Perspectives

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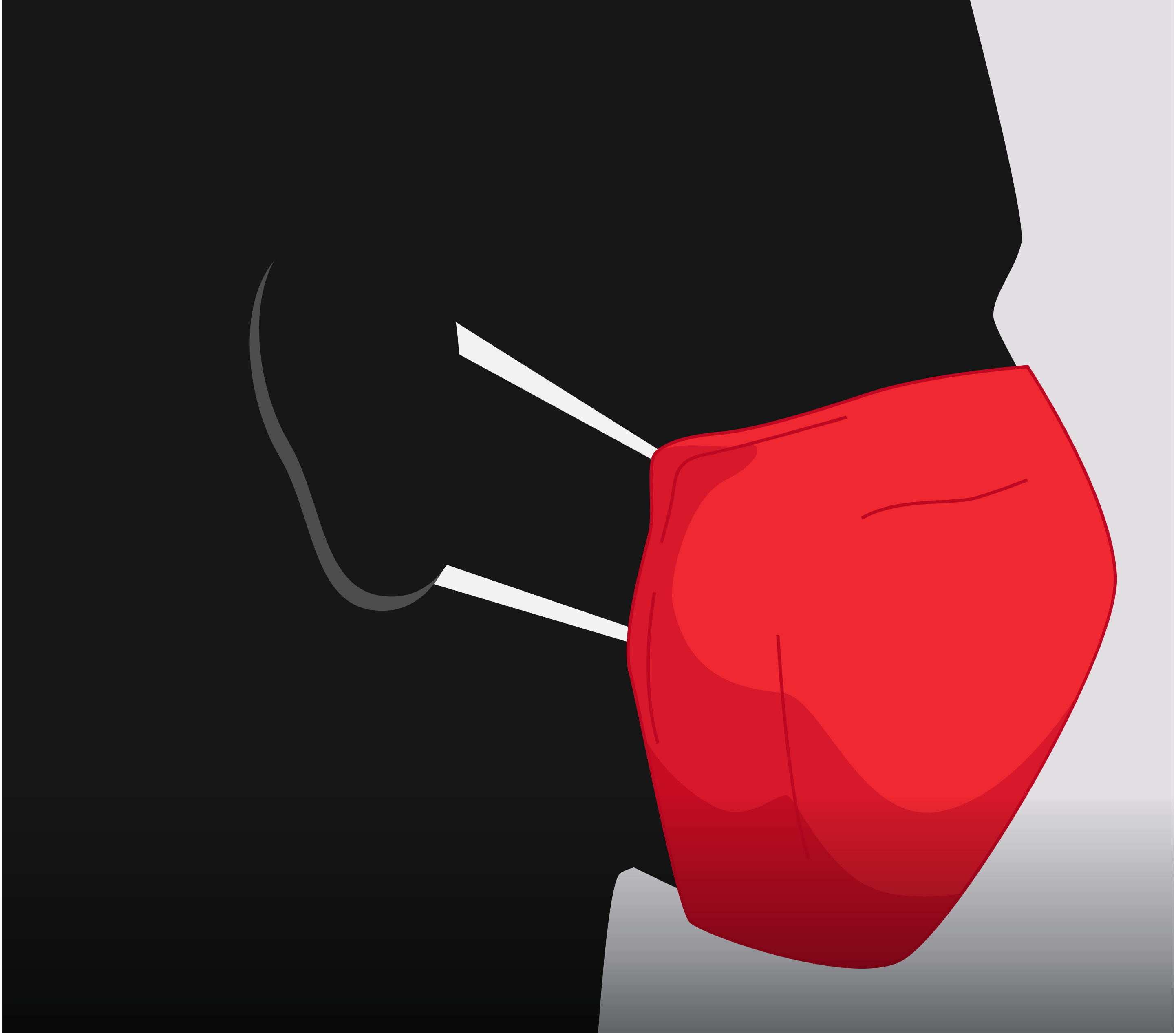
Al Mal Capital

March **2020**

When black swans collide



Global Markets: From FOMO to FOCO

Hot topic: Emergency Fed Rate Cuts - Is it Good or Bad?

