

Monthly Newsletter

August 6th, 2020

“There have been as many plagues as wars in history; yet always plagues and wars take people equally by surprise.” — Albert Camus, The Plague

“Great winds are powerless to disturb the water of a deep well.” — Chinese Proverb

Clues from Recent Asset Classes' Behavior

Macro: The Virus Has Resurged... The Economic Recovery Has Stalled

Oil: Consolidation Until the Drawdown in Inventory Becomes Clear

MENA: Overview of a Few Mena Markets

Introduction

The released Q2 2020 GDP data illustrated with lucidity the extent of the damage that has occurred to the global economy and has put into perspective the endurance ahead. For instance, the US, Eurozone and Germany saw their Q2 GDP dropping by -32.9%, -14.4% and -11.7%, respectively, on an annualized basis.

Despite this negative backdrop, markets pursued their rally into H2 backed by optimism related to expansionary fiscal and monetary policies, potential discovery of a vaccine or treatment and less strict lockdown strategies despite a resurgence in the infection rates.

Indeed, “decoupling” was a remarkable trait of the markets’ upward trend. Markets decoupled from the rising rates of infections as they were focusing on death rates and pressure on hospitalization capacity, which appeared to be under control while progress on the vaccine and treatment development was promising.

Markets decoupled from stalling mobility and high frequency data as they interpreted the less strict lockdown strategies and virus control measures as short-term pauses in recovery rather than a long-term stop. Thus, the markets are not seeing that the reopening process will be fully reversed despite new Covid-19 outbreaks.

Equities decoupled from bonds as the rally in stock markets is anticipating a quick recovery while low yields and flattening of the yield curve indicate a dim outlook but the flood of liquidity and the hunger for yields is explaining the reflation in prices

The positive sentiment in markets is excessive amid a highly overstretched valuation as the S&P 500 index is trading at a trailing P/E of 24 while a better than expected earnings season and depressed real yields could explain the rally.

Given that markets are priced for perfection we prefer to stay cautious and dynamic by holding a substantial portion of cash to be deployed tactically as opportunities arise. Simultaneously, we are investing in sectors benefiting from positive operating leverage such as miners of gold and silver and other commodities, or sectors benefiting from the gradual recovery such as payments and cybersecurity as the move to online has been fast forwarded by few years in the past months. We are selective on cyclicals as among the many indicators that we monitor, only the USD weakness is encouraging while the yield curve is alarming.

We are worried that volatility, illustrated by the VIX index curve, is sending some alarming signs over the few couple of months. The resumption of trade talks between the US and China is a welcome action but investors are factoring in the US elections, which are less than 100 days away, as they will have repercussions on the fiscal policy stance and targets, tax policy, and tech and healthcare regulations around the world.

