Markets Outlook

Middle East & Africa markets bulletin: November 2013

Invest AD
شركة أبوظبي للإستثمار
Abu Dhabi Investment Company

About Invest AD

Invest AD is a unique financial services company offering institutional investors access to high-growth opportunities in frontier and emerging markets, specialising in Africa and the Middle East.

Owned by the Abu Dhabi government, the company benefits from an extensive international network, established over three decades and spanning governments, business leaders, and regulators.

With a history as a long-term investor, the company is highly respected in emerging and frontier markets, allowing us to offer exceptional investment opportunities to our global partners.

We implement international best practice in governance throughout all our operations, while offering flexibility in investment – whether through funds, tailor-made products, or long-term partnerships.

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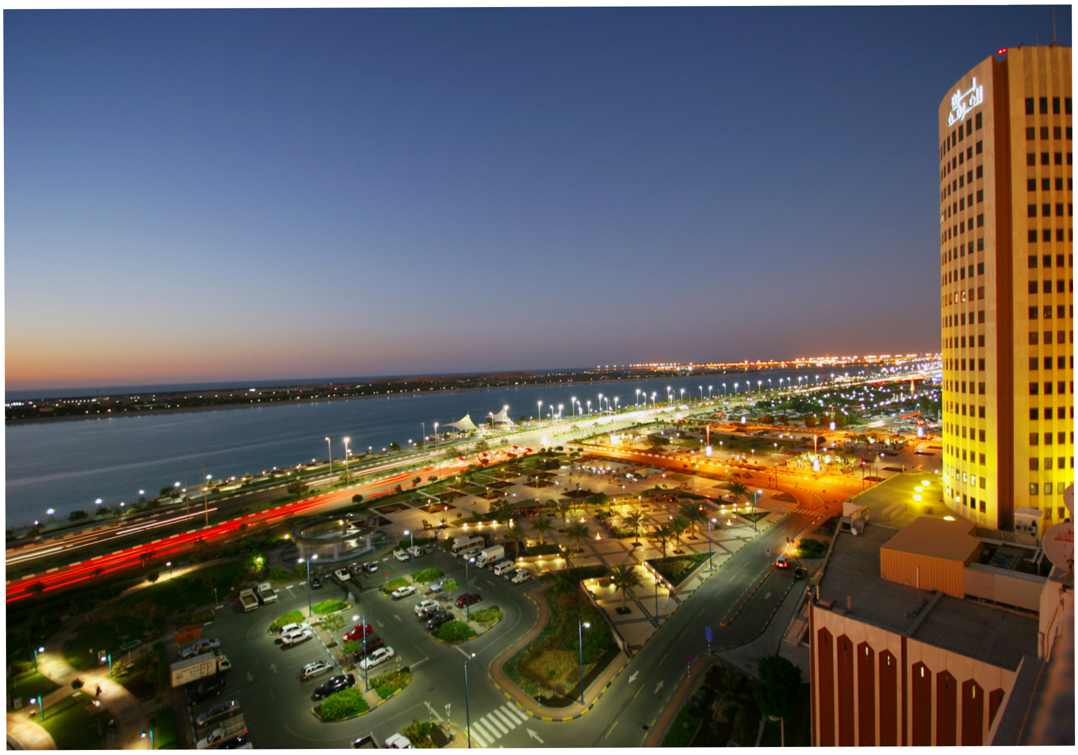

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Frontier markets provide extra kick

By Mohammed al Hashemi

Frontier markets are starting to show their true value to a portfolio, displaying low correlation to global markets, returns that reflect strong macro fundamentals, and a suggestion that drastic rerating is possible as some markets near emerging market status.

Relatively small markets such as Nigeria, Kenya, Ghana, Oman and Kuwait have been largely ignored by the mainstream, but there are clear signs of a change in attitudes as global investors look to add a little kick to their portfolios.

For example, an Invest AD - Economist Intelligence Unit survey last year found that institutional investors are looking to take their first step into Africa. Of the 158 investment managers surveyed, one in five of respondents had no allocation to Africa at all, and another quarter had less than one percent. But by 2016, all intend to have some exposure, with nearly one third expecting to have over 5 percent allocation to the region.

