

Monthly Newsletter

May 7th, 2020

“Talk of the year ahead and the devil laughs.” — Japanese Proverb

“Shallow men believe in luck. Strong men believe in cause and effect.” — Ralph Waldo Emerson

Clues from Recent Asset Classes' Behavior

Macro: A Deep Hit to Economic Outlook... Observing Key Data

Oil: After the Drama... Looking for an Inflection Point

MENA: A Look into the Sovereign Bonds Universe of Oil Exporters and Importers

Introduction

The spread of the coronavirus is in retreat and the health data around the globe is in good shape. The viral curve is bending, testing is on the rise, tracing is moving in line, hospitalization is taking a breath, recoveries are increasing but more importantly treatment options are widening and progress towards a vaccine, as per the statements of many policymakers and pharmaceutical companies, is encouraging.

The world is finally relieved; countries have started easing lockdown measures and are gradually going back to work. Steps towards reopening the economy are reviving the weak consumer confidence amid a substantial loss of jobs as merchants' ability to sell was disabled over the past two months. Powerful central banks actions and large fiscal stimuli came to the rescue to help the economy and society get over the deep plunge in economic activity worldwide.

Investors are usually sensitive to inflection points, rates of change, news that are less negative than expected, upward revision of earnings and they have for sure mastered a Pavlovian response to the liquidity injection by central banks as stock markets had the best performance last month since 1987. In fact, investors are dealing with a fragile equilibrium between many factors such as sentiment, policy response, market valuations and the extent of the expected hit to the economic outlook. Thus, it is better to be dynamic in managing investments; benefit from volatility by selling at strength and reducing risk while adding exposure when the tide turns or market positioning becomes more appealing.

We think that dynamic investment management is the way through as relaxing lockdown measures is a process and not an event on its own. Demand will not quickly and smoothly recover to its pre-Covid-19 levels. Some sectors such as airlines, tourism, restaurants, retail and entertainment will face substantial demand destruction, as people resort to more local and digital businesses with a focus on basics and necessities. The set of opportunities or companies that can generate cashflows is narrowing with new sectors such as technology thriving in a structural trend rather than a pure cyclical phenomenon like some other industries that will benefit from improving sentiment and stimulus measures.

This crisis did not emerge from a specific sector in the economy like in the past such as banking, housing or energy. Rather it started as a health problem and directly hit the supply chains and consumers. Given that the consumer is not in good shape, policies for re-opening the economy will not be as instrumental for recovery as the choices of the consumer; his/her new spending habits and ability to spend amid a rising jobless rate will determine the recovery. As the consumer is in bad shape, companies will not invest due to lack of aggregate demand growth and due to the uncertainty surrounding the disease. Thus, the risks that companies cannot price are significant for example what if a second wave erupts in the fall for example? Since we have lost the “C” and the “I” components of the GDP and trade is under the mercy of US-Chinese skirmishes, the world is relying on government spending and monetary policy to fill the gap, but all this will not mask weak fundamentals, which warrants a dynamic and cautious approach in running investments.

