

## Monthly Newsletter

March 4<sup>th</sup>, 2021

*"Success breeds complacency. Complacency breeds failure. Only the paranoid survives."* — Andy Grove

*"Maybe love is always forgiveness, to a degree."* — Joyce Carol Oates

### Clues from Recent Asset Classes' Behavior

#### Macro: Uneven Global Recovery

#### Oil: Remarkable Recovery

#### MENA: Consumer Spending Remains Soft in Saudi Arabia

### Introduction

Covid-19 infections and hospitalization are on a downward trend globally. Some reports mentioned that daily infections have peaked at 880k in January and now stand below 300k. Approval of new vaccines is the trend and deployment of the jab is moving in the right direction despite some missteps. Governments are easing restrictions gradually and mobility is picking up.

The world economy is moving through a vaccine-led recovery. This is supported by around USD 30trn in stimulus packages launched globally without including the USD 1.9trn under processing in the US. Fiscal expansion with a focus on infrastructure and green economy or climate change will boost aggregate demand and create jobs amid highly accommodative Central Banks.

This optimistic backdrop explains the bullish sentiment across markets. The excessive euphoria means that risky assets trading at high valuations are vulnerable to any sudden disappointments, be they hiccups in the recovery, the vaccine, or central banks' accommodation to name a few.

Vulnerabilities are demonstrated through the frequent spikes in the VIX index, which is a gauge of fear or volatility since September 2020. This is an illustration of a new trend of co-habitation between bullish sentiment in markets and frequent setbacks.

Inflation is another factor that investors should watch closely. It is understood that declining population growth and lack of productivity were behind the disinflationary trends in the past years. However, this time, market participants must pay attention to the outstanding fiscal stimulus which will be driving aggregate global demand from a lower base in 2020. Commodity prices are on the rise and supply disruption and rising shipping costs will lead to inflationary pressures. These will be amplified by the growth in money supply and rising velocity of money once mobility is unleashed at a larger scale.

This led us to factor in a new regime shift in yields which broke up significantly higher recently driven by inflationary and growth expectations. Market participants priced at a certain point an early tapering of asset purchases by central banks and a hawkish interest rate outlook. The recent rise in short term US nominal and real yields was a crystal depiction of this fear that pulled most asset classes and put high valuations in check.

We subscribe to the notion that we are in a regime shift regarding higher inflation and higher interest rates. However, dealing with a huge mountain of debt would require governments to engineer growth to service the interest burden but more importantly central banks will play a large role in calibrating the cost of debt through verbal intervention, or different types of yield curve control. Once a country has a large fiscal deficit, the only way through is to inflate the financial system to inflate the debt away and to keep the interest burden at bay along with debasing the currency, a process that could not easily be reversed.

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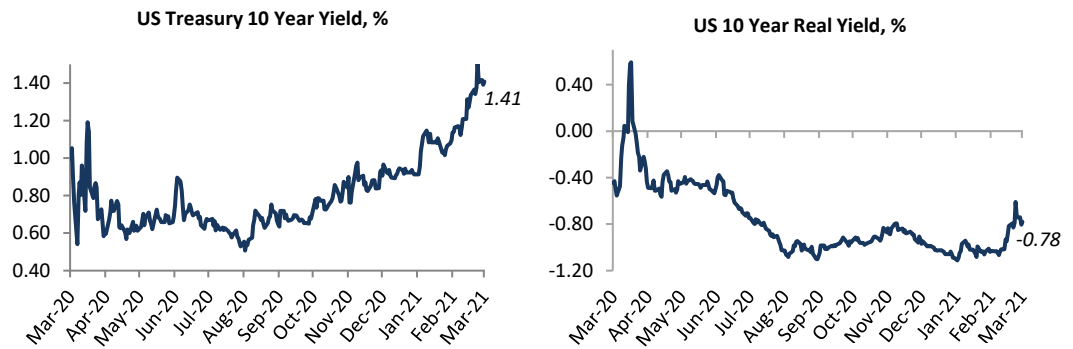
This report must be read with the disclaimer at the end of the report.

