

Monthly Newsletter

November 2nd, 2020

“One never notices what has been done; one can only see what remains to be done.” — Marie Curie Sklodowska

“Worry never robs tomorrow of its sorrow, it only saps today of its joy.” — Leo Buscaglia

Clues from Recent Asset Classes' Behavior

Macro: The Recovery is Pausing

Oil: Double Whammy of Falling Demand and Rising Supply

MENA: Overview of Fixed Income Spreads Before and After Covid-19

Introduction

Choppy trading has been dominating markets since September. However, at the end of October, market participants took notice that Covid-19 is in charge again. The pandemic was intensifying on both sides of the Atlantic. Cases were resurging again, north of 100k per day in the US and around 180k per day in Europe where hospitalization capacity was under pressure. The continuous spread of the pandemic has created challenges and raised uncertainties.

Almost all of Europe has moved into much stricter lockdowns than the targeted measures adopted in the summer. The reopening process has stalled. The second wave is depressing consumer and business confidence. The economic multiplier effect and the velocity of money are curbed, and the momentum of economic activity into Q4 is losing steam.

More pessimism was injected as news emerged that the vaccine trials are facing hiccups and improvement in therapies is not progressing. Winter is coming and the transmission rates of the virus are rising again. The economy is on the back foot again after a stellar rebound in Q3. Social distancing is the modus-operandi, welcome again to the “mask” economy.

Investors are factoring in a delay in recovery and new stimulus. As a result, liquidity pressure will re-emerge, insolvencies could rise, and earnings outlook could be downgraded. Such an adverse scenario is entailing a tightening of financial conditions and repricing of risk across equity and credit markets, to name a few.

Concerns over the US elections outcome is mounting and adding to the uncertainty. Equity markets are worried of a contested presidency. On the other hand, polls are indicating that Democrats may take the Presidency, the House and the Senate. The US government bond market is taking a notice and long-term yields are rising in anticipation of increased treasury supply and an extra stimulus package. Climbing yields meant the “death of bonds as a hedge” in turbulent times and marked the disconnect with equities.

We are not fully sheltered from the turmoil taking place in markets. We continue to think that the approval of a vaccine and the results of the US elections are binary events, thus strict prepositioning might be challenging. We prefer to have an all-weather portfolio. We like to capture long term trends, avoid stretched valuations, follow stimulus packages and identify positive inflection points. We have a very limited exposure to tech on valuation grounds, we are adding our exposure to Europe, notably Germany along with a few renewable plays. We are getting exposure to emerging markets through proxies meaning companies with economic exposure there. We are currently playing China and the US through investments in mining and infrastructure plays. We continue to be big fans of gold and silver miners. We have a limited exposure to the MENA region, however, markets' retreat is starting to provide opportunities to companies with a decent growth profile, healthy cashflow, fair dividends and a potential for growing market share.

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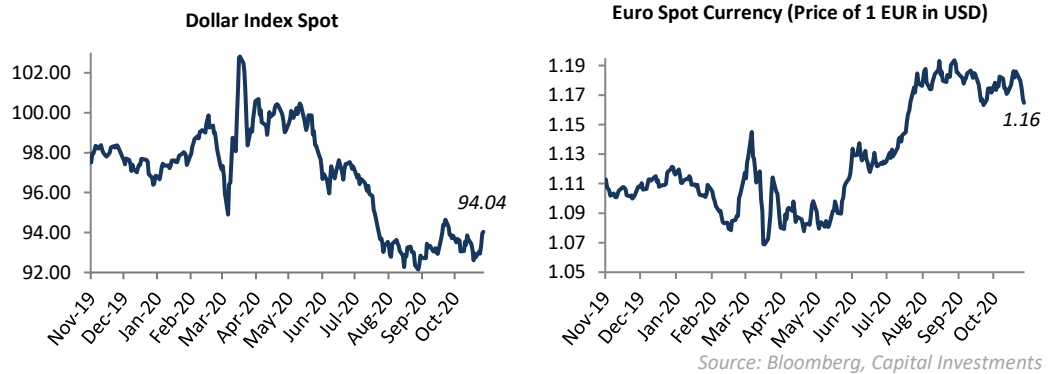
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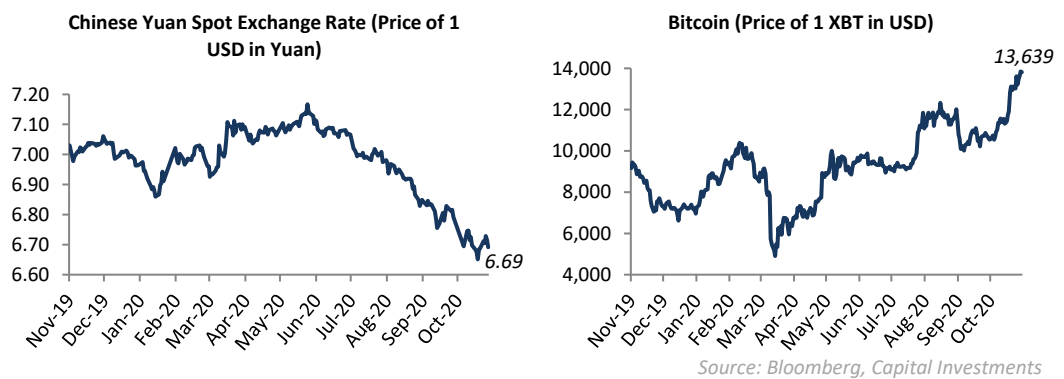
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Clues from Recent Asset Classes' Behavior