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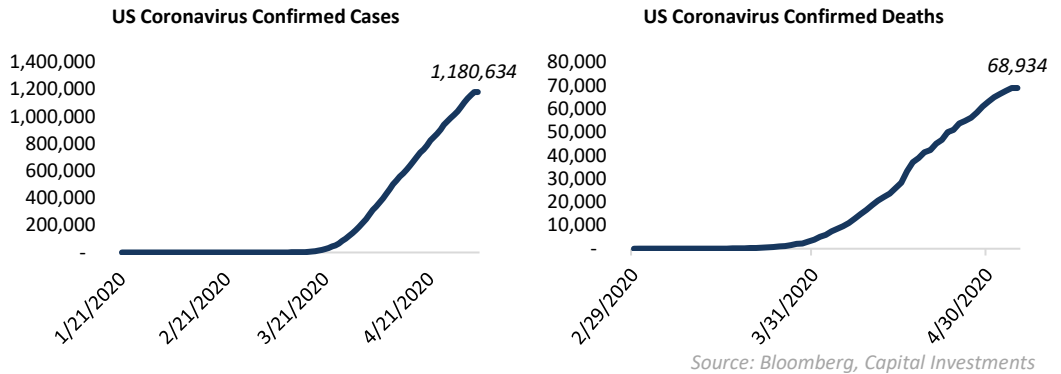
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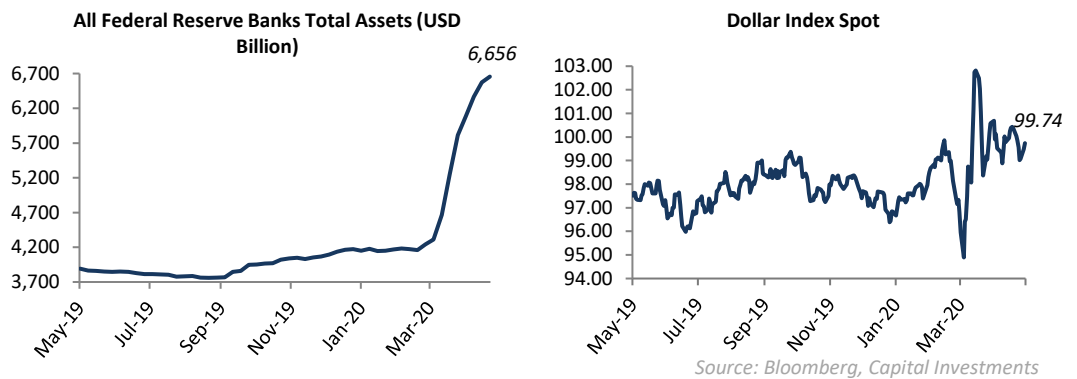
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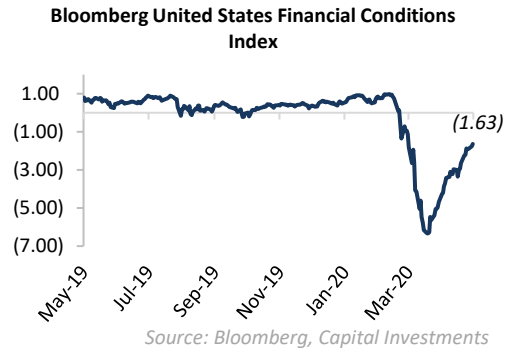
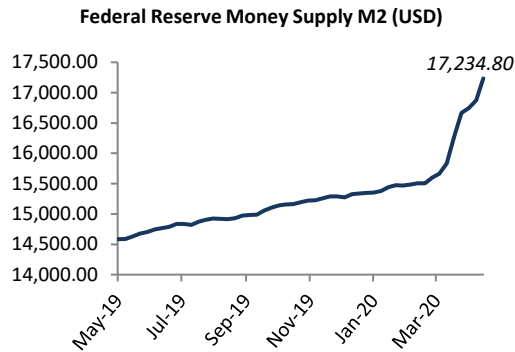
Clues from Recent Asset Classes' Behavior



The viral curve is dictating the trajectory for societies. Most countries were able to flatten the infection curve through testing and tracing and were able to reduce the death rate and free healthcare capacity. While this is a relief, only time will tell if science will be fast enough to get a cure or vaccine to save the community and the economy as they endure.

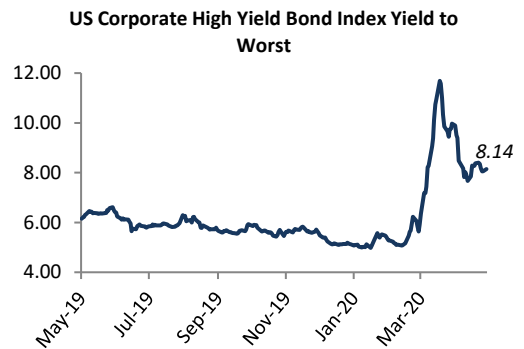


The US Fed expanded its balance sheet aggressively by almost 50%, as illustrated in the chart above, and established swap lines with major central banks in the world. This has tamed the rally in the USD which is again trading in a channel. The revival of the US-Chinese cold war over trade pumped some strength into the USD as the Chinese Yuan and other currencies lost some steam. It seems that investors shall keep an eye on geopolitical upheavals, trade wars and protectionism on top of the pandemic especially that 2020 is a presidential election year in the US.



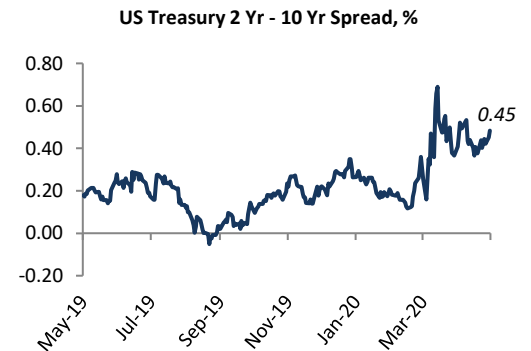
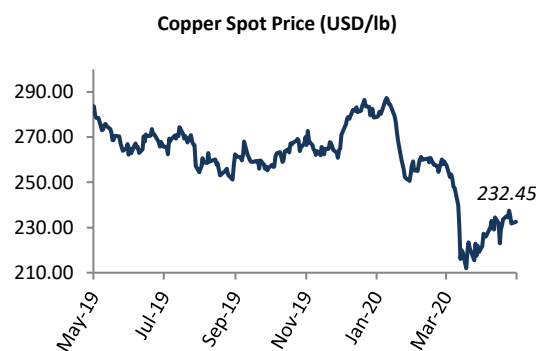
Source: Bloomberg, Capital Investments

The US Fed measures along with other central banks are leading to increased liquidity in the veins of the financial system. Financial conditions eased but stayed short of the pre-Covid-19 levels which indicates that despite the flood of money, some pockets of funding stress are still present.