We are positioning portfolios to have a reflation twist or bias in sectors that are inflation sensitive such as selective emerging markets, energy, commodities, infrastructure, and financials. In addition, we will be looking into beaten up industries that shall benefit from operating leverage as the economy reopens and the recovery gains track; these sectors include leisure and hospitality along with restaurants and transportation. At the same time, we prefer to be positioned in companies that are subscribed to new global trends related to the green economy or the 5G rollout globally such as semiconductors. Despite the deep hit taken by the gold and silver miners recently, we continue to be constructive on both.

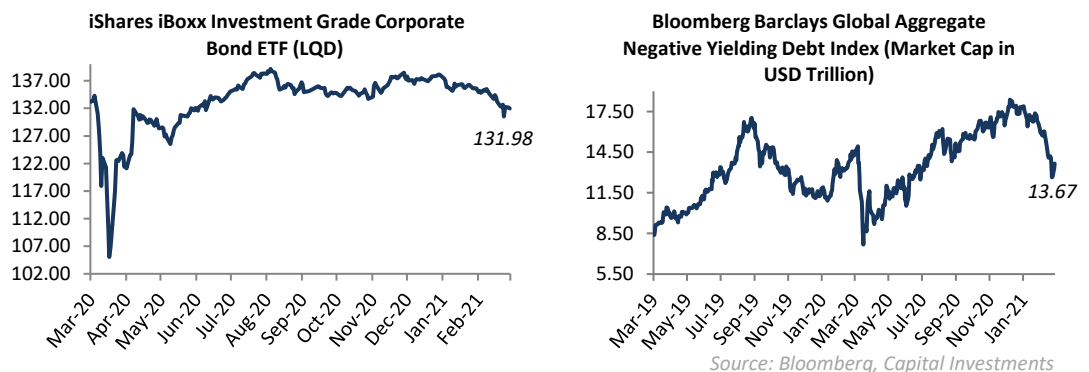
### Clues from Recent Asset Classes' Behavior



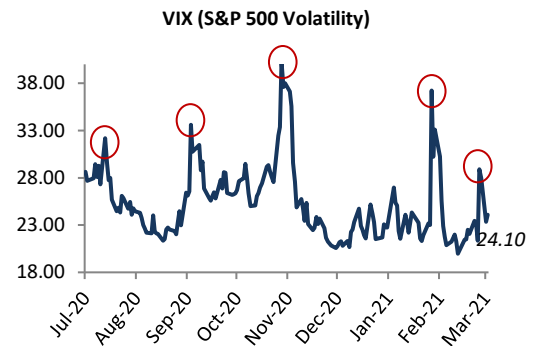
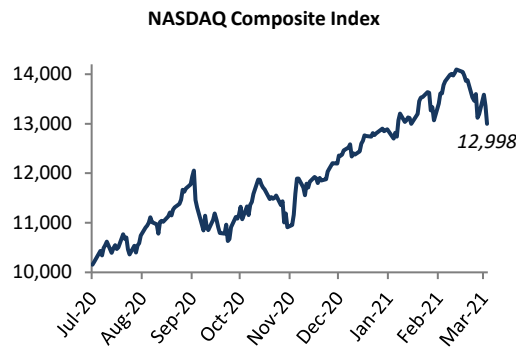
Despite the rise in US long term yields by around 40bps during the past month and a retreat in equity markets, the green back did not strengthen as expected during a flight to safety moment. In fact, the US dollar index or DXY gained some momentum when market participants started to price an early exit by the Fed from easing policy as indicated by the spike in short term yields. Notably, the 5-year US nominal and real yield climbed substantially before retreating recently on Fed members' comments and commitment to asset purchases. Other tailwinds include potential cyclical growth driven by the new stimulus and quicker return to normalcy vis a vis Europe. Emerging market currencies did not retreat significantly amid the turmoil. We think the USD is becoming an important barometer in relation to the next monetary policy action and might be indicating that the Fed will embark on a form of yield control.



Inflationary expectations driven by more stimulus and reopening drives pushed the US 10-year yield higher. It is worth noting that it has climbed from 0.5% in August 2020 to around 1.4% with around a 0.5% spike only in the past 45 days. Long-term real yields got less negative as a result but could not cross the -0.6% level. We think that real yields will continue to be negative as long as the Fed is in an asset purchase mode. The Fed will maintain its dovish stance and would allow inflation to overshoot 2% as per their new policy of average inflation target and would calibrate the rates' volatility to ensure a functioning treasury market and affordable interest rates to fund the fiscal deficit. However, the Fed will raise its bar before jumping into a full-fledged yield curve control policy similar to Australia or Japan.