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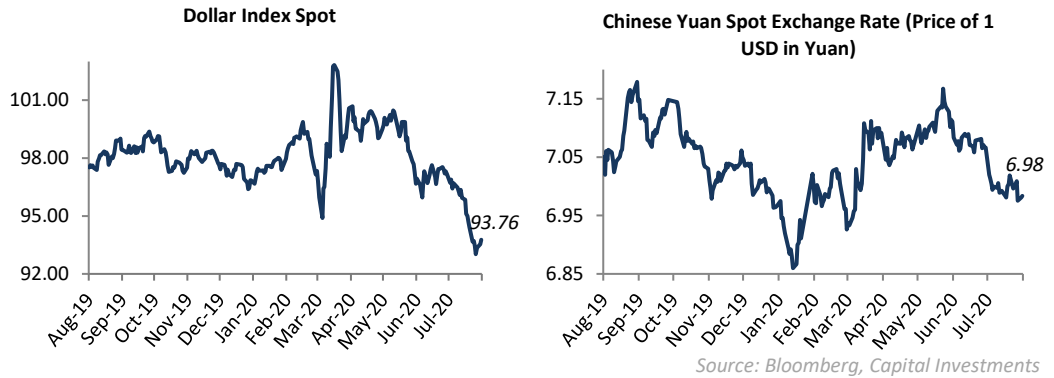
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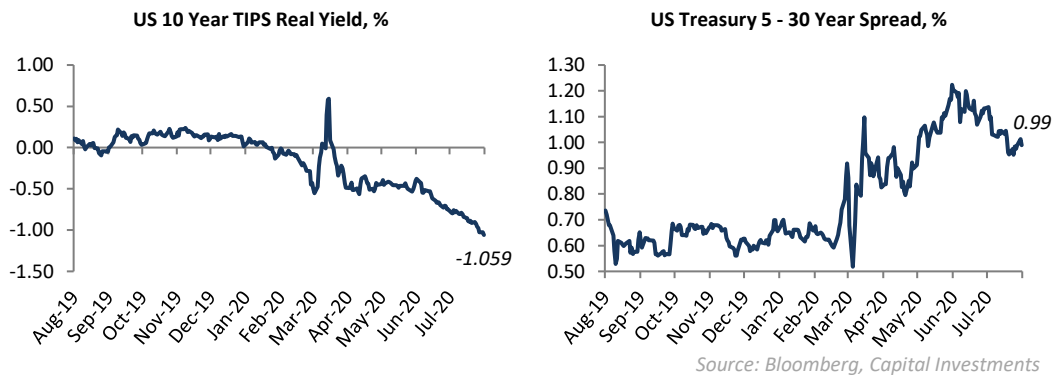
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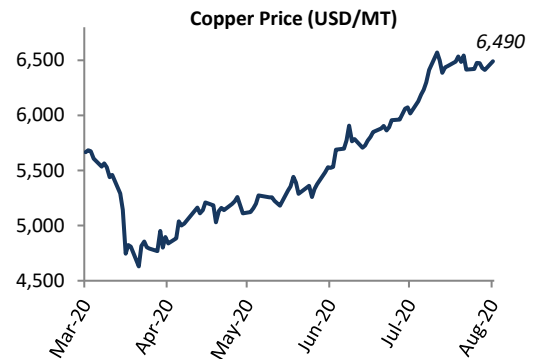
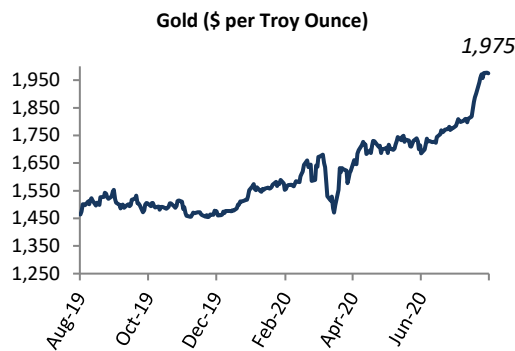
Clues from Recent Asset Classes' Behavior



It appears that the shortage in USD has receded on the back of the liquidity injections by the US Fed, as indicated by the slide in the greenback which was very sharp over the past month. The Euro has more reasons to strengthen after the approval of the Eur 1.1trn budget package and more importantly the approval of the next generation recovery fund of Euro 750bn which paved the way for the mutualization of debt issuance. It is worth noting that the Chinese Yuan was strengthening given that China assumed a targeted easing monetary policy, and its strength should be sustained if the trade talks with the US achieve a positive breakthrough.

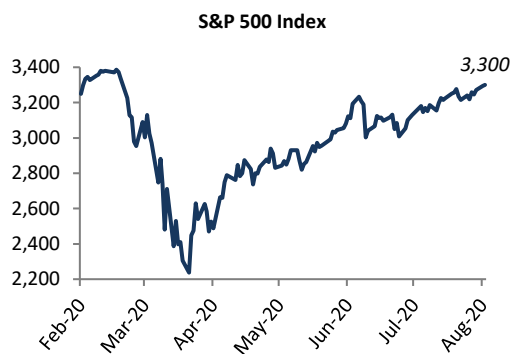


Inflation expectations are rising while nominal yields are being compressed by the monetary authorities. Real yields are deeply negative which is pushing asset prices higher, while the yield curve has lost some of its steepness due to consolidation in oil prices and restrictions on mobility amid the resurgence of the coronavirus, among other reasons. This has put some breaks on the cyclical rally.



