

August 5th, 2021

Monthly Newsletter

“When a nation goes down, or a society perishes, on condition may always be found, they forgot where they came from. They lost sight of what had brought them along” — Carl Sandburg

Clues from Recent Asset Classes’ Behavior

Macro: Softness in US, Recovery in Europe, Stimulus in China

Oil: OPEC+ Regains Control

MENA: Homeownership as a Means of Wealth Redistribution

Introduction

The Delta variant is a reminder that the coronavirus is here for the long haul. While the vaccine did not eradicate the virus, it helped keep people away from the hospitals and curb the death rate, a welcomed outcome.

The rapid spread of the new variant has negative implications on mobility and the services sector, which are slowing down after an encouraging recovery. The delta variant is exacerbating labor shortages, disrupting tourism activity during the summer season, and poses a bigger risk to emerging economies where vaccination rates are low.

The recovery may not be fundamentally derailed as the world is yet to reach the peak of reopening but continuous emergence of the virus in various parts of the world coupled with restrictions on mobility are delaying global economic activity and amplifying supply bottlenecks.

On top of the slowdown imposed by the virus, investors are struggling with loss in momentum in economic activity and a potential peak in fiscal and monetary policy at a time when inflation is not abating.

As a result, sovereign yield curves flattened with the long-term yield depicting a dim economic outlook. The delay in economic activity amid a spike in inflation rates around the world drove real yields to a record low. Amid fears of peak growth, high - yield spreads bottomed in July and turned the corner heading north. However, the stock markets mainly in the US are not taking note buoyed by the earnings seasons and flood of liquidity.

In China, decelerating economic momentum as displayed by the weak PMI data has confirmed the softness in the economy that took place in the second quarter of 2021. However, the regulatory crackdown on gaming, tech, and education in particular in China took its toll on the country’s equity market, sending stocks into a dive during July.

Amid this macro backdrop it would be difficult to imagine that long-term US yield will return above 1.5% without a catalyst related to economic data such as jobs report, inflation, or an improving public health situation or monetary policy action. The deeply negative real yield in the US is indicating that tapering is not imminent. Many Fed’s official are talking about steps necessary for starting tapering but we think that the Fed may follow the ECB and the PBOC by staying dovish until there is more data confirmation and assurance on the health situation once schools and universities reopen.

We are cautious of the US markets and are assessing the executive order of President Biden to deal with anti-trust and concentration in Tech. We are building positions in selective Chinese tech and cyclical plays amid an easing bias by authorities. We are constructive on Europe as the recovery is gaining pace. We continue to have a reopening tilt and a focus on energy, gold, silver and metals and mining in general.

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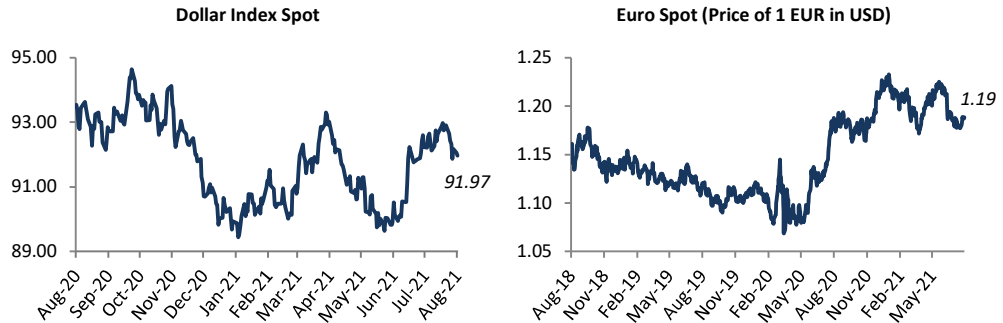
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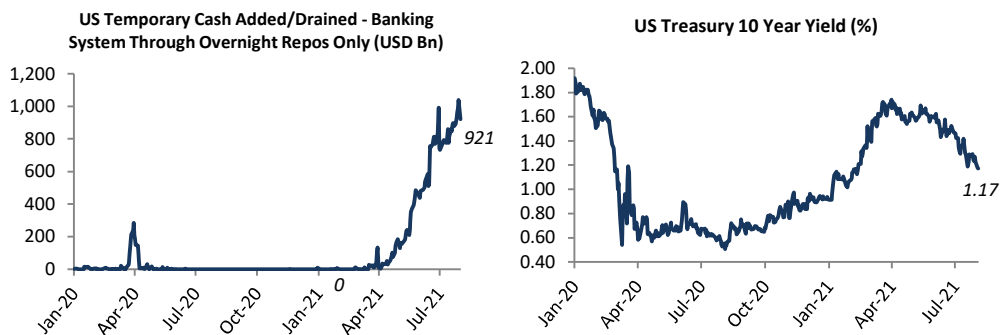
Clues from Recent Asset Classes' Behavior



