Capital Investments كابيتال للإستثمارات

Monthly Newsletter

January 8th, 2020

"At all times look at the thing itself- the thing behind the appearance." — Marcus Aurelius

"Confidence is contagious. So is the lack of confidence." — Vince Lombardi

Clues from Recent Asset Classes' Behavior

Macro: Central Banks Stimulus is Providing a Floor

Oil: Geopolitics in the Middle East may Risk Supply Disruption

MENA: Jordan, an Oasis of Tranquility in the Levant

Introduction

The new year has already started with a bundle of eye-catching events. We expect 2020 to be defined by politics. Market participants are facing the outcomes of binary events. There are many questions raised, would China and US move beyond the phase one deal due to be completed in January or would the narrative drift toward more de-globalization, heightened protectionism and confrontations on different fronts including supply chains, investment restrictions, and export controls? Would Brussels become the new epicenter of trade negotiation as the US turns its attention from China to the EU? How would developments progress when it comes to the Hong Kong protests or the Brexit process? Would the US label many countries as currency manipulators as in the case of Brazil and Argentina to push the USD lower? What path would the rising geopolitical tensions in the Middle East follow? How these events will unfold will have ramifications on equities, fixed income, oil and other asset classes. Investors hope that 2020 turns out to be the year of political deals, but caution is warranted. We expect a rise in idiosyncratic risks and heightened volatility across the board, while noting that we are not entering 2020 from lower bases in terms of valuations or price levels.

Given the rising medium-term uncertainty, markets are being supported by ample liquidity injections as major central banks have moved from contracting their balance sheets into expansion modes. Chief among those central banks is the US Fed which declared that it does not intend to raise interest rates until inflation is "persistent and significant". In addition, the Fed's balance sheet is once again in an expansionary mode at least until the end of Q1 2020, injecting liquidity in the range of USD 30bn to 60 bn per month. This is keeping liquidity in the global financial system at adequate levels and is increasing the supply of USD, thus contributing to its weakness. The Chinese central bank is following an expansionary monetary policy by gradually reducing the reserve requirement ratio in the Chinese Banking system thus releasing substantial liquidity that would complement the fiscal measures taken by the country to boost the economy and counter the trade war repercussions.

In terms of investment implications, 2020, in contrast to 2019, would be the year where coupon clipping would constitute the bulk of total returns in Fixed Income. Easy money and relatively low real yields are giving carte blanche to precious metals and commodities. Economic growth acceleration and weakened USD would also help EM and thematic growth plays. Diversification will continue to be key to any portfolio structure with continuous rebalancing. We will keep an eye on valuation as we prefer not to pay high for momentum, at the same time political developments will keep volatility high, and the interplay between investors mood and markets' overreaction is set to create opportunities. Easy money, as long as it is present with muted inflation, will provide a cushion and will help a few asset classes to break out. In the MENA region, we will continue to be selective, focusing on thematic plays related to index inclusions, and we will follow stimulus packages related to the Expo 2020 in Dubai, or mega projects in Abu Dhabi and Saudi Arabia.

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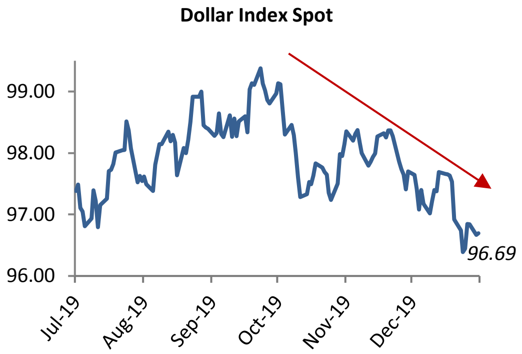
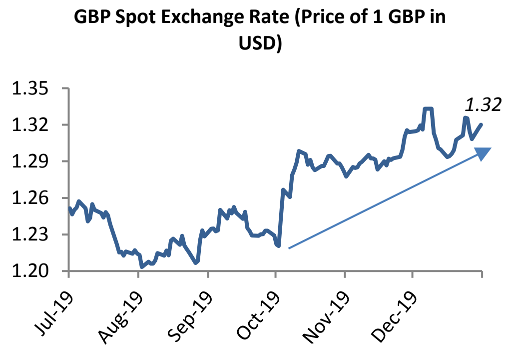
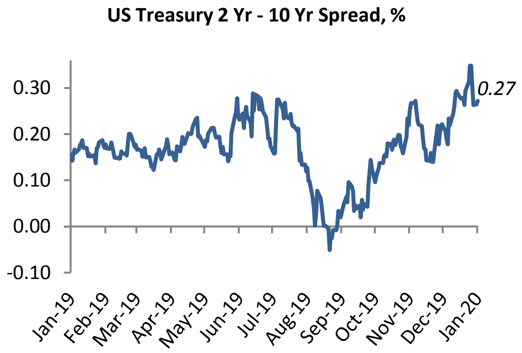
Clues from Recent Asset Classes' Behavior