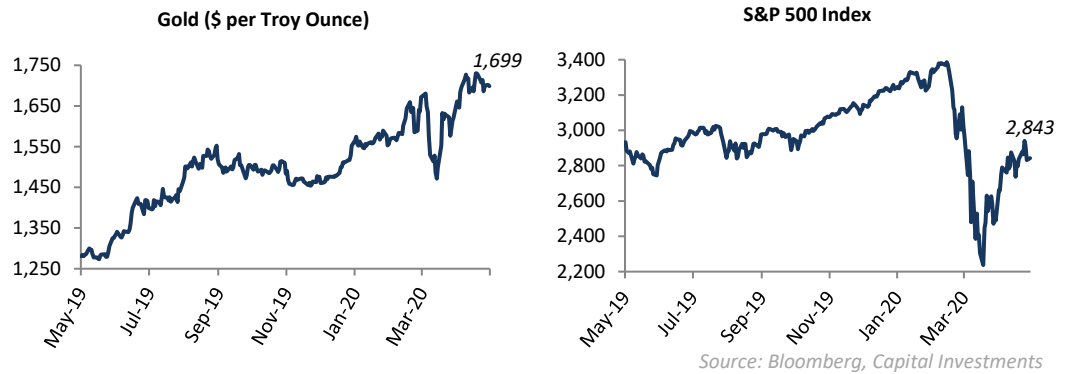
Source: Bloomberg, Capital Investments

Fed actions are so far short from pushing yields on junk corporate bonds in the US to the pre-crisis levels which shows that confidence and sentiment are still shaky, as indicated by the stubborn VIX index or volatility index, which is hovering around 40 and pointing towards a high level of uncertainty despite the recent policy response and market rally.



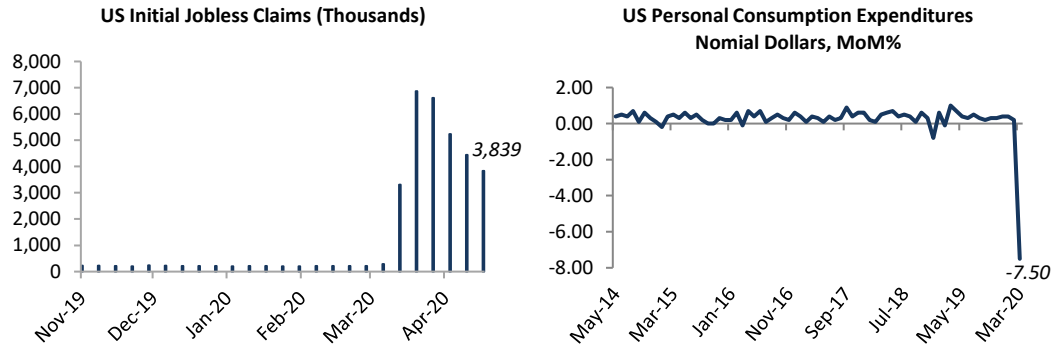
Source: Bloomberg, Capital Investments

Muted copper prices and contained US 10 yr-2yr yield spread point that growth expectations for the economic recovery and inflation expectations are modest and well contained over the medium term although oil appears to be at an inflection point, which may tactically favor some cyclical sectors in the market.



