

## Monthly Newsletter

July 7<sup>th</sup>, 2021

*“Societies in decline have no use for visionaries” — Anais Nin*

*“Maybe love is always forgiveness, to a degree” — Joyce Carol Oates*

### Clues from Recent Asset Classes' Behavior

**Macro: US is Passing the Baton to Europe**

**Oil: OPEC+ Abandons Policy Meeting**

**MENA: Saudi Non-Oil Economy Sees Full Recovery from Pandemic**

### Introduction

The investment narrative was shaped by three factors toward the end of the first half of 2021: a hawkish stance by the US Fed in terms of starting “talking about talking about tapering their asset purchase,” coupled with China curbing its credit impulse and commodity prices creating a sense of growth slowdown among investors. This happened at a time when the Delta variant took off and tamed the enthusiasm around mobility and reopening.

As a result, the inflation narrative or more appropriately the spikes in the rate of changes in prices is reaching a plateau for the moment. Both the peak in PMI momentum and retreat in commodity price complex supported this view. The US yield curve turned flat, value and cyclical stocks saw either a retreat or consolidation while growth stocks gained steam. Despite some deceleration, growth will continue to be above trend driven by expansionary policy and mobility which would favor a cyclical bias.

We still think that the next phase of the recovery will be driven by mobility and ease of restrictions and that services will lead the way through increased private spending. Increased vaccination rates will help on this front and close the gap between the US and Europe, and between the two aforementioned economies and emerging markets which are laggard on this front. We maintain the betas of our portfolios tilted toward mobility and reopening plays as those are set to benefit from rising volume and operating leverage as the easing of restrictions gain pace and we keep exposure to Europe, China and selectively to emerging markets. In the MENA region, rising oil prices are supporting the macro picture in the GCC however domestic policies related to switching between reopening and lockdown are weighing on economic activity.

The recent rally was driven mainly by excess liquidity and leverage beyond just the hope for and expectations of reopening and growth. Excess liquidity and leverage will be the major source of volatility in the second half of the year especially if the talks regarding asset purchase tapering gets serious. Meanwhile, investors are aware that the Fed and other major central banks did not dial back the liquidity and market participants are riding this wave which means that no one is willing to short the market now, thus creating a sense of complacency that warrants some attention. Beyond liquidity, we will be looking at Q2 earning releases, and for guidance to assess whether the momentum will be carried into H2 and whether margins will be under pressure. In addition, investors will be seeking clarity regarding taxation policy.

Amid the talks about tapering, investors should look out for the direction in real rates and keep an eye on financial conditions. Direction in long-term rates will be key for markets; we expect them to rise as reopening gains pace and the Delta variant gets tamed. We are worried about sudden and significant spikes in yield which would lead to corrections and margin calls, but beyond moments of volatility we are of the view that central banks are in control of the yield curve and thus yield cannot jump above 2% in the US as this will hurt both the economy and increase the debt burden.