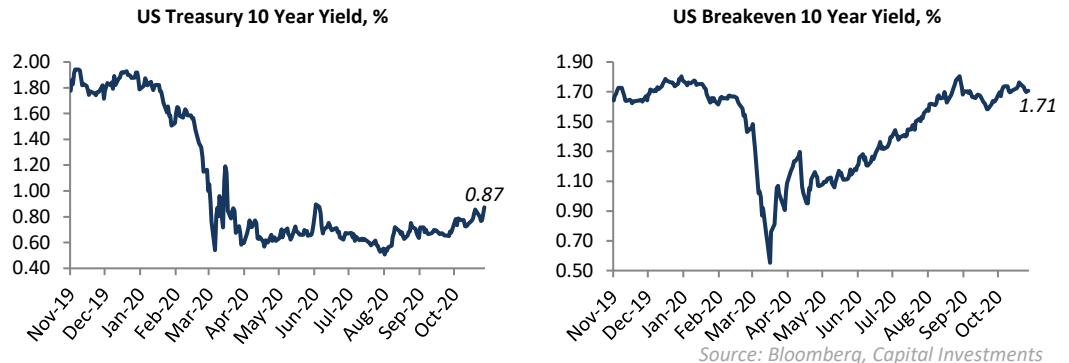


Uncertainty over the US elections coupled with the re-imposition of lockdowns in Europe lent some support to the USD which acted as a safe haven without breaking up meaningfully. The Euro has stopped its ascent and retreated on expectations of stalling economic activity in the old continent but did not break below the 1.15 level. We think that the ECB will increase its asset purchases in December which will tame European sovereign yield spreads and thus lend support to the Euro. It is worth mentioning that yields on both Italy and Greece did not exhibit signs of stress despite the lockdowns. Germany, from a fiscal perspective, is in a far better position than the US when we look at debt to GDP or fiscal deficit. The European recovery fund is still in place and would help putting a floor under the Euro.

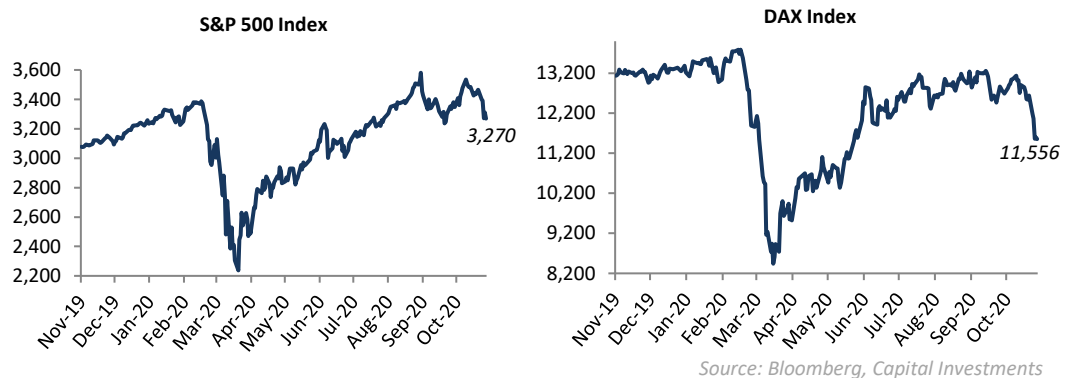


China seemed unhappy lately with the appreciation of the Yuan as it took certain measures related to banks' reserve requirements with regards to currency derivatives trading, which may allow some weakness in the Yuan. Bitcoin broke upwards on the back of news that PayPal will allow bitcoin and crypto spending, and on the news that China and Europe are going to launch digital Yuan and Euro, proving that the technology behind cryptocurrencies is gaining ground. It is worth mentioning that