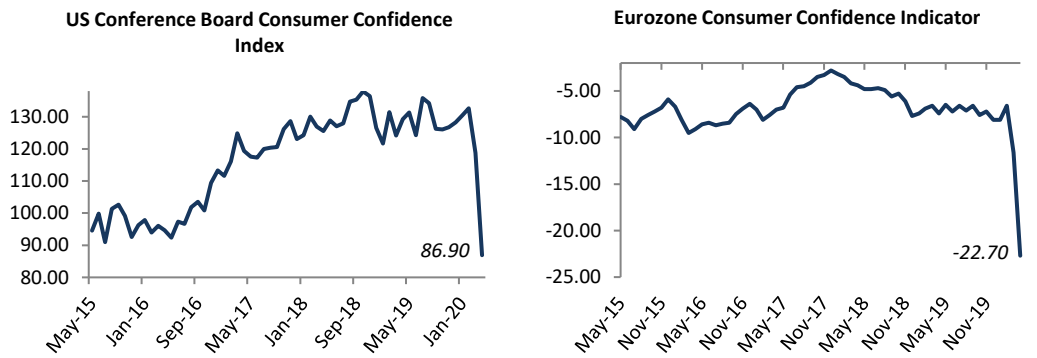
Muted economic growth coupled with expansive monetary policy and rising government debt are a good recipe for gold, which benefits from low to negative real yields, and anticipates that large mountains of public debt mean lower growth and lower interest rates for longer. At the same time, equities re-rated higher from their lows recorded in March backed by a flattening viral curve and large stimulus packages. As the economy re-opens, we will see a divergence in market behavior as leaders and winners will emerge as earning releases and guidance will indicate which sectors belong to the new economy and those that will be left behind due to the deep scars engraved by the coronavirus outbreak and its repercussions. Investors shall adopt a dynamic approach and rotate in style and sectors while keeping an eye on investors' positioning and sentiment indices.

Macro: A Deep Hit to Economic Outlook... Observing Key Data



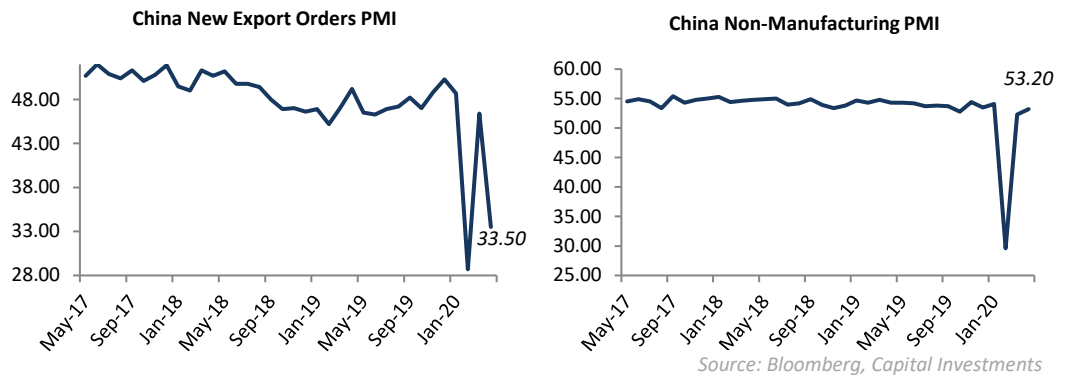
Source: Bloomberg, Capital Investments

The economic crisis that resulted from the forced shutdown of the economy caused supply destruction which led to a spike in jobless claims as illustrated in the chart above. This translated into a plunge in consumer spending and the economy will feel its echo for many quarters to come.



Source: Bloomberg, Capital Investments

As a result of rising unemployment and a drop in consumption levels, confidence indices plummeted around the world indicating that the recovery would not be V-shaped as private consumption will be ill for a while.



China offers some hope as its service PMIs is climbing, pointing towards an improvement in the domestic economy as the government is relaxing social distancing measures. However, we need to see a peak in jobless claims followed by an improvement in manufacturing and export PMIs along with a revival in confidence to factor in an adequate recovery and a reflationary trade. Meanwhile, we will focus on countries with substantial capacity to launch stimulus packages and the ability to control the disease until the global economy moves in a synchronized upward trend.

Purchasing Managers Indices (PMI) (2017-2018):											
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr
Global Manufacturing	49.4	49.3	49.6	49.8	49.8	50.3	50.1	50.3	47.1	47.3	39.8
Global Services	51.9	52.5	51.8	51.4	51.0	51.6	52.0	52.6	47.1	36.8	24.0
Global Composite	51.2	51.7	51.3	51.1	50.8	51.4	51.5	52.1	46.1	39.2	26.5
US Manufacturing	51.6	51.3	48.8	48.2	48.5	48.1	47.8	50.9	50.1	49.1	41.5
US Services	55.4	54.8	56.0	53.5	54.4	53.9	54.9	55.5	57.3	52.5	41.8
US Manuf. New Orders	50.5	51.1	47.6	48.5	48.9	46.8	47.6	52.0	49.8	42.2	27.1
EU Manufacturing	47.6	46.5	47.0	45.7	45.9	46.9	46.3	47.9	49.2	44.5	33.4
EU Services	53.6	53.2	53.5	51.6	52.2	51.9	52.8	52.5	52.6	26.4	12.0
EU Composite	52.2	51.5	51.9	50.1	50.6	50.6	50.9	51.3	51.6	29.7	13.6
China Manufacturing	49.4	49.7	49.5	49.8	49.3	50.2	50.2	50.0	35.7	52.0	50.8
China Services	54.2	53.7	53.8	53.7	52.8	54.4	53.5	54.1	29.6	52.3	53.2
China Manuf. New Orders	49.6	49.8	49.7	50.5	49.6	51.3	51.2	51.4	29.3	52.0	50.2