Source: Bloomberg, Capital Investments

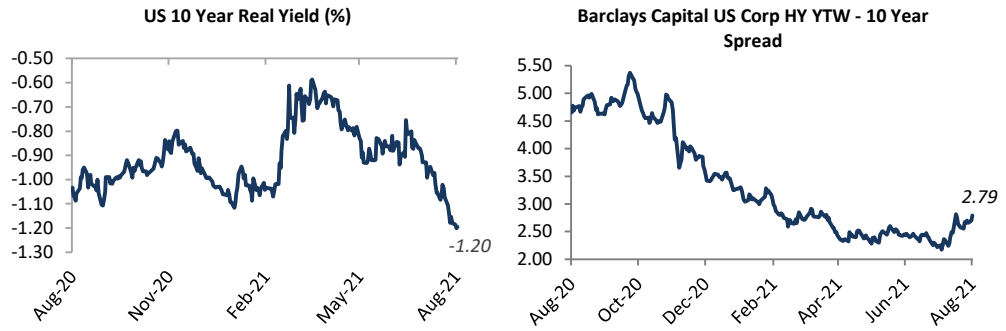
The flight to safety that drove the greenback higher on the back of a fast-spreading Delta variant and China’s regulatory crackdown is losing some momentum. The Euro looks to form a base and catch a bid supported by relatively encouraging macro backdrop in the old continent.

The Fed does not seem to be in a rush to taper its asset purchase program as they still need to see “substantial progress” in economic data, and they did not mention in their last statement that the progress in vaccination is curbing the spread of Covid-19. We think that this stance was relatively bearish for the USD and supportive for the Euro where reopening is gaining momentum.



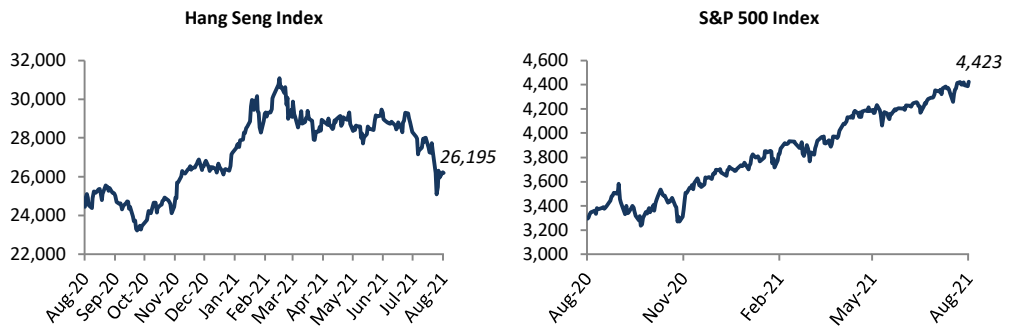
Source: Bloomberg, Capital Investments

Various factors in our opinion are driving the long- term US yield lower. These include continuous US Fed asset purchases which are curbing the risk premia. In addition, the liquidity available in the system, as indicated by the rising value of reverse repo whereby financial institutions are depositing money at the Fed due to dim corporate loan demand. Furthermore, softness in economic data and the spread of the Delta variant which points to a slowing growth outlook. On top of that, many hedge funds were caught in a short squeeze as they had bet on higher yields and therefore had to cover their positions as yields went down.