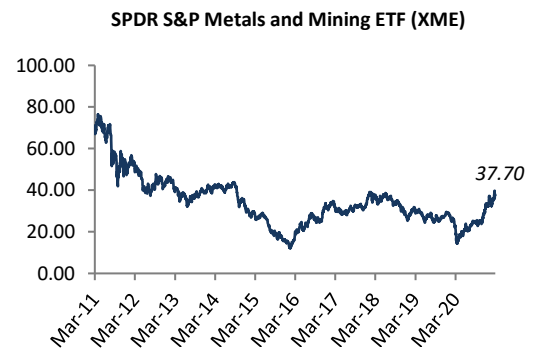
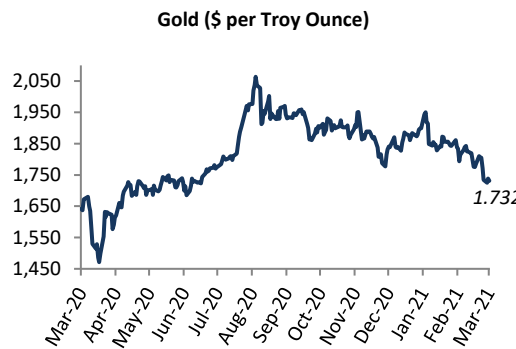


As a result of rising sovereign yields, investment grade bonds ETFs suffered, but the plunge was noticeable at the level of negative yielding debt which dropped from a peak of USD 18trn to USD 13.67 trn back to pre-pandemic levels, paving the way for a regime shift toward rising interest rates and a rotation towards the reflation trade.



Source: Bloomberg, Capital Investments

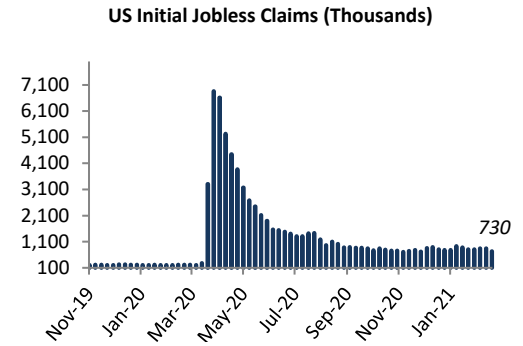
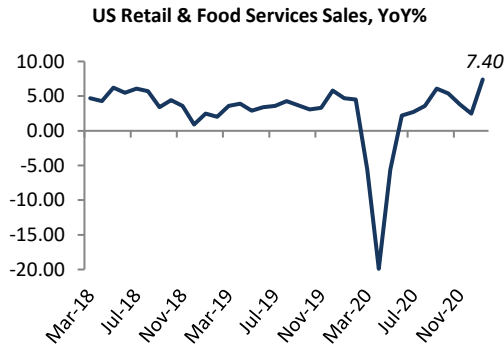
Long-term US yields bottomed in August 2020 and since then they are on an upward trend led by vaccine approvals and deployment and reopening and stimulus. Spikes in yields were coupled with jumps in the VIX and equity market retreats. Investors should expect a volatile investment journey in 2021.



Source: Bloomberg, Capital Investments

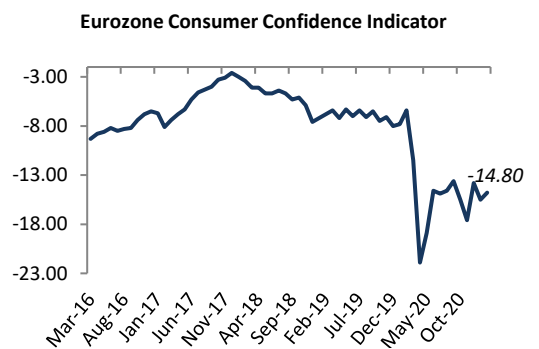
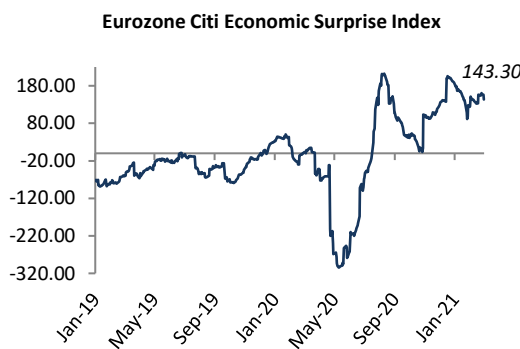
The Metal and Mining ETF is a good expression of the reflation trade which is trying to break decisively above a key resistance as the recovery gains momentum. As for gold, it got vaccinated earlier than covid-19 through the spike in real yield, although the decline in gold was less acute than the spike in yields. Levels of 1700 for gold may pave the way for consolidation and offer further opportunity to accumulate. A breakdown in the USD is key for gold to go higher.