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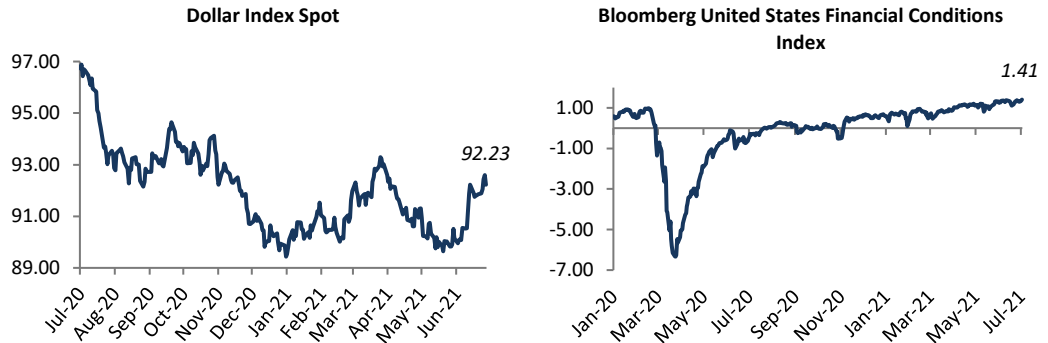
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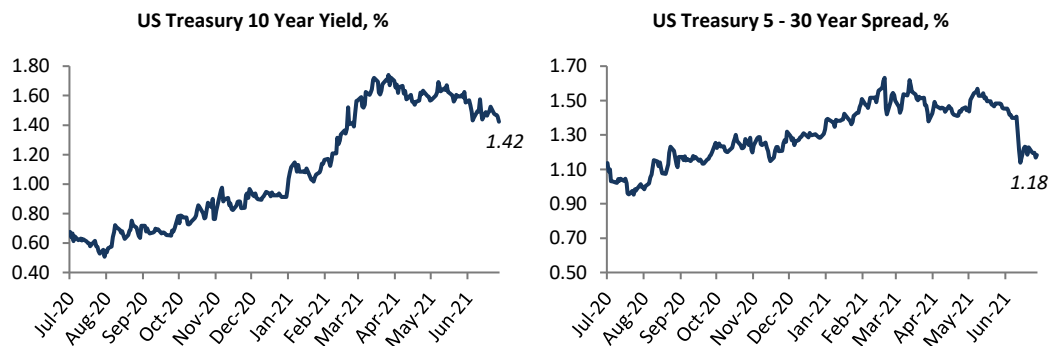
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## Clues from Recent Asset Classes' Behavior



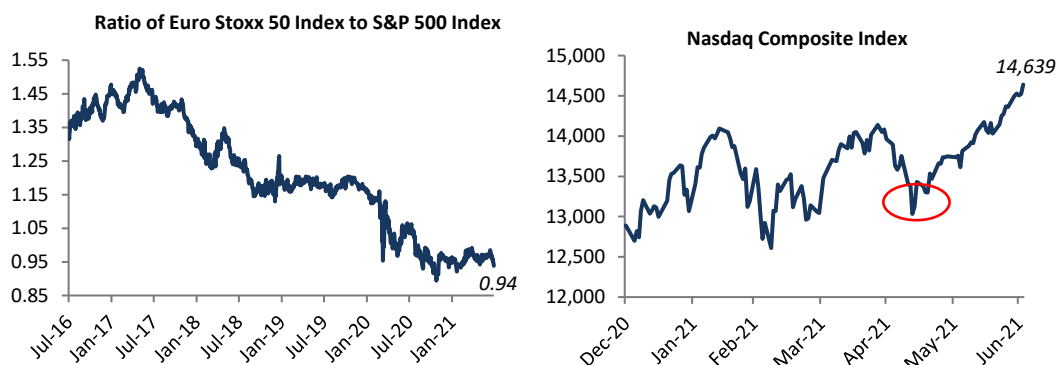
Source: Bloomberg, Capital Investments

The pause in inflationary pressure and the hawkish stance in the US Fed's tone boosted US real rates which became less negative. This was coupled with a decrease in breakeven rates which explain the strength in USD. The rally in greenback has run its course for the moment and will go into a consolidation phase. Weakness in the USD will be driven by the US budget deficit and growth in the rest of the world which is lagging due to mobility restrictions and delay in vaccine rollouts. Ease of financial conditions and liquidity levels will be the factors to monitor as the talk about tapering take shape.