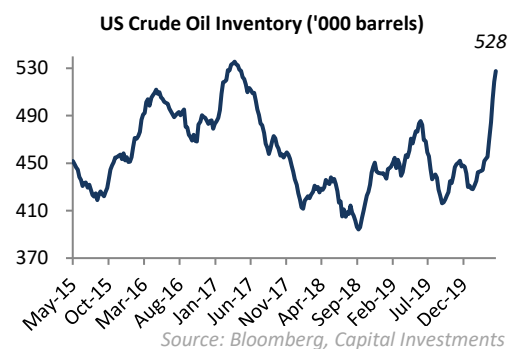
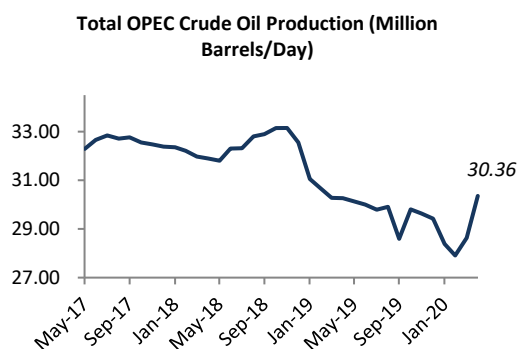
* PMI reading above 50 indicates economy expansion
 * Red points displayed within the lines above indicate highest point in the range
 * Figures in green indicate acceleration from previous month, while red indicate deceleration

Source: Bloomberg, Capital Investments

Oil: After the Drama... Looking for an Inflection Point

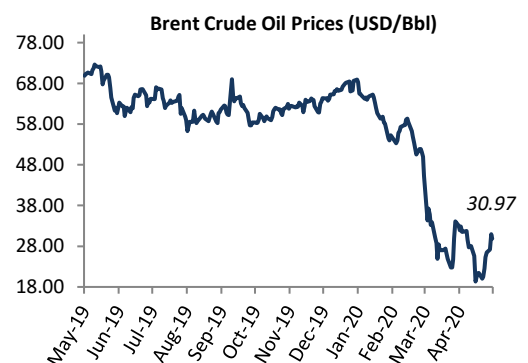
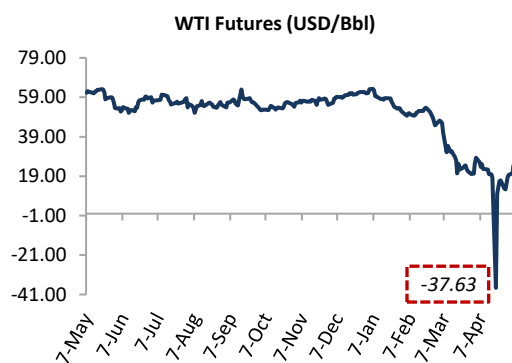
Following the devastating price war in March that contributed to Q1 being the worst quarter ever for oil, the start of Q2 offered a sense of relief as President Trump intervened to bring an end to the bloodbath. After a week-long marathon of calls and videoconferences, a historic deal, that includes almost all oil producers, finally emerged, with an output cut of nearly a 10th of global oil production, or 9.7 million b/d starting May, agreed upon.

However, the most ambitious deal to rescue the global oil industry ever was overwhelmed by a brutal wave of demand destruction and an unprecedented supply glut, casting doubt over whether such an agreement would be enough to steady the market. While OPEC ++ were cooking up a deal, more and more evidence of the lack of available storage capacity around the globe and most notably in the US, was emerging. For example, by the first week of April a quarter of the world’s floating storage capacity had already been used up as companies sought alternative options to store crude, and the cost of storing fuels at the Asian hub of Singapore had surged 38% as onshore tanks rapidly swelled to near capacity.



