

April 6th, 2021

Monthly Newsletter

"A room without books is like a body without a soul." — Marcus Tullius Cicero

"No man ever becomes wise by chance." — Aesop

Clues from Recent Asset Classes' Behavior

Macro: Uneven Global Recovery

Oil: Struggling for Direction

MENA: HY MENA Oil Exporting Countries' Bonds Outperforming Oil Importing Countries' Bonds

Introduction

The narrative surrounding the Covid-19 virus and its variants has moved to focus on the vaccine production and the vaccination rates around the world, while the hospitalization and death rates have retreated to the backseats. Despite the divergence in inoculation trends within the advanced economies as illustrated through an accelerated trend in the US and a sluggish move in Europe, coupled with a laggard trend in developed economies, market participants seem to be content with the progress. As a result, mobility is on the rise and people are gradually moving from online activities to face to face interaction although some economies will open faster than others.

The improving health situation is the bridge towards a normal economy which is being supported by commitments from central banks notably the US Fed to keep the tap open and the monetary policy loose. On the fiscal front, the US has delivered two packages worth of USD 2.8trn during the past quarters and is looking to pass new recovery plans in the range of USD 2 to 4trn. In Europe, the recovery fund of Euro 750bn is yet to gain momentum while China continues to pursue a targeted economic stimulus program.

The recipe of vaccine rollout coupled with mobility and stimulus is creating some pressures on the inflation front with the producer price indices leading the consumer price indices. Inflationary pressure is expected to increase as wage growth and velocity of money are bottoming and are yet to rise.

Short term yields started to tick higher to reflect the inflationary pressure and potential earlier tapering or tightening cycle, while long term yields seem to have reached an interim peak and are looking to consolidate. In conjunction, PMIs are on the rise and gaining steam with momentum gathering pace in services on the back of the reopening. All this means that the earnings boost for cyclicals will continue accelerating over the coming quarters- a trend that will favor reopening trades, small caps and infrastructure plays.

Given this backdrop, the investment journey appears to be promising into Q2 as factors related to yield expansion and central banks' tolerance towards inflation spikes seem to be priced by investors. However, there are a few lessons learned in Q1 that should stay in the background during our investment journey in 2021. First, monetary policy largess will lead to excesses and regular spikes in volatility. Second, it was noticeable that while High Yield ETFs/Indices registered a decent performance during the past quarter, we witnessed three credit events related to the collapse of Greensill Capital (a supply chain financing firm) and to margin call challenges faced by two hedge funds Melvin Capital and Archegos. These are reminders of the vicious power of leverage, the illusion of extreme valuations and a clear illustration of how spikes in yields can put a house in order and tame vigilante traders. Investors- long duration assets and speculative SPACs are recent victims of this sudden rise in yields.

We continue to be positioned into reopening trades along with small caps and infrastructure plays. Gold and silver miners are cheap and neglected value plays and we continue to like some 5G and semiconductor-related plays.

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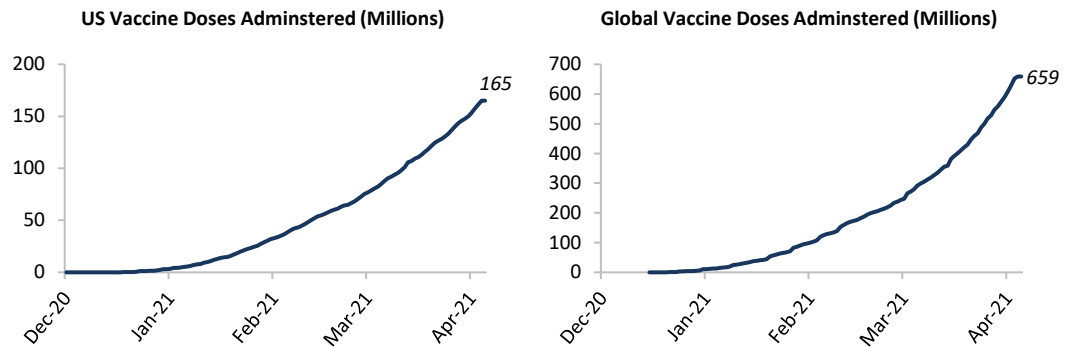
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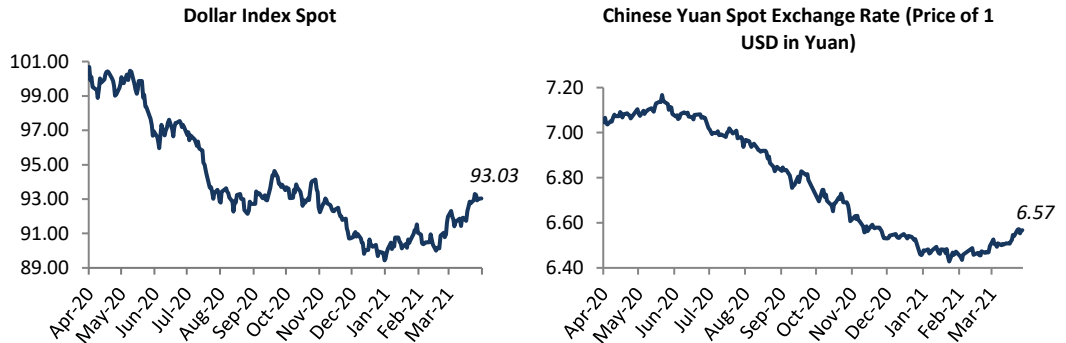