Source: Bloomberg, Capital Investments

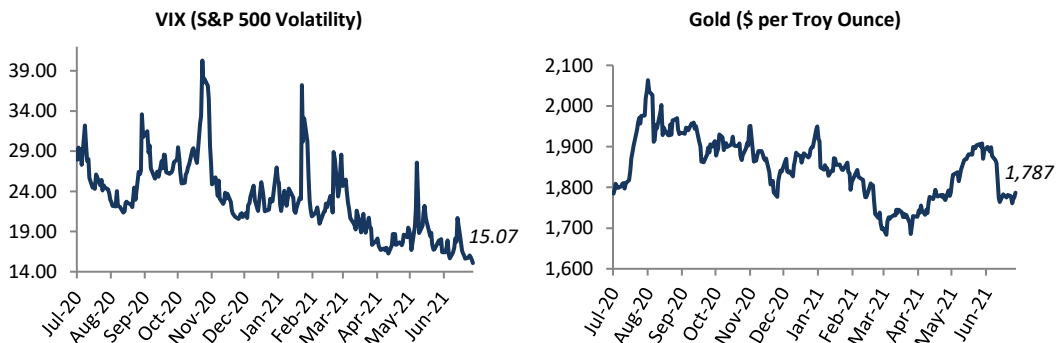
The noise about inflation and tapering was created by the Fed but the true action was taken by China. In fact, China curbed its credit impulse which capped the manufacturing PMIs and export orders, released commodities from its strategic reserve, and cracked down on commodity speculators. The retreat in commodity complex coupled with a relatively strong Yuan tamed the rise in inflation and raised the fear of slowing growth. This was reflected in a flattening yield curve and a collapse in spreads as indicated in the charts above.



Source: Bloomberg, Capital Investments

As a result of shrinking spreads and a flattening yield curve, the cyclical and value plays got tested and went into consolidation or retreat mode while growth stocks as epitomized by the Nasdaq Composite Index reversed their downward trend and climbed higher as suddenly growth became scarce from a narrative perspective and valuation acceptable.

The ratio of Euro Stoxx 50 index to S&P500 index clearly shows the concentration of capital in US markets and indicates that European equities are laggard. What is different this time is the fiscal stance adopted by Europe which will revive growth in the old continent. We keep our allocation to Europe and emerging markets and see any retreat as an opportunity to add.

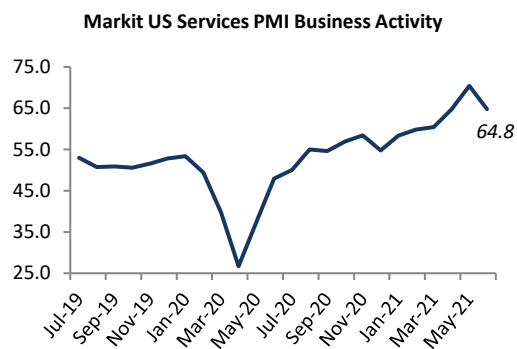
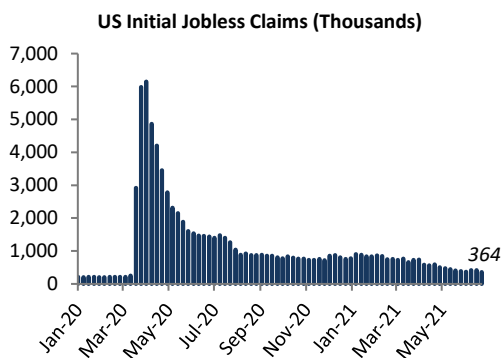


Source: Bloomberg, Capital Investments

A strengthening USD and a less negative real yield drove gold substantially lower. We think that the reaction in gold was excessive and driven by leveraged positions- we are positive on the gold outlook as retail demand picks up during the summer season.

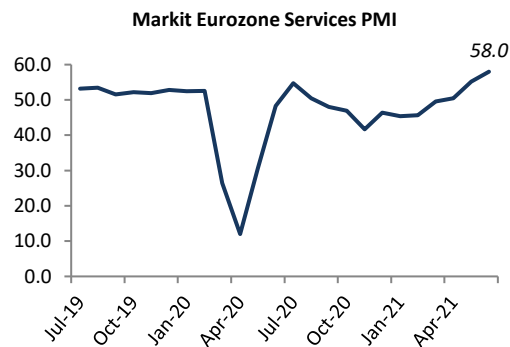
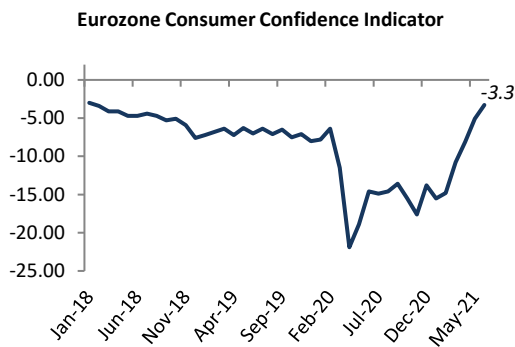
The VIX or volatility index, which is a gauge of fear, illustrates in the chart above that investors are content with the progress on the viral curve and can see through the health crisis. However, the spikes in VIX have been regular over the past year and driven by shocks to liquidity or credit events. They are a clear message that market participant should not be complacent during tranquil times.