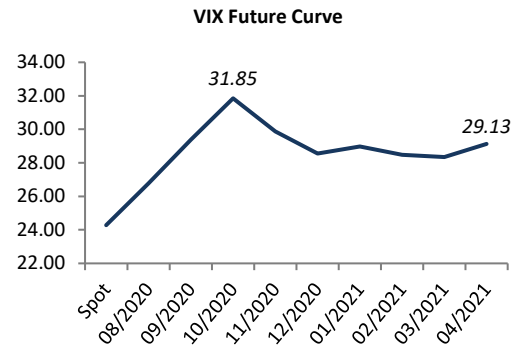
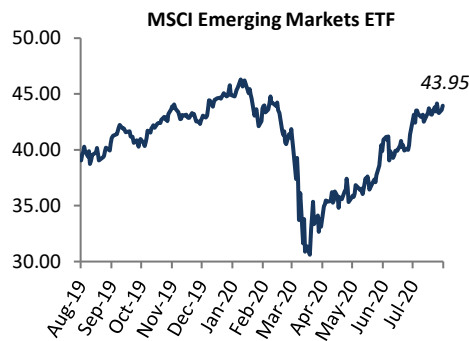
Source: Bloomberg, Capital Investments

Gold and silver have benefited from a weak USD and negative real yields and are set to climb more as the low interest rate policy is expected to stay for longer which will be positive for long duration assets. Copper is rallying as the market is pricing in a supply deficit in H2 2020 and a recovery in demand on the back of infrastructure spending in key nations notably China.



Source: Bloomberg, Capital Investments

Strong results from Tech bellwethers Amazon, Apple and Microsoft along with vaccine optimism pushed equities higher despite a lackluster macro backdrop and overstretched valuations. When comparing the market's earnings yield and the depressed treasury yield, it seems that the rally has more room to go but investors should be alarmed that the jobs market is sending some warning signals as jobless claims are resurging, amid rising uncertainty about a fiscal deal to extend the pandemic benefit as we are approaching the recess of the US Congress in mid-August.

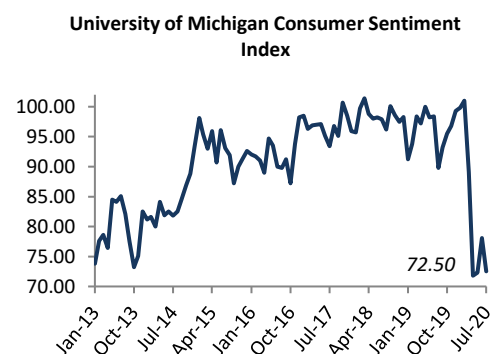
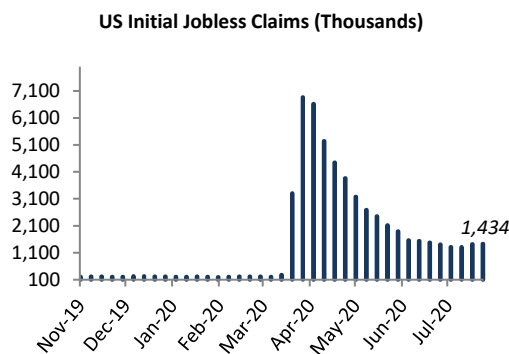


Source: Bloomberg, Capital Investments

Emerging market equities benefited from the compression in global yields and the weakness in USD along with the prospect of gradual global recovery. Amid this rosy picture, we are concerned that the VIX future curve is pointing towards near-term risk especially around the US elections in October.