Source: Bloomberg, Capital Investments

Q1 2021: Recap of a Crazy Quarter

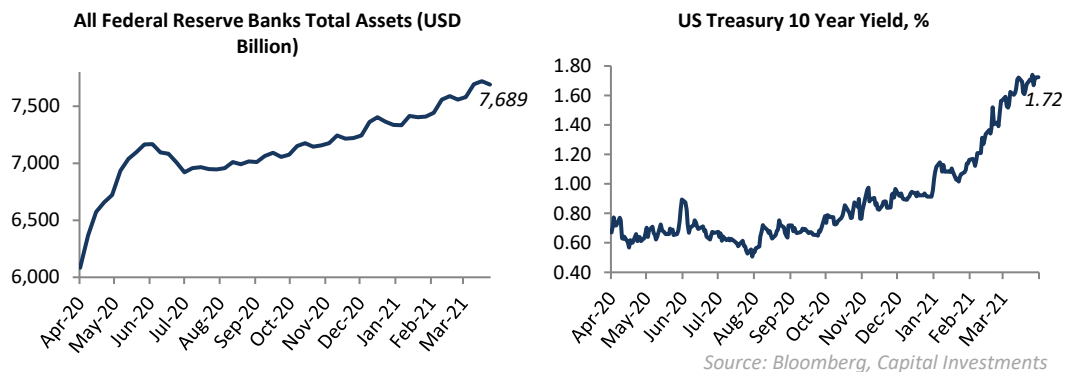
- US Coronavirus cases surge to new highs.
- Democrats win the senate, allowing the government to push for a bigger stimulus package than previously expected.
- Trump supporters storm the US Capitol.
- Meme stocks: Gamestop and AMC garner attention from retail investors and Melvin Capital loses 53% of its investment in January.
- Vaccine rollout gathers pace, raising expectations for a strong recovery.
- SPACs: celebrities embrace blank check companies, although the hype may have started to die down with the spike in market volatility amid surging interest rates. The IPOX SPAC Index is down c20% since its peak in February.
- Tech rotation: tech stocks and funds now lag behind those of financials and energy for the year.
- The meteoric rise of NFTs, the digital answer to collectibles: Christie's auction saw one sold for USD69 million.
- 10-year yield around 1.7% compared to 0.9% at the start of the year.
- Hedge fund, Archegos Capital, forced to liquidate its position in a number of stocks, namely ViacomCBS and Discovery, which have so far dropped 55% and 45%, respectively.
- Market indices sitting near all-time-highs, with small caps taking the lead for the year. The Vanguard Russell 2000 Index Fund ETF (VTWO) had a 16.5% gain, meanwhile, the Nasdaq was only up 3.4% and the S&P 500 was up 5.1%.