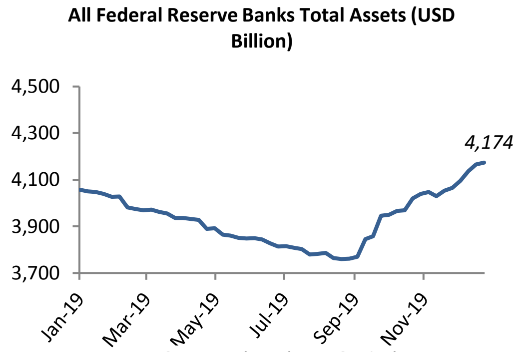




Source: Bloomberg, Capital Investments

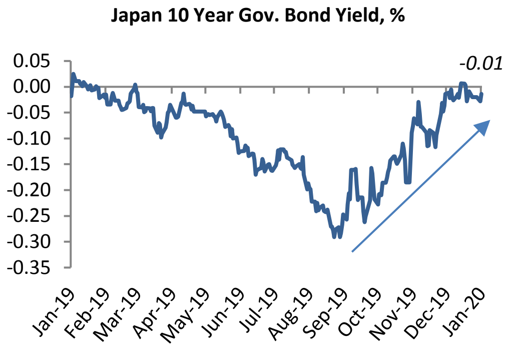
The US dollar is still weakening, breaking key support levels, and this downward bias has been reinforced by many factors. The easing in trade negotiations between the US and China played an important role, coupled by the US administration's indirect policy intervention through accusing a few countries of keeping their currencies artificially undervalued to boost exports and ensure competitiveness. In addition, a pick-up in long-term German and Japanese yields, which are near zero after spending most of 2019 in deep negative territories contributed to the shrinking of interest rate differentials with US yields. Measures taken by the Swedish Central Bank which raised rate and abandoned negative rates is weighing as well on the greenback. Much more clarity related to the Brexit process has contributed to a rally in the GBP which is now on an upward trend and seems to be influenced less by politics and more by economic fundamentals such as GDP growth, current account status, and business confidence

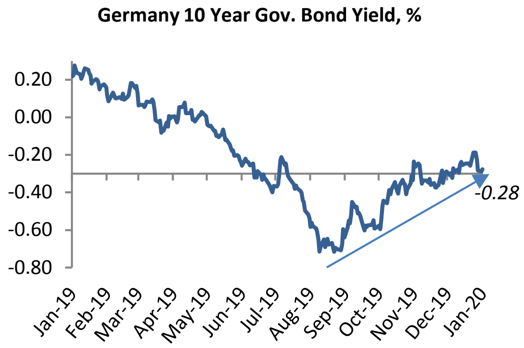




Source: Bloomberg, Capital Investments

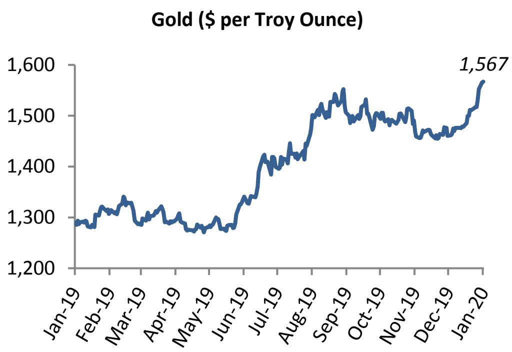
Despite the optimism about the economic prospects for 2020 and the receding of recessionary fears, steepness in the US yield curve is failing to strengthen at a time when the Fed's balance sheet is expanding rapidly. The Fed's expansionary mode has contributed to a rally in stock markets as witnessed in the S&P 500 index which has crossed the 3200 level, while the US 10-year yield failed to cross the 2% level. A durable rotation into cyclicals will be reinforced by the widening of the 2yr-10yr US spread.