Macro: The Virus Has Resurged... The Economic Recovery Has Stalled

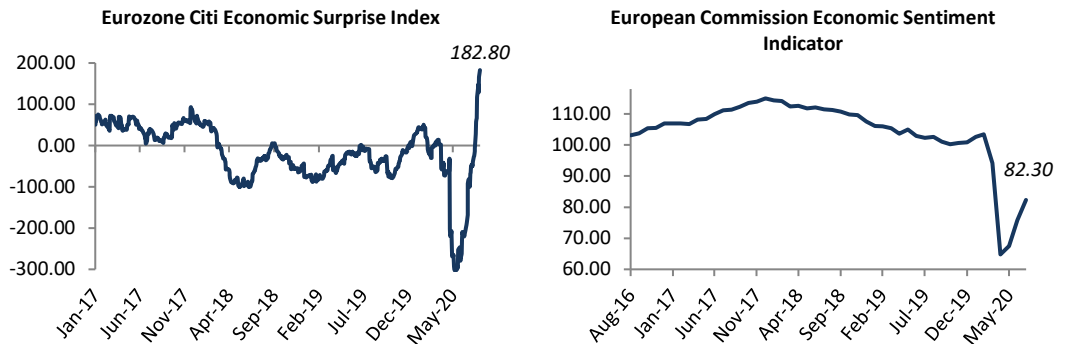
The resurgence of infection rates in key regions such as the US, Hong Kong, Spain and Belgium, to name a few, took its toll on mobility data and high frequency data which saw its improvement stalling. Investors are closely watching data related to labor markets along with developments related to personal consumption as credit and debit card purchases recovery seems to have lost momentum since early July, impacted by the re-imposition of restrictions by few countries. Investors are also tracking industrial activity which was improving in the US and Europe and losing momentum in China. Finally, the rising rate of bankruptcies is under close watch by investors around the world.



Source: Bloomberg, Capital Investments

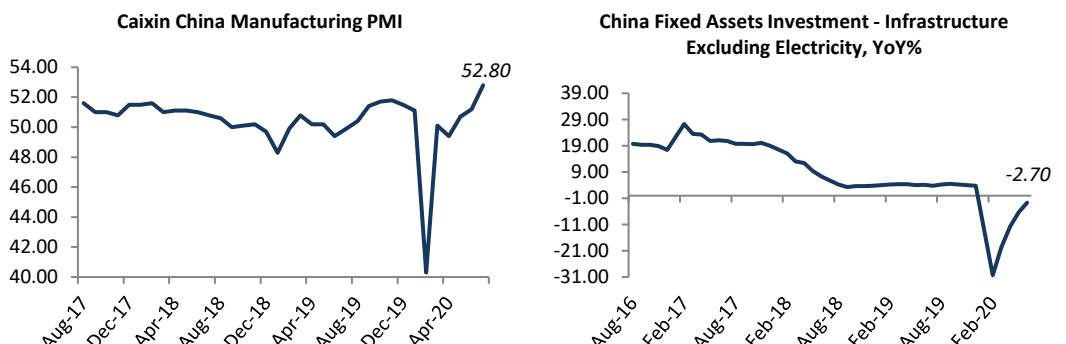
In the US, the deterioration in the jobs market was noticeable since mid-July. This comes amid a deterioration in consumer sentiment indices while negotiations over the next fiscal package are not

breaking through. Jobs data for July and the outcome related to the fiscal package negotiation are key for sentiment and equity markets in US.



Source: Bloomberg, Capital Investments

Europe appears on a better track than the US, the old continent is showing better management in controlling the virus than its counterpart on the other side of the Atlantic. Confidence is building and the Citi Economic Surprise Index is pointing towards a recovery. Europe is benefiting from the agreement over a EUR1.1trn budget for the next 7 years and a next generation recovery fund of EUR750bn. We continue to favor investments in European countries that have committed large stimuli such as Germany.



Source: Bloomberg, Capital Investments

Economic activity in China is improving gradually although the non-manufacturing PMI dropped in July in contrast to manufacturing. Infrastructure investment is progressing but in a targeted and less intense manner than in 2011 or 2015. We expect China to ease its monetary policy further in H2 2020 which will support economic activity.