Clues from Recent Asset Classes' Behavior



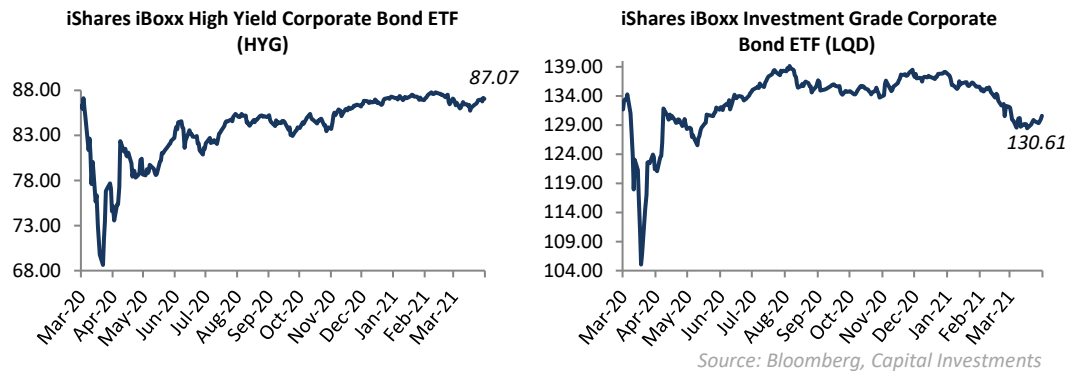
Source: Bloomberg, Capital Investments

Increasing vaccination rates along with rising government yields and large stimulus packages pushed the greenback higher vis a vis a basket of global currencies. This was coupled with moments of risk aversion in equity markets that necessitated a flight to safety by investors. It was remarkable that not only the Yen, Euro and GBP lost ground relative to the USD, but the Chinese Yuan lost some ground as the interest rate differential with the US decreased and Chinese macro indicators were uneven when compared to the trend in 2020. The USD is cyclically supported due to the factors mentioned earlier and would lose ground to the Euro and other currencies once Europe catches up on vaccination and reopening and the US deficit gets wider.

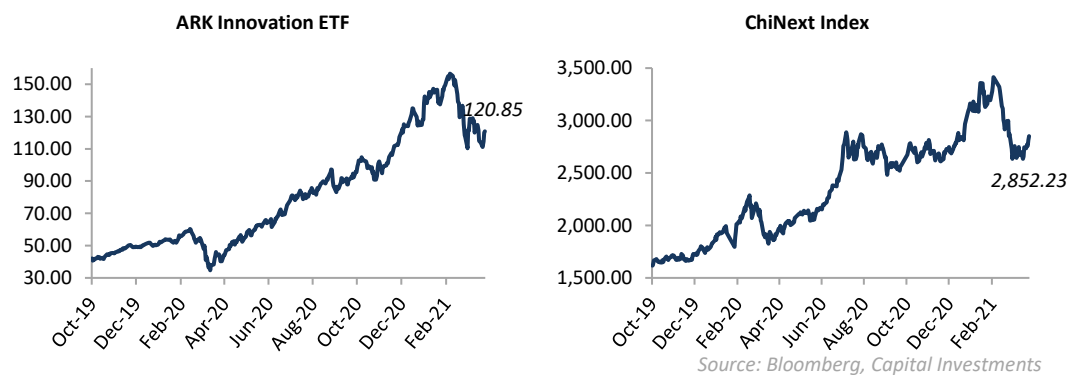


Source: Bloomberg, Capital Investments

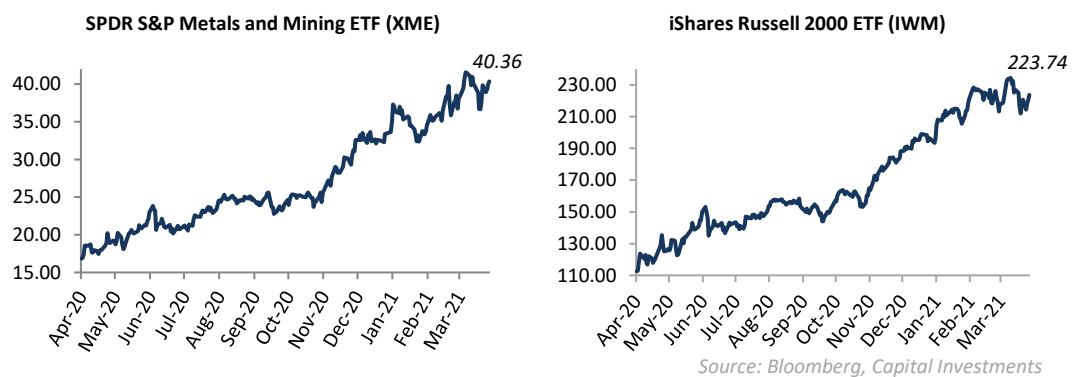
During the past month, the purchases of assets by the US Fed exceeded the announced amount of USD 120bn per month which may partially explain the consolidation in the US 10-year yield. We think that long term US yields are at an interim top and may even retreat from here and test few supports. For instance, the yield is becoming attractive for real money asset managers such as pension funds. The credit events that occurred during the first quarter of 2021 created some demand for safe-haven investments, and more importantly, the consolidation in oil and commodity prices has framed the expectations about the inflation overshoot from a lower base last year.