### Macro: Uneven Global Recovery



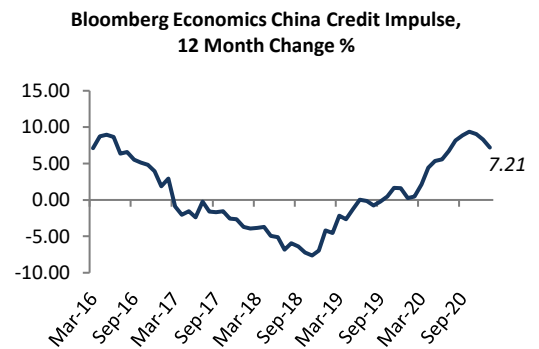
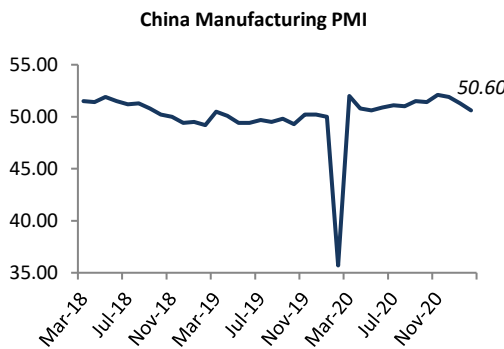
Source: Bloomberg, Capital Investments

Backed by stimulus plans that include income transfer and encouraging signs related to vaccine deployment that is supporting reopening, the US economy is printing encouraging economic reports ranging from retail sales, to durable goods, passing by a falling jobless claims trend which all confirm the recovery trajectory.



Source: Bloomberg, Capital Investments

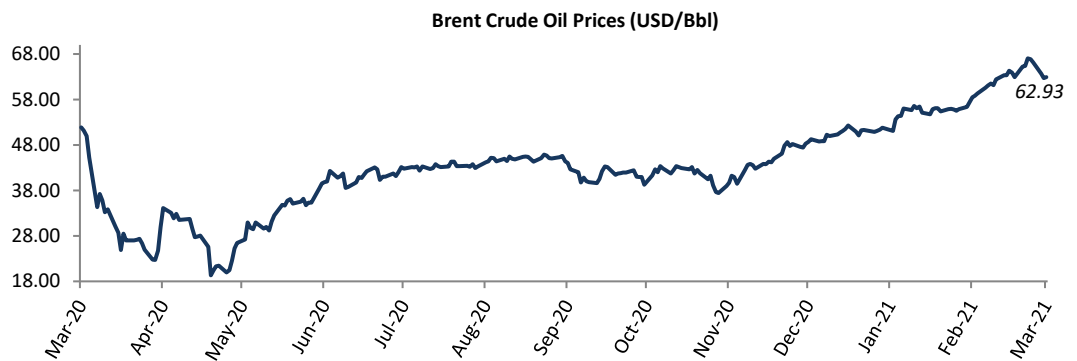
Europe clearly shows that the global economic recovery is not synchronized. Europe is facing delays in vaccine rollouts along with postponement in reopening the economies, which explains why the old continent is behind the US and Asia and will gain steam towards the mid of Q2 2021.