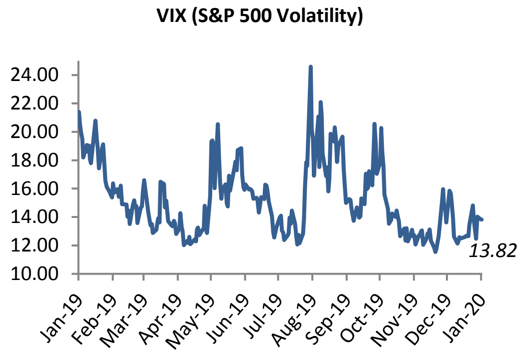




Source: Bloomberg, Capital Investments

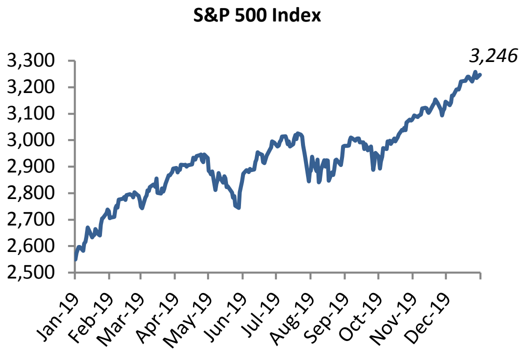
Both Japanese and German long-term yields were rising over the past few months which has put pressure on the mountain of negative yielding debt and is creating some dislocation in the fixed income and currency spheres. The climb in Japanese yields is supported by a fiscal stimulus of USD 121bn announced by the Japanese government, a stealth tapering of the Bank of Japan’s balance sheet, and an improving trade relationship with China. As for Germany, the rise in yields might be premature as it is not supported yet by economic data.

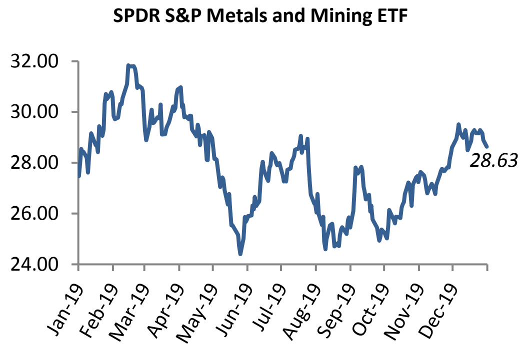




Source: Bloomberg, Capital Investments

A flood of liquidity by major central banks is helping in repressing financial volatility despite rising geopolitical tensions around the world. Simultaneously a combination of easy money, weak USD, low real yields, and a wave of consolidations in the mining industry will ensure sustainable capital flow into gold and other precious metals, not to mention that gold would act as the perfect safe haven during times of trouble.

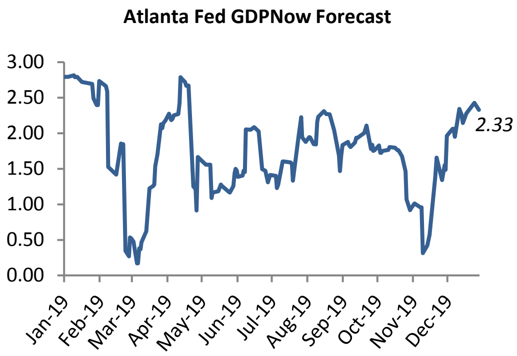


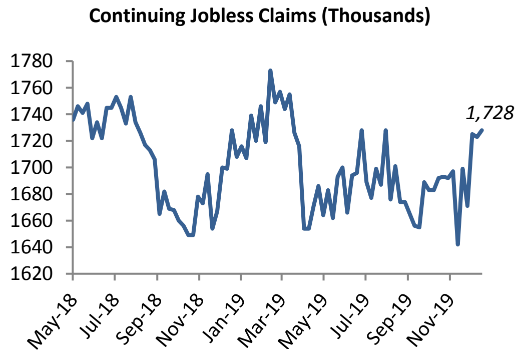


Source: Bloomberg, Capital Investments

Short term indicators were indicating that stock markets are exhibiting overbought signals and are priced for perfection which explains the decline triggered by escalating tensions in the Middle East. However, we think that the easing measures adopted by most central banks will lead to a breakout in key indices and it is worth keeping an eye on metals and mining, emerging markets and Europe, while plays related to the UK's domestic economy that benefit from a strong GBP should be part of any portfolio strategy.

