

Monthly Newsletter

October 1st, 2020

“Do the best you can until you know better. Then when you know better, do better.” — Dr Maya

Angelou

“Art is not a thing; it is a way.” — Elbert Hubbard

Clues from Recent Asset Classes' Behavior

Macro: The Recovery Might Be Stalling

Oil: Increasing Supply Amid Muted Demand

MENA: PMIs Weaken in August... Pointing to Ongoing Sluggishness in Economic Activity

Introduction

The investment journey in September started off on a weak note. This negative tilt was amplified by a multitude of factors. A resurgence of the virus in many parts of the world and notably in Europe pushed governments to reimpose certain restriction measures on activity in a way to tame the virus transmission rate. Such actions, coupled with a more “health cautious” consumer, took its toll on mobility figures and high frequency data.

On the policy front, both the Fed and ECB refrained from adding new monetary stimulus in their latest meetings while there is high uncertainty regarding concluding the injection of a new fresh fiscal stimulus in the US before the US presidential elections. As a result, major financial institutions reviewed downward their GDP growth forecast for Q4 2020 especially in the US.

Equity markets went on a roller coaster ride with a downward bias and manageable correction mainly driven by rebalancing out of overvalued tech into some value plays.

The fact that the relationship between the emergence of new covid-19 cases and the death rates appears to be non-linear is limiting the panic effect so far. Investors believe that the hurdle for new strict lockdowns across the board is very high given that they are costly and unsustainable amid rising governments debt and falling revenues. All this helped in limiting the sell-off and putting a kind of a floor for markets especially that the system is still flood with liquidity.

Only the approval of a vaccine will be a game changer; it will accelerate the return to normality by curbing the fear factor and encouraging mobility and face to face activities. The big story will be that of a cyclical recovery driven by reopening, progress on the treatment front and governments' expansionary policies to mitigate the effect of previous lockdowns and rising unemployment.

The uncertainty that is governing the US presidential elections outcomes will continue to drive volatility in markets, and the recent debate between President Trump and his challenger Mr. Biden did not offer any clues as it was more of a mud war with a lack of substance, and what was not said seems much more important than what was said when it comes to critical issues that matter for investors such as the tax policy, climate change policy, infrastructure bill, tech regulation and globalization/protectionism issues.

Markets will need the economic recovery to remain on track, more clarity in relation to the US elections, along with sustained fiscal stimulus, as requested many times by central bankers. While we are still committed to the long-term recovery picture, we are aware that it may face a temporary interruption. We are still invested albeit with a cautious stance; we added vaccine plays and some investments in Europe, in the MENA region we like logistics plays and selective mid-cap opportunities. Our long positions in Gold and Silver did not help us in September but we are still constructive on the trade. We look to add more exposure related to the agribusiness and infrastructure spending beyond mining.

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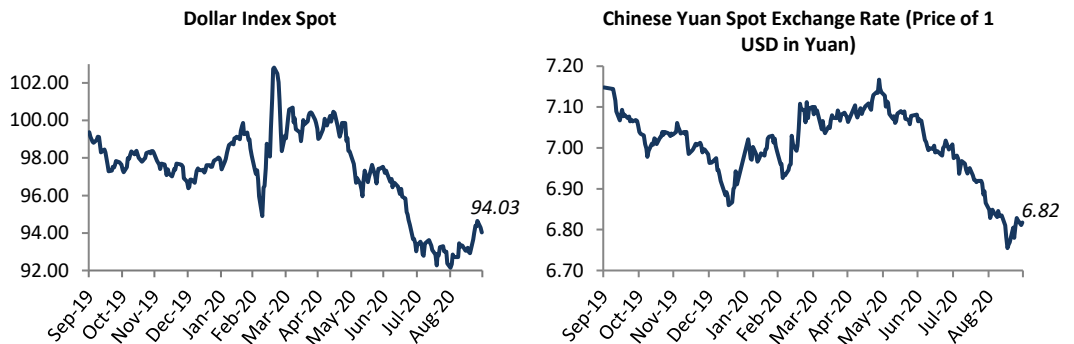
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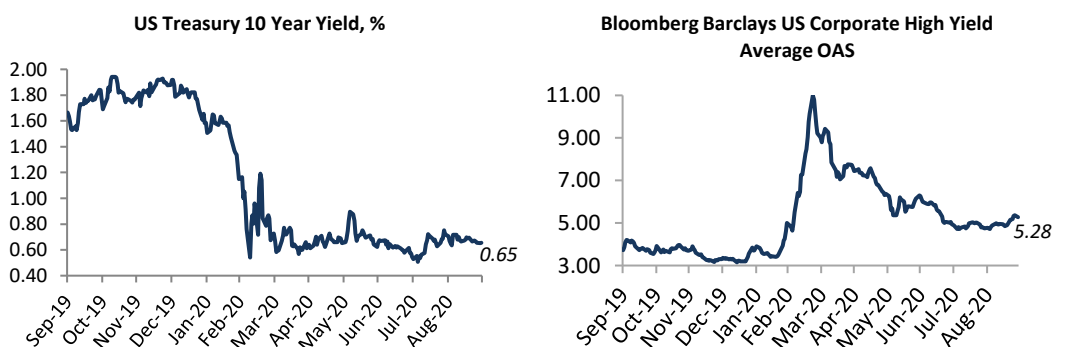
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Clues from Recent Asset Classes' Behavior