Source: Bloomberg, Capital Investments

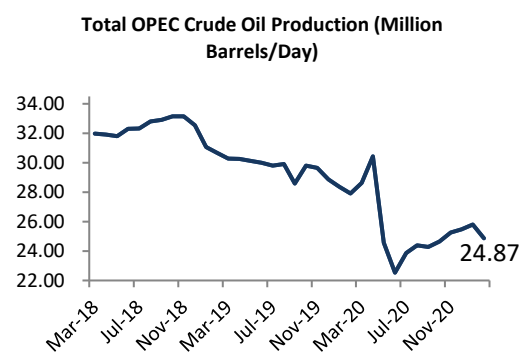
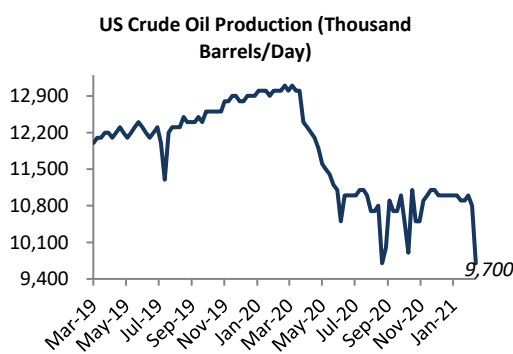
In China, where the pandemic was controlled early on and targeted stimulus measures were employed, the economy is showing some signs of cooling off as indicated by the weakness in PMI data and a peak in credit impulse.

### Oil: Remarkable Recovery



Source: Bloomberg, Capital Investments

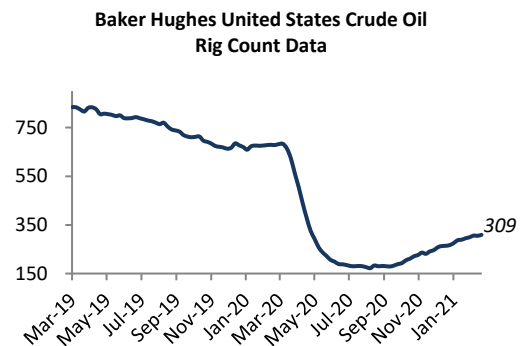
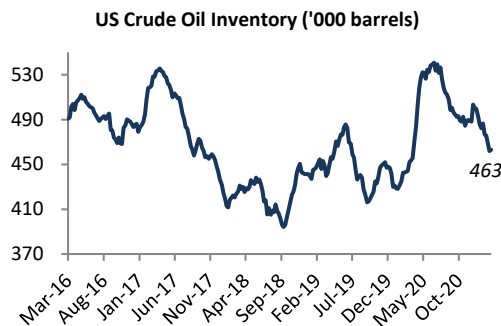
One year after the first signs of the catastrophe awaiting global oil markets emerged, crude is staging a remarkable recovery. The crisis triggered by the coronavirus was the worst the industry has ever seen, however, futures rallied 20% in the month of February as Chinese consumption surpasses pre-virus levels, the vaccine rollout restores confidence, and the OPEC + alliance curb supply. The crude glut that piled up during the pandemic is vanishing and global inventories are plunging at a steep rate, expanding Brent oil's time spread to the widest backwardation in more than a year which signals a tight market.



Source: Bloomberg, Capital Investments

Oil prices were further boosted in February by an energy crisis in the U.S that disrupted crude production and forced the shutdown of some of the nation's biggest refineries. The crisis took out almost 40% of US crude production, equivalent to more than 4 million barrels a day. The timeline for a full restoration of the production that was shut is unclear, however, about 80% of crude

production has been restored. The Permian Basin in Texas is producing around 2.9 million barrels per day versus 3.5 million prior to the disruptions.