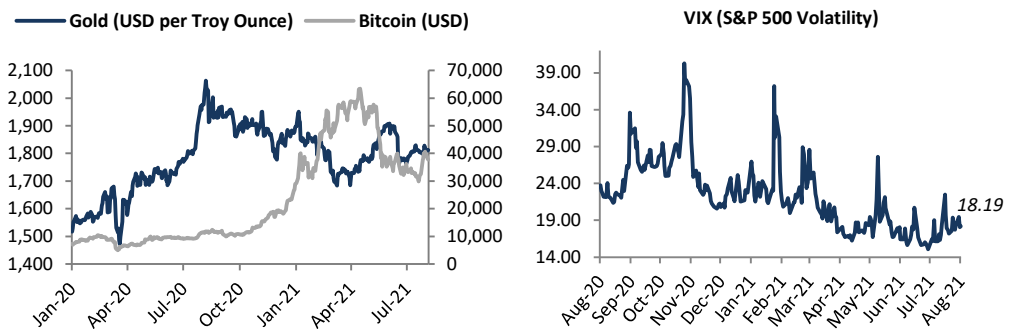
Source: Bloomberg, Capital Investments

Real yields are in a deeply negative territory which could explain the rise in valuation besides an encouraging earnings season. However the spread in the High Yield segment of the bond market warrants some caution.



Source: Bloomberg, Capital Investments

After dropping by around 40% from peak, select Chinese tech companies are offering attractive entry levels in addition we have been encouraged to accumulate in cyclical Chinese stocks by the easing tilt of the PBOC and the targeted expansionary approach adopted by the recent meeting of the Communist Party Politburo. We are constructive on H2 2021 in China as the authorities seem to be cushioning the trajectory of growth in 2022 in certain pre-emptive fiscal and monetary move.