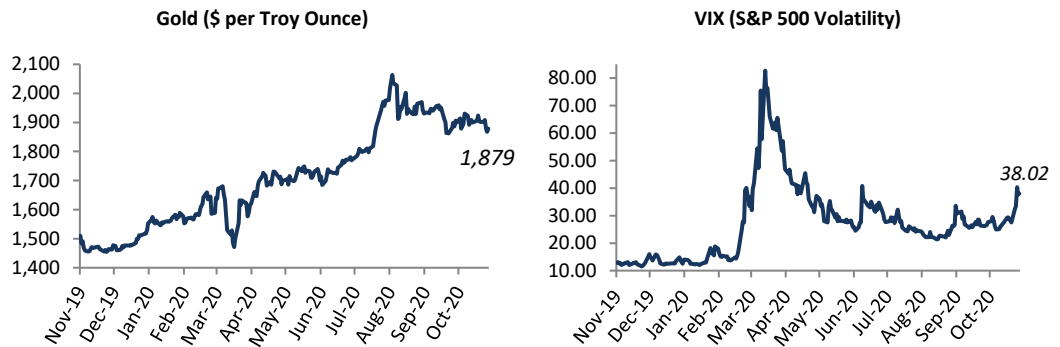
cryptos are a good hedge against currency debasement and it is evident that their correlation with gold has cracked as they recently moved in opposite directions.



US long-term yields are pricing in that Democrats will win the election and a huge supply of treasuries is coming, which is pushing yields higher. Therefore, it is not growth nor inflation that are driving yields at the moment. We have been emphasizing for a while in our Weekly Fixed Income Newsletter that investors should be cautious with regards to long term duration.



We are in favor of Europe and particularly Germany as the US markets are overvalued in comparison to their European counterparts especially when it comes to Tech. We understand that Europe is more of a cyclical and value play, but it is currently being offered at a cheaper price with a relatively good outlook. In the US we are interested in infrastructure plays and agribusiness investments.

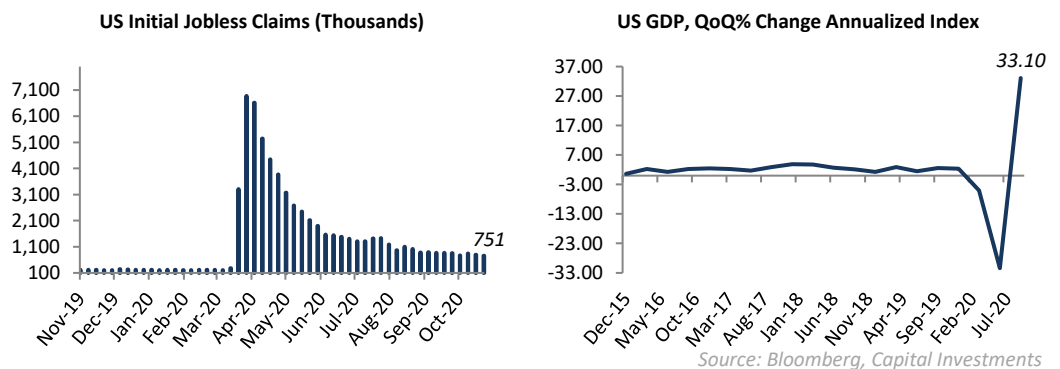


Source: Bloomberg, Capital Investments

The VIX index, which is a gauge of fear in the market, spiked on the news of lockdowns in Europe, however the future curve points toward a less stressed scenario as it is in backwardation meaning the equity market is not concerned about a contested US presidential election. Gold is being trapped by a strong USD and relatively rising US long-term real yields from -1.1% to -0.87%. We think current levels are an opportunity to accumulate for long-term buyers especially in miners related to gold and silver.

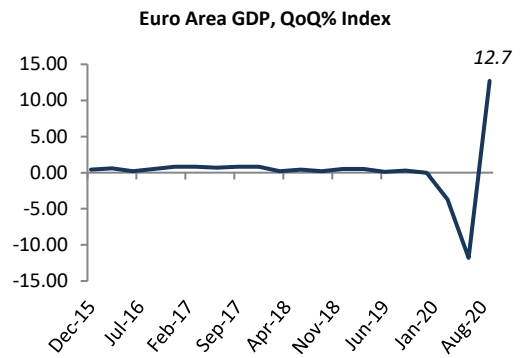
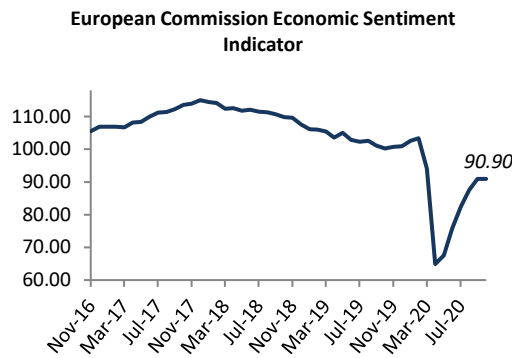
Macro: The Recovery is Pausing

In addition to the usual macro update, we include at the end of this section a table showing the different policies to be adopted by Trump and Biden in relation to various issues.



