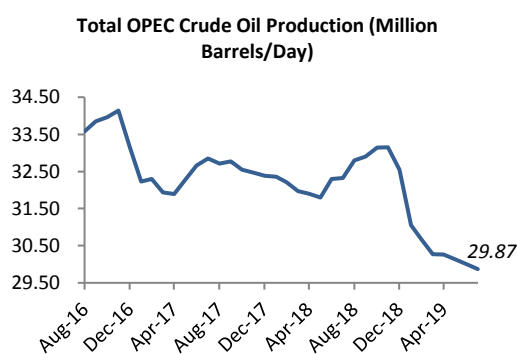
* PMI reading above 50 indicates economy expansion

* 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

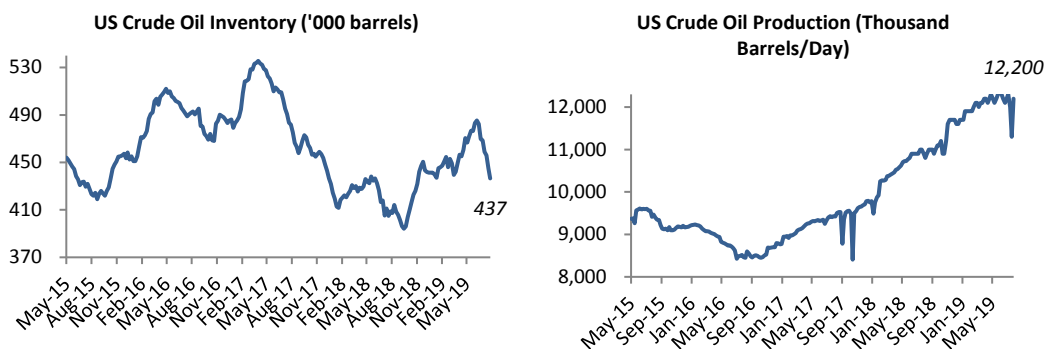
Source: Bloomberg, Capital Investments

Oil: Supply is Already Tight but Demand Will Confirm Price Strengthening



Source: Bloomberg, Capital Investments

Oil prices, once again, seem to be in a tug of war between supply and demand. OPEC's output hit its lowest level since 2011 in July, as the organization and its allies continue to implement their agreement. These production cuts have also been supported by supply disruptions, albeit acute, from Libya and Venezuela. Moreover, the implementation of the IMO 2020, which will enforce a new 0.5% global Sulphur cap on fuel content from 1 January 2020, could also lend support to oil prices as it will increase demand for certain end-products amid a lack of refining capacities. The geopolitical tensions in the Strait of Hormuz should also support prices.



Source: Bloomberg, Capital Investments

However, it seems to be that demand factors will determine the path that oil prices will follow, as weak demand due to the trade war continues to weigh negatively on oil prices. Therefore, the IEA does not see 'huge increases' in oil prices, despite inventory drawdown and lower production in the US.

MENA: A Few words on the UAE

A combination of positive factors contributed to the rally in UAE stock market in July; a dovish Fed, several stimulus measures taken by government authorities, and a potential bottoming in the real estate market.

As part of its stimulus measures, the UAE will allow foreigners to own 100% of businesses across various industries, and the new rules lift a federal requirement that has capped foreign ownership in local companies at 49%. This change stimulates the economy by attracting new foreign investors and creating new jobs and may trigger a higher weight in MSCI and FTSE indices.

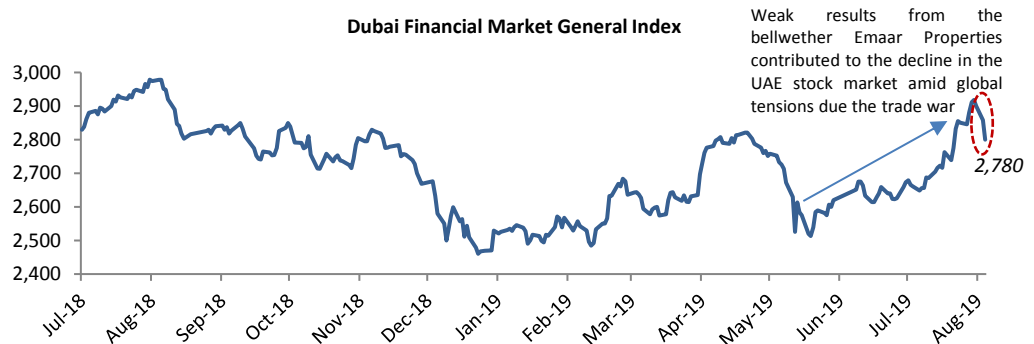
In addition, according to the Ministry of Human Resources, the government has cut fees on 145 services and 128 transactions supervised by the ministry. For example, work permit fees across all categories have been halved and fees for two-year work permit renewal has also been reduced. This will also provide a boost for businesses by cutting their costs. Also, the Ministry of Economy announced an amended fee structure for a package of 110 services, whereby fees of 102 services will be cancelled while those of the other eight services will be reduced by 50%. This reduces the cost of conducting trade and investment activities for all enterprises.

