FAB Investment Management Funds Update – 23rd March, 2020

- The Brent crude price (currently $26/barrel) remains volatile and has corrected by 20% last week.
- MENA equity markets corrected 2% last week with selling pressure partially coming from forced margin calls. MENA equity market has corrected by 25% year-to-date in-line with global market sell-off with the US market down by 28% year-to-date.
- In regional fixed income, credit spreads for high yield have further widened by 191 basis points. The lack of liquidity in the bond market has further aggravated the current market sell-off.
- Given the possibility of the global macro situation worsening, the world's major central banks have already announced massive monetary and fiscal stimulus.
- In the near term, market sentiment is expected to be driven by new number of reported coronavirus cases globally however in the medium term we expect to see economies benefitting from the announced stimulus packages.
- Our funds and segregated portfolios are positioned defensively in light of the current market volatility.
- We are cautious in the immediate short term and have further increased cash levels to 15-20%.
- If market conditions continue to deteriorate we may increase cash levels even further.

Crude oil prices further corrected by 20% last week before closing at $26/barrel. In the short term oil prices could correct further and remain volatile. In early 2016, Brent saw a closing low of USD 27.88/barrel, the current situation is somewhat similar, except now the pressure is coming from demand side coupled with the ramp up of supply. The demand pressures come from the coronavirus, versus in 2016, pressure was mainly due to upward march of US shale oil production. Saudi Arabia aims to force the higher-cost shale oil producers out of the market. Total crude production in the US is rising despite lower inventory levels. Lower crude prices are actually good for various EM oil-importing countries (especially China and India) as well as much of the developed world, and this will in time support a revival in global growth.

MENA Fixed Income: These markets unsurprisingly reacted negatively to the fall in oil price and lack of liquidity in the bond market has further aggravated the current market sell-off. During the previous week, the global economic growth forecast was slashed sharply by various economists, now global growth is expected to be in the range of 0% to 0.9% in 2020 after many countries have announced a complete lockdown of economies to prevent the spread of Covid-19. Given the possibility of the global macro situation worsening, the world's major central banks have already announced massive monetary and fiscal stimulus. In the near term, market sentiment is expected to be driven by new number of reported coronavirus cases globally however in the medium term we expect to see economies benefitting from the announced stimulus packages. We do certainly not subscribe to any doomsday scenarios, essentially because – although it will take time to rebuild supply chains – the virus will be a passing event.

Credit spreads have further widened by 191 basis points in below investment grade, High Yield bonds during the last week. Investment Grade (IG) bond spreads widened less, by 82 basis points, showing the defensive nature of the asset class. The current volatility has prevented new issuance coming to the market, with deals being postponed until markets stabilize. Overall GCC bond market (Bloomberg Barclays GCC USD Credit Total Return Index Value Unhedged) has corrected by around 10% during the last one month, the regional bond market have underperformed broader global bond market partially due to lack of liquidity in the market. The benchmark US 10-year Treasury has rallied considerably, with the yield plunging to 0.81%. This is the lowest level in history, as investors seek safety. Those MENA bonds correlated to US Treasuries have therefore been the most resilient.

The flagship MENA Bond Fund (MBF) is 65% invested in IG bonds, and 35% in HY bonds, with an overall average IG rating. Before this market sell-off we had in any case de-risked the portfolio, by reducing some high yield names. Exposure to Bahrain, Oman and Egypt was reduced by 50%, after successfully buying their bonds at much lower levels during the last two years. The overall fund positioning has helped mitigate the effects of the current market sell-off.

We remain comfortable with the MBF's credit spread, and the 4.03 average duration (reduced from 4.11 last week) of the portfolio is not excessive. Currently, the cash levels are relatively higher than 2019 across funds and segregated portfolios.

At present the MBF is holding 13% cash, plus 5% in short term money market instruments. Eligible portfolio cash is deployed in deposits. The MBF is up 0.59% for the YTD as at the end of February, compared to the return of the benchmark of 0.32%. The overall composition of the fund remains defensive, and we are continuing to de-risk it by moving into short term, higher-rated bonds.

The funds and portfolios are well positioned to overcome the current conditions. Cash levels and only high quality bonds have been positioned in a defensive manner in the fixed income portfolios.

<u>MENA Equities:</u> The MENA equity market corrected by around 2% during the last week with selling pressure partially coming from forced margin calls. MENA equity market has corrected by 25% year-to-date in-line with global market sell-off with US market down by 28% year-to-date.

During the next four weeks, most of the companies are going to be ex-dividend in the UAE, we might see some selling pressure on these names. After the current market sell-off, however, the dividend yield on certain quality names have moved into a range of 9-10%.

We expect market volatility to subside only after fall in new coronavirus cases globally. In our base case scenario, we expect markets to remain volatile in the second quarter of 2020 with economic activity remaining below its full potential. We expect earnings to remain weak for the next three quarters with peak decline in earnings expected in the second quarter of 2020.

Overall the positioning of the equity portfolios has been made increasingly defensive. We are underweight in the petrochemical sector, there is limited exposure to MENA real estate, and only selected exposure to the banking sector.

Saudi Arabia remains an overall underweight. We are increasing our exposure to select names in defensive sectors like telecommunication, utilities and REITs. We expect these names with a strong balance sheet to remain relatively more resilient in the current environment. In Kuwait we have reduced our overweight, although expect its MSCI EM index inclusion in May to support the market leading into the event itself. In UAE equities, we are selectively overweight in banks, although have been reducing this in favour of an increasing overweight in utilities and telecommunications.

The MENA Dividend Leader Fund (MDL) is 18% in cash. As per the investment guidelines the fund can hold a maximum of 20%. The cash raised has been in response to the current market conditions. We will look to deploy this cash as and when the current market situation stabilizes. For select names we are repositioning to defensive sectors once the stock becomes ex-dividend. **The current dividend yield on MDL has risen to 5.7% as market has corrected and valuations are progressively more attractive though we remain defensive in our positioning.**

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