Relatively fast growing economies and an emerging middle class are the main attractions, and those fundamentals are being reflected in market performance as investors look for alternatives to the weary BRICs story. The Kenya and Ghana markets have gained nearly 50 percent this year, while Nigeria is up nearly 20 percent, thanks to improved macro-economic management and increased domestic consumption. That compares to a negative 3 percent performance by the MSCI Emerging Markets index.

Unlike many emerging markets, a sizeable portion of companies listed in the frontier markets derive their income largely from domestic activities rather than through export of goods or services. Hence, the stronger underlying economic and demographic trends in those countries have more of a direct impact on their listed equities valuations and ultimately performance.

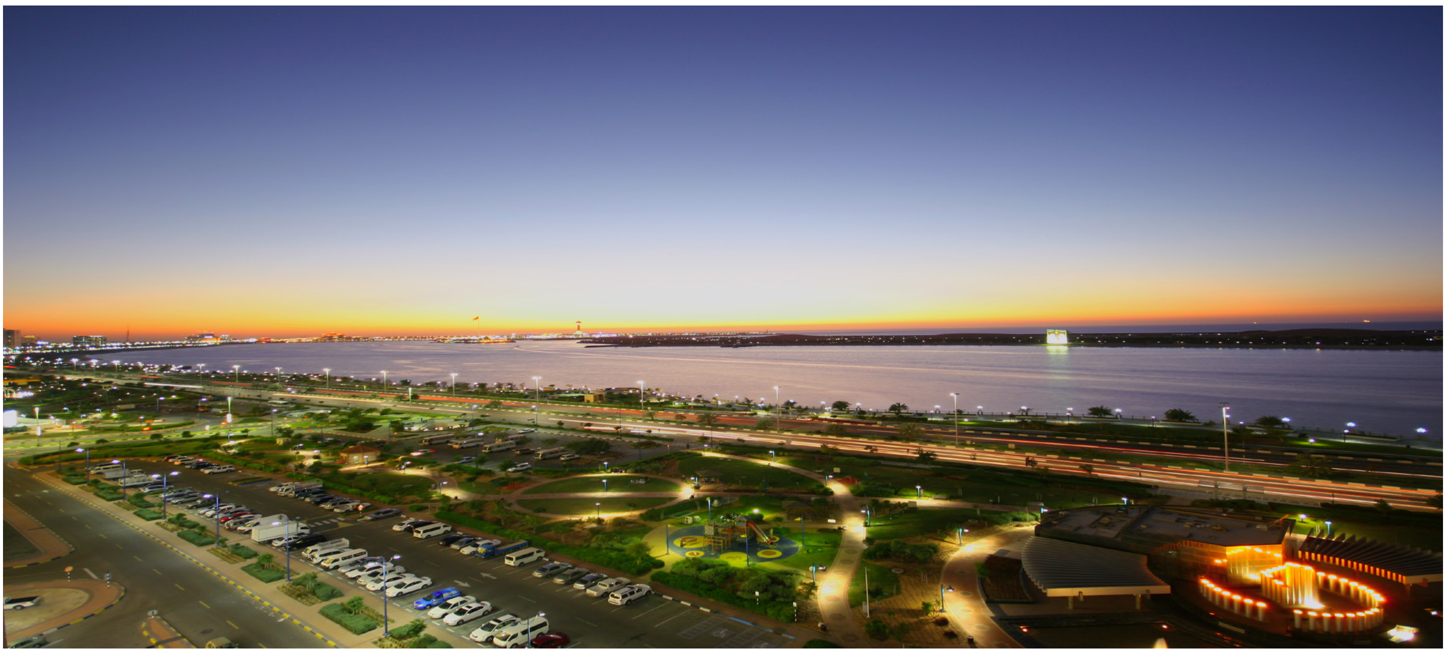
As frontier markets come of age, they can enhance portfolio diversification that is increasingly difficult to achieve in an increasingly interconnected world. Emerging markets are almost synonymous with Asia and have developed a fairly high positive correlation with developed markets, particularly the United States. Meanwhile, the MSCI EFM Africa (ex South Africa) index displays a correlation of 0.26 with the S&P 500 and 0.33 with the MSCI Emerging Markets index on the basis of rolling three-year weekly returns. Frontier markets have also been much less volatile in the last couple of years than emerging markets.