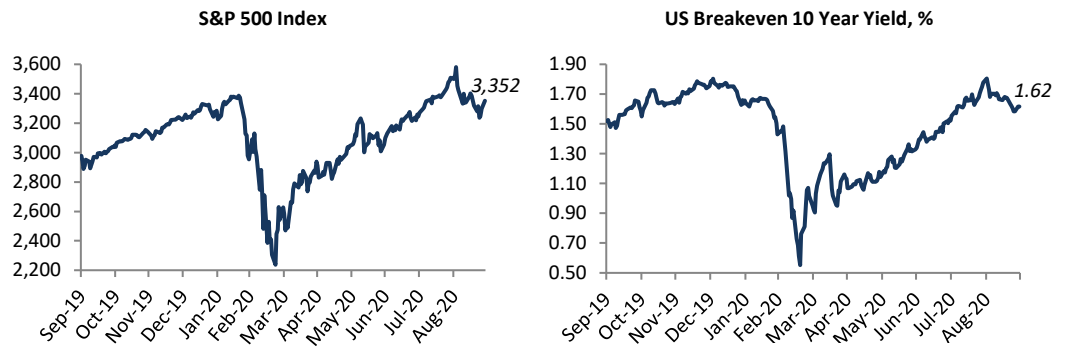
Source: Bloomberg, Capital Investments

Since the beginning of September, the USD left its short-term technical oversold territory to strengthen by around 2.5% for the month vis a vis a basket of major currencies and was supported by a risk off trade mode as the rally in risky assets was losing momentum. As a traditional safe-haven play in times of turbulence, the USD benefited from a slight improvement in US long term real yields. Lack of sustainable fundamental factors, as the US is facing expanding trade and budget deficits coupled with a loose monetary policy, means that the recent rally in USD is of a short-term nature. On a separate note, the appreciation of the Chinese Yuan seems to be driven by an attractive interest rate differential vis a vis the US, an improvement in China’s economic activity, a relatively less loose monetary policy, and reduced tension in relation to its trade policy with the US.