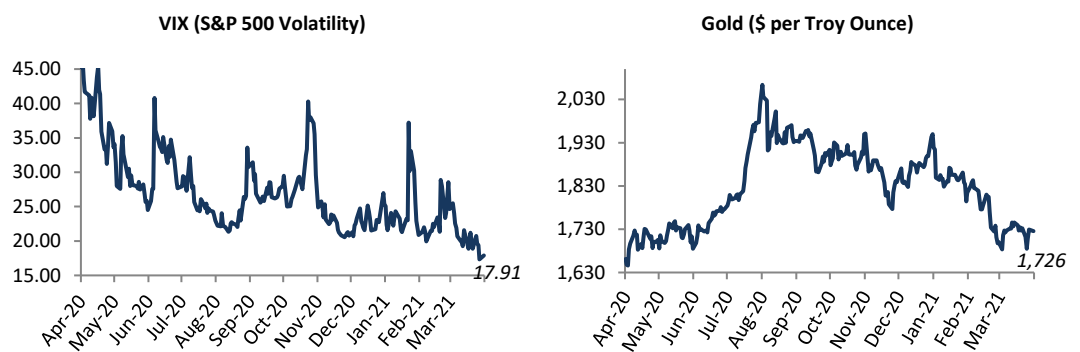
The interest-sensitive Investment Grade bonds, as illustrated by the LQD ETF, have suffered when compared to high yield bonds described through the HYG ETF. Encouraging economic growth expectations coupled with loose monetary policy will support lower quality bonds while higher duration bonds will continue to be challenged by rising yields. We continue to pursue a cautious approach in fixed income given that spreads are relatively tight.



Capital concentration and extreme valuation of long duration assets, notably growth tech stocks, was challenged by the rise in yields which pulled these investments sharply down by more than 20%. A stabilization in yields is giving support to the old leader in the market but the structural picture is still in favor of cyclicals and value plays over the medium term.



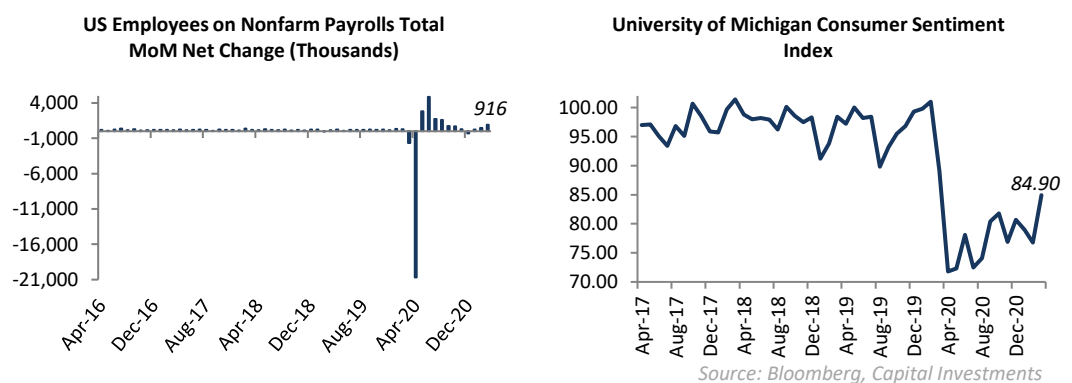
The recent retreat in cyclicals and reopening plays after registering short term extreme overbought conditions was a good opportunity for long term players to accumulate. Those plays are set to benefit over the coming months as overvalued growth stocks have no ready buyers given that long time holders are becoming forced sellers and amid large stimulus packages and reopening of economies, growth is no longer restricted to few clusters in the market and the concentration of capital will move from inflated market caps to depressed or relatively cheaper cyclical and value sectors. We are adopting a barbell strategy between growth and value but with a clear cyclical bias and a decent position in gold miners.