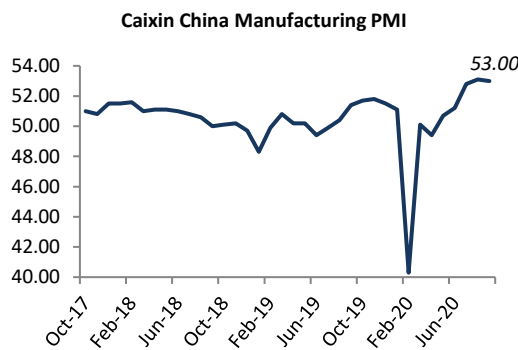
Source: Bloomberg, Capital Investments

US GDP rebounded sharply in Q3 2020 by an annualized figure of 33.1% showing that a combination of stimulus packages and reopening of the economy has supported economic activity. Jobless claims are moving in a downward trend, retail sales and durable goods are on an encouraging trajectory along with housing and manufacturing PMI. However, more stimulus is needed to restore growth and income to pre-Covid-19 levels.



Source: Bloomberg, Capital Investments

In Europe the intensification of the pandemic is weighing on consumer sentiment and thus the mobility index. This will cause economic activity to lose steam into Q4 2020 after a strong rebound on a quarterly basis (not annualized). We expect that in 3 weeks the virus curve will begin to flatten, and the ECB will provide extra stimulus that will keep yields at bay and will support fiscal expansion.



Source: Bloomberg, Capital Investments

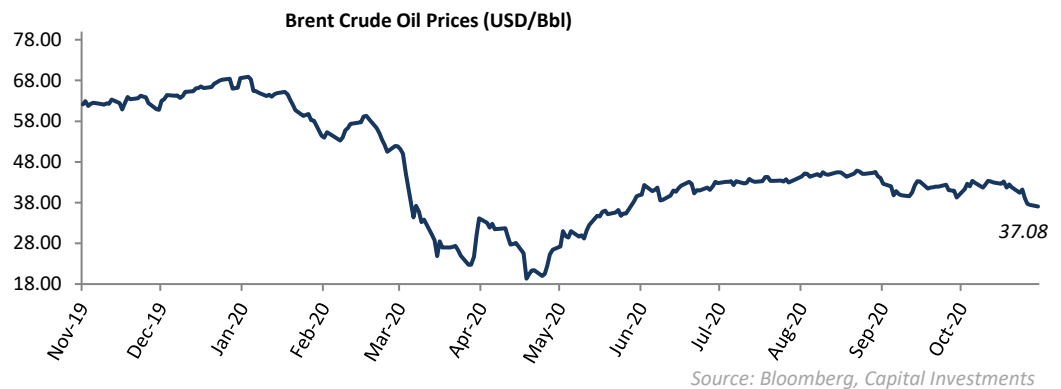
In China, the recovery is notable without a vaccine and without the threat of a second wave. The recovery was based on revival in exports (external demand) and a credit stimulus targeting real estate and infrastructure. The governing party in China had its plenum to agree on the new 5-year plan which emphasized on growing domestic demand, reforms and self-reliance.