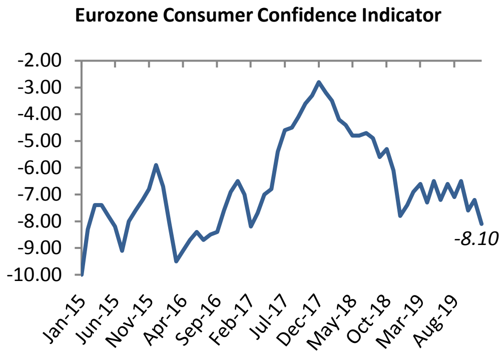
Macro: Central Banks Stimulus is Providing a Floor

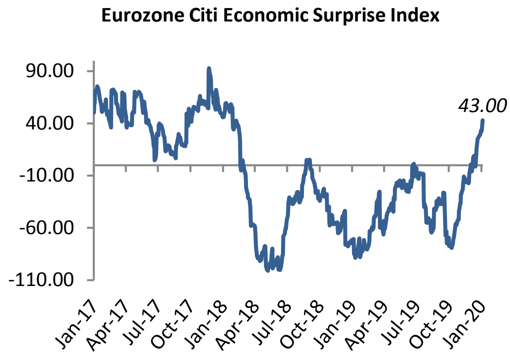




Source: Bloomberg, Capital Investments

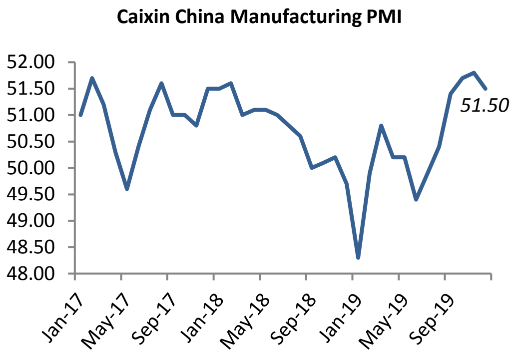
US consumers benefiting from a low unemployment rate and a low interest rate environment are enjoying a high confidence level and sustaining spending, although continuous jobless claims are rising and thus sending some alerts. Businesses and CEOs' confidence continues to show hesitance and reluctance toward new fresh investments which would put a cap on the economic activity amid a weak manufacturing sector.

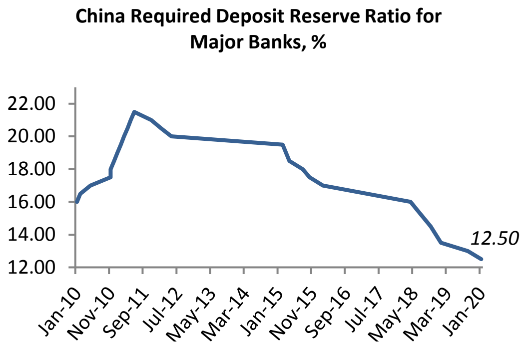




Source: Bloomberg, Capital Investments

In Europe, investors need to dig deeper to get a clear picture as loan growth is improving and new order PMIs are showing upticks along with the Eurozone Citi Economic Surprise Index. Soft indicators such as confidence indices did not yet detect the forward-looking indicators and are still anchored with falling manufacturing PMIs.





Source: Bloomberg, Capital Investments

Turning to China, the improvement that occurred over the past two months did not seem to be sustainable as indicated by the Caixin manufacturing and services PMIs. This explains the stimulus measures taken by the authorities to boost lending to SMEs especially that unemployment is rising in China, which is a precursor to socio-economic stability although the situation appears to be manageable so far. In contrast to this, the Shanghai composite index is breaking out, reflecting the easing in financial conditions.