As well as being driven by somewhat different macro-economic fundamentals, frontier markets tend to behave differently precisely because foreign investors still tend to account for a minority of trading activity. Although disclosure is often better than in many emerging markets, many investors are still put off by the relative shortage of analyst research – which, in fact, is a huge advantage for asset managers willing to put boots on the ground, and (to elegantly mix metaphors) kick the tyres.

A lack of liquidity is a risk in some frontier markets, partly because of buy-and-hold local institutions and high net worth individuals, but this issue can be handled by properly diversifying a frontier market portfolio and steering away from very small cap, and low-free-float stocks.

In the long term, frontier markets become emerging markets, attracting extra liquidity and perhaps even a rerating. In a year when MSCI has finally decided to elevate the UAE and Qatar markets to emerging market status, the markets have seen trading volumes triple. Dubai stocks have soared over 70 percent, while Qatar stocks are up 19 percent. If and when Saudi Arabia – a heavyweight among frontier markets because of its capitalisation and developed corporate landscape -- finally decides to open up further to foreign investors, we can expect an equally strong surge in interest.

Mohammed Al Hashemi is Executive Director of Asset Management at Invest AD



Equities

GCC

With regional earnings looking like a mixed bag, market sentiment could see some short-term weakness, but could bounce back if Dubai's bid for the World Expo 2020 goes its way and as investors start to focus on 2014 growth prospects, which look robust. Third-quarter results from Saudi Arabian banks have shown an average of 8 percent year-on-year net profit growth for the sector, but balance sheet growth and earnings quality has split the sector down the middle between clear outperformers and underperformers. Meanwhile, SABIC failed to live up to the optimistic expectations of sell-side analysts. In the UAE, Emaar reported a 50 percent rise in third quarter net profit, giving further rise for optimism about Dubai's economy – also backed up by double-digit loan growth at the country's banks. In Qatar, Industries Qatar and QNB results were muted, leading to market weakness, with some local investors and foreign institutions emerging as sellers. The medium term prospects for regional markets will however be determined by a number of factors which include progress on recently announced infrastructure projects, the demand scenario for petrochemicals particularly in Asia, and monetary action by the U.S. Federal Reserve.

Africa

The Egyptian market has performed well in recent weeks, with retail investors buying actively as hopes that further GCC financial support will alleviate pressure on the government as it tackles economic reform. But with the trial of former president, Mohammed Morsi, scheduled to start in early November, and the Muslim Brotherhood planning protests, investors are likely to tread cautiously in coming days. Given recent performance, any correction could lead to renewed interest from some institutional investors, on the hope that the market will bounce back. On the economic front, the IMF has praised Egypt's US$ 3.2 billion stimulus plan and has forecast 2.8 percent GDP growth for this year. In Nigeria, banks reported mixed third-quarter results, with several banks hit by tightened market liquidity. Guarantee Bank's net profit is down 22 percent quarter-on-quarter. General investors sentiment is unlikely to be dented in the long term, although the market has lacked direction for a few weeks. Meanwhile, Morocco's third quarter GDP growth decelerated to 4.5 percent from 5.1 percent in the second quarter due to a slowdown in the non-agricultural sector, while agricultural output rose 18.9 percent as the national grain harvest recovered from drought. The state planning agency expects growth to accelerate again in the fourth quarter, with a forecast of 5.3 percent for the period.

Iraq

The Iraqi market has moved steadily upwards in the last few weeks, driven by some banks and Baghdad Soft Drinks, with the bottling and distribution company recording a 26 percent rise in nine-month net profit. However, following a central bank decision this month to force many banks to reach a paid-up capital threshold of 250 billion Iraqi dinars, there is a risk that some liquidity will be sucked out of the market through capital raising in the coming weeks. The central bank appears to have lost patience with the 16 listed banks (of 21) that have failed to reach its minimum threshold, ruling in late October that it would bar them from opening new branches, entering the central bank's dollar auctions, as well as taking part in other activities, including transferring money or selling cash. The banks have been given a four-month period to raise capital. In a boost to general investor confidence, Emaar Properties, Dubai's largest property firm, has announced a US$ 3 billion development in Erbil, the capital of Iraq's Kurdistan region. The mixed-use project is due to be completed in three stages over a period of around five years.