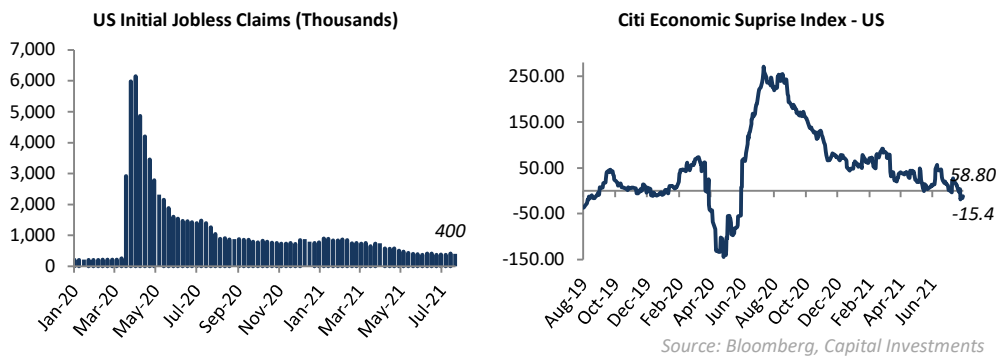


Source: Bloomberg, Capital Investments

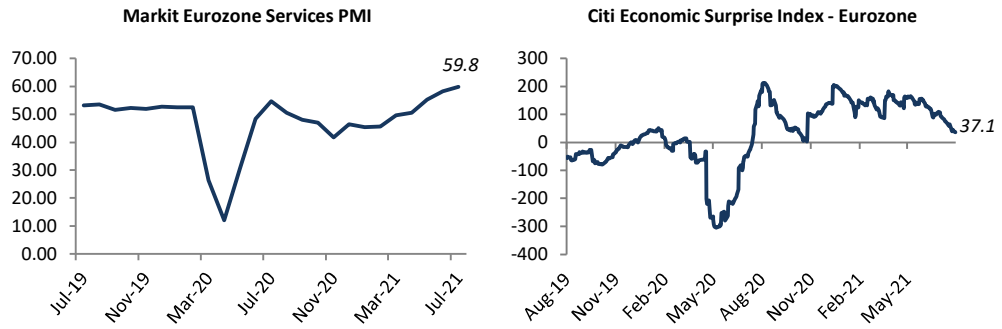
The chart above illustrates an interesting point of view related to Gold and Bitcoin, as it happened to be that the peak in bitcoin prices around USD 65000 coincided with the bottom in gold prices at

USD 1670 per ounce. Simultaneously Google search trends are showing that people are losing interest in bitcoin while gold is gaining more attention especially that rising pricing acts as a magnet. Gold is playing a catch-up game with real yield and the same applies to silver while weakness in the USD is a supporting factor. We are worried about a possible spike in the VIX index, which is a gauge of fear, for an unknown reason. In fact, if we take the ratio of the VIX to the VVIX index (which is the 30 day forward) or if we look at the future curve of VIX, both are pointing to higher levels of volatility in the near future, implying that US equities are vulnerable to shock amid high valuations that are currently supported by low yields. Given the VIX pattern coupled with fear of slowdown and rising high yield spread and low US yield that offers no refuge in case of turmoil, we think that gold and silver may provide some hedge for those invested in the market.

Macro: Softness in US, Recovery in Europe, Stimulus in China

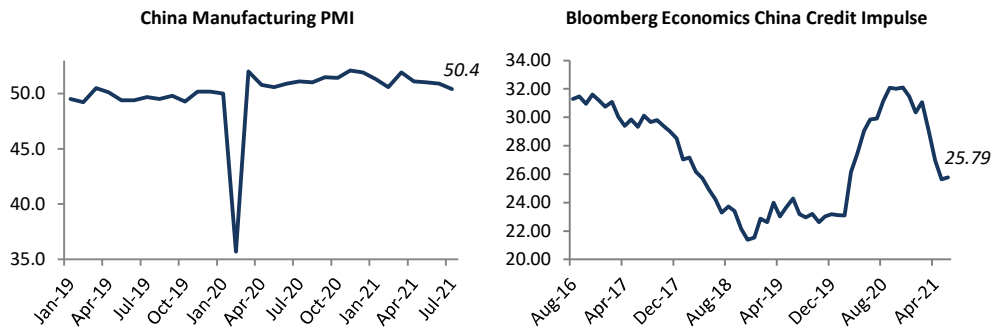


The Citi economic surprise index shows that the recovery is losing momentum, as the effect of the fiscal stimulus is receding while reopening is not gaining pace due to the emergence of new variants. Recovery in the jobs market, and improvements in consumer spending and capex spending by corporates will be key in the medium term. Investors will be monitoring developments related to the budget and to infrastructure stimulus and tax reform plans of the new administration to get further direction for investment.



Source: Bloomberg, Capital Investments

Despite some softness in the Citi Economic Surprise Index in Europe, the service sector is still expanding which means that the recovery in Europe still has legs supported by rising vaccination rates, a dovish ECB, and supportive fiscal policies.