### Macro: US is Passing the Baton to Europe



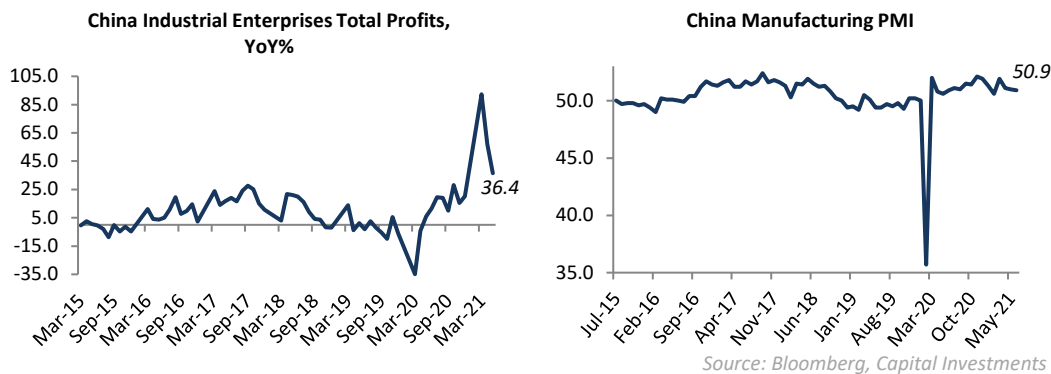
Source: Bloomberg, Capital Investments

Recent data announcement in the US ranging from Jobless claims, home sales, PMI data along with confidence indices showed some softness or were a tad below expectations. The data confirms that the economy is growing and on the right path, however, it is not overheating.



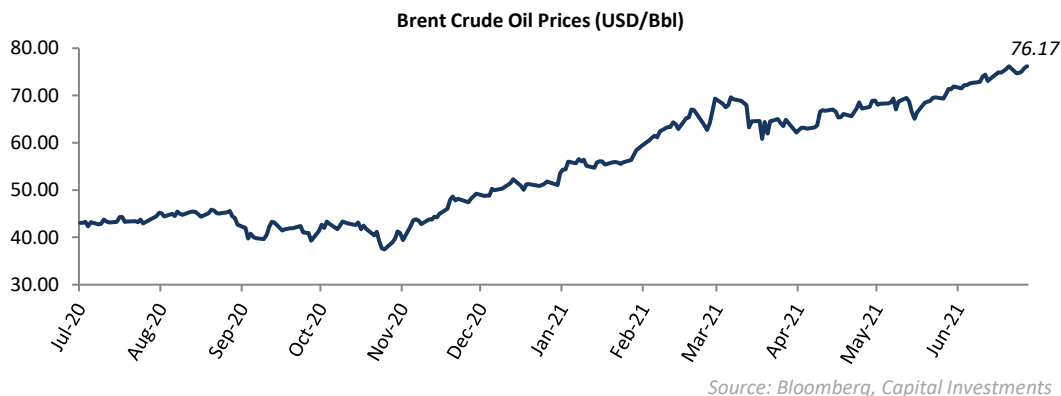
Source: Bloomberg, Capital Investments

In contrast, economic indicators in Europe show that the activity is gaining pace and accelerating and are pointing toward a gradual recovery toward the year end as the momentum gathers steam in Q3, supported by the disbursement of the recovery fund and through easing mobility restrictions.



