FAB IM Update

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FAB Investment Management Funds Update

MENA assets should reflect better geopolitics, economic diversification — and higher crude prices

♦ We remain optimistic on MENA assets overall, and especially for UAE equities, which appear particularly cheap

♦ Most global investors do not understand the improved geopolitics, industrial diversification, or reforms in MENA

♦ The outlook for risk assets globally looks good; investors are focusing on late 2021 and into 2022, past current issues

♦ Crude oil prices have recovered to $55.11/barrel for Brent, helped by further OPEC+ production restraint led by KSA

♦ FAB MENA Equity funds returned on average –2.48% in 2020, recovering strongly by 7.78%, in the fourth quarter

♦ MENA bonds are attractive; the FAB MENA Bond Fund had respectable 2020, returning 4.52%, and yields 3.31%

♦ In 2020, FAB Conservative, Balanced and Growth Allocation funds returned 5.66%, 6.46% and 5.09% respectively.

Overview

The year 2020 turned out to be an unprecedented year in the history of global equity markets, firstly with the pandemic causing immense havoc via related lockdowns, and in terms of the massive monetary and fiscal response on the part of world central banks and governments. Global equities fell faster than they had even done so before, but then recovered faster to the breakdown point than ever before. The IMF recently estimated advanced economies are likely to have seen an overall contraction in GDP of 5.8% last year, and one of 3.3% for emerging and developing economies (buoyed by moderate growth in China).

However, despite remaining immediate challenges, global investors are increasingly looking towards the second half of the current year, and into 2022 for the normalization that vaccination programs should deliver. Indeed, the IMF recently expected advanced economies to grow by 3.9% this year, eclipsed by 6.0% for emerging and developing countries. The global economic recovery is our basic premise to be optimistic on markets, together with the fact that governments' debt loads will force central banks to keep official interest rates very well anchored. Maintained negative real rates will continue to pressure the US dollar on its index, and this should in turn underwrite a good overall performance for EM assets. Equity investors are learning to select stocks from 'value' sectors, and are placing less reliance on growth as a style, however this must be done with care. Value tends to perform sporadically, while although prone to periodic overvaluation, growth is more reliable and should return to favour later this year.

Crude oil prices, usually being a dominant factor driving regional markets, rose by almost 14% over the last month, with Brent quoted at a closing high of $56.99/ barrel. This was a new high since the initial acceleration of the pandemic, driven by risk-on sentiment related to growth expectations for the second half of 2021, the shutting down of about 2 million barrels/day of shale oil production in the US, and OPEC+ delivered a positive surprise at its recent meeting when Saudi Arabia volunteered a production cut of 1 million barrels per day for February and March. The FAB house view is for Brent to average $58/barrel this year, followed by $65 in 2022.

MENA Fixed Income

Regional bond prices have recovered, with the Bloomberg Barclays GCC USD Credit Total Return Index (Unhedged) generating 8.68% in 2020, not far behind the 9.20% return for the Global-Aggregate benchmark .

We think the ongoing hunt for yield, central bank buying, and a vaccine-induced economic recovery will continue to support fixed income markets in 2021. The news flow around the rollout of Covid-19 vaccines has generated serious investor enthusiasm. Nonetheless, there is still a significant immediate upsurge of virus cases and tightening economic restrictions to reckon with. Longer-term, the Fed's corporate bond buying program will be wound down as a more normal economic environment returns.

Looking into 2021, this is expected to be another record year of regional credit issuances. There are still funding gaps that need to be plugged as a result of ongoing high fiscal deficits, and with credit ratings under pressure, especially in Saudi Arabia. On top of the pandemic -related economic pressures still hanging over from 2020, there remains a need for underlying fiscal consolidation in the region to ensure long-term economic sustainability.

There are significant maturities due in 2021-2022, and these must be refinanced. Across the GCC, the fiscal position of Abu Dhabi stands outs positively from most of its neighbours, and also given its asset-backing

Issuance in the primary market has picked up in January and we expect issuance to remain buoyant during the first half of the year. However, the new issue market was subdued in December after record year-to-date issuance to the end of November.