Investment Strategy: COVID-19 Winners & Losers

MENA Equities: COVID-19 and Falling Oil Prices

Innovation: The Rise of Neobanks

Contents

Welcome to the 33rd edition of Perspectives. After a strong start of the year, the FOMO (“Fear-of-Missing-Out”) effect was quickly replaced by FOCO (“Fear-Of-the-Coronavirus-Outbreak”) as the increase in COVID-19 cases outside China, led to a sharp selloff of risk assets towards the end of the month. In the first half of March, the sell-off accelerated and led to the fastest bear market in history as the first "black swan" (an economic shock spurred by COVID-19) collide with an oil crash after OPEC+ production cut agreement fell apart in Vienna. Even worse, central banks are losing credibility as the US Treasury market does not seem to function normally.

In the first article of this edition, we try to assess what could be the global macro-economic impact of COVID-19 and how the various asset classes and sectors are expected to perform depending on 3 scenarios – V-shaped recovery, U-shaped recovery or L-shaped (recession). We also highlight the implications of the recent market developments to update our global asset allocation views.

We then briefly review the history of the Fed Emergency rate shifts and share our key takeaway from this important monetary policy decision.

In the Investment Strategy section, we review the global asset classes, sectors and types of companies which will either be penalized or benefit from COVID-19 while making a distinction between short-term and long-term winners and losers.

The same exercise is performed on our Middle East equities universe. This section also includes our first take on the oil situation following OPEC’s meeting and the subsequent surprising announcement.

The last article takes a step back from market action by looking at Neo-banking, a segment expected to go through a period of fast growth.

We hope you will enjoy this issue.

#MARKET WATCH

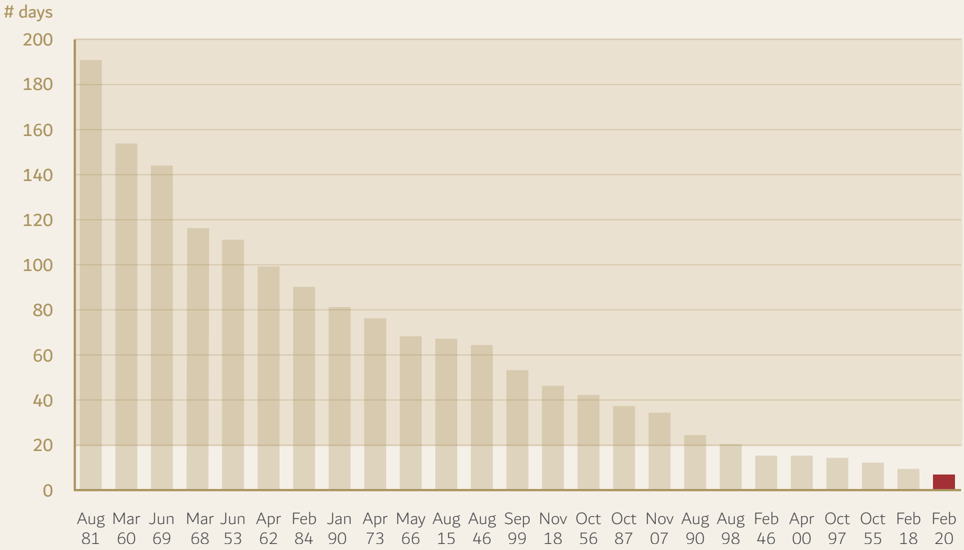
The last week of February was the fastest -10% correction ever

Big Swoon

It was also the worst week for the S&P 500 since 2008.

Ten-Year yields hit a 150-year low as they dropped below 1.0% for the first time since 1871.

Time taken for S&P 500 to correct 10% from peak ▶



A Negative 30-Year Real Yield

Since 1871, benchmark Treasury yields had never before dropped below 1.0%.

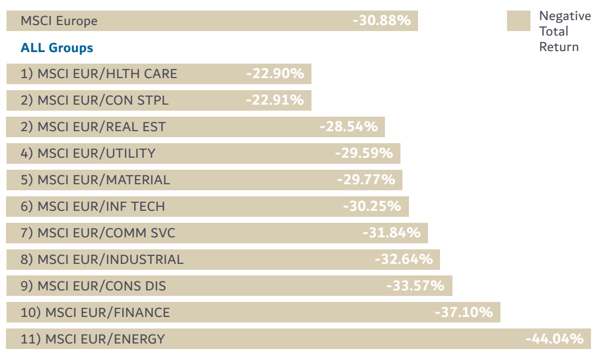
Market Volatility Since Coronavirus News

VIX Index score daily highs since the coronavirus outbreak was announced.