Since the beginning of Q2, authorities are recalibrating the economic activity in China to avoid overheating. Economic data notably manufacturing, and services PMI are pointing toward more normalization. The Chinese policymakers are adjusting the path of economic recovery on one front and re-organizing the regulatory ecosystem on another. We are still confident in the growth story in China especially that the government is committed to key plans related to decarbonization, infrastructure, and 5G rollout. We are taking advantage of the weakness in Chinese equities to add exposure as the long-term story is still constructive.

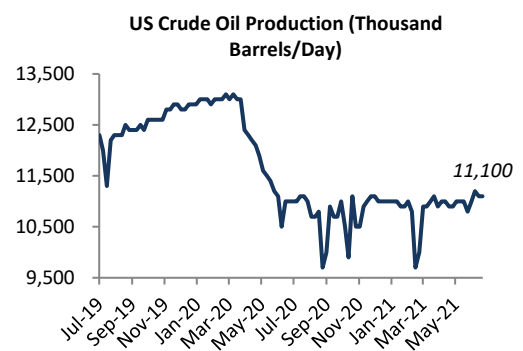
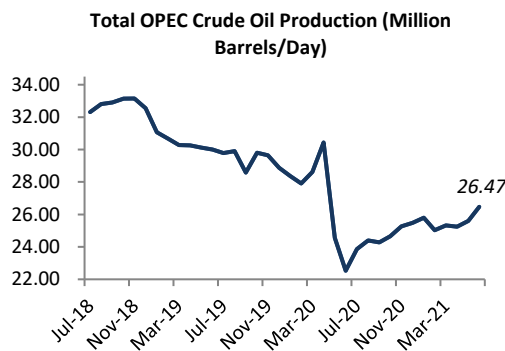
### Oil: OPEC+ Abandons Policy Meeting



Oil prices trended upwards throughout the month of June on the back of strengthening demand and tightening supply, although the improved outlook was weighed down slightly by potential and existing anti-virus curbs as the more infectious delta variant spreads across the globe. Prices however ended the month on a strong note as the OPEC+ infighting sent crude surging to a 2-year high.

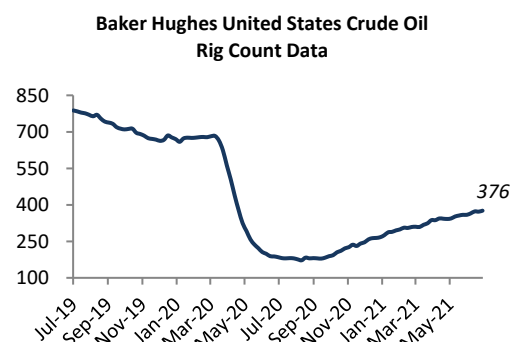
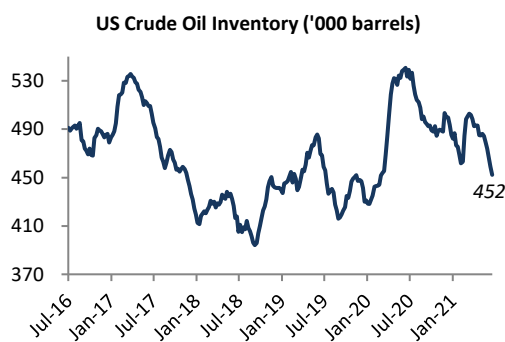
Crude oil futures traded around their highest level since 2018, after the United Arab Emirates unexpectedly blocked an OPEC+ deal at the last minute. Most OPEC+ members backed a proposal to add 400,000 barrels a day each month from August and push back the expiry of their broader

supply deal into late 2022. Although the UAE said it supported a proposed gradual increase in production, it opposed the deal as it said it also wanted an increase in its own permitted level of production. OPEC+ therefore abandoned its meeting without a deal, tipping the cartel into crisis. Failure to reach an agreement on increasing output would squeeze an already tight market, potentially driving crude prices higher. However, the opposite scenario is also possible: if unity breaks down entirely, a free-for-all approach would crash prices as it did during the price war between OPEC+ allies last year.