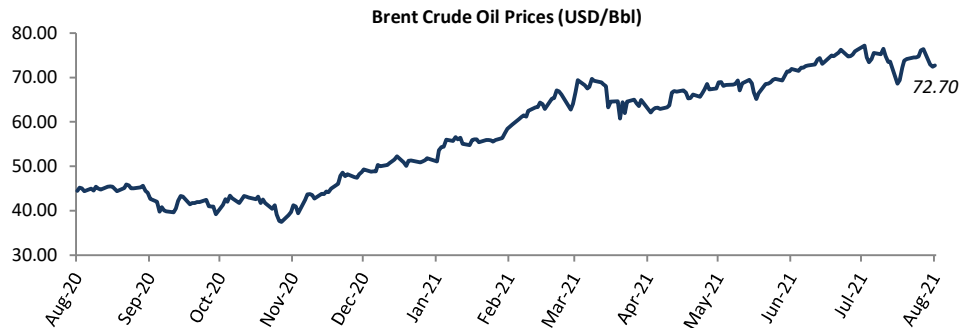
Source: Bloomberg, Capital Investments

The Chinese authorities took notice of the deceleration in the economy and thus they are loosening the monetary policy again and expanding the targeted fiscal measures. The credit impulse in China seems to be turning the corner favoring cyclical investments there.

Oil: OPEC+ Regains Control

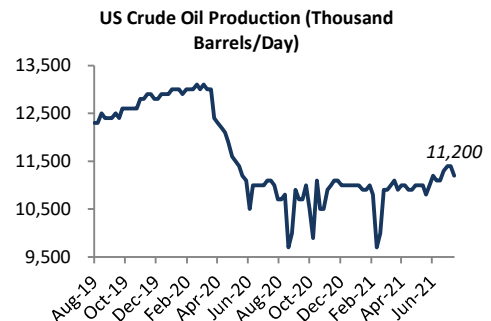
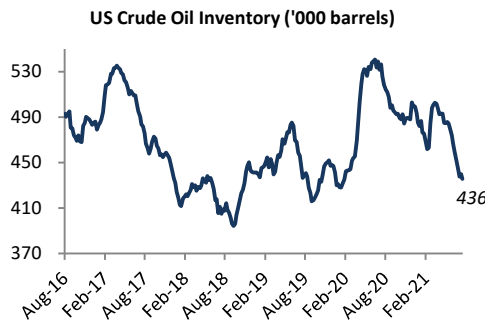
Oil prices swung between gains and losses throughout the month of July as traders initially tried to understand how the clash inside the OPEC+ alliance will play out in global markets, and as divergent signs of demand recovery emerged across the globe. While tightening supplies supported prices, prices closed the month flat as the alliance came to an agreement and as the fast-spreading delta variant raised concerns about the short-term demand outlook.

The high levels of uncertainty regarding supply caused a surge in volatility in July. The immediate result of the collapse in talks was that the output hike expected for August would no longer take place, leaving the market short of barrels just as the world economy was starting to recover from the Covid-19 outbreak. However, more than halfway through the month, OPEC+ struck a deal to pump more oil into the recovering global economy, overcoming their internal rift. The group agreed on monthly supply hikes of 400,000 b/d from August and will continue raising output until all of its 5.8 million b/d of halted production has been revived. The UAE's level was increased to 3.5 million b/d, below the 3.8 million it was demanding when it blocked the OPEC+ deal but above the previous baseline of 3.17 million. The deal puts OPEC back in control of the market and reduces the risk of an inflationary oil price spike.