VIX Index score measures the expection of stock market volatility over the next 30 days, based on S&P 500 options. Source: Macrotrends.

Virus in Europe

Energy and Financials lead the drop among European sectors since Feb. 19 peak (as of March 13th).



Source: Bloomberg

February ETF Inflows Positive despite Virus

A powerful coronavirus-fueled sell-off in global stock markets wasn't enough to derail February's flows picture.

A respectable **$21.2 billion** flowed into U.S.-listed ETFs during the period, pushing year-to-date inflows up to **$72.3 billion**, ahead of 2019's pace of $20.8 billion.

Unsurprisingly, **U.S. fixed income ETFs** picked up the bulk of new assets in February (+$13.4 billion). The AGG and the IEF were the most popular fixed income products of the month.

But even though fixed income led the charge, **equity ETFs** managed to eke on a net inflow for the month. Funds popular with long-term investors, like the VOO, the IVV and the VTI topped the inflows list for the month.

ZIRP (Zero Interest Rate Policy)

On the 4th of March, the US Federal Reserve (capitalization) decided to cut rates by half point to combat coronavirus slowdown. On March 15th, the Fed effectively cut its benchmark by a full percentage point to zero.

Donald J. Trump
@realDonaldTrump

"The Federal Reserve is cutting but must further ease and, most importantly, come into line with other countries/competitors. We are not playing on a level field. Not fair to USA. It is finally time for the Federal Reserve to LEAD. More easing and cutting!"

Coronavirus Expected to Impact Tech Industry Shipments

Estimated impact of COVID-19 outbreak on global tech shipment in Q1 2020

TVs	Video Game Consoles	Smart Phones	Smart Speakers	Notebooks	Smart Watches
-4.5%	-10.1%	-10.4%	-12.1%	-12.3%	-16.0%

Source: Statista

On the Cheap

S&P 500 dividend yields now exceeds 30-year Treasury yields (it already happened in 2009).

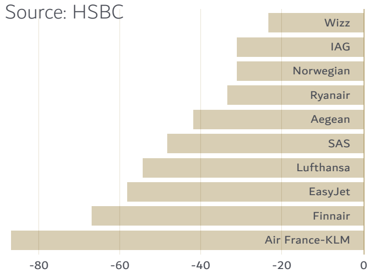
European stocks trade at near-record discount to the US.

Goldman Sachs now expects 0% S&P 500 EPS growth in 2020.

0%

Coronavirus impact on Airlines 2020 profits (%)