Source: Bloomberg, Capital Investments

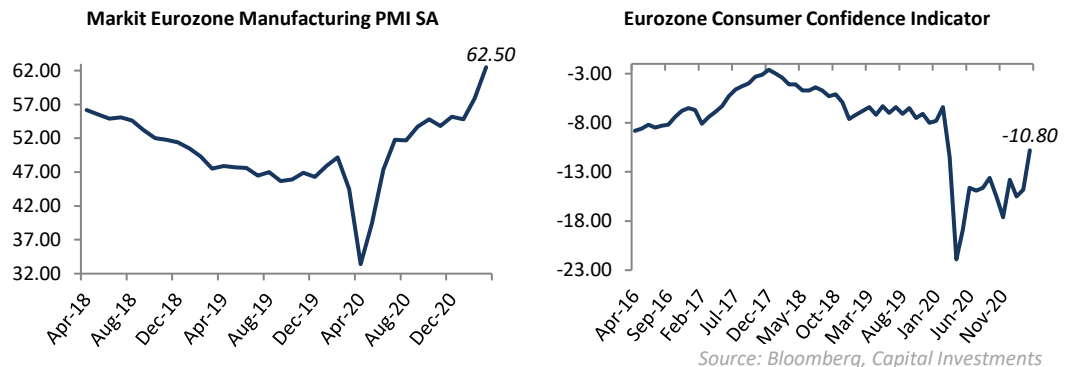
The VIX index, or the gauge of fear, has dropped below 20, paving the way for a recovery in equities. As for gold, it registered a double bottom around USD 1680 per ounce and rebounded by USD 50 so far, still an important resistance at 1765 needs to be cleared to confirm that the correction is ending.

Macro: Uneven Global Recovery

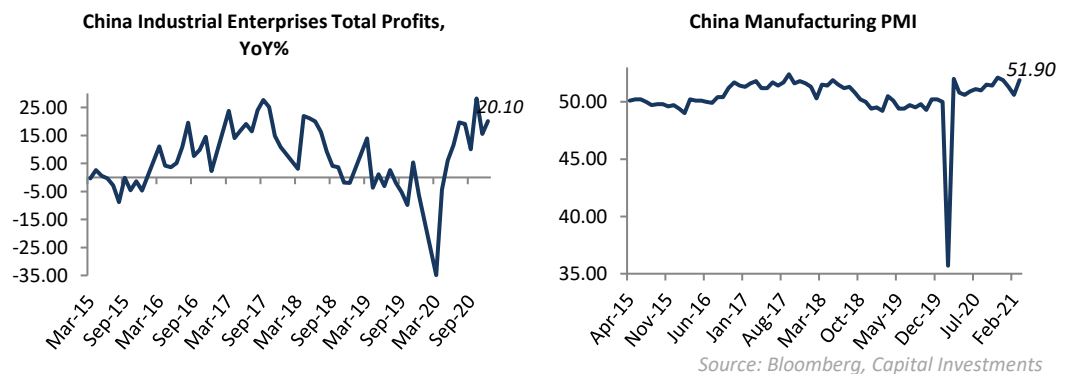


Source: Bloomberg, Capital Investments

The recovery in US remains intact and is turbo charged by the vaccination rollout and stimulus packages. This is illustrated by the improving labor data coupled with rising consumers' morale who are set to spend an excess of USD 3trn in savings over the course of the coming quarters.

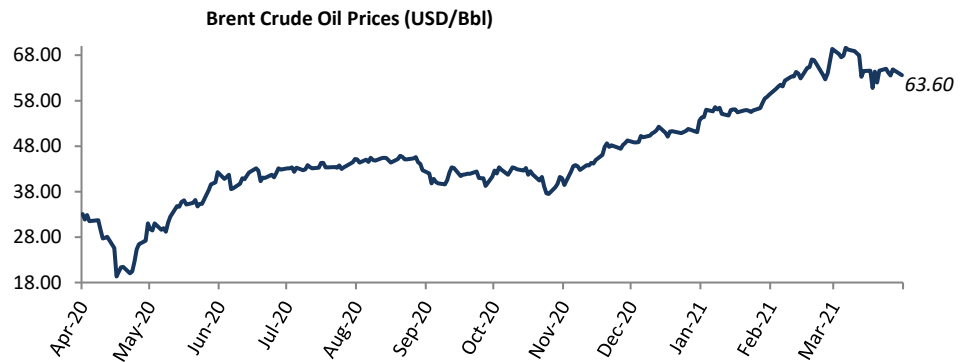


Despite strict lockdowns across Europe, the manufacturing sector is leading the recovery and consumer sentiment is improving as the old continent is due to ramp up its vaccination efforts in Q2 and to ease mobility restrictions. Services are still under pressure in Europe and are expected to recover in Q3 2021.



Data releases from China were mixed recently. While industrial production, export and manufacturing data continue to show solid printing, softness was noticed at the level of retail sales and fixed asset formation. China is trying to recalibrate its monetary policy in a way to tame a bubble in the housing sector without curbing the recovery which explains the deceleration in the credit impulse momentum. On the fiscal side, China is targeting a lower budget deficit/GDP of 3.2% in 2021 in comparison to 3.6% in 2020, signifying a less expansionary fiscal policy. We believe that after the recent correction in Chinese equities, they are offering relatively attractive entry levels especially for key large cap and cyclical plays.