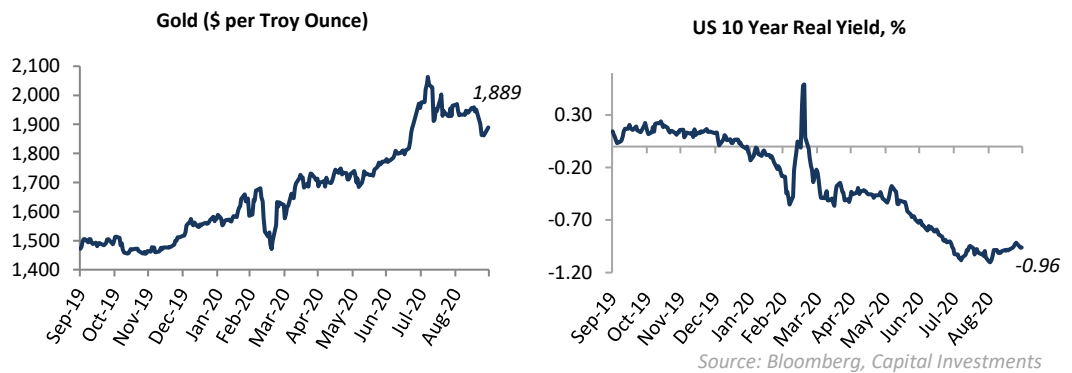


Source: Bloomberg, Capital Investments

Rising uncertainty over the US election outcomes along with further restrictions on mobility due to the resurgence of the virus and the absence of new fresh stimulus measures have capped the increase in the long-term US yield, which has started to drift slowly down since the beginning of September. Additionally, with a lack of substantial progress on the vaccine front, investors started to factor in an interruption in economic activity, which contributed to a widening of credit spreads in the US and Emerging economies.

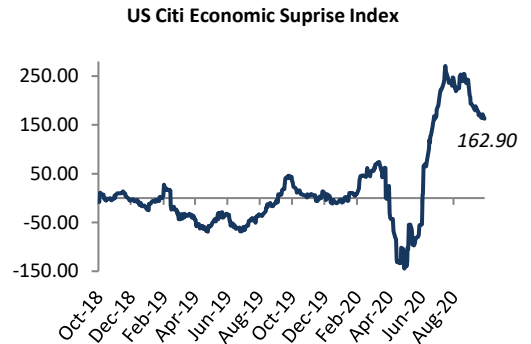
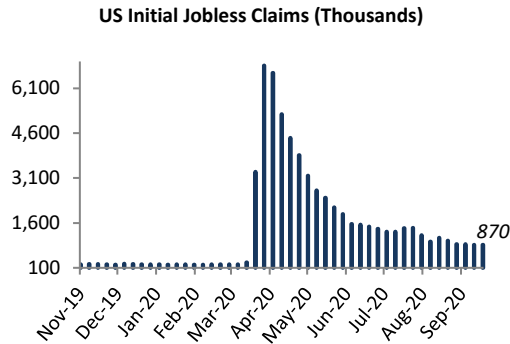


The fear of further restrictions on economic activity and lack of stimulus pricked the inflationary expectations in the market, causing the US breakeven rates to lose altitude as investors factored in less growth for the coming quarter. Stocks seen as a medium to hedge inflation and as an expression of the flood of liquidity in the market moved in correlation with US break-even rates and lost ground.



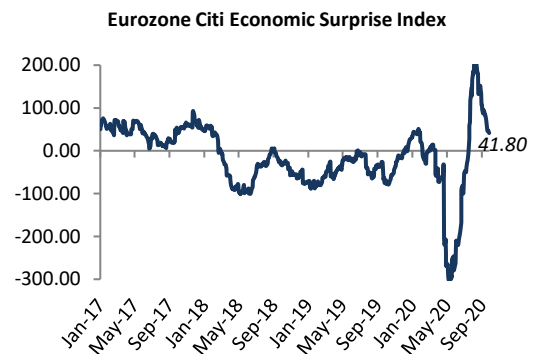
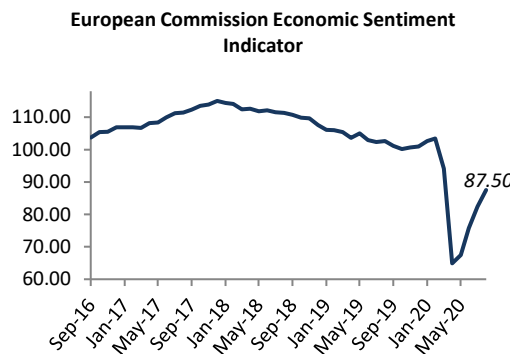
The combination of a strong USD, lower breakeven rates and rising US real yield was the reason behind the gravity that pulled down the price of gold which was technically overbought over the recent months. We continue to think that the precious metal trade is intact as it acts as a safe haven in times of turbulence and will benefit from the loose monetary policies and currency debasement. However, a strong rally will always entail some volatile patterns.