Box 1: Biden Vs. Trump... Policy Issues

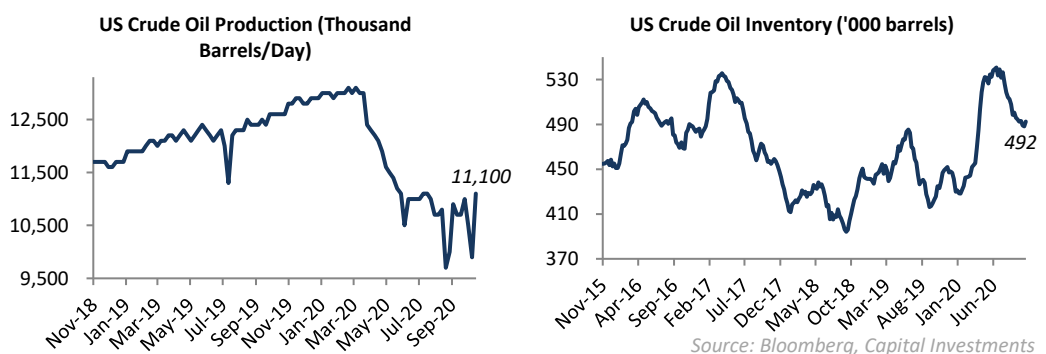
	Biden	Trump
Tax	Plans to reverse many of Trump's tax cuts for the wealthy and corporations to fund, in part, costly climate, education and health-care plans. Biden said he would not increase taxes for anyone earning less than \$400,000	Expanding existing tax breaks, creating credits for specific industries and activities, and unspecified tax cuts for individuals. Supports changes related to capital gains and middle-class tax cuts.
Infrastructure Bill	Plans to create millions of good, union jobs building and upgrading a cleaner, safer, stronger infrastructure for all Americans- including smart roads, water systems, municipal transit networks, schools, airports, rail, ferries, ports, and universal broadband access- whether they live in rural or urban areas INVESMTNET IMPLICATIONS: Buy US Materials & Industrials Equities plus Base Metals	Infrastructure policy includes ensuring U.S. energy independence, safeguarding the cybersecurity of the national power grid and other critical infrastructure, and rolling back regulations to ease the process of planning and construction.
Economy	Biden backed the final version of the United States-Mexico-Canada Agreement, although his campaign said he does not think it is ideal. Supports a minimum wage of \$15 an hour, as well as ending the lower minimum wages for tipped workers and people with disabilities. INVESMTNET IMPLICATIONS: Buy Consumer Discretionary stocks due to higher minimum wage ,keep an eye on inflation	Trump won bipartisan support for the revamped trade agreement, fulfilling his campaign pledge to rework the North American Free Trade Agreement. Trump hinted at possible action on the minimum wage in July and expressed openness to \$15 an hour in 2019.
Climate/Environment	Introduced a \$2 trillion plan to fight climate change that pledges to eliminate carbon emissions from the electric sector by 2035, impose stricter gas mileage standards, and fund investments to weatherize millions of homes and commercial buildings and upgrade the nation's transportation system INVESMTNET IMPLICATIONS: Buy Clean Energy Stocks	Dismissed the science behind climate change, announced U.S. withdrawal from the Paris climate accord and heavily promoted the fossil fuels linked to rising temperatures. Trump began the process of withdrawing the United States from the climate accord.
Healthcare/Coronavirus	Plans to institute a national mask mandate. Biden routinely wears a mask when he appears at public events. Biden said he would adopt nationwide testing and contact tracing. INVESTMENT IMPLICATIONS: BUY Healthcare socks on status quo policies	Intends to withdraw from the World Health Organization over what he called the group's "China-centric" coronavirus response. Trump opposes a national requirement for mask-wearing and has been seen many times in public without wearing a mask
Foreign policy	Opposes annexation of the West Bank. Biden said the embassy should not have been moved. Biden says Trump's withdrawal prompted Iran to restart its nuclear program. Biden called for the United States to end its assistance to Saudi Arabia for its war in Yemen. INVESMTNET IMPLICATIONS: -Buy/Overweight EM Asian Equities and Currencies -Sell Brent crude vs WTI on possible restart of Iran nuclear deal and resumption of Iranian crude exports	Trump's Middle East peace proposal allows for Israeli annexation of portions of the West Bank. Trump upended decades of U.S. policy by formally recognizing Jerusalem as the capital of Israel and ordering the relocation of the U.S. Embassy to that city. The trade war has been the centerpiece of Trumps trade policy In fact, Trump promises to always put America first in all dealings and has placed an extremely high trade deficit due to the fact that he believes some countries are unfairly taxing American companies overseas INVESMTNET IMPLICATIONS: Sell/Underweight EM Asian Equities and Currencies

Oil: Double Whammy of Falling Demand and Rising Supply

Oil prices are testing the lower end of their recent trading range as the double whammy of falling demand and rising supply keep prices in check.