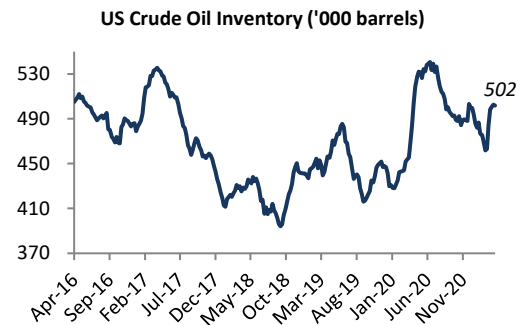
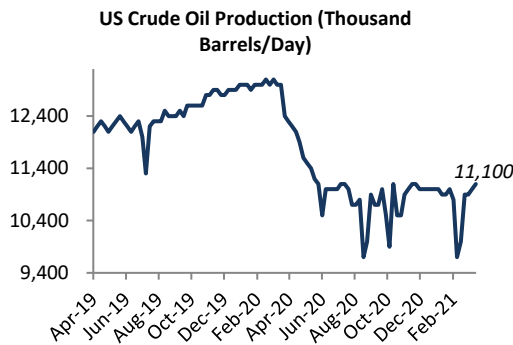
Oil: Struggling for Direction



Oil prices entered March on a strong note, buoyed by OPEC+ decision to not relax supply curbs at the beginning of the month. The producer alliance agreed to hold output steady April, with Saudi Arabia maintaining its 1 million b/d voluntary cut. Prices were also temporarily supported by an attack on a storage tank in Saudi Arabia and by the blockage of the Suez Canal. However, following the rally, oil hit a rocky patch amid conflicting signals for demand, mixed stockpiles reports, and a fluctuating dollar. This drove the near-term market pricing structure back into contango, signaling oversupply.

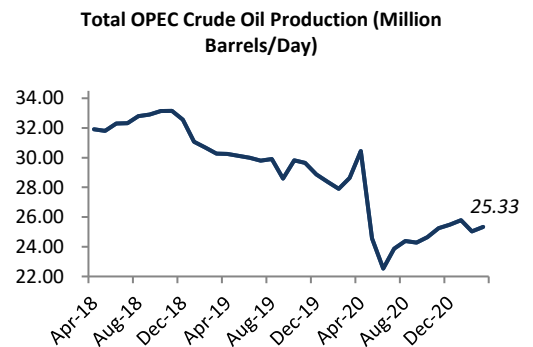
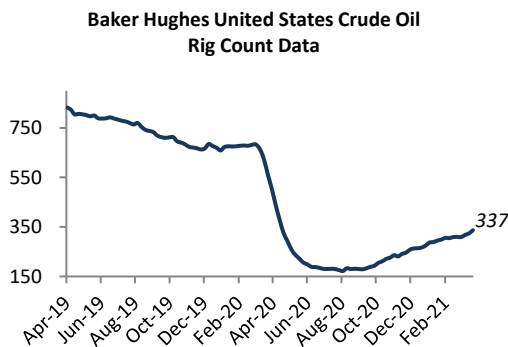
As mentioned, the picture on the demand side is mixed, driven by divergence among nations in vaccination rollouts as well as in lockdown vs. reopening measures. On the one hand, near-term signs are pointing to rising fuel consumption from America to the UK. For instance, retail gasoline sales in the US rose to levels just 1% below year-ago levels, while jet fuel is showing signs of rebound. On the other hand, oil consumption by India, the world's third largest oil importer, slumped almost 5% in February, posting the biggest annual drop since August and the fourth monthly drop since October.

Moreover, both OPEC and the IEA have downgraded their demand for crude. OPEC revised down oil-demand estimates for its crude over the next two quarters by 690,000 b/d, amid a weaker picture for demand and stronger growth in rival supply. The OPEC+ committee also now estimates that global oil demand will expand by 5.6 million b/d in 2021, down from 5.9 million previously. Meanwhile, the IEA stated that global oil demand will not return to pre-pandemic levels until 2023, and growth will be subdued thereafter amid new working habits and shift away from fossil fuels. The agency also stated that global gasoline consumption is unlikely to ever return to its 2019 levels.