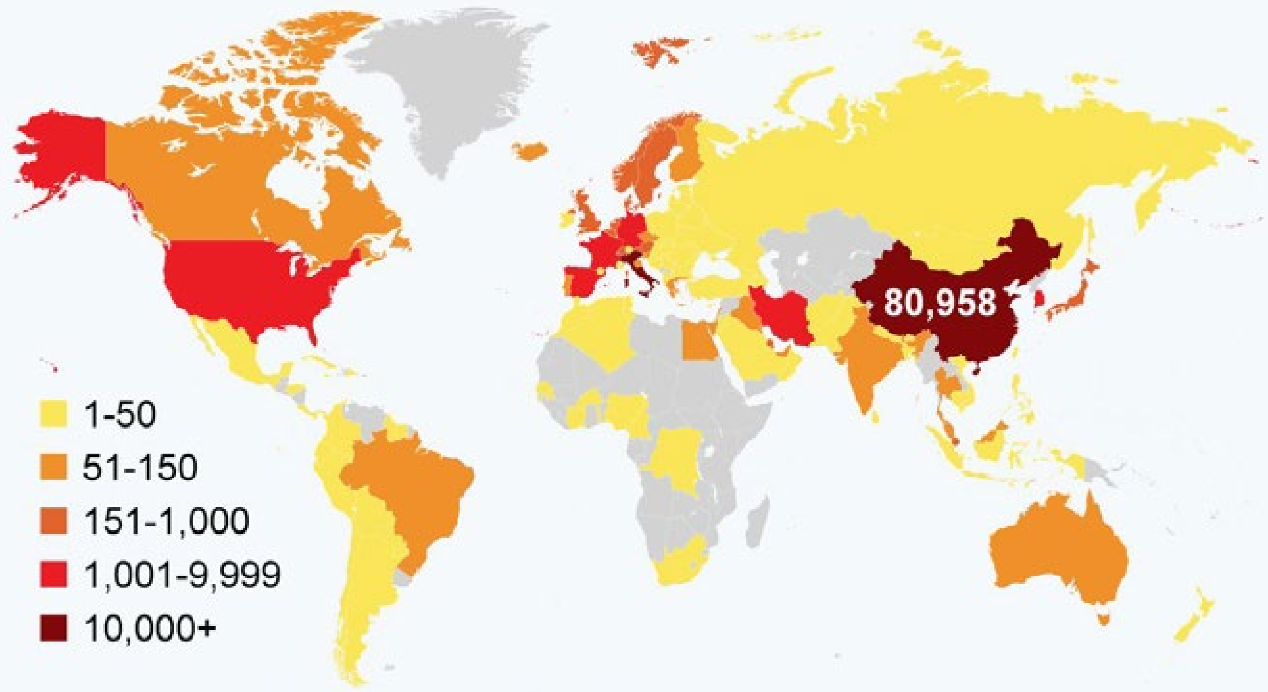
Source: HSBC



#TRENDS

Nearly 125,000 Cases of COVID-19 Confirmed Worldwide

Locations by number of confirmed COVID-19 cases*

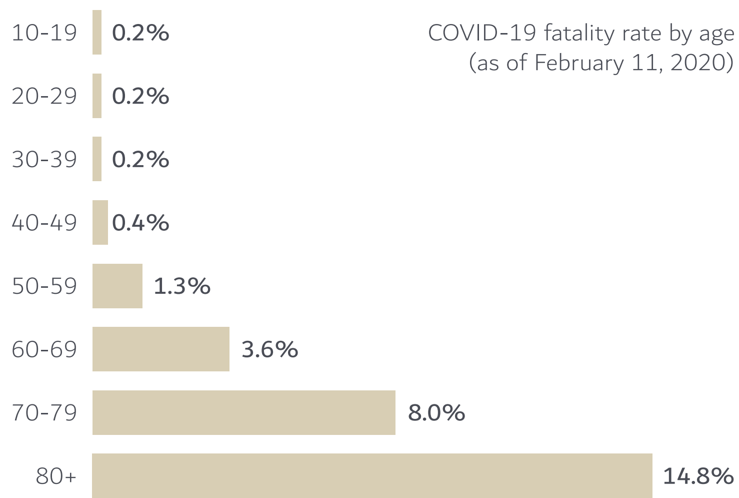


*Hong Kong and Macau included in China figure. *As of March 12, 2020 at 6am EST. Source: John Hopkins University.*

Over 80% of coronavirus cases are mild. This could explain why it is spreading so rapidly.

STUDY: Elderly most at risk from the Cronavirus.

Source: Chinese Centre of Disease Control and Prevention. ▶



Sizing the coronavirus shock

155 countries with confirmed cases of COVID-19

$113 billions of revenues could be lost by airlines around the world due to COVID-19

Italy is now in full lock down as it is currently the most affected country by the viral outbreak outside Asia

25x size of temporary global GDP hit from viral outbreak compared to the **disruption from a major US hurricane**

40 billion "missing working hours" if all Chinese firms had restarted on the 1st allowable day– the equivalent of **all US workers taking an unplanned break for two months**

60 million the population of Hubei, the province where the virus outbreak began, similar to the **total number of people living in Spain and Portugal**

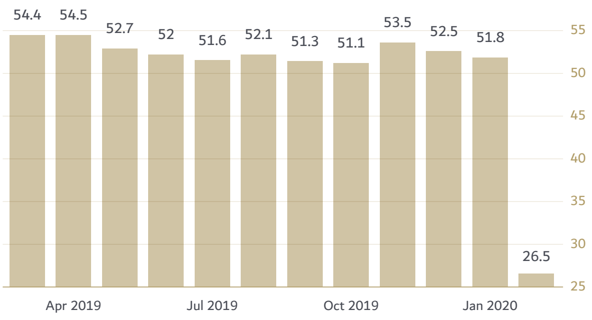
2,000 Starbucks locations that have temporarily closed in China