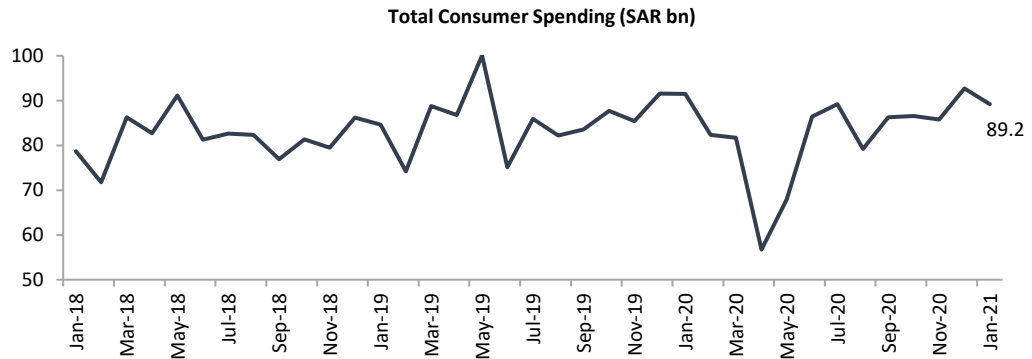
Source: Bloomberg, Capital Investments

According to Russia’s deputy prime minister, global oil markets have balanced following last year’s collapse in demand. Nonetheless, the IEA has cautioned that the recovery in the market is still fragile, especially in the near-term where market conditions face a temporary setback. Demand will decline by 1 million barrels per day in Q1 versus late last year, and the IEA now forecasts that stockpiles will increase during Q2. The agency cut forecasts for world oil consumption in 2021 by 200k barrels per day as the pandemic continues to limit travel and economic activity. It also boosted supplies outside of OPEC by 400k barrels per day as a price recovery encourages investment. The agency sees about 60% of the demand lost last year recovering over the course of 2021.

Saudi Arabia and Russia are once again heading into an OPEC+ meeting on opposite sides; Riyadh is urging fellow members to be “extremely cautious”, while Moscow is indicating that it still wants to proceed with a supply increase. Also on the supply side, Iraq’s crude oil exports jumped in the first half of February even after the country pledged to cut production this month. Moreover, the White House said it would be willing to meet with Iran, which could potentially lead to more crude exports from the latter. In the U.S, crude output slid below 10 million barrels a day during the big freeze, while Shale explorers reported almost 6 million barrels of combined oil-production losses in the same period. It is worth noting that despite the freeze in Texas, explorers added 4 rigs in the Permian Basin last week. Drillers have added rigs every week except one for 15 consecutive weeks.

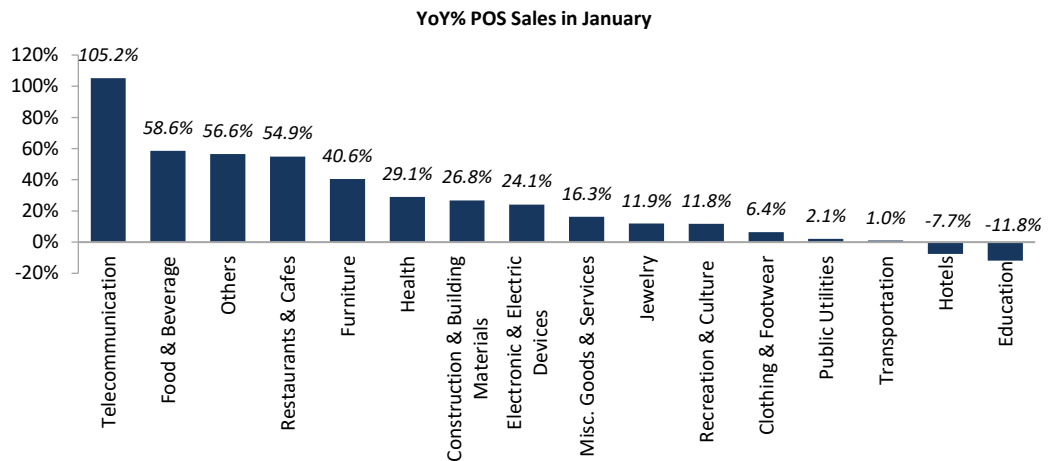
Concerns about near-term demand remain as new variants of the virus spread across the globe, and all eyes will be on the OPEC+ meeting today that may see some supply returning to the market.

### MENA: Consumer Spending Remains Soft in Saudi Arabia



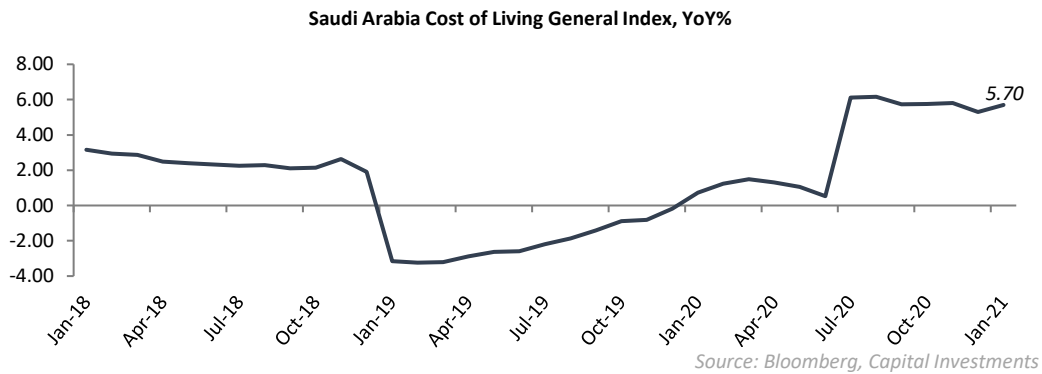
Source: Saudi Central Bank (SAMA), Capital Investments