Source: Bloomberg, Capital Investments

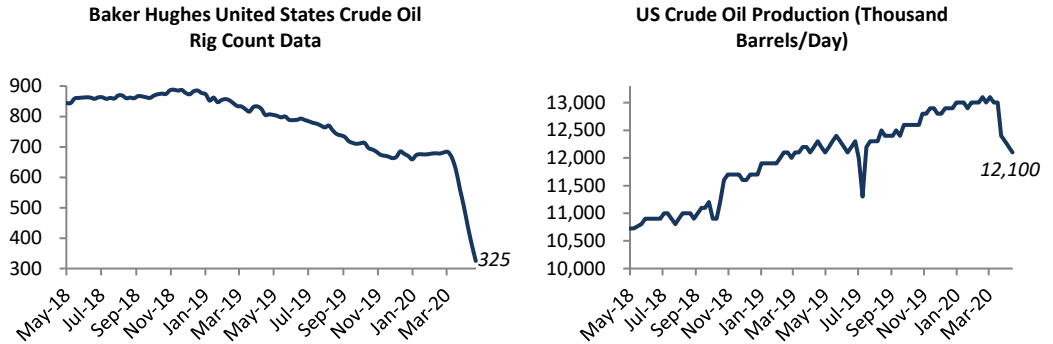
Moreover, amidst the price war and before the deal takes effect, OPEC’s crude production surged by the most in almost 30 years in April with Saudi Arabia pumping a record of more than 11 million b/d. Meanwhile, Brent’s future curve deepened into contango, indicating over-supply amid plummeting demand due to the coronavirus outbreak. The IEA predicts that oil demand will fall by over 9 million b/d in 2020, and OPEC believes that demand for its oil will drop to the lowest level in three decades.



Source: Bloomberg, Capital Investments

The aforementioned factors contributed to the historic crash in WTI oil prices. As the expiry date of the WTI May futures contract was approaching, oil prices plunged, turning negative for the first time in history. This meant that oil producers were willing to pay buyers to take the commodity off their hands and avoid taking delivery of actual oil over fears that storage capacity, particularly at the American hub at Cushing could run out in May. In what could be described as one of the worst oil

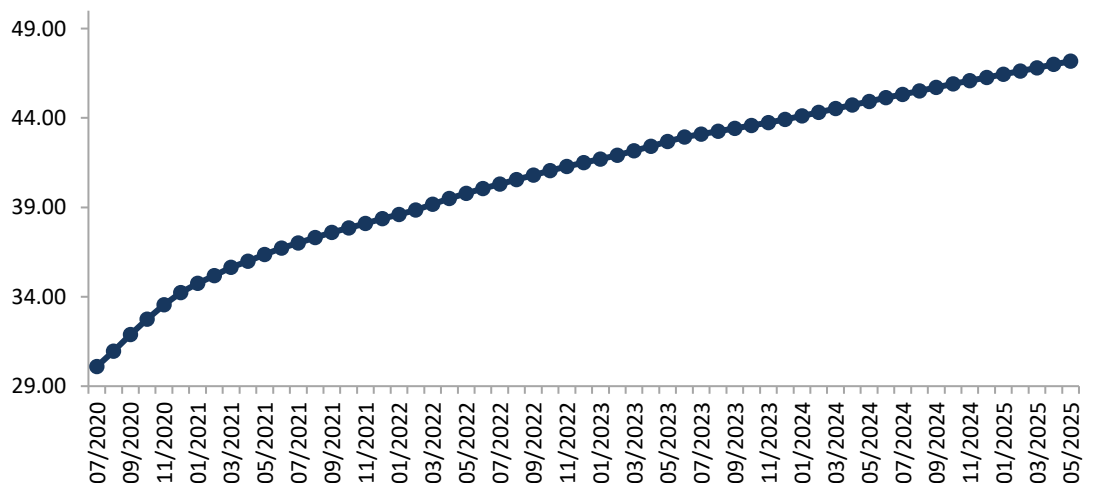
market crashes, the price of a barrel of WTI fell as low as minus \$37.63. Brent prices followed suit and fell as much as 17%.



Source: Bloomberg, Capital Investments

Following the rollercoaster of events, oil prices seem to have bottomed, and several factors indicate that we may be at an inflection point. For starters, the biggest oil ETF already sold its position in its June WTI contract before its expiry, thus potentially avoiding another drastic drop in prices. Moreover, the historic crash in crude prices has caused the shutdown of more and more rigs in the US, with explorers closing 14% of rigs last week. OPEC++ production cuts will bring some relief to oil prices, although we believe that their impact will not be seen before H2 as clearing the build-up in inventory will take time. Additionally, the production cuts have come just as early signs that the plunge in demand may have bottomed are emerging, as some countries begin to ease their lockdown measures.