Source: Bloomberg, Capital Investments

On the supply side, OPEC+, to the market’s surprise, agreed to boost its collective production over the next three months starting in May with Saudi Arabia also easing its additional 1 million b/d of voluntary cuts, betting on demand recovery as vaccinations roll out across the world. The deal involves gradually easing production cuts by 350 kbd in May, 350k b/d in June and 441 k b/d in July. OPEC+ also expects the global oil-stockpile surplus that built up during the pandemic to be mostly gone in the next quarter, earlier than previously forecast. The group pumped 25.07 million barrels per day (bpd) in March, up 180,000 bpd from February due to a rise in supply from Iran. Output has risen every month since June 2020 with the exception of February. Meanwhile, in the US, the Energy Information Administration (EIA) reported that crude oil inventories fell by 900,000 barrels for the week ended March 26 versus a forecast of 600,000 barrels increase, marking first draw in five weeks due to a surge in refinery demand.



Source: Bloomberg, Capital Investments

As long as the demand picture remains mixed, oil prices will continue to struggle for direction, adding more uncertainty and volatility to the market.

MENA: HY MENA Oil Exporting Countries' Bonds Outperforming Oil Importing Countries' Bonds

In this month's newsletter, we look at the difference between oil importing HY countries and oil exporting HY countries in the MENA region.

First, EM investors took a different stance last quarter when looking at different countries across the HY space in the MENA region. For instance, given the rise in oil prices, they started to differentiate between HY oil exporting vs oil importing countries. The rise of oil prices has helped oil exporting countries more than oil importing ones, despite the spike in yields in general which showed a sell-off sign in the market.

Second, we divide them into two clusters oil importers and oil exporters:

Cluster 1 (oil importers): **Jordan, Egypt, and Tunis.**

Cluster 2 (oil exporters): **Iraq, Oman, and Bahrain.**

Regarding Cluster 1: All countries were affected by the rise in oil prices, with most of spreads widening. However, Tunis was hit the most, when Moody's downgraded its bonds by one notch to b3 for political reasons. These countries will be affected fundamentally by the rise in oil prices such as pressures on balance of payments as well as the trade balance.

Bond	Moody's Credit Rating	Average Z-spread			
		Before Covid	After Covid Till Vaccine News	On Vaccine Announcement	Current
JORDAN 6 1/8 01/29/26	B1	350	473	327	355
JORDAN 7 3/8 10/10/47	B1	505	622	496	519
EGYPT 7 1/8 11/10/26	B2	384	554	406	458
EGYPT 8.7002 03/01/49	B2	598	774	435	428
BTUN 5 3/4 01/30/25	B3	583	782	810	890

Source: Bloomberg, Capital Investments

Regarding Cluster 2: The positive oil sentiment has helped oil exporters' bonds to move higher despite the rise in the US 10-year yield level in 2021 to reach its pre-corona level of 1.78%. What is interesting is that Iraq's outlook was adjusted to stable during last quarter. It can be noticed from the tables below that both Oman and Iraq outperformed the most given their strong fundamentals.

Bond	Moody's Credit Rating	Average Z-spread			
		Before Covid	After Covid Till Vaccine News	On Vaccine Announcement	Current
OMAN 5 3/8 03/08/27	Ba3	396	593	416	345
OMAN 6 1/2 03/08/47	Ba3	515	678	537	496
BHRAIN 6 3/4 09/20/29	B1	352	474	389	388
BHRAIN 6 09/19/44	B1	414	531	450	453
IRAQ 6.752 03/09/23	Caa1	439	852	732	662

Source: Bloomberg, Capital Investments

Finally, investors took a more favourable stance in general on oil exporters vs. oil importers, leading to a tightening in Z-spreads vs. a widening in Z-spreads, respectively.

Table 3: HY MENA Oil Exporting Countries		Average Z-spread		
	Moody's Credit Rating	*Widening/Tightness After Covid	**Widening/Tightness After Vaccine	***Widening/Tightness On Last Price
OMAN 5 3/8 03/08/27	Ba3	196.9	-176.64	-71.3
OMAN 6 1/2 03/08/47	Ba3	162.9	-140.46	-41.7
BHRAIN 6 3/4 09/20/29	B1	121.9	-85.29	-1.4
BHRAIN 6 09/19/44	B1	117.0	-81.42	3.3
IRAQ 6.752 03/09/23	Caa1	412.8	-120.18	-69.6