Total consumer spending (cash ATM withdrawals and POS sales) in nominal terms declined 2.4% y-o-y in January (-3.7% m-o-m). Trailing 12-month spending is down 5% y-o-y due to the VAT hike in July, suspension of cost of living allowances, expat departures, and COVID-19 disruptions.

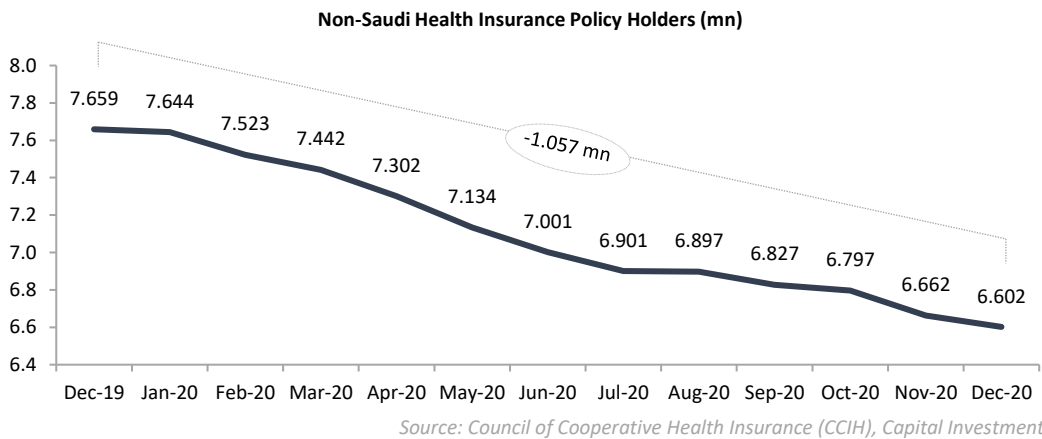


Source: Saudi Central Bank (SAMA), Capital Investments

Telecom POS sales drove growth in January (+105% y-o-y) on blockbuster smartphone and next-generation gaming console launches. Food & beverage sector POS sales increased 59% y-o-y with the installation of POS terminals at all grocery shops and as travel restrictions guaranteed local consumption that would otherwise have happened abroad, which is unsustainable and could weigh on consumption in Q3. At the other end of the scale, some sectors that continue to face headwinds are hotels as tourism remains weak, and education as online classes (and the discount that comes with them) continued into 2021.



Inflation was 5.7% in January, compared with 0.7% a year ago, mainly due to high VAT pass-through in the food & beverage and tobacco sector. Inflationary pressure will likely continue to erode purchasing power into 2021 as the tripling of VAT in July continues to drive inflation into H1 2021.



Using the number of insured non-Saudis as a proxy for the expat population, it appears that over 1 million non-Saudis left the country during 2020. The latest numbers point to a further decline of 128,000 expats so far in 2021. The full impact of the VAT hike and the suspension of cost of living allowances are producing volume weakness further accentuated by expat exodus.

The prevailing conditions and outlook lead us to prefer discretionary names that have been able to accelerate market share consolidation, over staples that are heavily-reliant on volumes and may be struggling with cost inflation.

In positive news, March 3<sup>rd</sup> marked the day the country passed 1 million administered doses of the coronavirus vaccine, and authorities have promised reopening the country’s land, sea, and air borders by 17 May. These factors present a positive read across for companies that benefit from increased mobility. In terms of Hajj season, the Saudi Health Minister directed that acceptance of local pilgrims for Hajj this year will be dependent on their vaccination status, however, it remains unclear whether vaccinated pilgrims from outside the Kingdom will be allowed.