Market data as of October 31, 2013

Country/Region	Closing price	MTD	YTD	3M	1Y	3Y
S&P GCC	164.35	1.38%	22.77%	24.31%	23.36%	28.48%
S&P Frontier BMI	102.91	2.56%	15.10%	25.47%	18.90%	-0.01%
S&P Pan Arab	153.33	2.01%	19.76%	21.64%	19.77%	19.69%
MSCI Emerging Markets	1,034.42	-1.70%	-1.68%	-1.68%	3.23%	12.07%
MSCI World Total Return	4,167.22	3.91%	21.89%	31.60%	25.77%	40.07%
MSCI EFM Africa Ex S.A.	660.21	-0.07%	5.77%	5.56%	28.72%	9.93%
Total return in local currency (MSCI)						
MSCI UAE	121.45	0.85%	24.70%	25.28%	34.84%	15.60%
Saudi Arabia	2,144.96	3.61%	6.83%	5.64%	-4.34%	17.61%
MSCI Kuwait	2,062.15	-1.76%	0.22%	-0.57%	-1.06%	0.22%
MSCI Qatar	244.77	2.82%	8.09%	8.84%	1.88%	38.98%
MSCI Oman	1,975.81	2.56%	5.72%	7.52%	-0.04%	-8.12%
MSCI Bahrain	441.20	4.21%	7.36%	7.00%	-3.75%	-31.62%
Total return in USD (MSCI)						
MSCI Egypt	182.31	-6.36%	-10.84%	-12.28%	-3.92%	-27.29%
MSCI Turkey	549,491.42	7.90%	7.99%	7.70%	42.35%	35.83%
MSCI Jordan	270.17	-3.71%	-0.16%	0.01%	-5.74%	-19.66%
MSCI Lebanon	0.45	-1.63%	-1.23%	-1.16%	-3.14%	-26.84%
MSCI Morocco	35.31	-1.15%	-3.17%	-3.96%	-16.77%	-21.36%
MSCI Botswana	106.34	14.76%	20.18%	20.18%	35.65%	1.32%
MSCI Ghana	1,255.36	11.84%	53.18%	53.34%	95.19%	101.41%
MSCI Kenya	19.93	12.35%	28.60%	28.82%	72.29%	82.14%
MSCI Mauritius	33.35	1.71%	10.03%	10.53%	14.50%	28.50%
MSCI Nigeria	4.99	1.48%	15.86%	17.27%	78.63%	59.61%
MSCI Tunisia	787.32	-0.77%	-2.05%	-1.93%	-4.75%	-4.76%
MSCI South Africa	111.68	-1.65%	-9.42%	-9.68%	-1.96%	19.94%
S&P Zambia	195.14	-1.94%	35.78%	34.51%	43.80%	39.21%

Source: Bloomberg

Fixed income

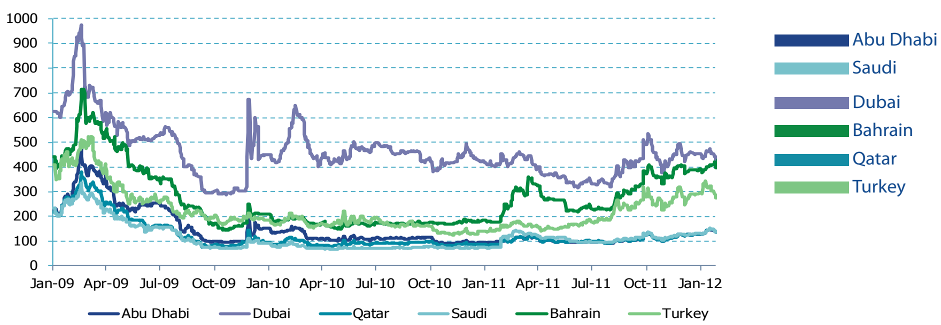
Middle East credit markets have been maintaining a positive momentum, with investors focusing on new issuance. The second half of October saw new issuance announcements from QNB, which raised two tranches of US$ 750 million each through a three-year floating rate and a five-year fixed rate. The floating rate note was the first in the category for a few years and was welcomed by investors, doing well in the secondary markets. The fixed-rate bond was priced too tightly and was met with a wave of selling in the secondary markets and continues to trade in the red – underlining the need for investors to be selective. Some recent issuances in the markets that were regarded as too tightly priced have been flipped in the secondary markets and then continued to languish as they were slowly driven out of demand.