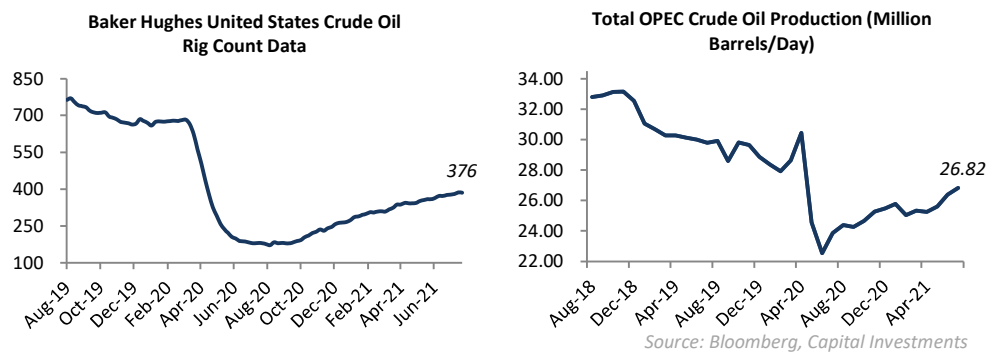
Source: Bloomberg, Capital Investments

OPEC oil output rose in July to its highest since April 2020, as the group further eased production curbs. OPEC pumped 26.72 million b/d in July, up 610,000 b/d from June's figure. Output has risen every month since June 2020 apart from in February. To the market's surprise, the EIA reported a crude inventory build of 3.6 million barrels for the week ending July 30th, versus analyst expectations of a 2.9-million-barrel draw. Gasoline inventories however recorded a 5.29 million barrel draw, versus analyst expectations of 1.78 million. Meanwhile, the total number of rigs rose by 7 to 387 for the week ending July 23, extending drilling growth for a fourth straight week.



Source: Bloomberg, Capital Investments

There is a clear divergence amongst nations in the pace of demand recovery. Although there are signs that demand for fuels such as gasoline has increased as vaccination programs are rolled out, the fast-spreading delta variant has raised concerns about the short-term outlook as tight restrictions have been renewed in some places, most notably in a largely unvaccinated southeast Asia. On one hand, air traffic in Europe has surged to 62% of pre-covid levels, up 26% from the start of May, while gasoline demand surged to a record high in the U.S in July. On the other hand, delta variant is restricting mobility in places like Indonesia, Malaysia and Thailand, and its most recent detection in China, the world's biggest crude market, is also weighing down on sentiment. The IEA, the EIA and OPEC all say that global oil demand will continue to recover to at least the end of next year, and all three agencies see consumption exceeding comparable 2019 levels and hitting new highs. The International Energy Agency sees global oil demand increasing by 3.1 million b/d between the second and third quarters, with another 1.35 million b/d added in the fourth.



Despite the concerns over the delta variant, the market's structure remains in backwardation suggesting that investors are choosing to focus more on the broad global economic recovery.

MENA: Homeownership as a Means of Wealth Redistribution

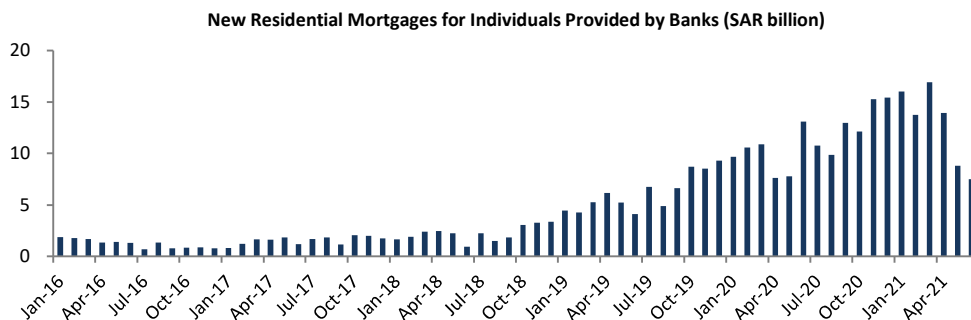
Governments in the region have increasingly been adopting new socioeconomic goals and have realized some can be achieved through the banking sector. A recent trend sweeping the region is the introduction of mortgage laws to increase home ownership, ultimately reducing wealth inequality. The idea is by no means revolutionary and countries that have had similar policies in place for some time have seen positive spillovers arise as a result. Homeownership is an important vehicle for horizontal redistribution; households accumulate wealth in owner-occupied housing during working lives before benefiting from rent streams in retirement. Housing wealth's welfare

role is broader than ever before with flexible mortgages enabling people to smooth their consumption over the life of the loan.