Table 4: HY MENA Oil Importing Countries		Average Z-spread		
	Moody's Credit Rating	*Widening/Tightness After Covid	**Widening/Tightness After Vaccine	***Widening/Tightness On Last Price
JORDAN 6 1/8 01/29/26	B1	122.8	-146.69	28.4
JORDAN 7 3/8 10/10/47	B1	117.2	-126.29	22.7
EGYPT 7 1/8 11/10/26	B2	170.8	-147.90	51.1
EGYPT 8.7002 03/01/49	B2	175.7	-338.59	-6.7
BTUN 5 3/4 01/30/25	B3	199.1	28.20	80.2

Source: Bloomberg, Capital Investments

Major Indices	Status as of end		Performance	
	December. 2020	March. 2021	March.2021	YTD (31 March. 2021)
MENA				
Abu Dhabi	5,045.32	5,912.56	4.40%	17.19%
Bahrain	1,489.78	1,458.03	-0.57%	-2.13%
Dubai	2,491.97	2,550.23	-0.05%	2.34%
Egypt	10,845.26	10,568.37	-8.30%	-2.55%
Jordan	1,657.22	1,772.26	0.62%	6.94%
Kuwait	6,051.07	6,324.44	2.71%	4.52%
Lebanon	657.89	869.80	25.31%	32.21%
Morocco	11,287.38	11,483.65	1.10%	1.74%
Oman	3,658.77	3,708.71	2.67%	1.36%
Palestine	471.26	466.21	-3.81%	-1.07%
Qatar	10,435.96	10,401.50	2.52%	-0.33%
Saudi Arabia	8,689.53	9,907.82	8.34%	14.02%
Tunisia	6,884.93	7,089.37	6.17%	2.97%
S&P Pan Arab Composite	769.49	855.69	6.14%	11.20%
Dow Jones MENA	581.51	638.16	5.12%	9.74%
Americas				
Dow Jones Industrial	30,606.48	32,981.55	6.62%	7.76%
S&P 500	3,756.07	3,972.89	4.24%	5.77%
NASDAQ Composite	12,888.28	13,246.87	0.41%	2.78%
S&P/Toronto Composite	17,433.36	18,700.67	3.55%	7.27%
Europe				
EURO Stoxx 50	3,552.64	3,919.21	7.78%	10.32%
S&P Europe 350 Index	1,585.57	1,711.04	6.11%	7.91%
FTSE 100 Index/ London	6,460.52	6,713.63	3.55%	3.92%
FTSE MIB Index/ Italy	22,232.90	24,648.56	7.88%	10.87%
DAX Index/ Germany	13,718.78	15,008.34	8.86%	9.40%
ASIA/Pacific				
NIKKEI 225/ Japan	27,444.17	29,178.80	0.73%	6.32%
S&P/ASX 200/ Australia	6,587.10	6,790.67	1.76%	3.09%
BRIC				
Brazil/ Bovespa	119,017.20	116,633.70	6.00%	-2.00%
Russia/ RTS	1,387.46	1,477.11	4.62%	6.46%
India/ Bombay Sensitive	47,751.33	49,509.15	0.83%	3.68%
China/ Shanghai Composite	3,473.07	3,441.91	-1.91%	-0.90%
Hong Kong/ Hang Seng	27,231.13	28,378.35	-2.08%	4.21%

Source: Bloomberg, Capital Investments

Description	Closing Prices as of end		Performance	
	December. 2020	March. 2021	March.2021	YTD (31 March. 2021)
Commodities (in USD)				
Brent Spot (Barrel)	51.17	62.41	-3.14%	21.97%
WTI Cushing Spot (Barrel)	48.52	59.16	-3.80%	21.93%
Natural Gas NYMEX (MMBtu)	2.56	2.61	-7.16%	2.07%
Gold Spot (OZ)	1,898.36	1,707.71	-1.52%	-10.04%
Silver Spot (OZ)	26.40	24.42	-8.44%	-7.52%
Copper LME Spot (MT)	7,749.00	8,787.75	-3.85%	13.40%
Corn CBOT Active Month (Bushel)	4.83	5.64	3.06%	16.76%
Wheat CBOT Active Month (Bushel)	6.40	6.18	-6.40%	-3.36%
Soybean CBOT Active Month (Bushel)	13.07	14.37	2.31%	9.95%
Rough Rice Futures (USD/cwt)	12.40	13.18	3.37%	6.29%
Currencies Spot Exchange Rates Against US Dollar				
Euro	1.22	1.17	-2.86%	-3.98%
GBP	1.37	1.38	-1.08%	0.83%
CAD	0.79	0.80	1.41%	1.38%
Yen	0.01	0.01	-3.76%	-6.68%
CNY	0.15	0.15	-1.20%	-0.39%

Source: Bloomberg, Capital Investments

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