The composition of our flagship MENA Bond Fund is split 70:30 between IG and HY bonds, with an overall average IG rating of BBB. As markets have recovered and spreads have tightened, fund performance has further improved. The fund has taken an active role in the primary market, participating in deals that offered value to the secondary curve, while maintaining a high degree of risk control. The portfolio yield is around 3.31%, with conservative duration of around 4.65 years. Our portfolio positioning remains conservative in terms of risk metrics, and still with a preference for investment grade over high yield. Rates should soon see resistance following the uptick since December, leaving us comfortable with only moderate duration.

The MENA Bond Fund generated a return of 4.52% in 2020, recovering strongly from the lows of April, and gave a return of 3.11% over the last three months.

MENA Equities

MENA equities' performance has recently picked up, and the underperformance vs. Emerging and Developed markets has narrowed. During the last three months, MENA equities were up 6.20% and UAE equities were up 12.09% while the MSCI EM index was up 19.61%, and the MSCI World Index was up 14.07%.

We expect positive market performance to continue in 2021. The macro fundamentals have improved in the fourth quarter with further normalization of economic activities. Our preferences remain for sectors offering recovery as well as potential for valuation re-rating in 2021, including consumer discretionary, material, real estate and healthcare sectors.

We remain neutral-to-underweight in financials overall, mindful of still low NIMs, together with the likelihood that average asset quality and loan provisioning could still see some deterioration. Accordingly, our selections in regional financials remain highly selective, however with the improvement in economic activities we have reduced our exposure to defensive sectors like telecom and utilities. During the first quarter our funds positioning remains skewed towards stocks which are expected to pay dividend during the quarter.

Turning to country exposures, we are maintaining our overweight exposure in the UAE, as it still offers an attractive combination of cheap valuations and recovery potential. Over the last two months our overweight positioning in UAE has paid-off well, and is reflected in our funds' performance. At the country level, we are now overweight in Saudi Arabia, driven by stock selection with respect to blue chip quality names and stocks expected to benefit from economic recovery. In Saudi, we have increased our exposure to the materials sector on the back of higher petrochemicals and metals prices. We are underweight in Kuwait at the country level as post the MSCI EM index inclusion valuations look expensive, and it is undergoing fiscal challenges.

Our MENA equity funds generated returns in the range of 2% to -7% for 2020, after showing strong recovery during the fourth quarter. The MENA Dividend Leader and MENA Growth Funds were up by 5.90% and 6.31% respectively over the last three months. UAE Growth and UAE Trading funds were up 13.45% and 10.23% over the same time period.

Asset Allocation Funds

During 2020, the FAB Conservative, Balanced and Growth Allocation funds returned 5.66%, 6.46% and 5.09% respectively. After a very tough Q1 characterized by major drawdowns across all asset classes, the funds posted steady recoveries up to year-end. Frenzied selling in March as the pandemic forced the world into lockdown gave way to massive combined fiscal and monetary stimulus, including immediate rate cuts. Credit spreads subsequently tightened over Q2 and Q3. Equity prices recovered strongly, initially driven by technology stocks and later extending to cyclical stocks as positive news on vaccine emerged.

With peak to trough drawdowns of between 15% (Conservative Allocation) and 25% (Growth Allocation), the asset allocation funds provided better downside protection compared to equities, which saw losses of over 30% across major indices. Indeed, the diversified composition of the funds helped to protect performance, notably with positions in safe haven assets such as treasuries and gold. Over the year, positive contributors to performance were gold, US stocks, plus treasuries and corporate bonds. The primary negative contribution came from MENA equity. Japanese equities exposure was increased in November, taking global equities slightly overweight from neutral. Some profits were taken on gold during the summer, close to $2,000/oz

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Despite a very difficult market environment the AAFs delivered positive performances, highlighting the importance of staying invested with a robust asset allocation process and diversification. The Conservative and Balanced fared better than Growth, given their larger allocation towards fixed income. **The Asset Allocation Funds are designed for long-term and regular investors seeking to build capital via each of the risk profiles.**

FAB IM Weekly Update

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