Housing Status (United States)	Mean Net Worth		
	2016	2019	Change
Owner	1,099.9	1,102.1	0%
Renter or other	96.8	95.6	-1%

Source: Federal Reserve Bulletin September 2020, Capital Investments

The mortgage fad started in Saudi Arabia, which instituted new mortgage laws after decades of deliberation about whether home loans should be Shariah-compliant. Mortgages were permitted only in 2012, when it was decided that they should follow the principles of Islamic law. In 2014, the Saudi Central Bank (then SAMA) enacted a series of real estate mortgage and financial laws under Saudi Vision 2030 which aim to increase home ownership for citizens to 70% by 2030. Saudi Arabia still has one of the lowest mortgage penetration rates in the world. Currently, just 8% of homes are bought with mortgages, compared to more than 50% in many western countries. Al Rajhi Bank is a clear winner as its existing reputation among retail customers allows it to take maximum advantage of the trend. Housing is a major area of discussion in Saudi Arabia; the severe lack of affordable housing and realistic financing options are among the biggest challenges facing the country’s government. To ease the housing crisis, the government says it will build 1.5 million affordable homes before 2030.



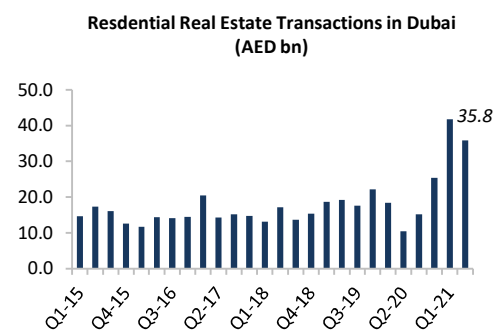
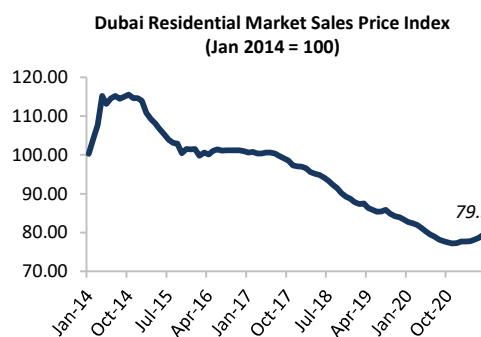
Source: Saudi Central Bank, Capital Investments

Seemingly by contagion, the last few months saw two economies in the region approving or taking steps to approve a new mortgage law. The Kuwaiti finance minister, in late May, indicated that the new real estate financing law was sent to parliament for approval, and, if approved, will give borrowers the option to obtain housing loans from banks and financing companies as well as from the Kuwait Credit Bank (KCB). When local banks provide eligible locals with loans, the government will compensate banks for the interest service. Retail loans represent around 40% of total loans in Kuwait. Current mortgage practice in Kuwait means a ticket size of KWD 170k with KWD 100k going

through the banking system and KWD 70k via a government agency, after the law is passed, the ticket size will be the entire KWD 170k. Installment amount should not exceed 40% of the net monthly salary for employees. Analysts estimate there is a backlog of about 90k locals on the waiting list for new homes, with a current supply of approximately 60k units. The KCB has been struggling to meet growing demand for residential housing and the limited supply of land was leading to long waiting lists and appreciation in home prices in Kuwait. Execution through banks will mean a faster process, and Islamic banks and lenders with a stronger retail franchise such as NBK, BOUBYAN, and GBK should be the key beneficiaries.

Furthermore, as recently as three weeks ago, Egypt introduced an EGP 100 billion mortgage finance initiative targeting low and middle-income citizens. The CBE’s official circular states that the new initiative gives low and middle-income nationals the ability to receive loans from banks and mortgage companies with an interest rate of 3% and a 30-year repayment period to purchase fully finished housing units.

The UAE has seen the start of a similar trend from the consumer side, with some banks in Dubai showing an uptick in mortgages, noting that end-users are a rising proportion of applicants. A turnaround in Dubai real estate prices has supported the positive narrative on local real estate developers. Nonetheless, prices remain well below 2014 levels and given a low interest rate environment and higher LTV, banks should be able to reap the benefits of a larger number of renters who can now afford to dip their toes in the housing market.



