capital investments

Monthly Newsletter

June 4th, 2020

"In the fields of observation chance favors only the prepared mind." — Louis Pasteur
"Doing the best at this moment puts you in the best place for the next moment." — Oprah Winfrey

Clues from Recent Asset Classes' Behavior

Macro: Green Shoots of Recovery

Oil: OPEC++ to Extend the Oil Production Cut Deal

MENA: Egypt… a Cautious Outlook

Introduction

A positive sentiment is reigning across markets. It is supported by encouraging headlines laying the ground for an optimistic narrative for the outlook. The fall in the number of infections in key countries coupled with a decline in mortality rates along with serious progress on the scientific front, in terms of finding a cure or vaccine, has relieved substantial pressure.

Moving from the health front to the socio-economic aspect of the crisis, the month of April is deemed to be the nadir of economic activity. Investors are cheering up the process of reopening the economies across the globe, especially that it is occurring while the virus transmission rate is still contained. High frequency data in terms of transportation, mobility and electricity consumption is trending up from the low levels registered. Jobless claims are on a downward trend in the US, albeit far from normalized levels, and consumer sentiment indices are ticking up. This is coupled by a pick-up in Purchasing Managers' Indices (PMIs) for manufacturing, new orders and services which are pointing towards a gradual recovery and improving sequential growth. The rally in oil prices pulled up other commodities, notably key industrial metals, as many industries are resuming activity and many of them are re-stocking to benefit from a weaker USD.

Substantial fiscal packages enacted by the US in the range of USD 3trn along with a recovery fund in Europe in the range of Euro 750bn, consisting mostly of grants and targeting hard hit countries coupled, with an extra stimulus from Japan of over USD 1trn, not to mention measures taken by China, are cushioning the impact of tail risk. The fiscal twist was preceded by generous monetary stimulus in terms of quantitative easing or asset purchases by central banks and interest rate reduction which flooded markets with liquidity as the balance sheet of central banks expanded and money supply increased.

It is obvious that the positive sentiment has outpaced the negative economic impact that is due to unfold in the coming quarters. For instance, the stimuli enacted are aimed at limiting the hit as they are not expansionary. The consumer is not in good shape as the number of unemployed people in the world is soaring which will weigh on spending power. Corporates have shelved their investment plans as they are preoccupied with repairing their balance sheets, noting that some of them such as airlines, hotels and restaurants will not see a full come back while a soaring trend in bankruptcies will weigh on economic activity. Other factors to watch include social unrest in the US and rising tensions between the US and China.

We think that elevated valuation and a recessionary environment would mean a cautious approach to the market. We will continue to follow key rules and rotate across themes. We will look at laggard and recovery plays and follow the footprint of stimuli and the industries benefiting from packages. At the same time, we will keep our eyes on new social trends such as social distancing, working from home, e-commerce and the new world infrastructure revolving around technology such as the advancement of 5G networks.

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

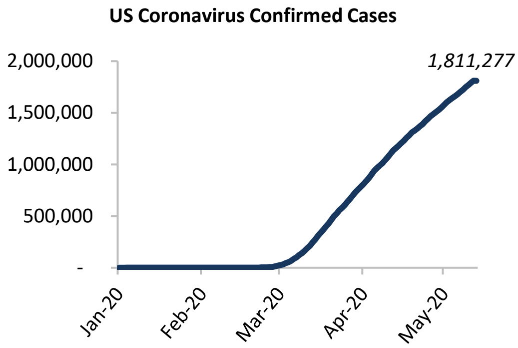
Ghaleb Mihyar
Financial Analyst
Ghaleb.Mihyar@Capitalinv.com

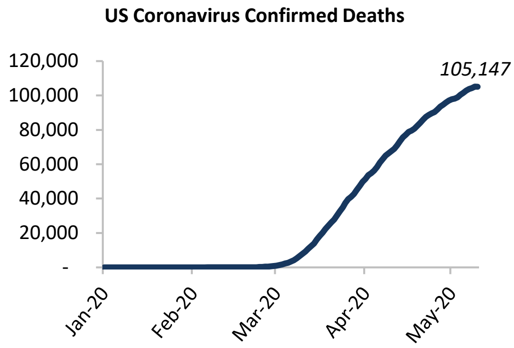
For further information and to discuss possible investment opportunities, please contact:

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

We are looking at companies with resilient business models and/or stable or growing return on equity. We are focusing on businesses that can generate cashflows, reduce costs to maintain margins, or have a pricing power amid a jobless recovery.