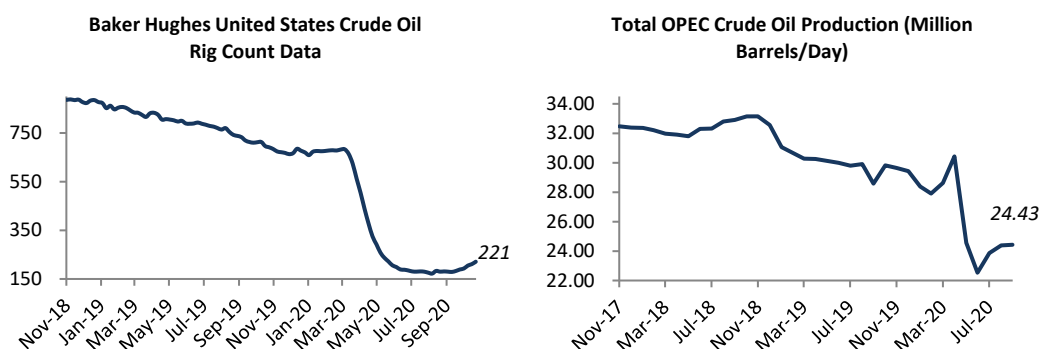


New lockdown measures in Europe and rising cases in the US have raised concerns, once again, over the recovery in oil's demand. The IEA has stated that the oil market will suffer a long-lasting impact from the coronavirus, with consumption not returning to pre-crises levels before 2023 provided that the virus is brought under control in 2021. The agency also reinforced its view that global oil demand will plateau around 2030. The infection of President Trump with Covid-19 also weighed negatively on prices in the month of October. On a brighter note, demand from Asia is showing some signs of recovery, whereby Chinese oil imports rose 2.1% MoM in September.



Meanwhile, on the supply side, Libya lifted the force majeure on its Ras Lanuf and Es Sider ports and oil output will surpass 1 million barrels a day in four weeks, adding another headache to OPEC+ as

they try to bring some balance into the market. The group has recently warned of a precarious outlook for the market as the virus resurges across the globe, and have therefore pledged action to support oil prices, including the possibility of reversing January's output increases. The group will face some tough decisions regarding their output cuts when they meet at the end of this month. Moreover, oil workers in Norway have called off a strike that had shut down about 8% of the country's production, also weighing negatively on prices. To add fuel to the flames, US crude-oil inventories climbed by 4.3 million barrels last week versus an analyst forecast of 1.23 million barrels, the biggest increase since late July.



Source: Bloomberg, Capital Investments

The oil market faces great uncertainty and the risk seems to be to the downside. A stronger USD also continues to pressure prices, however, any progress on the vaccine or stimulus bill will offer some relief.

Box 2: Carbon Neutral Policies

A growing number of policy makers are setting targets to end their contribution to climate change; more than 60 countries are aiming to reduce carbon emissions to net-zero by 2050.

- **United States:** Mr. Joe Biden plans to spend **\$2trn over four years** on low-carbon infrastructure and energy, He plans to reach **net-zero emissions by 2050 and emissions-free electric power by 2035**.
- **China:** China's leader, Xi Jinping, pledged to speed up reductions in emissions in the world's top-polluting nation and **reach carbon neutrality by 2060**. The country would also adopt "more vigorous policies and measures" to **peak emissions before 2030**.
- **European Union:** At the start of the year, the EU announced a European Green Deal. The deal looks to **invest €1 trillion over the next 10 years to transform the EU into a climate-neutral economy by 2050**. The EU's green ambitions were further boosted over the summer after EU member states agreed on a **€750 billion Covid-19 pandemic recovery fund (2021-2024)**, some **€225 billion will be available in the form of "green bonds" to help promote a green recovery**. Nearly all EU member states (26 of 27) have officially released their **National Energy Plans (NEPs)**, which **establish a decarbonization roadmap for Europe through to 2030**. The EC has declared that **about half of these plans are already aligned with Green Deal decarbonization targets (a 50%-55% reduction in carbon emissions by 2030, vs. 1990)**, whilst the remainder are compliant with existing goals (**-40% by 2030**).
- **Japan:** The center-right cabinet approved a plan setting "**a carbon-neutral society as the final goal and seeking to realize it at the earliest possible time in the latter half of this century**". Japan commits to commercializing carbon capture and utilization (CCU) technology by 2023, and carbon capture and storage (CCS) used in coal-fired power generation by 2030.
- **Canada:** Government of Canada announced commitments to further strengthen existing and introduce new greenhouse gas reducing measures in order to **exceed Canada's current 2030 emissions reduction goal**. In addition, Canada will develop a plan to achieve **net-zero emissions by 2050** and will set legally-binding, **five-year emissions reduction milestones**.
- **India:** under the Paris agreement on climate change, **India has promised to ensure that 40 percent of its electricity-generation capacity comes from non-fossil fuel sources by 2030**. It will also reduce its "emissions intensity" — a ratio of total emissions to gross domestic product — by at least one-third compared with 2005 levels. **India has increased its solar-energy capacity more than twelvefold since 2014 and launched initiatives to save electricity**.