0.30-0.35% of annual global GDP is generated by China's travel spending, **double the amount of the US**

Source: Johns Hopkins, Goldman Sachs

CHINA

Caixin Services PMI

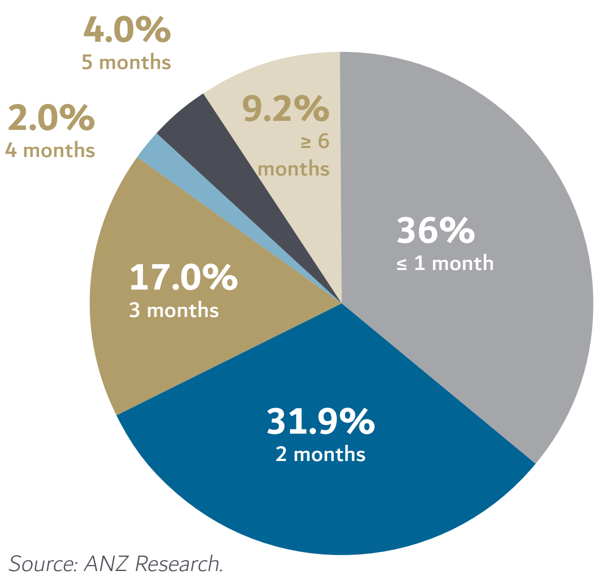


ACTUAL: **26.5** PREVIOUS: **51.8**

Release Date: Mar 3, 2020. Source: Markit Economics.

How long can your business survive without cash inflows?

China: 85% of China's small and medium-sized businesses surveyed said they are unable to operate for more than three consecutive months if they rely on their cash reserves.