Purchasing Managers Indices (PMI) (2017-2018):											
	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Global Manufacturing	50.6	50.5	50.4	49.8	49.4	49.3	49.5	49.7	49.8	50.3	50.1
Global Services	53.3	53.7	52.7	51.6	51.9	52.5	51.8	51.4	51.0	51.6	52.1
Global Composite	52.6	52.8	52.1	51.2	51.2	51.6	51.3	51.1	50.8	51.4	51.7
US Manufacturing	54.2	55.3	52.8	52.1	51.7	51.2	49.1	47.8	48.3	48.1	47.2
US Services	59.7	56.1	55.5	56.9	55.1	53.7	56.4	52.6	54.7	53.9	55.0
US Manuf. New Orders	55.5	57.4	51.7	52.7	50.0	50.8	47.2	47.3	49.1	47.2	46.8
EU Manufacturing	49.3	47.5	47.9	47.7	47.6	46.5	47.0	45.7	45.9	46.9	46.3
EU Services	52.8	53.3	52.8	52.9	53.6	53.2	53.5	51.6	52.2	51.9	52.8
EU Composite	51.9	51.6	51.5	51.8	52.2	51.5	51.9	50.1	50.6	50.6	50.9
China Manufacturing	49.2	50.5	50.1	49.4	49.4	49.7	49.5	49.8	49.3	50.2	50.2
China Services	54.3	54.8	54.3	54.3	54.2	53.7	53.8	53.7	52.8	54.4	53.5
China Manuf. New Orders	50.6	51.6	51.4	49.8	49.6	49.8	49.7	50.5	49.6	51.3	51.2

** PMI reading above 50 indicates economy expansion*

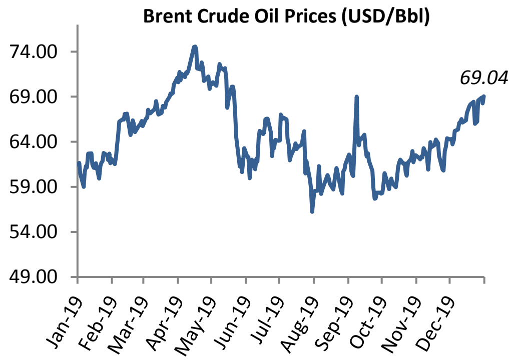
** Red points displayed within the lines above indicate highest point in the range*

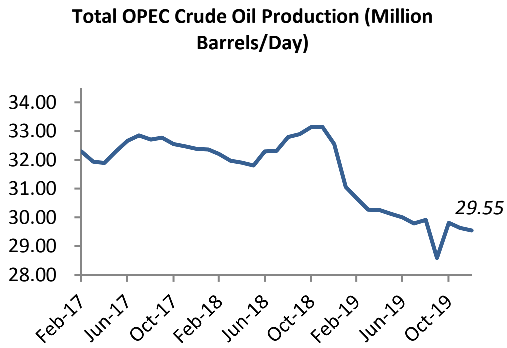
** Figures in green indicate acceleration from previous month, while red indicate deceleration*

Source: Bloomberg, Capital Investments

Oil: Geopolitics in the Middle East may Risk Supply Disruption

The oil market is heading into 2020 in a completely different state from a year ago on the back of heightened geopolitical tensions, tightening supply, and a potential trade deal looming in the horizon. In what was arguably a bumpy start to the year, oil prices spiked 4% after the US killed Iranian General Qassim Soleimani, and as long as the geopolitical tension remains high, the risk that confrontation could pull into other Middle Eastern countries and disrupt production will keep prices afloat.