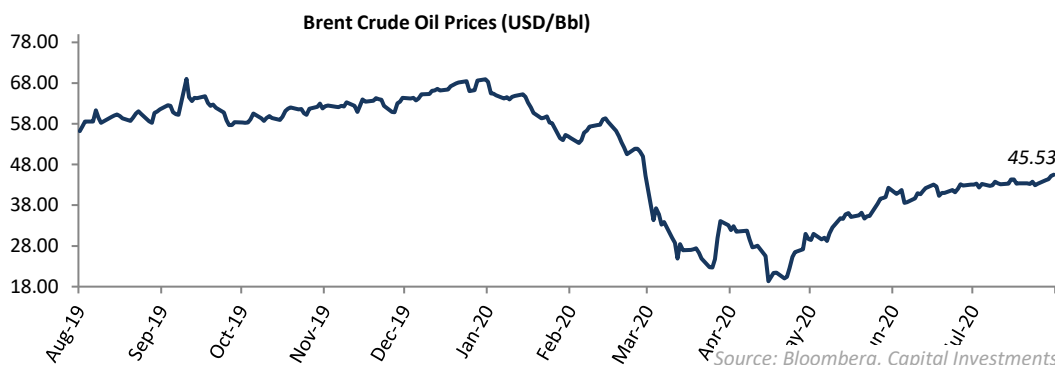
Purchasing Managers Indices (PMI) (2019-2020):											
	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul
Global Manufacturing	49.8	49.8	50.3	50.1	50.3	47.1	47.3	39.6	42.4	47.9	50.3
Global Services	51.4	51.0	51.6	52.0	52.7	47.1	36.8	23.7	35.2	48.0	50.5
Global Composite	51.1	50.8	51.4	51.5	52.1	46.1	39.2	26.2	36.3	47.8	50.8
US Manufacturing	48.2	48.5	48.1	47.8	50.9	50.1	49.1	41.5	43.1	52.6	54.2
US Services	53.5	54.4	53.9	54.9	55.5	57.3	52.5	41.8	45.4	57.1	58.1
US Manuf. New Orders	48.5	48.9	46.8	47.6	52.0	49.8	42.2	27.1	31.8	56.4	61.5
EU Manufacturing	45.7	45.9	46.9	46.3	47.9	49.2	44.5	33.4	39.4	47.4	51.8
EU Services	51.6	52.2	51.9	52.8	52.5	52.6	26.4	12.0	30.5	48.3	54.7
EU Composite	50.1	50.6	50.6	50.9	51.3	51.6	29.7	13.6	31.9	48.5	54.9
China Manufacturing	49.8	49.3	50.2	50.2	50.0	35.7	52.0	50.8	50.6	50.9	51.1
China Services	53.7	52.8	54.4	53.5	54.1	29.6	52.3	53.2	53.6	54.4	54.2
China Manuf. New Orders	50.5	49.6	51.3	51.2	51.4	29.3	52.0	50.2	50.9	51.4	51.7

* 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

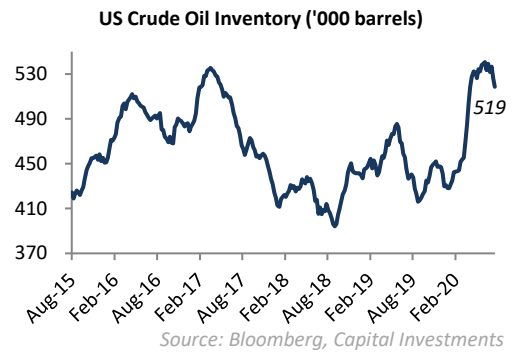
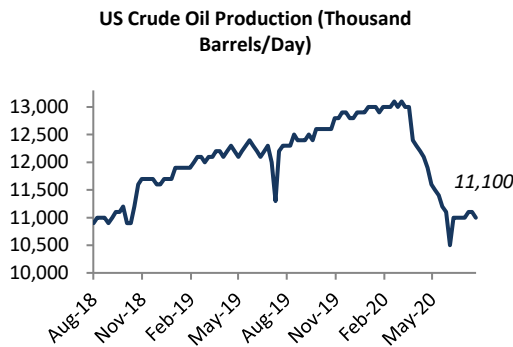
Oil: Consolidation Until the Drawdown in Inventory Becomes Clear

Oil prices moved in a range in July as supply cuts from OPEC+ were balanced by weak demand that is at the risk of further regressing. Prices were also caught in a tug of war between a weakening dollar and a dovish FED on one side, and escalating tensions between China and the US and weak macro data on the other.