Source: Bloomberg, Capital Investments

OPEC oil output has risen in June as the group further eased supply curbs as per their last agreement- the group pumped 26.24 million barrels per day (bpd) in June, up 740,000 bpd from May. With the exception of February, output has increased every month since June 2020. Libya’s oil output is also increasing after a pipeline leak was fixed. The latest talks, however, between world powers and Iran to revive a nuclear deal ended without an agreement. Meanwhile, according to the IEA, crude output from major U.S shale players will rise 38,000 b/d in July. The July estimate would be the highest since December, but still short of the level seen in March 2020. Inventories however are on a downward trend, confirming the market’s tightness and strengthening the curve into backwardation.

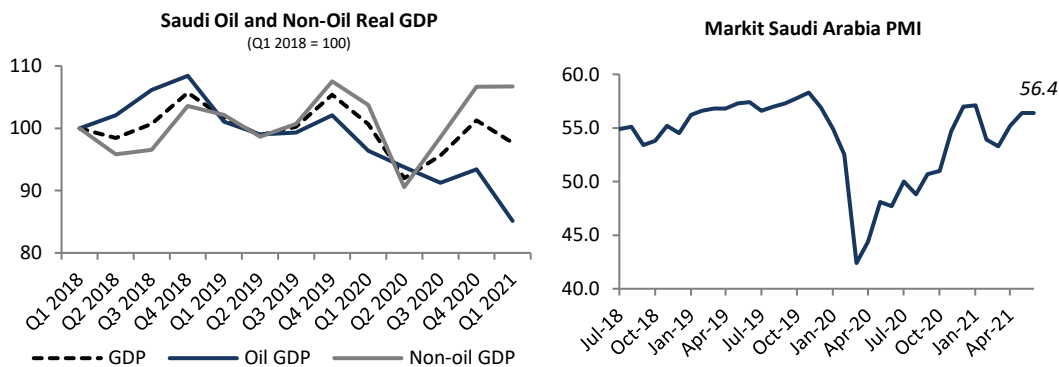


Source: Bloomberg, Capital Investments

Oil extended gains throughout the month of June as OPEC+ and the IEA provided an upbeat assessment of the demand outlook, which has been reflected in signs of improving demand across the globe. Traffic is back to pre-pandemic levels in the US and of Europe, whilst gasoline demand in China in May was 5% higher than the same period in 2019. According to OPEC, the global oil demand recovery will strengthen in the second half of the year, increasing by about 5%. Moreover, as developed nations bring the virus under control, the IEA expects that global oil demand will rebound to pre-pandemic levels in late 2022 and urged OPEC and its partners to maintain a balanced market by tapping their spare production capacity. However, the recovery in gasoline consumption across Asia remains patchy as improvements in some nations such as India are partially offset by deteriorations in others like Taiwan and Malaysia.

The aforementioned OPEC+ crisis reaffirmed the group’s crucial role in controlling crude prices, especially as U.S production is lagging pre-pandemic levels, leaving little competition by the latter to manage markets. The group’s upcoming decisions will therefore set the path for prices in the coming months.