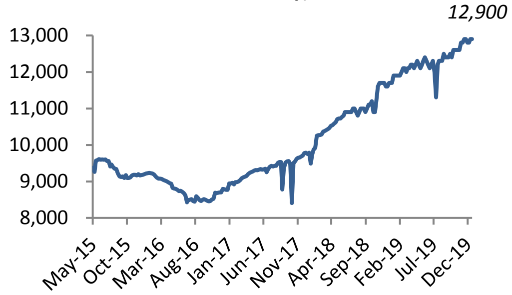




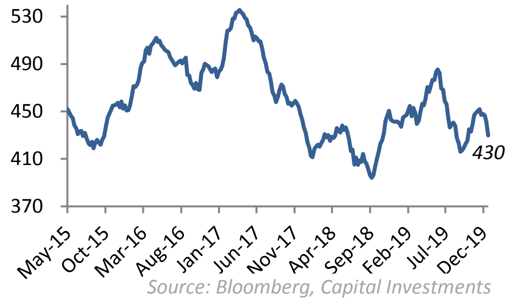
Source: Bloomberg, Capital Investments

Nonetheless, prior to this incident, oil prices had already received some support from numerous factors. The U.S and China agreed to sign the first phase of the trade deal in January, easing worries of slowing demand growth due to the trade war. Moreover, Russia confirmed that the deepened production cuts of OPEC and its allies' production would continue even if a trade deal materializes. Output from the cartel fell by 90,000 barrels a day to 29.55 million in December. In addition, U.S inventories fell by 7.9 million barrels for the week ended Dec.20, vs analyst expectations of a draw of only 1.83 million barrels, despite higher crude pumping from U.S producers, which reached a record high of 13 million bpd in November.

US Crude Oil Production (Thousand Barrels/Day)



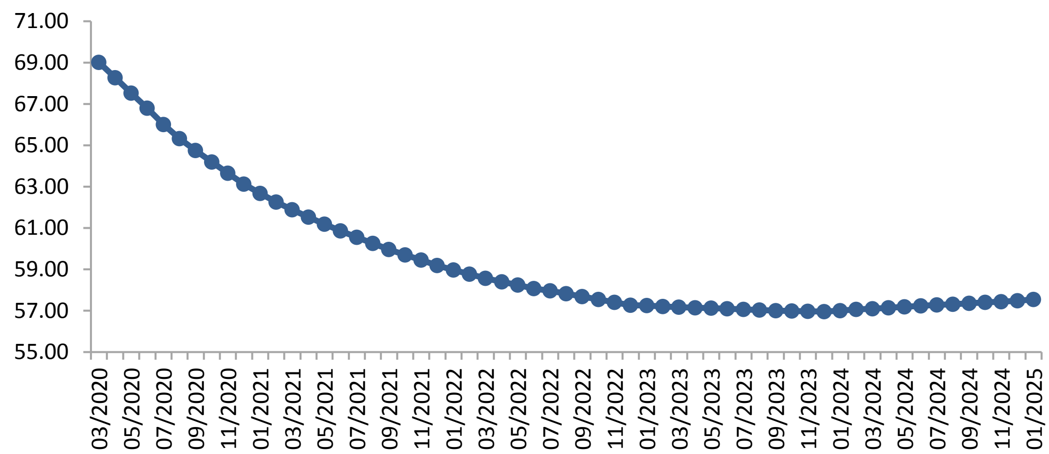
US Crude Oil Inventory ('000 barrels)



Source: Bloomberg, Capital Investments

Meanwhile, Saudi Arabia and Kuwait have agreed to resume oil production in their shared 'neutral zone' more than four years after halting output. It's expected that full production, which amounts to 500,000 bpd, will be restored within 12 months, but it would not add significant amounts of oil to the market as both countries adhere to the OPEC+ deal.

Brent Oil Future Curve (USD/Barrel)



Source: Bloomberg, Capital Investments

MENA: Jordan, an Oasis of Tranquility in the Levant

Jordan's economy is approaching 2020 on a positive note with many indicators showing that it is heading towards consolidation amid chaos in neighboring countries. The government has announced four economic bundles to stimulate economic growth and increase investments in the country. The first bundle provided incentives in the real estate sector, focused on boosting exports and production, and introduced measures to increase job opportunities for Jordanians. The second bundle lowered taxes on electric cars, removed the vehicle weight tax, reduced and controlled government purchases, worked on merging and abolishing certain government entities, and resolved bureaucracy issues. The third bundle emphasized increasing the salaries of employees and pensions for retirees in the public sector and the military, which according to the Jordanian Prime Minister, Omar Razzaz, has the biggest direct impact as it benefits 700k Jordanians. As for the fourth bundle, it focused on improving services in the education, health and transportation sectors. Furthermore, the government announced that it is currently working on a fifth bundle and will reveal its details soon. These bundles should have a positive effect on the domestic economy by boosting spending and consumer consumption, especially since the Jordanian Prime Minister affirmed that the 2020 general budget will not include any new taxes, and given that the government announced that it will review taxes on basic materials to reduce the burden on citizens.