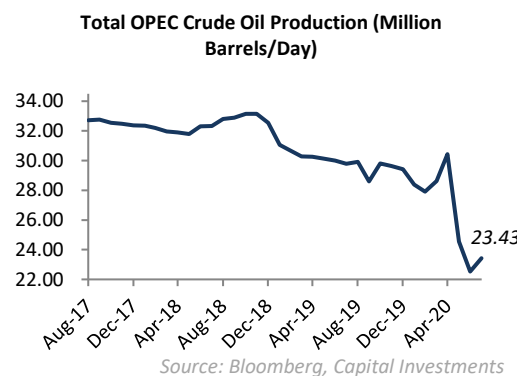
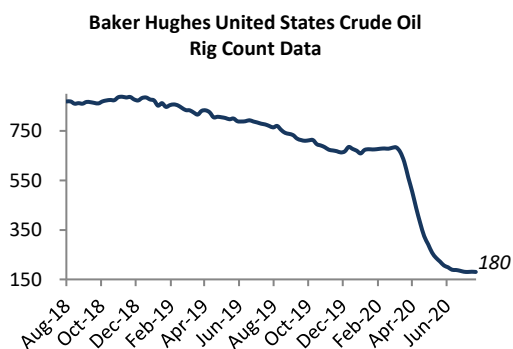
OPEC’s production reached 23.2 million bpd in July, an increase of 970,000bpd from the month of June, in which the group’s output fell to its lowest since 1991. While Saudi Arabia continued to show discipline in its cuts, other members such as Iraq and Nigeria fell short in implementing their promised curtailments. Moreover, Libya’s oil exports decreased in July as opposition forces opposed continued to block shipments. Nonetheless, after almost three months of historic output cuts, OPEC and its allies will begin gradually restoring oil supply this month- the group will return 1.3 million to 1.5 million barrels a day. Meanwhile, US crude inventories decreased by 7.4 million barrels last week versus an analyst expectation of a 2.3 million draw only, therefore lending some support to prices.

However, although rig count remains well below 2019 figures (180 vs 942), it seems that the plunge in drilling activity may be bottoming out.



Source: Bloomberg, Capital Investments

OPEC’s tapering of its production curbs comes at a delicate time. While the coalition had stated that the impact of its increased production will be “barely felt”, the recovery in global oil demand is unsteady amid the resurgence in coronavirus, posing a great challenge to the group. The virus continues to spread throughout the world, with cases surging in the US, Hong Kong, Australia, Spain, among others. Many countries across the globe have now paused or reversed re-opening measures, weighing negatively on energy demand. Meanwhile, Indian consumption of petroleum products is at 88% of year-ago levels, China’s top refiner has lowered operating rates at some of its plants in July due to severe flooding, and the U.S economy suffered its sharpest downturn since at least the 1940s in Q2, further dampening sentiment. Nonetheless, the outlook for demand has been supported by some positive and promising results from vaccine trials and treatments.