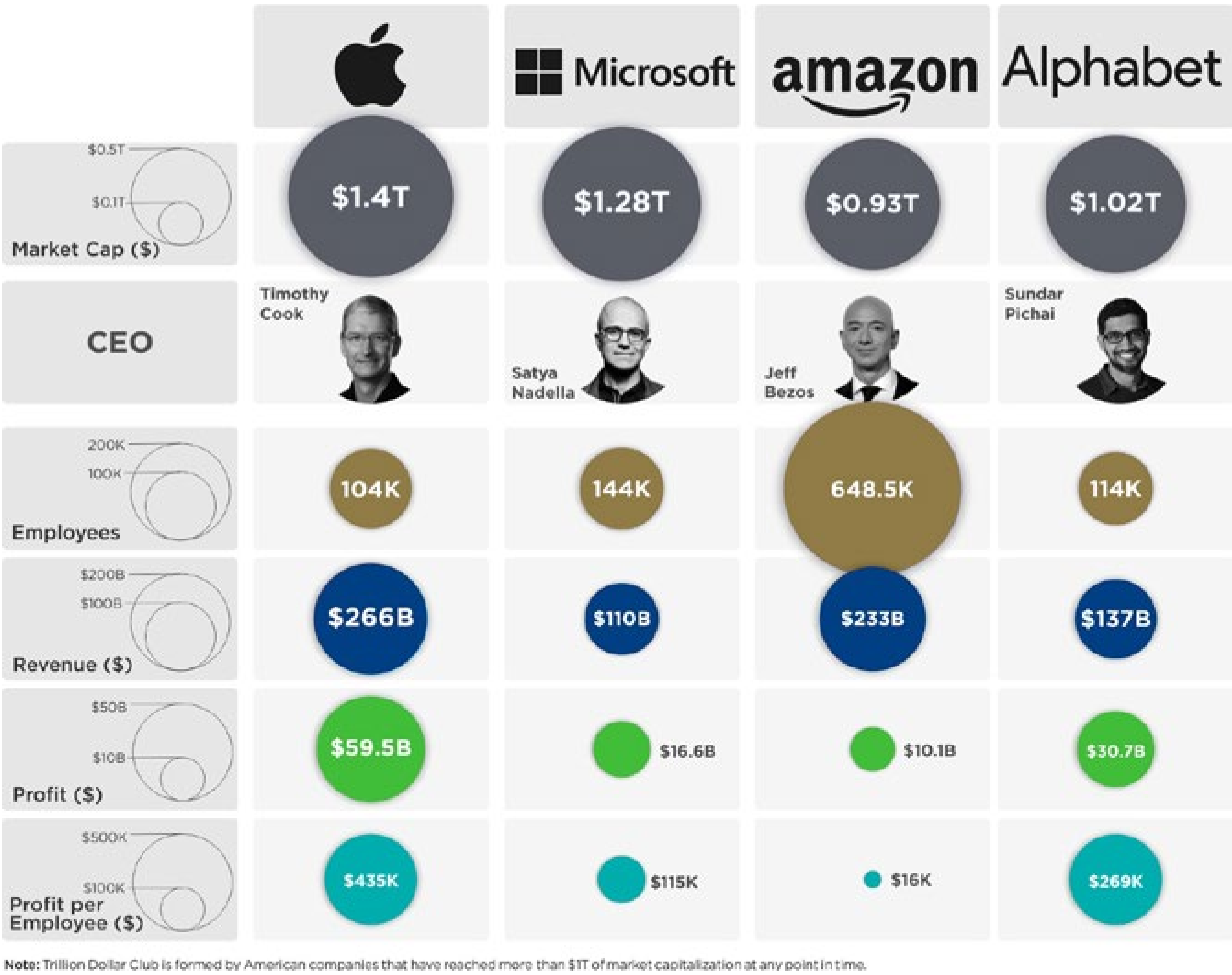


Source: ANZ Research.

#THE BIG PICTURE

Companies in the Trillion Dollar Club

Comparing Apple, Microsoft, Amazon and Alphabet by their Key Metrics. *Source: howmuch.net*



The Economic Impact of Venture Capital

VC-Backed companies as a percentage of public U.S. companies founded since 1979.

43%	57%	38%	82%
Total Number	Total Market Capitalization	Total Employees	Research and Development

Some of the largest US VC-Backed Companies of all time: 3Com • Tesla • Genentech • Bed Bath & Beyond • Whole Foods Market • Apple • Starbucks • Costco

Nearly 40% of the LatAm population is unbanked. *Source: CB Insights.*


23M Number of **Argentinians that lack a bank account**, representing roughly **50%** of the total population

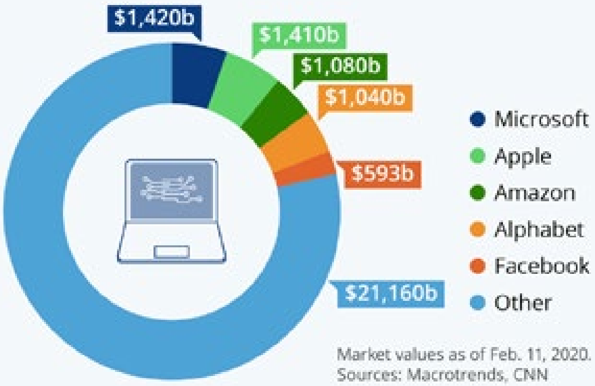

55M Number of **Brazilians that lack a bank account**, representing over **25%** of the total population


30M Number of **Colombians that lack a bank account**, representing over **50%** of the total population


42M Number of **Mexicans that lack a bank account**, representing over **30%** of the total population