Macro: The Recovery Might Be Stalling



Source: Bloomberg, Capital Investments

The recovery in the US is losing momentum. There are no further meaningful gains on the jobs front while other data such as retail sales are showing deceleration in growth. As a result, the US Citi surprise index is trending downward, factoring in a slower Q4 growth in 2020.



Source: Bloomberg, Capital Investments

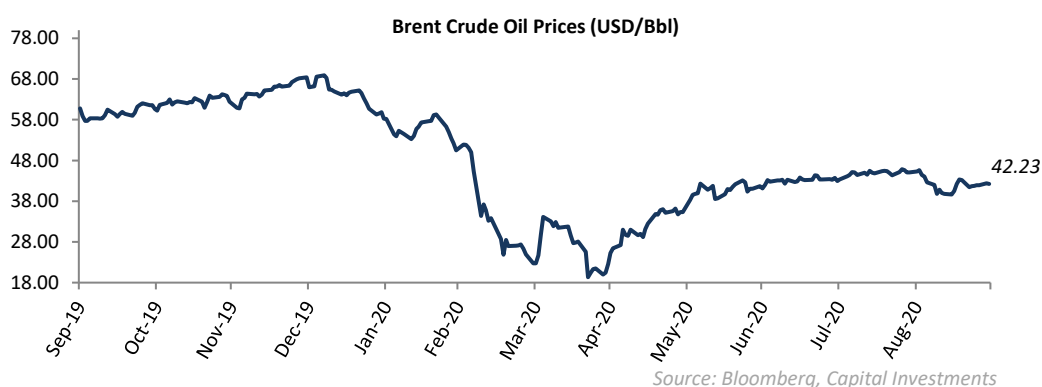
A similar picture to the US appears to be dominating the scene in Europe driven mainly by the lack of extra monetary stimulus by the ECB and more importantly stricter mobility restrictions which are affecting the economic activity. In Europe, there was a clear divergence in preliminary PMIs for manufacturing and services with the latter decelerating. The recovery in Europe is currently being interrupted but the big picture still points towards a gradual growth driven by stimulus measures.



Source: Bloomberg, Capital Investments

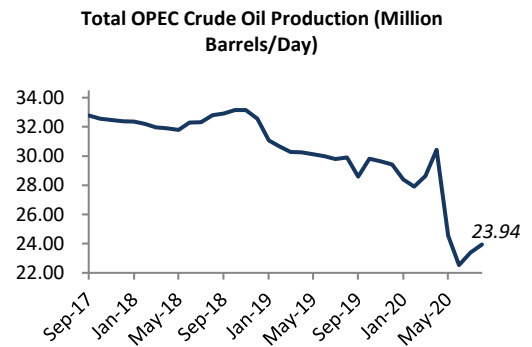
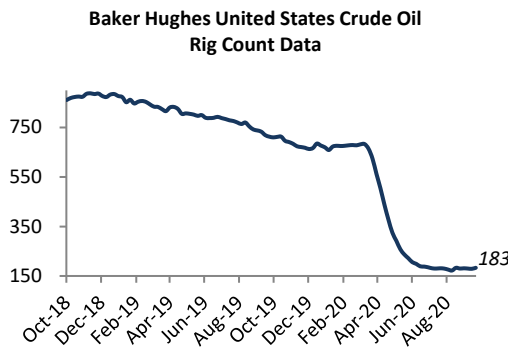
China stands out as growth is still on track driven initially by domestic consumption and buoyant industrial activity, and by both targeted fiscal and monetary stimulus measures. We continue to be constructive on China as the authorities are managing the growth trajectory well so far, as confirmed by economic data notably PMIs.