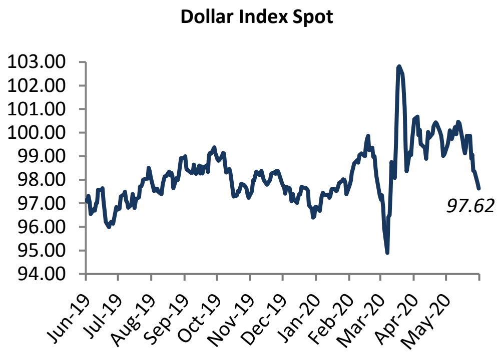
Clues from Recent Asset Classes' Behavior

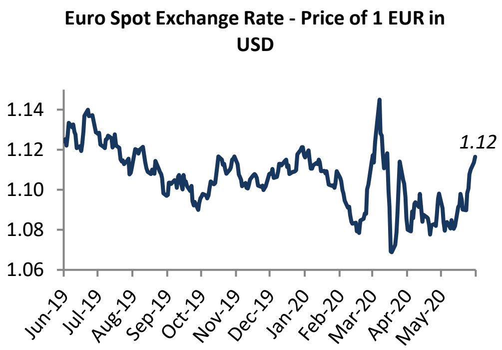




Source: Bloomberg, Capital Investments

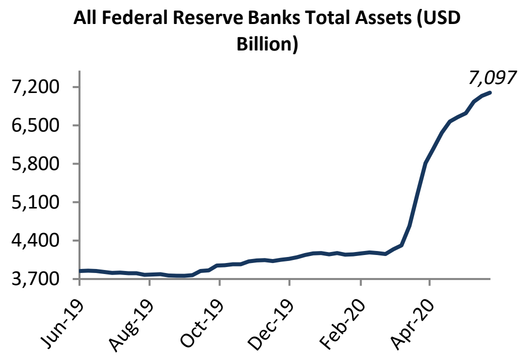
The fall in the number of infections in key countries coupled with a decline in mortality rates along with serious progress on the scientific front, in terms of finding a cure or vaccine, has relieved substantial pressure.

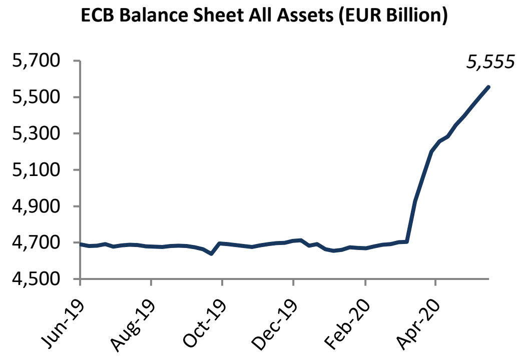




Source: Bloomberg, Capital Investments

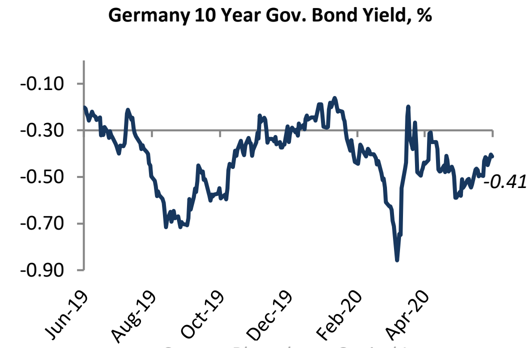
On the currency front, it was all about the Euro. As a firm response to Covid-19 economic repercussions, the old continent's policymakers established a generous €750bn recovery fund aiming to improve the economic situation in its hard-hit countries. This was coupled with improving health conditions in key European countries notably Spain and Italy. This lent support to the Euro which broke key resistance levels, while the USD was breaking down key support levels. The fall in the greenback revived risk sentiment, as investors raised their holdings in emerging markets as well as commodities and other cyclical investments.