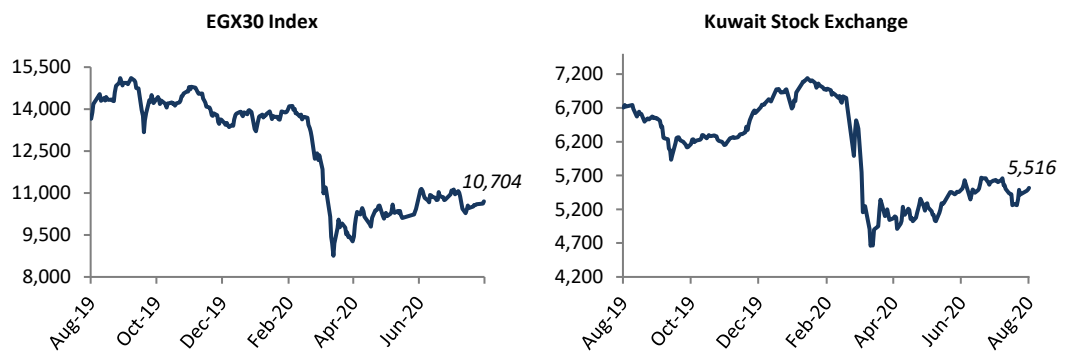
Source: Bloomberg, Capital Investments

MENA: Overview of a Few Mena Markets

Countries in the MENA region face a dual shock from the coronavirus pandemic and a sharp fall in oil prices and thus their financial markets are a play on global cyclical recovery and a gradual increase in oil prices. Finding top down investments is challenging but the region offers bottom up opportunities. Key catalysts include a compression in real yields, industry consolidation, market share expansion and selective resilience at the level of corporate profitability through stable margins and ROEs.

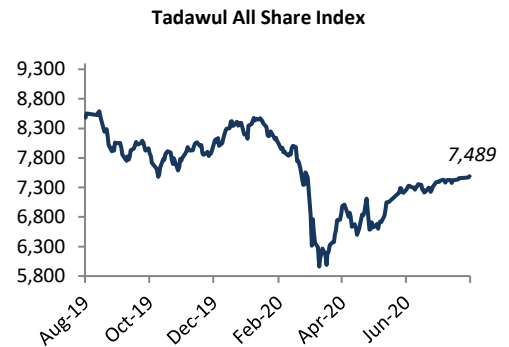
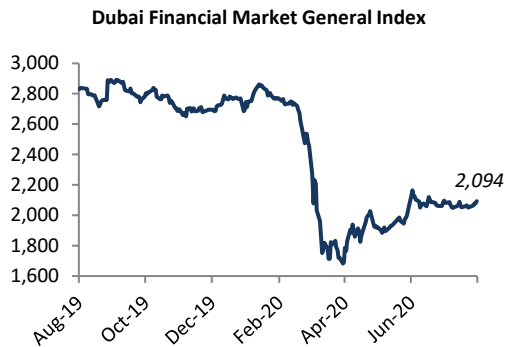
Egypt: Cheapest valuation amid large domestic demand which provides a cushion, while the lean lockdown strategy kept the economic wheel moving. Macro challenges are external as key dollar generation channels in the current account will face pressure, mainly Suez Canal receipts, tourism revenue and expat remittances. The IMF forecasts pandemic-induced tourism losses to be worth more than 2% of Egypt's GDP in 2020. It also noted that remittances would take a hit, given the vulnerability of migrant workers and their exposure to unemployment and wage loss risk in impacted sectors, including food and hospitality, retail, and tourism. On the other hand, external geopolitical challenges such as the turmoil in Libya and the negotiations related to the Renaissance Dam with Ethiopia shall be on a de-escalation mode which will provide comfort.

Kuwait: Valuation is rich, and the country is not a reform play until Vision 2035 goes into real implementation, fiscal consolidation takes place and a debt law is passed. Kuwait might be a delayed liquidity play due to its inclusion into the MSCI EM index in November 2020.



UAE: A high beta market that may perform well if positive sentiment returns, however, key challenges include a great decline in tourism and a weak property market. Banks may provide selective opportunities due to M&As and government support and index inclusion, however, asset quality will remain an issue.

Saudi Arabia: Rich valuation supported by the currency peg and low bond yields, however as the USD weakens, investors will prefer other EM plays that are set to benefit from the USD’s soft trend. The currency peg and low oil prices will force Saudi Arabia to adopt a defensive fiscal policy, the VAT hike from 5% to 15% is a case in point. Petrochemical companies’ valuation looks rich and banks did not pay a dividend for H1, thus investors shall be selective in looking into domestic plays as the country will go through a phase of fiscal consolidation.