On another positive note, the Social Security Investment Fund (SSIF) is offering all the subscribers covered by its unemployment insurance to withdraw their allowances from their accounts within certain conditions and limits. Around JOD 180mn has been withdrawn so far and this figure is expected to further increase. This initiative is also stimulating the domestic economy through increasing spending on healthcare, education, and discretionary goods.

Jordan's 2020 budget includes an increase in domestic revenues which are estimated to reach JOD7.75 billion, recording an increase of 10.4% from the JOD7.02 billion re-estimated in 2019. Around 66% of 2020 revenues are expected to be generated from tax returns, 25% from non-tax sources, and 9% from grants. The deficit in the 2020 budget is estimated to reach JOD1.25 billion after grants, which is equivalent to 3.9% of GDP, up from the re-estimated value for 2019 of JOD1.22 billion. So far, The European Parliament has approved to grant Jordan a soft loan of 500 million Euros at favorable terms, as part of a Macro Financial Assistance Program to improve growth, create job opportunities, support economic stability, and speed up measures to implement economic reforms. In addition, France agreed to extend soft loans of 250 million Euros to finance projects in the water and judiciary sectors.

Going back to the budget, current expenditures are estimated to reach JOD 8.38 billion, constituting 85% of the public spending in 2020, while capital spending is projected to make up 15%, reaching JOD1.43 billion. Unveiling the 2020 state budget, Finance Minister, Mohamad Al-Ississ, mentioned the government's plans to boost investments and economic growth rates through increasing capital expenditure by 33%. The Minister also stated that the government has informed a delegation from the International Monetary Fund (IMF) that there will be no increase in taxes and that the government will continue working on lowering unemployment rates and cutting production costs.

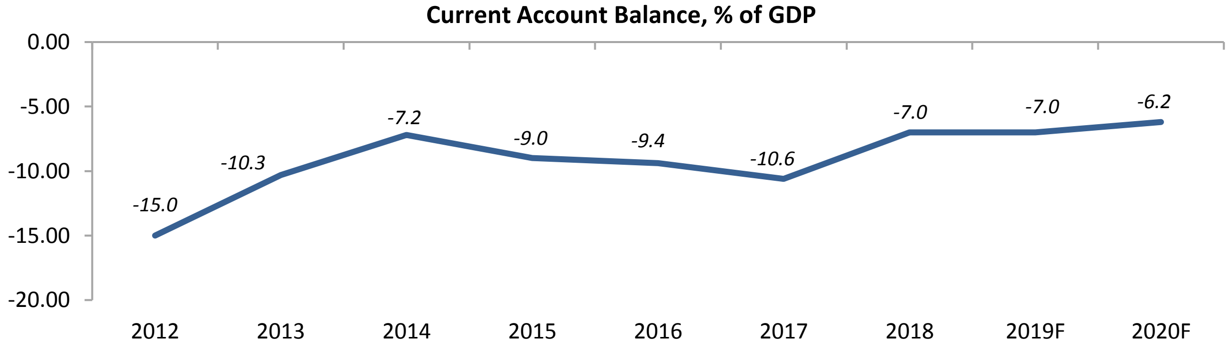
According to the Central Bank of Jordan's Governor, Ziad Fariz, the foreign currency reserves at the CBJ currently exceed USD13.4 billion, which is enough to cover the cost of the Kingdom's imports of goods and services for seven months, while the international standard for foreign reserves is a coverage of three months. In addition, the current account deficit, which is a key measure of the external health of the economy is narrowing and has been on a downward trend over the past two years. These positive data support the economic stability of Jordan.

Government Bond ($)	Credit Rating	Yield (%)	G-Spread
Bahrain 2026	B+	3.70	205.00
Jordan 2026	B+	4.65	299.00
Oman 2027	BB	4.90	316.00
Egypt 2026	B+	5.40	371.00
Turkey 2027	B+	5.60	390.00
Tunisia 2025	B+	7.00	535.00

**Prices as at January 7th, 2020*

Source: Bloomberg, Capital Investments

From a credit perspective, investors are seeing resilience in Jordan's papers when compared to regional peers, as indicated by the current market yields and g-spreads for papers within the similar credit bracket.