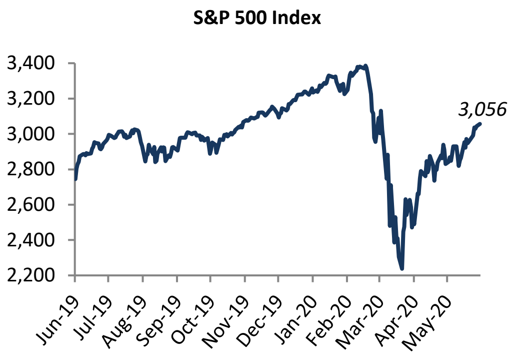
Source: Bloomberg, Capital Investments

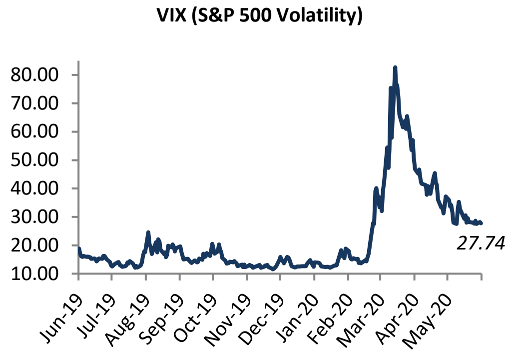
Liquidity injection by Central Banks played a major role in stabilizing the funding market and in providing the necessary liquidity for markets to rally. However, it appears that the US Fed is tapering its asset purchase, as indicated by the recent growth in the size of its balance sheet, at a time when the US Treasury is looking to issue around USD 3trn in long duration securities to fund the stimulus package. Amid rising tensions with China and given the fact that foreigners' holding of US treasuries is not on an upward trend, should the US government's issuances outpace the purchases made by the Fed, this would indicate that incremental liquidity will be on a downward trend, causing the equity rally to lose steam in our opinion.



Source: Bloomberg, Capital Investments

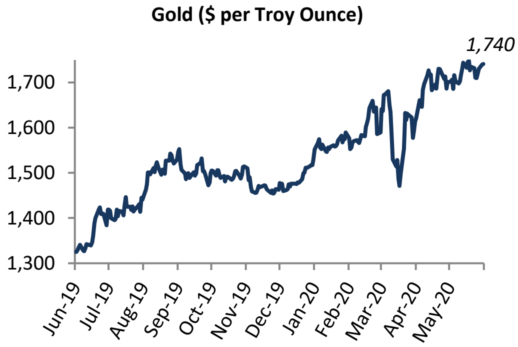
The sovereign bond markets in the US and Europe are pointing towards rising deficit in the US as well as lack of liquidity as indicated by the widening 5 year- 30year US spread. The pick-up in the German yields, which are not becoming more negative, indicate that budget deficits are increasing in Europe, and some modest signs of inflation are showing.

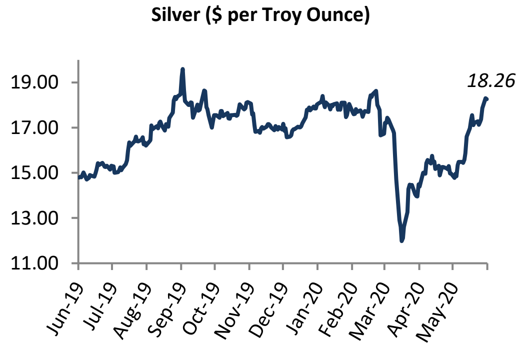




Source: Bloomberg, Capital Investments

The equity market in the US started phase 2 of the rally from May 13 onward, supported by the economy reopening and progress in identifying a cure to Covid-19. The market broke its 200-day moving average at an index level of 3000 and sprinted further despite relatively high volatility as indicated by the VIX index. The rally also showed a high correlation among stocks, which indicates that market participants are not differentiating between industries despite the recent rotation toward cyclicals and value stocks. We prefer to take a cautious view at the current level and to rebalance our portfolios as many stocks are priced for perfection- the narrative and sentiments are positive, but the story is pricey.