Oil: Increasing Supply Amid Muted Demand



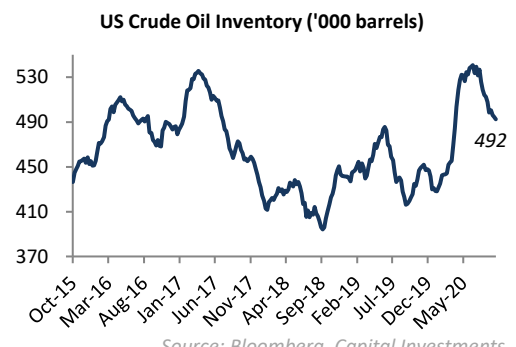
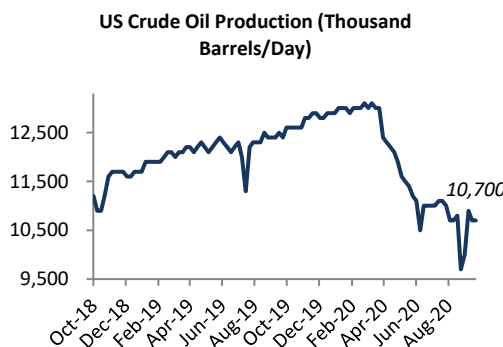
The rally in oil prices from April's bottom has stalled with prices down 8% in September amid a deteriorating demand backdrop and a continued increase in output from the OPEC+ alliance. Brent's future curve is nearing the widest contango since late May, indicating that concerns about over-supply are returning.

A stalling recovery in Asian, namely India's, demand, the end of U.S summer driving season, as well as resurgence of coronavirus cases have raised doubts about a sustained recovery in consumption and have weakened market sentiment, driving both the IEA and OPEC to trim their global oil demand forecasts. The IEA has lowered its demand outlook for global oil demand growth to 91.7 million barrels per day, which marks a contraction of 8.4 million bpd YoY, more than the 8.1 million bpd contraction the agency had predicted in August. The agency expects the recovery in oil demand to noticeably decelerate in 2H20, however, it expects growth of around 5.5 million bpd in 2021, reaching an average of 97.1 million bpd.



Source: Bloomberg, Capital Investments

OPEC has also revised its global oil demand outlook downwards to an average of 90.2 million bpd in 2020, 400,000 bpd lower than their August estimates, and reflecting a contraction of 9.5 million bpd YoY. Looking ahead, the alliance expects global oil demand to grow by 6.6 million bpd to an average of 96.9 million bpd next year, also 400,000 bpd lower than its previous estimate, as it sees weak Asian demand continuing through 1H21.



Source: Bloomberg, Capital Investments

The picture is just as bleak on the supply side. As OPEC+ are gradually opening their taps again, Libya has restarted oil production and exports after the blockade on the country’s ports have been lifted. Libya’s production almost tripled to 250,000 bpd a week after it recommenced its operations, with output set to expand further. Meanwhile, Iraq may seek a two-month extension to implement compensatory cuts under the OPEC+ output agreement, indicating the producer won’t be able to curb its production as quickly as previously promised. Nonetheless, the determination that Saudi Arabia demonstrated in OPEC’s latest meeting to defend the market lent some support to prices. The Saudis hinted they are prepared for new production cuts and warned OPEC+ members that have cheated on production quotas.

Moreover, although US crude inventories dropped by 1.98 million barrels last week vs. an expectation of a 1.569 million build, they remain above the five-year average for the season. US oil output also increased to 10.575 million barrels per day from 10.325 million barrels in the previous

week. Additionally, there are reports of oil traders chartering oil tankers so that they can be ready to store excess barrels if necessary, in attempts to avoid April's storage fiasco. This indicates that these traders believe the oil market is moving into a surplus.

With increasing supply and a muted demand outlook, the oil market seems to be moving further into a surplus, which will weigh negatively in prices in the coming quarter. Any upside risk will come from Covid-19 vaccine developments, improvements in US-Sino relations, and a weakness in USD.