### MENA: Saudi Non-Oil Economy Sees Full Recovery from Pandemic



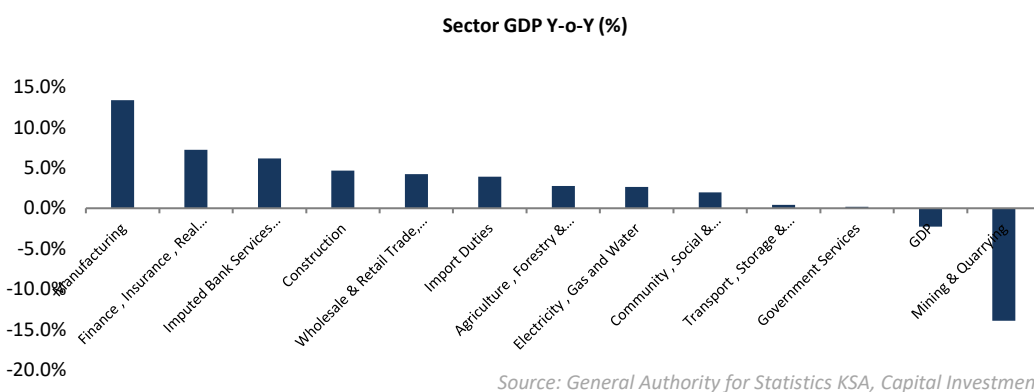
Source: Bloomberg, Capital Investments

Saudi Arabia released its GDP estimates for Q1, showing a 3.0% decline in overall real GDP on a year-on-year basis. The decline was driven by the oil sector, down 11.7% y-o-y, which continued to contract due to further production cuts by OPEC+ in Q1 2021 and a voluntary cut by Saudi Arabia. The dependence of global oil demand on the pace of vaccine rollouts and recovery from the pandemic, in addition to Saudi Arabia’s role as swing oil producer means considerable uncertainty clouds outlook for the country’s oil sector in the near term. Higher oil prices should not only reduce

the need for consolidation measures and sustain the SAR peg, but also help accelerate the plans to reduce VAT to 5-10% by 2022.

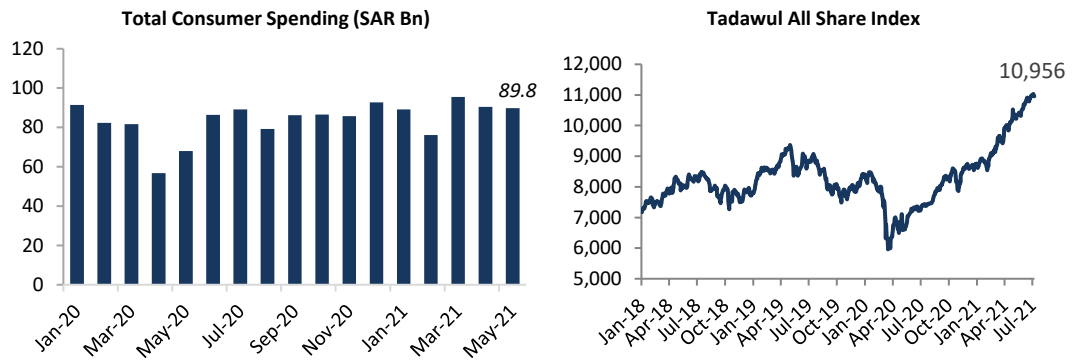
On the other hand, the non-oil economy rose 2.9% y-o-y, returning to pre-pandemic levels, exceeding analysts’ prior forecasts. The pick up in non-oil GDP is in line with the recent PMI numbers, which came in at 56.4 once again for June. The numbers suggest that the non-oil economy has already fully recovered from the adverse impact of the pandemic in Q2 2020, despite lingering covid-related restrictions on internal mobility and international travel. There remains a 70% correlation between oil revenues and non-oil GDP in spite of the government’s diversification efforts.

Looking forward, non-oil GDP growth will be supported by budget and off-budget investments, notably the PIF’s commitment to spend SAR150 billion domestically; the gradual easing of local restrictions and travel bans (approximately 50% of the population have received the first dose, with a target of reaching 100% by the end of 2021); and the possibility of lower VAT next year.



From a sector perspective, the recovery has been broad-based, led by manufacturing (excluding petroleum refining), up 10.8% y-o-y SA<sup>1</sup>; real estate, up 8.8% y-o-y SA; and finance, up 7.2% y-o-y SA.

<sup>1</sup> SA: seasonally adjusted



Source: Saudi Central Bank, Bloomberg, Capital Investments

Higher capex investments are not yet fully reflected in consumption data. POS numbers will rebase starting August (one year after the final deadline enforcing the installation of POS terminals for all retail activities) and ATM transactions will likely continue to decline due to less reliance on cash. The surge in investments to help restore pre-COVID-19 activity will trickle down to growth in consumption potentially by 2022, again, supported by the lifting of restrictions.