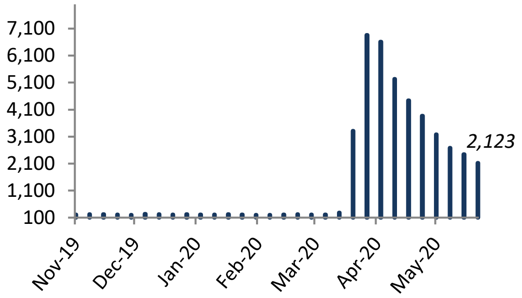


Source: Bloomberg, Capital Investments

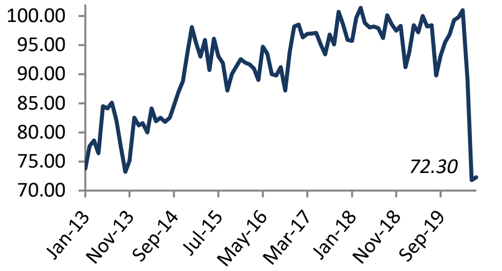
The reopening of the economy meant the constrained supply of gold is hitting the market again because refinery are back to work and many airlines are summing flights. This, coupled with a revival in risk appetite, capped the rally in gold which may see a consolidation or downward trend in the coming few months as June and July are historically weak months for Gold. However, we are constructive on both gold and silver miners and are buyers of any dip, as they present a hedge and a play on recovery and will benefit from low interest rates, production cost reduction, and operating leverage.

Macro: Green Shoots of Recovery

US Initial Jobless Claims (Thousands)



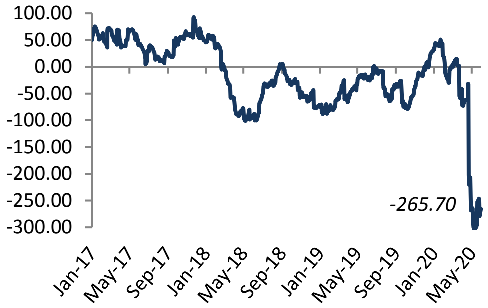
University of Michigan Consumer Sentiment Index



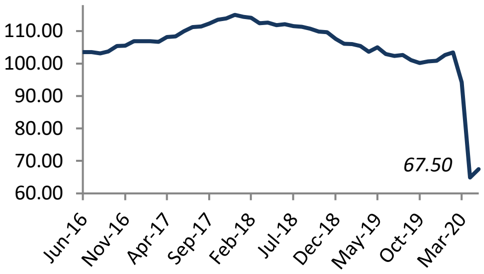
Source: Bloomberg, Capital Investments

US jobless claims are on a downward path which shows that the major hit is behind us but at the same time gives an indication of the large number of unemployed people that will put pressure on private consumption in the coming quarters despite the support provided by the government, and the rise in saving rates, not to mention the potential increase in bankruptcies. Consumer sentiment appears to have reached a nadir pointing towards gradual recovery.

Eurozone Citi Economic Surprise Index



European Commission Economic Sentiment Indicator



Source: Bloomberg, Capital Investments

The hit to Europe was much harder as many countries suffered from long and strict lockdowns which weighed heavily on the economic activity especially that authorities reacted with a lag when it came to the fiscal front. However, the charts above indicate that the worst is behind us in relation to the European economy.

Source: Bloomberg, Capital Investments

The National People's Congress meeting this quarter refrained from providing a growth target for the Chinese economy due to the deep impact of Covid-19. The authorities will be focusing mainly on employment and living standards in their response to the economic challenges. Their plan to invest in traditional and new economy infrastructure such as those related to the 5G network will provide support for the economy. Data released recently form China are encouraging, however tensions between the US and China over many issues will keep asset managers alert. Tensions related to Honk Kong, Taiwan, and more importantly issues linked to potential delisting of Chinese companies from US markets, and the export control of key technological materials to China are key challenges facing investors. The noise around the Sino-US relationship will continue to rise as we approach the US election in November.