Brent Oil Future Curve (USD/Bbl)



Source: Bloomberg, Capital Investments

MENA: A Look into the Sovereign Bonds Universe of Oil Exporters and Importers

Countries	NIIP (%)	Gross External Debt (\$Bn)	FX Reserves (\$Bn)	C/A Balance (% of GDP)	Gov. Debt (% of GDP)	Budget Balance (% of GDP)	Fiscal Breakeven Oil Price (\$)	Oil & Gas Revenues (% of Total Revenues)	Net Oil & Gas Exports (% of GDP)
Oil Importing countries									
Egypt	-66%	98	45.4	-3.20%	85%	-7.60%	-	-	-1%
Jordan	-107%	32**	11.7	-7.00%	95%	-3.40%	-	-	-10%
Lebanon	-	115	29.5	-26.40%	165%	-10.50%	-	-	-8%
Tunisia	-143%	36	7.3	-10.40%	74%	-4.40%	-	-	-5%
Morocco	-65%	39	25.7	-4.50%	65%	-3.70%	-	-	-7%
Oil Exporting Countries - High Yield									
Iraq	-	72	60.1	-3.50%	51%	-2.40%	62.5	92%	37%
Oman	-	81	16.4	-7.20%	60%	-6.70%	87.3	78%	34%
Bahrain	70%	74	3.3	-4.30%	102%	-8.00%	95.1	82%	1%
Oil Exporting Countries - Investment Grade									
Qatar	-	206	55.1	6.00%	53%	7.00%	48.8	83%	38%
KSA	80%	237	501.4	6.90%	23%	-6.10%	86.5	67%	29%
UAE	0%	295	109.9	9.10%	20%	-1.30%	70.2	36%	14%

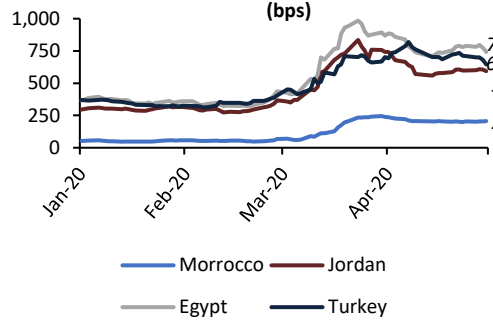
**Excludes deposits of non-residents held in the banking system

Source: Bloomberg, IMF, MENA Central Banks, Capital Investments
Data as at March 2020

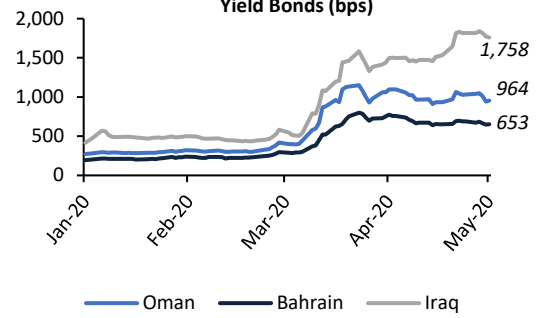
As shown in the table above, the higher external funding requirements in High Yield papers relative to Investment Grade papers are largely consistent with the 'flight to quality' within the asset class. High yield oil exporting countries' papers tend to have a lower quality compared to investment grade oil exporting countries' papers. For example, we prefer Abu Dhabi papers over Oman papers, as the former has lower external funding requirements relative to its large reserves. Countries with higher external funding requirements relative to reserves also have wider spreads. For instance, we prefer Egypt papers over Turkey papers since the latter has higher external funding requirements relative to its reserves. Finally, Jordan papers remain stable, as the decline in oil prices has made the country's current account balance constant at -7% as a percentage of GDP.

In addition, for oil exporting countries, it is expected for Iraq and Oman to lose 50% of their reserves, whereas Bahrain is expected to lose 2/3 of its reserves due to the oil shock. Furthermore, Kuwait bonds might be expensive as the oil shock will decrease its current account by 50% compared to its bond's spread.

Mid Z-Spread for Non-Oil Exporting Countries (bps)

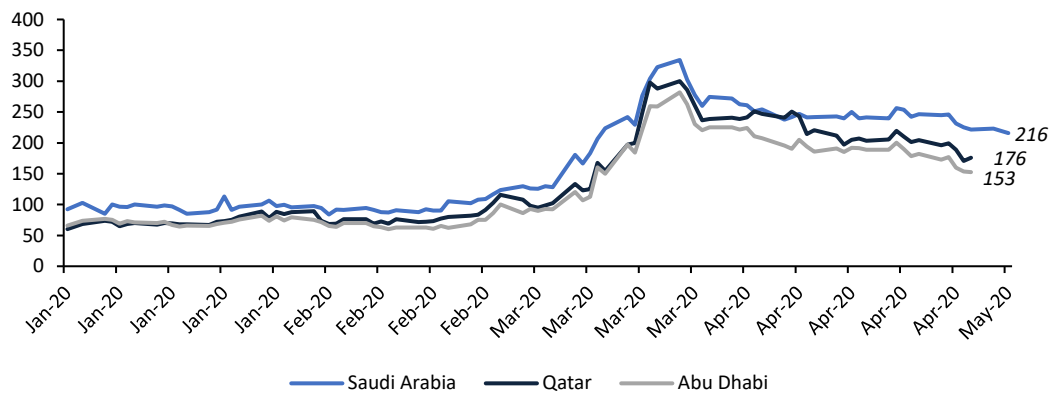


Mid Z-Spread of Oil Exporting Countries High Yield Bonds (bps)