A MAF perpetual deal, which was delayed from May, finally came to the market and this deal too followed the usual practice of setting a high initial guidance to boost the order books and then tightening by more than 50 bps to eventually raise US$ 500 million at 7.125 percent. The initial price guidance helped to build a book of more than US$ 4 billion, with many regional institutional accounts involved but private banking accounts more lukewarm, given the poor performance of financial perpetual bonds during the last bout of market volatility. The tightening of pricing in favour of MAF also led to poor secondary market performance, with the bond struggling to hold its issue price. In all recent issuances, it is evident that when the syndicate tries to tighten pricing by building up a huge order book, the secondary market performance is dismal and does not reflect interest seen in the primary markets. Investors should therefore focus on pricing, rather than the size of the order books.

On the global markets front, the U.S. economy added 148,000 jobs in September, with the disclosure of the data delayed by the government shut down. Although the payroll data can experience monthly swings, the trend has been weakening. In the third quarter, monthly job gains averaged 143,000 versus 182,000 in the second quarter and 207,000 in the first quarter of 2013. It is unlikely that September's weakness had anything to do with worries about an impending shutdown. It looks as if this year's tepid economic growth has finally crept into the labour market.

The rise in long-term interest rates during the spring and summer, as investors bet that the Fed would begin reducing its bond purchase in September, may also have played a role. The October job report, slated for release on November 8 is much more likely to reflect the government shut-down and the hope is that the blow will be only temporary.

Sovereign CDS spreads



Source: Bloomberg

GCC CDS spreads

Sov CDS	Level	Wk (bps)	YTD (bps)
Abu Dhabi	61	-2	-23
Dubai	205	7	-20
Qatar	67	-2	-15
Saudi	69	3	-3
FI & Corp CDS			
NBAD	109	6	-5
ADCB	116	1	-14
Emirates Bank	227	-17	-1
Samba	97	-3	-31
TAQA	133	0	1
DP World	193	-17	0

Source: Bloomberg

Market data as of October 27, 2013

Financials – senior	Maturity	Cpn	Bid	Ask	Bid sprd	Ask sprd	S&P	CCY	Type
ADCB	8-Oct-14	4.75%	103.50	104.00	121	80	A	USD	C
ADCB	22-Nov-16	4.07%	105.25	105.75	157	142	A	USD	S
ADCB	6-Mar-18	2.50%	97.75	98.50	169	151	A	USD	C
ADCB	3-Jun-23	4.50%	100.25	101.25	192	179	A	USD	C
ADIB	29-Oct-49	6.38%	101.75	102.75	448	426	N.R.	USD	S
BBK	28-Oct-15	4.50%	101.50	102.50	325	279	A-	USD	C
Burgan Bank	29-Sep-20	7.88%	108.75	110.75	433	400	BBB	USD	C
Saudi Fransi	22-May-17	2.95%	101.75	102.25	145	132	A	USD	S
COM QAT	11-Apr-17	3.38%	102.50	103.00	166	152	A-	USD	C
DIB	30-May-17	4.75%	104.00	104.75	262	241	BBB+	USD	S
Emirates Bank	28-Mar-17	4.63%	104.00	104.50	248	233	A3	USD	C
First Gulf Bk	9-Oct-17	2.86%	100.25	100.75	164	152	A	USD	C
KIPCO	17-Oct-16	8.88%	113.50	115.50	351	290	BBB-	USD	C
NBAD	13-Aug-19	3.00%	97.25	98.25	169	150	A+	USD	C
Qatar Islamic Bank	10-Oct-17	2.50%	99.75	100.25	141	128	A-	USD	S
QNB	14-Feb-18	2.13%	96.75	97.75	157	133	A+	USD	C
Saudi British Bank	12-Nov-15	3.00%	103.25	104.25	105	62	A	USD	C
Tamweel	18-Jan-17	5.15%	104.00	105.00	304	274	BBB+	USD	S

Source: Bloomberg