Purchasing Managers Indices (PMI) (2019-2020):

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	
Global Manufacturing	49.3	49.6	49.8	49.8	50.3	50.1	50.3	47.1	47.3	39.6	42.4	
Global Services	52.6	51.8	51.4	51.0	51.6	52.0	52.7	47.1	36.8	23.7	35.2	
Global Composite	51.7	51.3	51.1	50.8	51.4	51.5	52.1	46.1	39.2	26.2	36.3	
US Manufacturing	51.3	48.8	48.2	48.5	48.1	47.8	50.9	50.1	49.1	41.5	43.1	
US Services	54.8	56.0	53.5	54.4	53.9	54.9	55.5	57.3	52.5	41.8	45.4	
US Manuf. New Orders	51.1	47.6	48.5	48.9	46.8	47.6	52.0	49.8	42.2	27.1	31.8	
EU Manufacturing	46.5	47.0	45.7	45.9	46.9	46.3	47.9	49.2	44.5	33.4	39.4	
EU Services	53.2	53.5	51.6	52.2	51.9	52.8	52.5	52.6	26.4	12.0	30.5	
EU Composite	51.5	51.9	50.1	50.6	50.6	50.9	51.3	51.6	29.7	13.6	31.9	
China Manufacturing	49.7	49.5	49.8	49.3	50.2	50.2	50.0	35.7	52.0	50.8	50.6	
China Services	53.7	53.8	53.7	52.8	54.4	53.5	54.1	29.6	52.3	53.2	53.6	
China Manuf. New Orders	49.8	49.7	50.5	49.6	51.3	51.2	51.4	29.3	52.0	50.2	50.9	

** PMI reading above 50 indicates economy expansion*

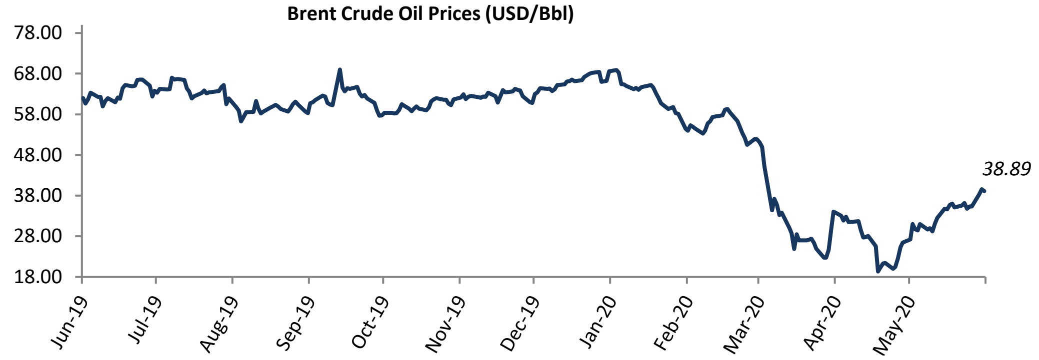
** Red points displayed within the lines above indicate highest point in the range*

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

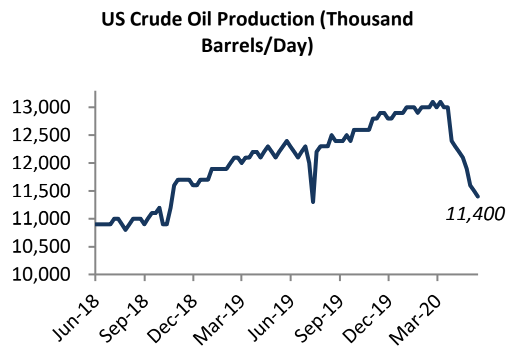
Source: Bloomberg, Capital Investments

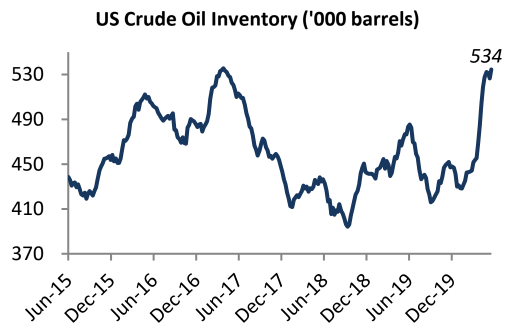
Oil: OPEC++ to Extend the Oil Production Cut Deal

Oil prices rebounded in May amid deepening production cuts, signs of demand recovery, and optimism that the world is getting close to finding a vaccine for the virus.