Furthermore, Aldar Properties partnered with the government to deliver AED5bn worth of projects in Abu Dhabi. The projects cover an AED2bn contract to develop 899 villas in Al Falah, an AED2bn contract to complete infrastructure in Saadiyat Island, and an AED1bn contract to develop

“twofour54” campus on Yas Island which will bring a working population of 10,000 to the island. This is part of the Abu Dhabi government’s accelerator program, Ghadan 21, focusing on economic development, ease of doing business, innovation, and livability in the capital of the UAE.

As supply across the UAE property market rises, regulators have introduced a rent-to-own scheme to boost demand for owning houses, which is a win-win for both parties involved since developers get to sell their current stock, while customers can afford to buy what they could not afford before due to the shortage of funds available for a down payment.

All these factors are positive for the UAE economy and any retreat in the stock market is an opportunity to reaccumulate ahead of the Expo 2020 given attractive valuations and generous dividend yields.



Source: Bloomberg, Capital Investments

Major Indices	Status as of end		Performance	
	December. 2018	July. 2019	July.2019	YTD (31 July. 2019)
MENA				
Abu Dhabi	4,915.07	5,317.90	6.79%	8.20%
Bahrain	1,337.26	1,547.68	5.21%	15.74%
Dubai	2,529.75	2,918.38	9.77%	15.36%
Egypt	13,035.77	14,100.74	0.00%	8.17%
Jordan	1,908.81	1,873.46	-0.35%	-1.85%
Kuwait	5,267.36	6,744.08	5.76%	28.04%
Lebanon	976.75	865.67	0.00%	-11.37%
Morocco	11,364.31	11,287.04	0.00%	-0.68%
Oman	4,323.74	3,760.63	-3.20%	-13.02%
Palestine	529.35	529.43	1.85%	0.02%
Qatar	10,299.01	10,505.00	0.47%	2.00%
Saudi Arabia	7,826.73	8,732.62	-1.01%	11.57%
Tunisia	7,271.65	7,149.00	0.00%	-1.69%
S&P Pan Arab Composite	728.72	803.08	0.90%	10.20%
Dow Jones MENA	556.65	615.06	1.24%	10.49%
Americas				
Dow Jones Industrial	23,327.46	26,864.27	0.99%	15.16%
S&P 500	2,506.85	2,980.38	1.31%	18.89%
NASDAQ Composite	6,635.28	8,175.42	2.11%	23.21%
S&P/Toronto Composite	14,322.86	16,406.56	0.15%	14.55%
Europe				
EURO Stoxx 50	3,001.42	3,466.85	-0.20%	15.51%
S&P Europe 350 Index	1,367.94	1,558.36	0.18%	13.92%
FTSE 100 Index/ London	6,728.13	7,586.78	2.17%	12.76%
FTSE MIB Index/ Italy	18,324.03	21,398.19	0.77%	16.78%
DAX Index/ Germany	10,558.96	12,189.04	-1.69%	15.44%
ASIA/Pacific				
NIKKEI 225/ Japan	20,014.77	21,521.53	1.15%	7.53%
S&P/ASX 200/ Australia	5,646.40	6,812.56	2.93%	20.65%
BRIC				
Brazil/ Bovespa	87,887.30	101,812.10	4.93%	15.84%
Russia/ RTS	1,066.13	1,360.04	-1.48%	27.57%
India/ Bombay Sensitive	36,068.33	37,481.12	-4.86%	3.92%
China/ Shanghai Composite	2,493.90	2,932.51	-1.56%	17.59%
Hong Kong/ Hang Seng	25,845.70	27,777.75	-2.68%	7.48%

Source: Bloomberg, Capital Investments

Description	Closing Prices as of end		Performance	
	December. 2018	July. 2019	July.2019	YTD (31 July. 2019)
Commodities (in USD)				
Brent Spot (Barrel)	53.17	64.13	-0.47%	20.61%
WTI Cushing Spot (Barrel)	45.41	58.58	0.19%	29.00%
Natural Gas NYMEX (MMBtu)	2.73	2.23	-2.15%	-18.06%
Gold Spot (OZ)	1,282.45	1,413.90	0.32%	10.25%
Silver Spot (OZ)	15.50	16.26	6.18%	4.94%
Copper LME Spot (MT)	5,949.00	5,902.25	-1.33%	-0.79%
Corn CBOT Active Month (Bushel)	3.98	4.10	-4.98%	3.14%
Wheat CBOT Active Month (Bushel)	5.28	4.87	-7.59%	-7.76%
Soybean CBOT Active Month (Bushel)	9.35	8.82	-4.50%	-5.75%
Rough Rice Futures (USD/cwt)	10.10	11.95	5.94%	18.33%
Currencies Spot Exchange Rates Against US Dollar				
Euro	1.15	1.11	-2.61%	-3.41%
GBP	1.28	1.22	-4.23%	-4.67%
CAD	0.73	0.76	-0.75%	3.38%
Yen	0.01	0.01	-0.82%	0.77%
CNY	0.15	0.15	-0.25%	-0.08%

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.