Source: REIDIN, EFG Hermes, Capital Investments

Major Indices	Status as of end		Performance	
	December. 2020	July. 2021	July. 2021	YTD (31 July. 2021)
MENA				
Abu Dhabi	5,045.32	7,318.18	4.22%	35.48%
Bahrain	1,489.78	1,597.00	3.95%	6.59%
Dubai	2,491.97	2,765.71	0.47%	12.78%
Egypt	10,845.26	10,742.23	-0.51%	-5.43%
Jordan	1,657.22	2,087.56	2.24%	26.65%
Kuwait	6,051.07	7,164.62	2.91%	14.63%
Lebanon	657.89	962.00	-1.75%	34.43%
Morocco	11,287.38	12,304.15	2.43%	9.94%
Oman	3,658.77	4,030.40	5.47%	11.06%
Palestine	471.26	578.16	1.27%	14.57%
Qatar	10,435.96	10,753.28	-0.16%	2.82%
Saudi Arabia	8,689.53	11,012.71	4.10%	26.41%
Tunisia	6,884.93	7,304.52	-2.01%	5.24%
S&P Pan Arab Composite	769.49	935.41	1.90%	20.20%
Dow Jones MENA	581.51	695.19	1.43%	17.87%
Americas				
Dow Jones Industrial	30,606.48	34,935.47	-0.08%	12.73%
S&P 500	3,756.07	4,395.26	2.22%	14.41%
NASDAQ Composite	12,888.28	14,672.68	5.49%	12.54%
S&P/Toronto Composite	17,433.36	20,287.80	2.10%	15.56%
Europe				
EURO Stoxx 50	3,552.64	4,089.30	0.61%	14.40%
S&P Europe 350 Index	1,585.57	1,833.82	1.56%	13.75%
FTSE 100 Index/ London	6,460.52	7,032.30	0.21%	8.93%
FTSE MIB Index/ Italy	22,232.90	25,363.02	-0.27%	12.90%
DAX Index/ Germany	13,718.78	15,544.39	0.71%	13.21%
ASIA/Pacific				
NIKKEI 225/ Japan	27,444.17	27,283.59	-0.24%	4.91%
S&P/ASX 200/ Australia	6,587.10	7,392.62	2.11%	11.02%
BRIC				
Brazil/ Bovespa	119,017.20	121,800.80	0.46%	6.54%
Russia/ RTS	1,387.46	1,625.76	3.52%	19.19%
India/ Bombay Sensitive	47,751.33	52,586.84	1.05%	9.91%
China/ Shanghai Composite	3,473.07	3,397.36	-0.67%	3.40%
Hong Kong/ Hang Seng	27,231.13	25,961.03	-1.11%	5.86%

Source: Bloomberg, Capital Investments

Description	Closing Prices as of end		Performance	
	December. 2020	July. 2021	July. 2021	YTD (31 July. 2021)
Commodities (in USD)				
Brent Spot (Barrel)	51.17	75.38	9.30%	46.80%
WTI Cushing Spot (Barrel)	48.52	73.95	10.78%	51.42%
Natural Gas NYMEX (MMBtu)	2.71	3.91	20.72%	33.63%
Gold Spot (OZ)	1,898.36	1,814.19	-7.17%	-6.76%
Silver Spot (OZ)	26.40	25.49	-6.78%	-1.05%
Copper LME Spot (MT)	7,749.00	9,701.00	-8.75%	20.68%
Corn CBOT Active Month (Bushel)	4.35	5.45	7.88%	35.37%
Wheat CBOT Active Month (Bushel)	6.30	7.04	1.84%	7.81%
Soybean CBOT Active Month (Bushel)	11.12	13.49	1.91%	25.84%
Rough Rice Futures (USD/cwt)	12.40	13.68	-0.94%	6.25%
Currencies Spot Exchange Rates Against US Dollar				
Euro	1.22	1.19	-3.02%	-2.93%
GBP	1.37	1.39	-2.68%	1.18%
CAD	0.79	0.80	-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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