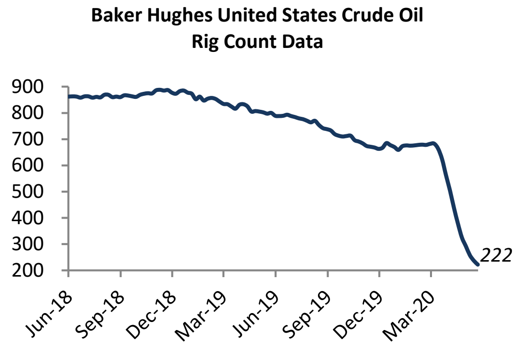
Source: Bloomberg, Capital Investments

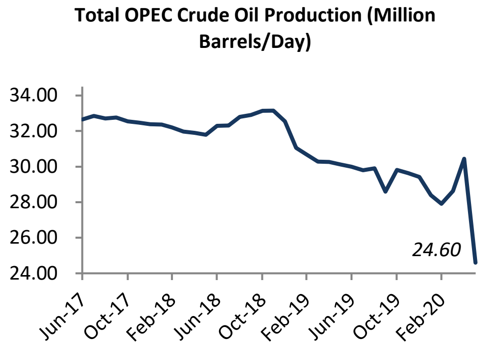




Source: Bloomberg, Capital Investments

It is estimated that global oil supplies plummeted by 12 million barrels a day, or 12% MoM in May, reaching their lowest level in nine years. This comes on the back of deep production cuts by OPEC++ led by Saudi Arabia and Russia which have been amplified by less deliberate action among producers outside the OPEC+ coalition, such as the U.S. and Canada. Moreover, Saudi Aramco will cut production in June by a further 1m b/d, which translates to a new production level of 7.5 m b/d in June, the lowest level in the Kingdom since 2002. Meanwhile, Saudi Arabia and Kuwait will halt production from their shared oil field in June, with cuts estimated at 80K b/d.



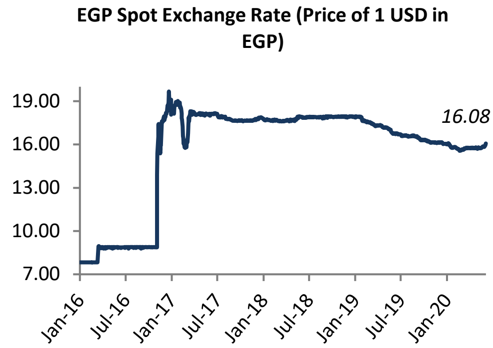


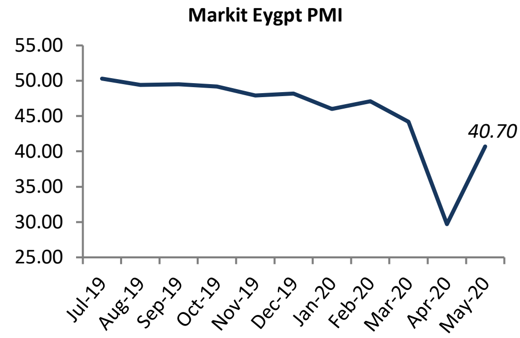
Source: Bloomberg, Capital Investments

Meanwhile, signs of increasing demand have been emerging as countries around the world start to relax lockdowns. For example, oil traders have noticed an increase in oil demand in Asia driven by rising gasoline consumption. China's independent refiners processed a record 2.09 million b/d of imported crude oil in April, the highest level since January 2015. Nonetheless, the oil market is still in a very difficult position. Although the IEA boosted its estimates for oil demand in Q2 by 3.2 million b/d to 79.3 million b/d, consumption for the quarter is on track for about a loss of almost 20 million barrels a day. For FY2020, the demand forecast was increased by 700,000 barrels a day, but it still on track for an annual decline of 8.6 million a day, or about 9%.