Source: IMF, Capital Investments

The current account balance is improving given measures taken by the government and despite the burden of around one million Syrian refugees. We hope that oil prices do not spike so that Jordan maintains the positive trend in its external balance especially that tourism is flourishing in the country.

Major Indices	Status as of end		Performance	
	December. 2018	December. 2019	December.2019	YTD (31 December. 2019)
MENA				
Abu Dhabi	4,915.07	5,075.77	0.89%	3.27%
Bahrain	1,337.26	1,610.18	5.45%	20.41%
Dubai	2,529.75	2,764.86	3.22%	9.29%
Egypt	13,035.77	13,961.56	0.81%	7.10%
Jordan	1,908.81	1,815.20	1.11%	-4.90%
Kuwait	5,267.36	6,975.96	7.00%	32.44%
Lebanon	976.75	785.56	2.98%	-19.57%
Morocco	11,364.31	12,171.90	2.96%	7.11%
Oman	4,323.74	3,981.19	-2.04%	-7.92%
Palestine	529.35	525.96	0.85%	-0.64%
Qatar	10,299.01	10,425.51	2.74%	1.23%
Saudi Arabia	7,826.73	8,389.23	6.75%	7.19%
Tunisia	7,271.65	7,122.09	2.48%	-2.06%
S&P Pan Arab Composite	728.72	788.75	5.65%	8.24%
Dow Jones MENA	556.65	605.23	5.42%	8.73%
Americas				
Dow Jones Industrial	23,327.46	28,538.44	1.74%	22.34%
S&P 500	2,506.85	3,230.78	2.86%	28.88%
NASDAQ Composite	6,635.28	8,972.60	3.54%	35.23%
S&P/Toronto Composite	14,322.86	17,063.43	0.14%	19.13%
Europe				
EURO Stoxx 50	3,001.42	3,745.15	1.12%	24.78%
S&P Europe 350 Index	1,367.94	1,676.79	1.99%	22.58%
FTSE 100 Index/ London	6,728.13	7,542.44	2.67%	12.10%
FTSE MIB Index/ Italy	18,324.03	23,506.37	1.06%	28.28%
DAX Index/ Germany	10,558.96	13,249.01	0.10%	25.48%
ASIA/Pacific				
NIKKEI 225/ Japan	20,014.77	23,656.62	1.56%	18.20%
S&P/ASX 200/ Australia	5,646.40	6,684.08	-2.37%	18.38%
BRIC				
Brazil/ Bovespa	87,887.30	115,645.30	6.85%	31.58%
Russia/ RTS	1,066.13	1,548.92	7.68%	45.28%
India/ Bombay Sensitive	36,068.33	41,253.74	1.13%	14.38%
China/ Shanghai Composite	2,493.90	3,050.12	6.20%	22.30%
Hong Kong/ Hang Seng	25,845.70	28,189.75	7.00%	9.07%

Source: Bloomberg, Capital Investments

Description	Closing Prices as of end		Performance	
	December. 2018	December. 2019	December.2019	YTD (31 December. 2019)
Commodities (in USD)				
Brent Spot (Barrel)	53.17	66.42	8.28%	24.92%
WTI Cushing Spot (Barrel)	45.41	61.06	10.68%	34.46%
Natural Gas NYMEX (MMBtu)	3.00	2.19	-3.23%	-26.98%
Gold Spot (OZ)	1,282.49	1,517.27	3.64%	18.31%
Silver Spot (OZ)	15.50	17.85	4.83%	15.21%
Copper LME Spot (MT)	5,949.00	6,149.00	5.23%	3.36%
Corn CBOT Active Month (Bushel)	4.07	3.88	1.70%	-4.73%
Wheat CBOT Active Month (Bushel)	5.54	5.59	3.14%	0.95%
Soybean CBOT Active Month (Bushel)	9.54	9.56	7.21%	0.18%
Rough Rice Futures (USD/cwt)	10.10	13.14	5.21%	30.11%
Currencies Spot Exchange Rates Against US Dollar				
Euro	1.15	1.12	1.77%	-2.22%
GBP	1.28	1.33	2.57%	3.94%
CAD	0.73	0.77	2.23%	4.99%
Yen	0.01	0.01	0.79%	0.90%
CNY	0.15	0.14	1.00%	-1.22%

Source: Bloomberg, Capital Investments

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Disclaimer