We are positive on the long-term theme of clean energy and display below a few potential investments



MENA: Overview of Fixed Income Spreads Before and After Covid-19

Table 1: MENA High Yield* Bonds

Bond	Moody's Credit Rating	Z-Spread Before Covid-19	Z-Spread After Covid-19	Difference
Jordan 26	B1	358.4	473.1	114.7
Jordan 47	B1	508.2	627.1	118.9
Oman 27	Ba3	406.5	591.1	184.6
Oman 47	ba3	519.6	677.3	157.7
Bahrain 27	B1	360.6	475.7	115.1
Bahrain 44	B1	417.9	532.3	114.4
Egypt 26	B2	423.7	569.0	145.2
Egypt 49	B2	602.6	852.6	250.0
Tunis 25	B2	586.5	763.2	176.7
Iraq 23	Caa1	432.7	841.3	408.6

Source: Bloomberg, Capital Investments

Table 2: MENA Investment Grade** Bonds

Bond	Moody's Credit Rating	Z-Spread*** Before Covid-19	Z-Spread After Covid-19	Difference
Kuwait 27	AA	74.3	101.2	26.9
Qatar 26	Aa3	86.5	104.8	18.3
Qatar 49	Aa3	175.8	199.0	23.2
KSA 26	A1	114.5	130.9	16.4
KSA 46	A1	204.5	241.4	36.9
Abu Dhabi 49	Aa2	142.1	180.1	38.0
Abu Dhabi 27	Aa2	150.3	103.1	-47.2
Sharjah Sukuk 29	Baa2	150.3	207.4	57.0

Source: Bloomberg, Capital Investments

*High yield bonds (junk bonds) – defined as bonds/sukuk rated below BBB– or Baa3 by by Standard and Poor's, Moody's, or Fitch.

**Investment grade- refers to the quality of a company's credit. To be considered an investment grade issue, the company must be rated at 'BBB' or higher by Standard and Poor's, Moody's, or Fitch.

***Z-spread is the constant spread that makes the price of a security equal to the present value of its cash flows when added to the yield at each point on the spot rate Treasury curve where cash flow is received.

In this month's newsletter, we highlight the average difference in Z-spread levels before and after Covid-19, measuring the effect on the High Yield (HY) and Investment Grade (IG) bonds in the MENA region.

The average difference in MENA HY spreads before and after Covid-19 is 180bps, while the average difference in MENA IG spreads, excluding Dubai, is 31bps. It can be noticed that the widening in spreads for HY sovereign bonds was larger as their economies were severely hit by the pandemic, while the IG sphere coped better mainly due to fact that they have stronger balance sheets and enjoy

healthier fiscal buffers, which helped them weather the storm. Additionally, the FED's action to support US IG bonds has indirectly supported the IG universe across the world by curbing the credit risk.

As shown in table 1, the MENA HY is trading at wider spreads than before the pandemic. This implies that the market is already pricing a one notch credit downgrade and is seeing through a widening in credit risk, which is fair in our opinion, as most countries in the high yield cluster will face a tough ride in 2021 due to deteriorating economic conditions.

Moving towards 2021, EM and MENA High Yield countries will be under radar. In fact, investors will be focusing on idiosyncratic factors and key KPIs such as fiscal deficit as a percentage of GDP, debt to GDP, inflation, current account as a percentage of GDP and medium-term GDP growth. The ability of each country to navigate smoothly across these trajectories will ensure an easy access to international markets to finance the expected deficit. We hope that the G20 initiative in relation to debt relief and the largess of monetary policies adopted by major central banks coupled by IMF programs targeting those countries may help avoiding contagious effects in times of stress.

For illustration purposes, it is noticed that low rated countries such as Oman, Egypt, Tunis and Iraq were severely impacted by the pandemic. For example, Oman's current spreads imply that the country is trading at a credit rating of B, although the sovereign composite credit rating is B+. This attitude can be attributed to a worsening fiscal balance and potential high debt levels and it is an indication of the difficult fiscal trajectory for Oman in 2021 should oil prices continue to be depressed. However, it is worth mentioning that Oman received 1\$bn in aid from Qatar and this should indeed provide support and thus a cushion. In the case of Iraq, low oil prices, political noises and poor economic policies are the main reasons behind the spread widening, however the country has decent pile of reserves which will help it to navigate the storm. Moving to North Africa, Tunisia is strongly linked to the EU, therefore, the latest lockdown measures in the old continent weighed on Tunisia's current account through the trade and tourism channels. Tunisia is adopting a floating currency regime which is helping it in shoring up its reserves yet Tunisia will still have to tap the international markets next year to fund the deficit and investors will scrutinize its numbers further in absence of aid when assessing the attraction of its bonds. As for Egypt, we believe the spread widening is due to political factors, as the economy will grow this year and the years after. In a nutshell, we think MENA HY sovereign bonds are reflecting the abovementioned risks at these levels, further accommodation by large central banks, a vaccine approval and better economic growth should support these high yielders.