The outlook for the oil market in H2 seems to be more encouraging as global economies recover, and Russia expects the market to balance in June or July. Nonetheless, OPEC members will need to exercise caution when it comes to increasing output as the demand recovery has yet to take place in the U.S. or Europe, and in much of Asia ex-China. Moreover, U.S shale producers have begun restoring output as oil prices recover, posing a challenge to OPEC. Therefore, an agreement by OPEC+ producers to extend their output cuts by a further 1-3 months should support the tightening process of the market. In addition, the IEA has acknowledged that "major uncertainties remain", as it is unclear whether governments can resume economic activity without causing a second wave of infections, how far the OPEC+ alliance will implement their supply curbs.

MENA: Egypt… a Cautious Outlook



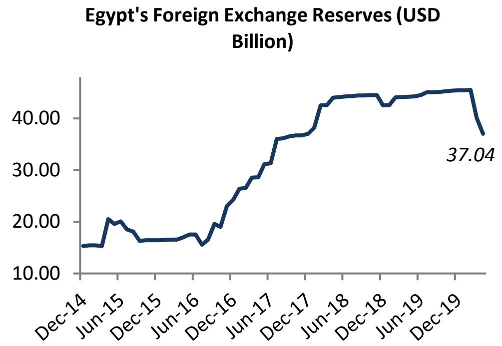


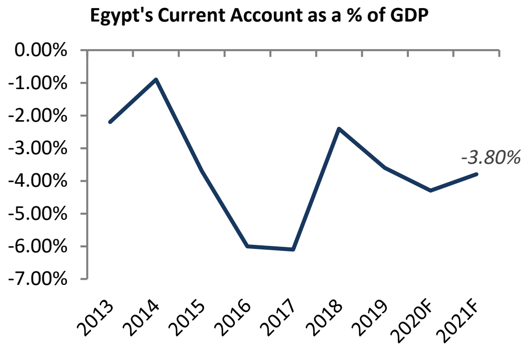
Source: Bloomberg, Capital Investments

The measures taken to fight the coronavirus are expected to weaken some macroeconomic data in Egypt. GDP is expected to grow at 1.5% instead 5.1% in 2020 with the tourism and hospitality industry the most affected. Also, we noticed a fall in the PMI from 44.2 in March to 29.7 in April due to Covid-19, and then to 40.7 in May as the economy starts reopening. However, it remains in contraction since the PMI is below 50. In addition, inflation rose by 5.9% YoY in April from 5.1% YoY in March. This comes with continued uncertainty on the global and domestic impact of the coronavirus on the Egyptian economy.

Source: Bloomberg, Capital Investments

The Central Bank of Egypt (CBE) reduced interest rates by 300 bps, which is likely to reduce the carry trade effect of investing in T-bills. Also, as mentioned, core inflation picked up due to the deprecation in the EGP. Although the recent reduction in the interest rate has put less burden on the government to service its debt, Debt/GDP is expected to rise by approximately 2% in 2020 as the country has issued 3 tranches of Euro-bonds that amounted to around $5bn with total subscription reaching $22bn, at a very attractive yield. This, in addition to the emergency funding received by the IMF, is likely to help the economy recover in the short term.





Source: Bloomberg, Capital Investments

The fall in PMI data due to lower business output has led firms to cut costs, which in turn has created more unemployment and weaker consumption. This is likely to cause the current account to deteriorate further and to lead to capital outflows from foreign investments in T-bills and equities, which is expected to lower the FX reserve to USD34bn in June 2020. The fall in the FX reserve is also due to the government's intervention to stabilize the EGP- this is likely to hurt the economy in the long run.

Finally, the funding from the IMF which amounted to USD2.77bn will provide short-term support to the economy. However, we advise that investors avoid rolling back investments and avoid investments in Egyptian T-bills in such circumstances. In our opinion, the effect of the coronavirus on tourism and remittances as well as FDI is likely to put pressure on the current account. In fact, this will add more pressure on the FX reserve, which in all cases will lead to deprecation in the EGP.