MENA: PMIs Weaken in August... Pointing to Ongoing Sluggishness in Economic Activity

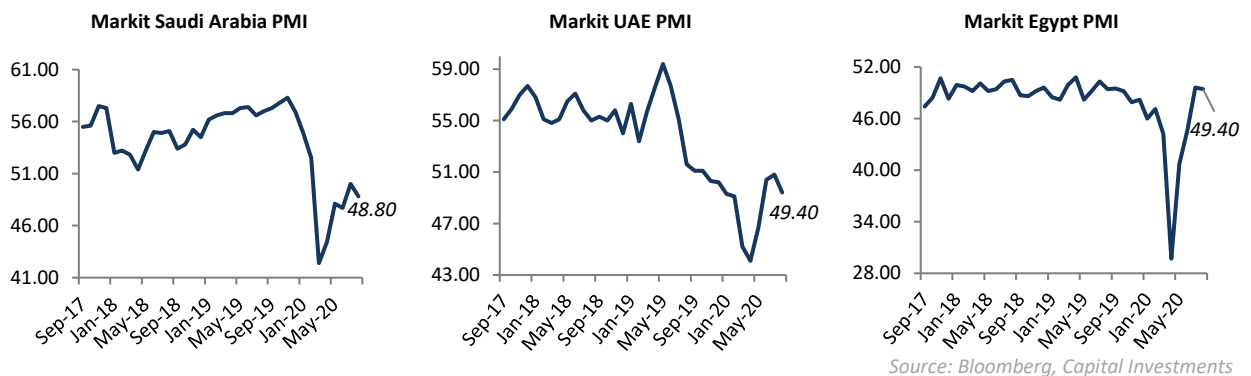
There is a noticeable decoupling between some of the region's equity market movements and actual fundamentals, especially in Saudi Arabia, whereby Tadawul Index is up around 40% from the bottom it reached in March and is trading near its pre-Covid levels. According to SAMA data, Tadawul's traded value almost doubled (91% Y-o-Y) to SAR150bn in August; the flood of local liquidity, low interest rates and lower cost of equity are pushing retail and high net worth investors into stocks despite economic contraction.

Markit Purchasing Managers' Index (PMI) for Saudi Arabia, the UAE and Egypt fell in August and data continues to point to a subdued recovery nearly six months after the outbreak of Covid-19. All three countries reported sub-50 readings, indicating deteriorating business conditions vs. July, although this was mainly driven by continued job losses. However, in Saudi Arabia, activity dropped as well, in contrast to Egypt and the UAE, on the back of the VAT hike on July 1st, 2020.

New orders continued to be in the green for both the UAE and Egypt in August, signifying economic activity continues to recover post Covid-19, though at a softer pace vs. July. In the UAE, domestic demand remained the main driver of the positive output numbers as foreign demand dropped for the second consecutive month. As for Egypt, domestic demand mostly led the decent output numbers, but Foreign demand grew as well on the back of an uptick in tourism. On the other hand, Saudi Arabia showed a drop in new orders, which contracted vs. July, clearly indicating that demand is softening post the tripling in VAT. Considering the weak demand, businesses reduced their capacities, with output lowered for the sixth consecutive month.

In addition, while PMI levels in all three countries are in a similarly contractionary territory, the trajectory of each relative to pre-Covid levels is rather different. Already sluggish pre-Covid growth in the UAE and Egypt has meant that August PMIs are within 1.5 points of their six-month average pre-Covid. On the other hand, Saudi Arabia’s August PMI is almost 8 points down vs. its six-month pre-Covid average, meaning a greater slowdown there than in the other two countries. This reflects the dual impact of lockdown measures and lower oil prices, which have forced the government to cut spending and increase taxes.

Continued job losses is the trend shared by all three countries. Saudi Arabia, the UAE and Egypt reported a drop in employment for the sixth consecutive month, and again, higher unemployment is the main driver of the sub-50 PMI readings this month. Businesses continued to lay off their employees in order to cut costs as demand is still unable to catchup to pre-Covid levels. The UAE recorded the steepest rate of job cuts in the survey’s history. Business sentiment followed suit, falling to the lowest level in history, with numerous firms saying the weak recovery could lead to businesses shutting down. Saudi Arabia and Egypt sustained job losses as well, though at a moderate pace when compared to the UAE. These trends that we have been seeing in the past few months clearly point to a weak economic growth backdrop that is likely to persist for a while. However, we are still committed to the long-term recovery picture and continue to invest in selective opportunities in the region.