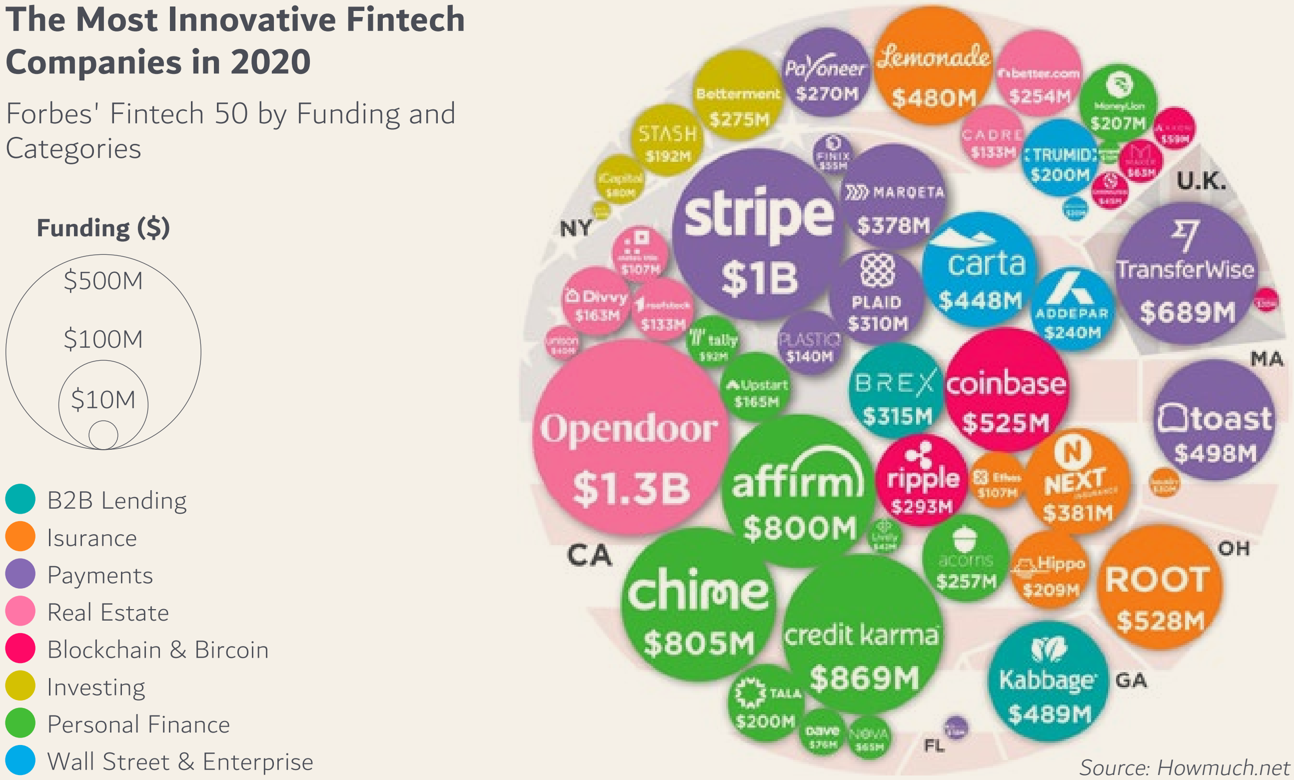
Tech companies dominate S&P 500 index. *Source: Statista.*

Market valuation of S&P 500 top five tech companies relative to all others (in billion US dollars)



The Most Innovative Fintech Companies in 2020

Forbes' Fintech 50 by Funding and Categories



Source: Howmuch.net

Global Markets:
From FOMO to FOCO

COVID-19 Fears Drove Fastest Bear Market In History

In late December 2019, a cluster of pneumonia cases of unknown cause was reported by health authorities in Wuhan, Hubei Province, People's Republic of China. The initial cases mostly had links to the Huanan Seafood Wholesale Market. The earliest reported symptoms occurred on 1st December 2019. The WHO declared the outbreak to be a Public Health Emergency of International Concern on 30th January. Since that day, the Coronavirus (then COVID-19) story has been in the headlines in traditional and social media with the "Infodemic" becoming even more spectacular than the epidemic itself.

During the early stages of the outbreak, the number of cases doubled approximately every seven and a half days. In early and mid-January 2020, the virus spread to other Chinese provinces, helped by the Chinese New Year migration, as Wuhan is a transport hub in China and the infected individuals quickly spread throughout the country. On 20th January, China reported nearly 140 new patients in a day, including two people in Beijing and one in Shenzhen.

On 26th February 2020, WHO reported that, as new cases dropped in China, they suddenly increased in Italy, Iran and South Korea. The number of new cases outside China had exceeded the number of new cases in China for the first time on 25th February 2020. At the time of our writing, it is spreading worldwide (nearly 160 thousands cases as of 15th of March) and triggering major cities across the globe to lock down.