Major Indices	Status as of end		Performance	
	December. 2019	May. 2020	May.2020	YTD (31 May. 2020)
MENA				
Abu Dhabi	5,075.77	4,141.61	-2.10%	-18.40%
Bahrain	1,610.18	1,269.63	-3.14%	-21.15%
Dubai	2,764.86	1,945.09	-4.02%	-29.65%
Egypt	13,961.56	10,220.14	-3.16%	-26.80%
Jordan	1,815.20	1,643.31	-1.49%	-9.47%
Kuwait	6,975.96	5,424.33	1.27%	-22.24%
Lebanon	785.56	575.37	-8.59%	-26.76%
Morocco	12,171.90	9,852.80	4.81%	-19.05%
Oman	3,981.19	3,544.58	0.14%	-10.97%
Palestine	525.96	475.51	-4.69%	-9.59%
Qatar	10,425.51	8,844.74	0.92%	-15.16%
Saudi Arabia	8,389.23	7,213.03	1.41%	-14.02%
Tunisia	7,122.09	6,488.61	4.42%	-8.89%
S&P Pan Arab Composite	788.75	648.69	1.10%	-17.76%
Dow Jones MENA	605.23	495.37	0.87%	-18.15%
Americas				
Dow Jones Industrial	28,538.44	25,383.11	4.26%	-11.06%
S&P 500	3,230.78	3,044.31	4.53%	-5.77%
NASDAQ Composite	8,972.60	9,489.87	6.75%	5.76%
S&P/Toronto Composite	17,063.43	15,192.83	2.79%	-10.96%
Europe				
EURO Stoxx 50	3,745.15	3,050.20	4.18%	-18.56%
S&P Europe 350 Index	1,676.79	1,397.62	2.45%	-16.65%
FTSE 100 Index/ London	7,542.44	6,076.60	2.97%	-19.43%
FTSE MIB Index/ Italy	23,506.37	18,197.56	2.87%	-22.58%
DAX Index/ Germany	13,249.01	11,586.85	6.68%	-12.55%
ASIA/Pacific				
NIKKEI 225/ Japan	23,656.62	21,877.89	8.34%	-7.52%
S&P/ASX 200/ Australia	6,684.08	5,755.69	4.23%	-13.89%
BRIC				
Brazil/ Bovespa	115,645.30	87,402.60	8.57%	-24.42%
Russia/ RTS	1,548.92	1,219.76	8.42%	-21.25%
India/ Bombay Sensitive	41,253.74	32,424.10	-3.84%	-21.40%
China/ Shanghai Composite	3,050.12	2,852.35	-0.27%	-6.48%
Hong Kong/ Hang Seng	28,189.75	22,961.47	-6.83%	-18.55%

Source: Bloomberg, Capital Investments capital investments

Description	Closing Prices as of end		Performance	
	December. 2019	May. 2020	May.2020	YTD (31 May. 2020)
Commodities (in USD)				
Brent Spot (Barrel)	66.42	36.63	54.56%	-44.85%
WTI Cushing Spot (Barrel)	61.06	35.49	88.38%	-41.88%
Natural Gas NYMEX (MMBtu)	2.30	1.85	-14.79%	-19.71%
Gold Spot (OZ)	1,517.27	1,730.27	2.60%	14.04%
Silver Spot (OZ)	17.85	17.87	19.34%	0.07%
Copper LME Spot (MT)	6,149.00	5,352.25	3.72%	-12.96%
Corn CBOT Active Month (Bushel)	4.01	3.26	1.80%	-18.77%
Wheat CBOT Active Month (Bushel)	5.64	5.21	-0.67%	-7.59%
Soybean CBOT Active Month (Bushel)	9.80	8.41	-1.70%	-14.19%
Rough Rice Futures (USD/cwt)	13.14	17.22	0.35%	31.06%
Currencies Spot Exchange Rates Against US Dollar				
Euro	1.12	1.11	1.33%	-1.00%
GBP	1.33	1.23	-1.99%	-6.89%
CAD	0.77	0.73	1.23%	-5.70%
Yen	0.01	0.01	-0.58%	0.76%
CNY	0.14	0.14	-1.02%	-2.42%

Source: Bloomberg, Capital Investments

Disclaimer

Capital Investments

Asset Management Department

Tel: +962 6 5200330 Ext. 2494 and 2373

AssetManagement@Capitalinv.com