Major Indices	Status as of end		Performance	
	December. 2019	September. 2020	September.2020	YTD (30 September. 2020)
MENA				
Abu Dhabi	5,075.77	4,518.06	-0.03%	-10.99%
Bahrain	1,610.18	1,434.49	3.88%	-10.91%
Dubai	2,764.86	2,273.48	1.26%	-17.77%
Egypt	13,961.56	10,989.27	-3.31%	-21.29%
Jordan	1,815.20	1,587.75	0.90%	-12.53%
Kuwait	6,975.96	6,020.84	2.84%	-13.69%
Lebanon	785.56	601.81	0.73%	-23.39%
Morocco	12,171.90	9,987.83	-1.45%	-17.94%
Oman	3,981.19	3,614.64	-4.17%	-9.21%
Palestine	525.96	438.21	-1.74%	-16.68%
Qatar	10,425.51	9,990.39	1.48%	-4.17%
Saudi Arabia	8,389.23	8,299.08	4.51%	-1.07%
Tunisia	7,122.09	6,748.63	-0.30%	-5.24%
S&P Pan Arab Composite	788.75	725.35	2.11%	-8.04%
Dow Jones MENA	605.23	548.44	1.66%	-9.38%
Americas				
Dow Jones Industrial	28,538.44	27,781.70	-2.28%	-2.65%
S&P 500	3,230.78	3,363.00	-3.92%	4.09%
NASDAQ Composite	8,972.60	11,167.51	-5.16%	24.46%
S&P/Toronto Composite	17,063.43	16,121.38	-2.38%	-5.52%
Europe				
EURO Stoxx 50	3,745.15	3,193.61	-2.41%	-14.73%
S&P Europe 350 Index	1,676.79	1,433.23	-1.52%	-14.53%
FTSE 100 Index/ London	7,542.44	5,866.10	-1.63%	-22.23%
FTSE MIB Index/ Italy	23,506.37	19,015.27	-3.15%	-19.11%
DAX Index/ Germany	13,249.01	12,760.73	-1.43%	-3.69%
ASIA/Pacific				
NIKKEI 225/ Japan	23,656.62	23,185.12	0.20%	-1.99%
S&P/ASX 200/ Australia	6,684.08	5,815.94	-4.03%	-12.99%
BRIC				
Brazil/ Bovespa	115,645.30	94,603.40	-4.80%	-18.20%
Russia/ RTS	1,548.92	1,178.51	-6.36%	-23.91%
India/ Bombay Sensitive	41,253.74	38,067.93	-1.45%	-7.72%
China/ Shanghai Composite	3,050.12	3,218.05	-5.23%	5.51%
Hong Kong/ Hang Seng	28,189.75	23,459.05	-6.82%	-16.78%

Source: Bloomberg, Capital Investments

Description	Closing Prices as of end		Performance	
	December. 2019	September. 2020	September.2020	YTD (30 September. 2020)
Commodities (in USD)				
Brent Spot (Barrel)	66.42	40.95	-7.75%	-38.35%
WTI Cushing Spot (Barrel)	61.06	40.22	-5.61%	-34.13%
Natural Gas NYMEX (MMBtu)	2.43	2.53	-13.46%	4.12%
Gold Spot (OZ)	1,517.27	1,885.82	-4.17%	24.29%
Silver Spot (OZ)	17.85	23.24	-17.44%	30.15%
Copper LME Spot (MT)	6,149.00	6,668.00	-0.44%	8.44%
Corn CBOT Active Month (Bushel)	4.03	3.79	5.94%	-5.84%
Wheat CBOT Active Month (Bushel)	5.78	5.78	4.66%	0.04%
Soybean CBOT Active Month (Bushel)	9.79	10.24	7.34%	4.57%
Rough Rice Futures (USD/cwt)	13.14	12.48	-0.12%	-5.02%
Currencies Spot Exchange Rates Against US Dollar				
Euro	1.12	1.17	-1.80%	4.53%
GBP	1.33	1.29	-3.37%	-2.54%
CAD	0.77	0.75	-2.05%	-2.48%
Yen	0.01	0.01	0.43%	3.02%
CNY	0.14	0.15	0.84%	2.53%

Source: Bloomberg, Capital Investments

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