Major Indices	Status as of end		Performance	
	December. 2020	June. 2021	June. 2021	YTD (31 June. 2021)
<b>MENA</b>				
Abu Dhabi	5,045.32	6,835.43	4.22%	35.48%
Bahrain	1,489.78	1,587.97	3.95%	6.59%
Dubai	2,491.97	2,810.56	0.47%	12.78%
Egypt	10,845.26	10,256.62	-0.51%	-5.43%
Jordan	1,657.22	2,098.80	2.24%	26.65%
Kuwait	6,051.07	6,936.12	2.91%	14.63%
Lebanon	657.89	884.39	-1.75%	34.43%
Morocco	11,287.38	12,409.24	2.43%	9.94%
Oman	3,658.77	4,063.40	5.47%	11.06%
Palestine	471.26	539.90	1.27%	14.57%
Qatar	10,435.96	10,730.68	-0.16%	2.82%
Saudi Arabia	8,689.53	10,984.15	4.10%	26.41%
Tunisia	6,884.93	7,245.73	-2.01%	5.24%
S&P Pan Arab Composite	769.49	924.92	1.90%	20.20%
Dow Jones MENA	581.51	685.42	1.43%	17.87%
<b>Americas</b>				
Dow Jones Industrial	30,606.48	34,502.51	-0.08%	12.73%
S&P 500	3,756.07	4,297.50	2.22%	14.41%
NASDAQ Composite	12,888.28	14,503.95	5.49%	12.54%
S&P/Toronto Composite	17,433.36	20,145.25	2.10%	15.56%
<b>Europe</b>				
EURO Stoxx 50	3,552.64	4,064.30	0.61%	14.40%
S&P Europe 350 Index	1,585.57	1,803.54	1.56%	13.75%
FTSE 100 Index/ London	6,460.52	7,037.47	0.21%	8.93%
FTSE MIB Index/ Italy	22,232.90	25,102.04	-0.27%	12.90%
DAX Index/ Germany	13,718.78	15,531.04	0.71%	13.21%
<b>ASIA/Pacific</b>				
NIKKEI 225/ Japan	27,444.17	28,791.53	-0.24%	4.91%
S&P/ASX 200/ Australia	6,587.10	7,313.02	2.11%	11.02%
<b>BRIC</b>				
Brazil/ Bovespa	119,017.20	126,801.70	0.46%	6.54%
Russia/ RTS	1,387.46	1,653.78	3.52%	19.19%
India/ Bombay Sensitive	47,751.33	52,482.71	1.05%	9.91%
China/ Shanghai Composite	3,473.07	3,591.20	-0.67%	3.40%
Hong Kong/ Hang Seng	27,231.13	28,827.95	-1.11%	5.86%

Source: Bloomberg, Capital Investments

Description	Closing Prices as of end		Performance	
	December. 2020	June. 2021	June. 2021	YTD (31 June. 2021)
<b>Commodities (in USD)</b>				
Brent Spot (Barrel)	51.17	75.12	9.30%	46.80%
WTI Cushing Spot (Barrel)	48.52	73.47	10.78%	51.42%
Natural Gas NYMEX (MMBtu)	2.72	3.65	21.38%	34.44%
Gold Spot (OZ)	1,898.36	1,770.11	-7.17%	-6.76%
Silver Spot (OZ)	26.40	26.13	-6.78%	-1.05%
Copper LME Spot (MT)	7,749.00	9,351.50	-8.75%	20.68%
Corn CBOT Active Month (Bushel)	4.35	5.89	7.88%	35.37%
Wheat CBOT Active Month (Bushel)	6.30	6.80	1.84%	7.81%
Soybean CBOT Active Month (Bushel)	11.12	13.99	1.91%	25.84%
Rough Rice Futures (USD/cwt)	12.40	13.18	-0.94%	6.25%
<b>Currencies Spot Exchange Rates Against US Dollar</b>				
Euro	1.22	1.19	-3.02%	-2.93%
GBP	1.37	1.38	-2.68%	1.18%
CAD	0.79	0.81	-2.69%	2.71%
Yen	0.01	0.01	-1.38%	-7.02%
CNY	0.15	0.15	-1.34%	1.08%

Source: Bloomberg, Capital Investments

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