

## Portfolio Managers Outlook

### All Aboard.

In our last comment, while discussing about the global backdrop, we said "Given the virtual freefall in some markets, any relief rally backed by some reasonable catalysts (most likely a coordinated policy response globally) promises to be fast and furious". And now, Germany and Russia bounced almost 20% off their October lows through to the end of the month, followed closely by the US and France with a gain of 14%. In Asia, Hong Kong gained 22% followed by South Korea with a rise of 15% and India, which gained 12%. This is an impressive response to the European plan, big on numbers however short on details. The voluntary nature of the Greek debt haircut meant no CDS trigger and prompted short covering, which promises to feed into a proper relief rally in risky assets. Undoubtedly, this situation remains highly speculative in nature and prone to failure.

Back home, most of the regional markets were lagging as compared to their global peers on October 4th. However the regional markets started recovering as the first reports of a large European stability fund emerged. So much for geographic diversification adding any value; the benefits disappear precisely when they are needed the most. The regional markets posted a marginal bounce at the back of developments in Europe, although on balance there is only a marginal improvement since our last comment.

Index	YTD in August %	Current YTD %
Saudi Arabia	-10.30	-6.40
Dubai	-10.90	-15.40
Abu Dhabi	-6.00	-8.20
Kuwait	-17.10	-12.50
Qatar	-6.70	-1.90
Egypt	-29.00	-33.90
Oman	-18.70	-17.30
Bahrain	-10.70	-20.00
S&P Pan Arab	-13.90	-12.40
MSCI EM	-15.70	-13.60

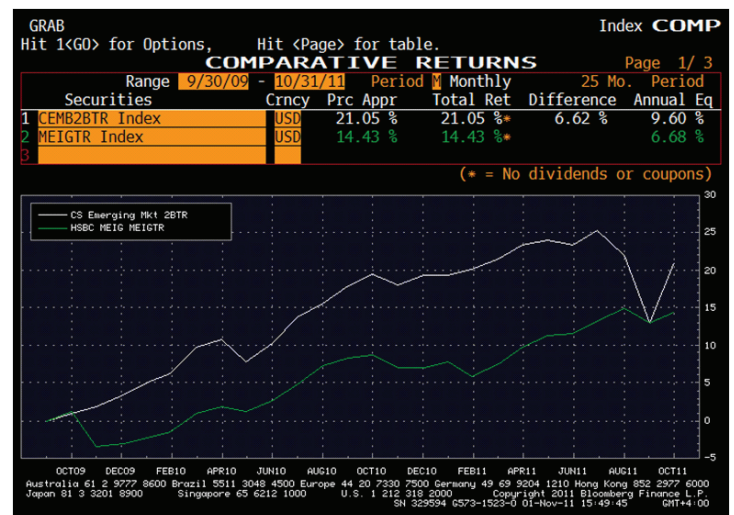
As seen in the table above, Saudi Arabia and Qatar have recovered the most, while Bahrain and Dubai have lagged the most. As we have noted in the past, UAE markets (more so Dubai) seem like a typical value play and are behaving accordingly. Hence, there is underperformance in a risk prone environment where markets have come back sharply. The results in the UAE Banking sector indicate a tightening of the liquidity situation, with a host of banks moving above 100% loan to deposit ratio. Dubai banks continue to show strains of credit challenges, while Abu Dhabi banks continue to show some growth. However, the increasing leverage may limit room for growth quickly. Emaar properties reported solid numbers and Du continued to grow impressively. This further highlights the Dubai Dilemma of how to capitalize on the strength in the retail and hospitality sectors. The aforementioned names would appear to be the best bets to try and do so.

Elsewhere in the region, chemical producers continued to show growth momentum while some Saudi retail names like Jarir posted good results. We expect consumption trends to remain strong and continue to favor companies that are likely to benefit. Outside the GCC, the Egyptian market remains volatile and we continue to be happy waiting for more clarity post elections. In Kuwait, despite identifying potential on a market level in August, we have struggled to find attractive individual investments and still remain on the hunt.

Libya has joined the ranks of gold members of the Arab Spring club, having successfully ousted the incumbent regime. The National Transition Council is in power and there is some discussion of oil prices retreating as Libyan oil supply comes back to the market. While this is, no doubt, ultimately going to happen, we believe Libya is far from political stability and we would not be surprised by some hiccups before a stable government emerges. Till such time, we expect oil prices to respond to the demand concerns (on the back of any Chinese weakness) rather than excess supply. We expect European developments to be the driving factor for market returns through to the year end, as regional developments on the corporate and political front remain in line with our expectations. If European leaders can manage to follow through on the Greece package, markets are likely to move higher. Though, there are serious challenges in achieving this, we remain long with some anxiety and are prepared to shift rapidly, should the Greek package unravel.

### Fixed Income (Volatility Continues)

What a quarter! The MENA fixed income markets stayed resilient to the global meltdown till late August, but September was a horrible month followed by a very strong October. November has started off very weak at the back of European uncertainty once again and uncertain data out of China has caused a reversal of some of October's strength. Unfortunately, this is a market that requires a lot trading discipline, while valuations are attractive in terms of credit spreads. Market volatility levels are extremely high as liquidity in the broker/dealer community is very low. This means, it is important to maintain 'take profit' and 'stop loss' disciplines and it is also important to limit your risk taking well researched names that you are comfortable holding through the volatility. In the near term, we are getting increasingly concerned about some of the refinancing risk for Dubai and Dubai related corporate entities. While we believe that entities like Dubai Holding, DIFC, and Jafza will be able to repay or refinance their obligations due next year, we do not feel that we are being compensated for the risk any longer. As such, we have reduced our exposure to these entities and are looking at some specific new issues in Turkey and Abu Dhabi.



Source: Bloomberg Data

The chart above however shows a heartening picture for regional credit. After many years of underperformance regional bonds (green line) have caught up global emerging bonds. This has mainly been due to the fact that, in the sell-off ensuing from the European crises, regional bonds have outperformed their peers to a significant extent. While the region is not cheap any longer from a global credit spread perspective, we believe that underlying credit fundamentals for the stronger issuers in the region are very robust and credit is cheap compared to the underlying credit quality.

Going into the 4th quarter, we continue to be concerned about the global economic environment. Primarily Europe and China, if we can see evidence of a soft landing in China along with some sort of longer term solution to the European debt crises, we would start getting more bullish about regional bonds. Until that time, we would prefer to be in higher quality issues in Qatar and Abu Dhabi, however once the market stabilizes, this sector is most prone to an increase of new issuance and hence we would scale out of it into some of the higher yielding credits.

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