Source: Bloomberg, Capital Investments, data as of April 6, 2020

Mid Z-Spread of Oil Exporting Countries IG Bonds (bps)



Source: Bloomberg, Capital Investments, data as of April 6, 2020

	Status as of end		Performance	
	December, 2019	April, 2020	April 2020	YTD (30 April, 2020)
MENA				
Abu Dhabi	5,075.77	4,230.37	13.27%	-16.66%
Bahrain	1,610.18	1,310.73	-2.95%	-18.60%
Dubai	2,764.86	2,026.61	14.41%	-26.70%
Egypt	13,961.56	10,554.04	10.01%	-24.41%
Jordan	1,815.20	1,668.18	0.00%	-8.10%
Kuwait	6,975.96	5,356.25	3.03%	-23.22%
Lebanon	785.56	629.46	5.36%	-19.87%
Morocco	12,171.90	9,400.70	-3.13%	-22.77%
Oman	3,981.19	3,539.46	2.64%	-11.10%
Palestine	525.96	498.90	0.00%	-5.14%
Qatar	10,425.51	8,764.05	6.78%	-15.94%
Saudi Arabia	8,389.23	7,112.90	9.34%	-15.21%
Tunisia	7,122.09	6,213.89	-4.16%	-12.75%
S&P Pan Arab Composite	788.75	641.63	8.17%	-18.65%
Dow Jones MENA	605.23	491.10	7.89%	-18.86%
Americas				
Dow Jones Industrial	28,538.44	24,345.72	11.08%	-14.69%
S&P 500	3,230.78	2,912.43	12.68%	-9.85%
NASDAQ Composite	8,972.60	8,889.55	15.45%	-0.93%
S&P/Toronto Composite	17,063.43	14,780.74	10.48%	-13.38%
Europe				
EURO Stoxx 50	3,745.15	2,927.93	5.06%	-21.82%
S&P Europe 350 Index	1,676.79	1,364.17	5.70%	-18.64%
FTSE 100 Index/ London	7,542.44	5,901.21	4.04%	-21.76%
FTSE MIB Index/ Italy	23,506.37	17,690.49	3.75%	-24.74%
DAX Index/ Germany	13,249.01	10,861.64	9.32%	-18.02%
ASIA/Pacific				
NIKKEI 225/ Japan	23,656.62	20,193.69	6.75%	-14.64%
S&P/ASX 200/ Australia	6,684.08	5,522.35	8.78%	-17.38%
BRIC				
Brazil/ Bovespa	115,645.30	80,505.90	10.25%	-30.39%
Russia/ RTS	1,548.92	1,125.03	10.90%	-27.37%
India/ Bombay Sensitive	41,253.74	33,717.62	14.42%	-18.27%
China/ Shanghai Composite	3,050.12	2,860.08	3.99%	-6.23%
Hong Kong/ Hang Seng	28,189.75	24,643.59	4.41%	-12.58%

Source: Bloomberg, Capital Investments

Description	Closing Prices as of end		Performance	
	December. 2019	April. 2020	April.2020	YTD (30 April. 2020)
Commodities (in USD)				
Brent Spot (Barrel)	66.42	23.70	10.39%	-64.32%
WTI Cushing Spot (Barrel)	61.06	18.84	-8.01%	-69.15%
Natural Gas NYMEX (MMBtu)	2.19	1.95	10.99%	-10.92%
Gold Spot (OZ)	1,517.27	1,686.50	6.93%	11.15%
Silver Spot (OZ)	17.85	14.97	7.13%	-16.15%
Copper LME Spot (MT)	6,149.00	5,160.25	4.48%	-16.08%
Corn CBOT Active Month (Bushel)	3.95	3.20	-7.51%	-18.94%
Wheat CBOT Active Month (Bushel)	5.62	5.24	-6.80%	-6.68%
Soybean CBOT Active Month (Bushel)	9.69	8.55	-3.85%	-11.72%
Rough Rice Futures (USD/cwt)	13.14	17.16	22.23%	30.61%
Currencies Spot Exchange Rates Against US Dollar				
Euro	1.12	1.10	-0.69%	-2.30%
GBP	1.33	1.26	1.40%	-5.00%
CAD	0.77	0.72	0.87%	-6.85%
Yen	0.01	0.01	0.32%	1.35%
CNY	0.14	0.14	0.27%	-1.41%

Source: Bloomberg, Capital Investments

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