Major Indices	Status as of end		Performance	
	December, 2019	October, 2020	October, 2020	YTD (31 October, 2020)
MENA				
Abu Dhabi	5,075.77	4,494.75	-0.52%	-11.45%
Bahrain	1,610.18	1,430.84	-0.25%	-11.14%
Dubai	2,764.86	2,252.91	-0.90%	-18.52%
Egypt	13,961.56	10,987.19	-0.02%	-21.30%
Jordan	1,815.20	1,585.92	-0.12%	-12.63%
Kuwait	6,975.96	6,020.84	0.00%	-13.69%
Lebanon	785.56	621.08	3.20%	-20.94%
Morocco	12,171.90	9,987.06	-0.01%	-17.95%
Oman	3,981.19	3,614.64	0.00%	-9.21%
Palestine	525.96	436.36	-0.42%	-17.04%
Qatar	10,425.51	9,910.72	-0.80%	-4.94%
Saudi Arabia	8,389.23	8,284.34	-0.18%	-1.25%
Tunisia	7,122.09	6,555.10	-2.87%	-7.96%
S&P Pan Arab Composite	788.75	707.15	-2.51%	-10.35%
Dow Jones MENA	605.23	538.54	-1.81%	-11.02%
Americas				
Dow Jones Industrial	28,538.44	26,501.60	-4.61%	-7.14%
S&P 500	3,230.78	3,269.96	-2.77%	1.21%
NASDAQ Composite	8,972.60	10,911.59	-2.29%	21.61%
S&P/Toronto Composite	17,063.43	15,580.64	-3.35%	-8.69%
Europe				
EURO Stoxx 50	3,745.15	2,958.21	-7.37%	-21.01%
S&P Europe 350 Index	1,676.79	1,359.51	-5.14%	-18.92%
FTSE 100 Index/ London	7,542.44	5,577.27	-4.92%	-26.05%
FTSE MIB Index/ Italy	23,506.37	17,943.11	-5.64%	-23.67%
DAX Index/ Germany	13,249.01	11,556.48	-9.44%	-12.77%
ASIA/Pacific				
NIKKEI 225/ Japan	23,656.62	22,977.13	-0.90%	-2.87%
S&P/ASX 200/ Australia	6,684.08	5,927.58	1.92%	-11.32%
BRIC				
Brazil/ Bovespa	115,645.30	93,952.40	-0.69%	-18.76%
Russia/ RTS	1,548.92	1,066.60	-9.50%	-31.14%
India/ Bombay Sensitive	41,253.74	39,614.07	4.06%	-3.97%
China/ Shanghai Composite	3,050.12	3,224.53	0.20%	5.72%
Hong Kong/ Hang Seng	28,189.75	24,107.42	2.76%	-14.48%

Source: Bloomberg, Capital Investments

Description	Closing Prices as of end		Performance	
	December, 2019	October, 2020	October, 2020	YTD (31 October, 2020)
Commodities (in USD)				
Brent Spot (Barrel)	66.42	36.90	-9.89%	-44.44%
WTI Cushing Spot (Barrel)	61.06	35.79	-11.01%	-41.39%
Natural Gas NYMEX (MMBtu)	2.60	3.35	7.60%	28.85%
Gold Spot (OZ)	1,517.27	1,878.81	-0.37%	23.83%
Silver Spot (OZ)	17.85	23.66	1.81%	32.51%
Copper LME Spot (MT)	6,149.00	6,707.50	0.59%	9.08%
Corn CBOT Active Month (Bushel)	4.03	3.99	5.15%	-0.99%
Wheat CBOT Active Month (Bushel)	5.78	5.99	3.55%	3.59%
Soybean CBOT Active Month (Bushel)	9.81	10.56	2.82%	7.64%
Rough Rice Futures (USD/cwt)	13.14	12.53	0.40%	-4.64%
Currencies Spot Exchange Rates Against US Dollar				
Euro	1.12	1.16	-0.63%	3.87%
GBP	1.33	1.29	0.21%	-2.34%
CAD	0.77	0.75	0.01%	-2.47%
Yen	0.01	0.01	0.76%	3.80%
CNY	0.14	0.15	1.48%	4.05%

Source: Bloomberg, Capital Investments

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