Major Indices	Status as of end		Performance	
	December. 2020	February. 2021	February.2021	YTD (28 February. 2021)
<b>MENA</b>				
Abu Dhabi	5,045.32	5,663.62	1.25%	12.25%
Bahrain	1,489.78	1,466.43	0.26%	-1.57%
Dubai	2,491.97	2,551.54	-3.86%	2.39%
Egypt	10,845.26	11,525.02	-0.18%	6.27%
Jordan	1,657.22	1,761.36	2.00%	6.28%
Kuwait	6,051.07	6,157.47	-2.38%	1.76%
Lebanon	657.89	660.10	0.00%	0.34%
Morocco	11,287.38	11,358.17	-2.34%	0.63%
Oman	3,658.77	3,612.38	-1.12%	-1.27%
Palestine	471.26	484.70	-1.50%	2.85%
Qatar	10,435.96	10,145.99	-3.13%	-2.78%
Saudi Arabia	8,689.53	9,144.99	5.08%	5.24%
Tunisia	6,884.93	6,677.60	0.30%	-3.01%
S&P Pan Arab Composite	769.49	806.22	2.68%	4.77%
Dow Jones MENA	581.51	607.08	1.74%	4.40%
<b>Americas</b>				
Dow Jones Industrial	30,606.48	30,932.37	3.17%	1.06%
S&P 500	3,756.07	3,811.15	2.61%	1.47%
NASDAQ Composite	12,888.28	13,192.35	0.93%	2.36%
S&P/Toronto Composite	17,433.36	18,060.26	4.17%	3.60%
<b>Europe</b>				
EURO Stoxx 50	3,552.64	3,636.44	4.45%	2.36%
S&P Europe 350 Index	1,585.57	1,612.51	2.56%	1.70%
FTSE 100 Index/ London	6,460.52	6,483.43	1.19%	0.35%
FTSE MIB Index/ Italy	22,232.90	22,848.58	5.92%	2.77%
DAX Index/ Germany	13,718.78	13,786.29	2.63%	0.49%
<b>ASIA/Pacific</b>				
NIKKEI 225/ Japan	27,444.17	28,966.01	4.71%	5.55%
S&P/ASX 200/ Australia	6,587.10	6,673.27	1.00%	1.31%
<b>BRIC</b>				
Brazil/ Bovespa	119,017.20	110,035.20	-4.37%	-7.55%
Russia/ RTS	1,387.46	1,411.93	3.24%	1.76%
India/ Bombay Sensitive	47,751.33	49,099.99	6.08%	2.82%
China/ Shanghai Composite	3,473.07	3,509.08	0.75%	1.04%
Hong Kong/ Hang Seng	27,231.13	28,980.21	2.46%	6.42%

Source: Bloomberg, Capital Investments

Description	Closing Prices as of end		Performance	
	December. 2020	February. 2021	February.2021	YTD (28 February. 2021)
<b>Commodities (in USD)</b>				
Brent Spot (Barrel)	51.17	64.43	17.47%	25.91%
WTI Cushing Spot (Barrel)	48.52	61.50	17.82%	26.75%
Natural Gas NYMEX (MMBtu)	2.54	2.77	6.91%	9.18%
Gold Spot (OZ)	1,898.36	1,734.04	-6.15%	-8.66%
Silver Spot (OZ)	26.40	26.67	-1.18%	1.01%
Copper LME Spot (MT)	7,749.00	9,139.25	16.24%	17.94%
Corn CBOT Active Month (Bushel)	4.83	5.48	0.00%	13.30%
Wheat CBOT Active Month (Bushel)	6.40	6.60	-0.34%	3.24%
Soybean CBOT Active Month (Bushel)	13.07	14.04	2.72%	7.46%
Rough Rice Futures (USD/cwt)	12.40	12.75	-5.27%	2.82%
<b>Currencies Spot Exchange Rates Against US Dollar</b>				
Euro	1.22	1.21	-0.50%	-1.15%
GBP	1.37	1.39	1.64%	1.92%
CAD	0.79	0.79	0.29%	-0.04%
Yen	0.01	0.01	-1.72%	-3.04%
CNY	0.15	0.15	-0.70%	0.82%

Source: Bloomberg, Capital Investments

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