Source: Bloomberg, Capital Investments

Major Indices	Status as of end		Performance	
	December, 2019	July, 2020	July,2020	YTD (31 July, 2020)
MENA				
Abu Dhabi	5,075.77	4,304.74	0.44%	-15.19%
Bahrain	1,610.18	1,290.57	1.01%	-19.85%
Dubai	2,764.86	2,050.77	-0.70%	-25.83%
Egypt	13,961.56	10,599.46	-1.53%	-24.08%
Jordan	1,815.20	1,581.82	-1.32%	-12.86%
Kuwait	6,975.96	5,415.27	-3.42%	-22.37%
Lebanon	785.56	597.26	-2.45%	-23.97%
Morocco	12,171.90	10,228.27	0.58%	-15.97%
Oman	3,981.19	3,568.10	1.48%	-10.38%
Palestine	525.96	460.86	-2.11%	-12.38%
Qatar	10,425.51	9,368.17	4.11%	-10.14%
Saudi Arabia	8,389.23	7,459.21	3.25%	-11.09%
Tunisia	7,122.09	6,584.33	-0.66%	-7.55%
S&P Pan Arab Composite	788.75	671.04	1.72%	-14.92%
Dow Jones MENA	605.23	510.97	1.32%	-15.57%
Americas				
Dow Jones Industrial	28,538.44	26,428.32	2.38%	-7.39%
S&P 500	3,230.78	3,271.12	5.51%	1.25%
NASDAQ Composite	8,972.60	10,745.27	6.82%	19.76%
S&P/Toronto Composite	17,063.43	16,169.21	4.22%	-5.24%
Europe				
EURO Stoxx 50	3,745.15	3,174.32	-1.85%	-15.24%
S&P Europe 350 Index	1,676.79	1,416.31	-1.70%	-15.53%
FTSE 100 Index/ London	7,542.44	5,897.76	-4.41%	-21.81%
FTSE MIB Index/ Italy	23,506.37	19,091.93	-1.46%	-18.78%
DAX Index/ Germany	13,249.01	12,313.36	0.02%	-7.06%
ASIA/Pacific				
NIKKEI 225/ Japan	23,656.62	21,710.00	-2.59%	-8.23%
S&P/ASX 200/ Australia	6,684.08	5,927.78	0.51%	-11.31%
BRIC				
Brazil/ Bovespa	115,645.30	102,912.20	8.27%	-11.01%
Russia/ RTS	1,548.92	1,234.44	1.80%	-20.30%
India/ Bombay Sensitive	41,253.74	37,606.89	7.71%	-8.84%
China/ Shanghai Composite	3,050.12	3,310.01	10.90%	8.52%
Hong Kong/ Hang Seng	28,189.75	24,595.35	0.69%	-12.75%

Source: Bloomberg, Capital Investments

Description	Closing Prices as of end		Performance	
	December, 2019	July, 2020	July, 2020	YTD (31 July, 2020)
Commodities (in USD)				
Brent Spot (Barrel)	66.42	42.81	4.70%	-35.55%
WTI Cushing Spot (Barrel)	61.06	40.27	2.55%	-34.05%
Natural Gas NYMEX (MMBtu)	2.31	1.80	0.56%	-22.15%
Gold Spot (OZ)	1,517.27	1,975.86	10.94%	30.22%
Silver Spot (OZ)	17.85	24.39	33.95%	36.62%
Copper LME Spot (MT)	6,149.00	6,422.00	6.95%	4.44%
Corn CBOT Active Month (Bushel)	4.03	3.27	-6.70%	-18.76%
Wheat CBOT Active Month (Bushel)	5.69	5.31	8.03%	-6.59%
Soybean CBOT Active Month (Bushel)	9.79	8.93	1.16%	-8.81%
Rough Rice Futures (USD/cwt)	13.14	11.60	-20.06%	-11.72%
Currencies Spot Exchange Rates Against US Dollar				
Euro	1.12	1.18	4.84%	5.04%
GBP	1.33	1.31	5.52%	-1.30%
CAD	0.77	0.75	1.22%	-3.14%
Yen	0.01	0.01	1.96%	2.63%
CNY	0.14	0.14	1.30%	-0.17%

Source: Bloomberg, Capital Investments

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