The initial reaction of financial markets to COVID-19 was rather muted although market leadership progressively started to price in the threat of the virus to global economic growth. From early February onwards, Gold and sovereign bond markets came ahead of US equities as the best performing asset class. Airlines, tourism and luxury stocks were suffering the most. Value, cyclical, small and mid-caps as well as emerging equities were clearly lagging while defensives and ultra-growth (FAANGs, Tesla, etc.) were the outperformers. While COVID-19 was dominating market sentiment, the "fear-of-missing-out" (FOMO) pushed the S&P 500 to a new all-time high around the 20th of February.

But at the end of the month, market sentiment suddenly shifted from FOMO to FOCO ("Fears of Coronavirus Outbreak") as stocks experienced their largest weekly drop since the Lehman crisis. Indeed, investors became increasingly concerned that the coronavirus outbreak will turn into a global pandemic with severe implications on economic growth. While the rate of new cases slowed in China, the headlines that the virus was spreading at an increased rate outside China triggered a 25% to 35% bear market for major equity indexes.

This bear market is the fastest in history as the Dow Jones index suffered its worst daily decline since 1987 on Thursday. "Circuit breakers" designed to halt trading when the S&P 500 falls by more than 7% were deployed twice in the same week (9th to 13th of March) and this for the first time since 1997. Meanwhile, the VIX Index - a popular measure of the stock market's expectation of volatility, reached its highest level since the financial crisis of 2008.

The sell-off seemed to have four major drivers:

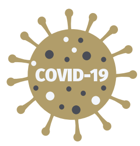
1) On Monday 9th of March, crude oil prices sank the most since the Gulf War in 1991 following Saudi Arabia's decision to radically increase exports in order to drive down prices and punish Russia for its refusal to follow production limits. The oil crash is putting considerable pressure on US shale producers and given their weight within the US high yield index, investors fear this could escalate into a full blown credit crisis. Boeing's decision to draw down a $13.8 billion credit line to help it deal with falling airline demand and its MAX 737 problems added to market stress;

2) The number of COVID-19 cases climbing sharply over the week, the cancellation of major leagues and events, reports of new quarantines and the WHO's official designation of a global pandemic unsettled investors;

3) US President Trump's surprise announcement of the EU travel ban added to the market panic and;

4) US Treasuries were extraordinarily volatile over the week of 9th–13th of March, with the 10-year yield decreasing to below 0.35% before Monday's U.S. market open before trading near 0.90% on Friday. The day before, there were some unusual dislocations in the prices of Treasury futures contracts and the underlying bonds and forcing the Fed to inject $1.5 trillion in liquidity into short-term lending markets on Thursday.

At the time of our writing, risk assets are in negative territory on a year-to-date basis with a -19% decline for the Dow Jones index and -46% decline for WTI crude oil. *(see chart on the next page).*



Selected risk assets year-to-date performance as of March 13th

INDEX	YEAR-TO-DATE
Dow Jones Industrial Average	-18.8%
S&P 500 Index	-16.1%
NASDAQ	-12.2%
MSCI EAFE	-26.8%
Oil ($/bbl)	-45.7%
US High Yield Bonds	-1.6%

In the sections which follow, we try to assess what could be ***the global macro-economic impact*** *of COVID-19 and* ***how the various asset classes and sectors are expected to perform depending on 3 scenarios – V-shaped recovery, U-shaped recovery or L-shape (recession).*** *We then* ***bring the current correction into a historical perspective****, reminding our readers how (bad) market timing poses a risk to long-term returns.*

Finally, we highlight the implications of the recent market developments to ***our global asset allocation views****.*

A V-shape recovery, U-shape recovery or L-shape recession?

As we entered into the new year, our base case was for the global economic cycle to be extended just slightly more in 2020. Signs that manufacturing PMIs were stabilizing and likely to improve further out had increased, and financial conditions were expected to remain favorable. We also expected that the two major political headaches that dominated most of 2019 – the US-China trade war and Brexit – to have less impact in 2020. Overall, we assumed a cyclical strengthening to prolong the growth cycle, with global GDP growth in 2020 to be broadly in line with 2019 (2.6% in 2020 in real terms).

To our opinion, the COVID-19 shock could affect global growth at 3 different levels:

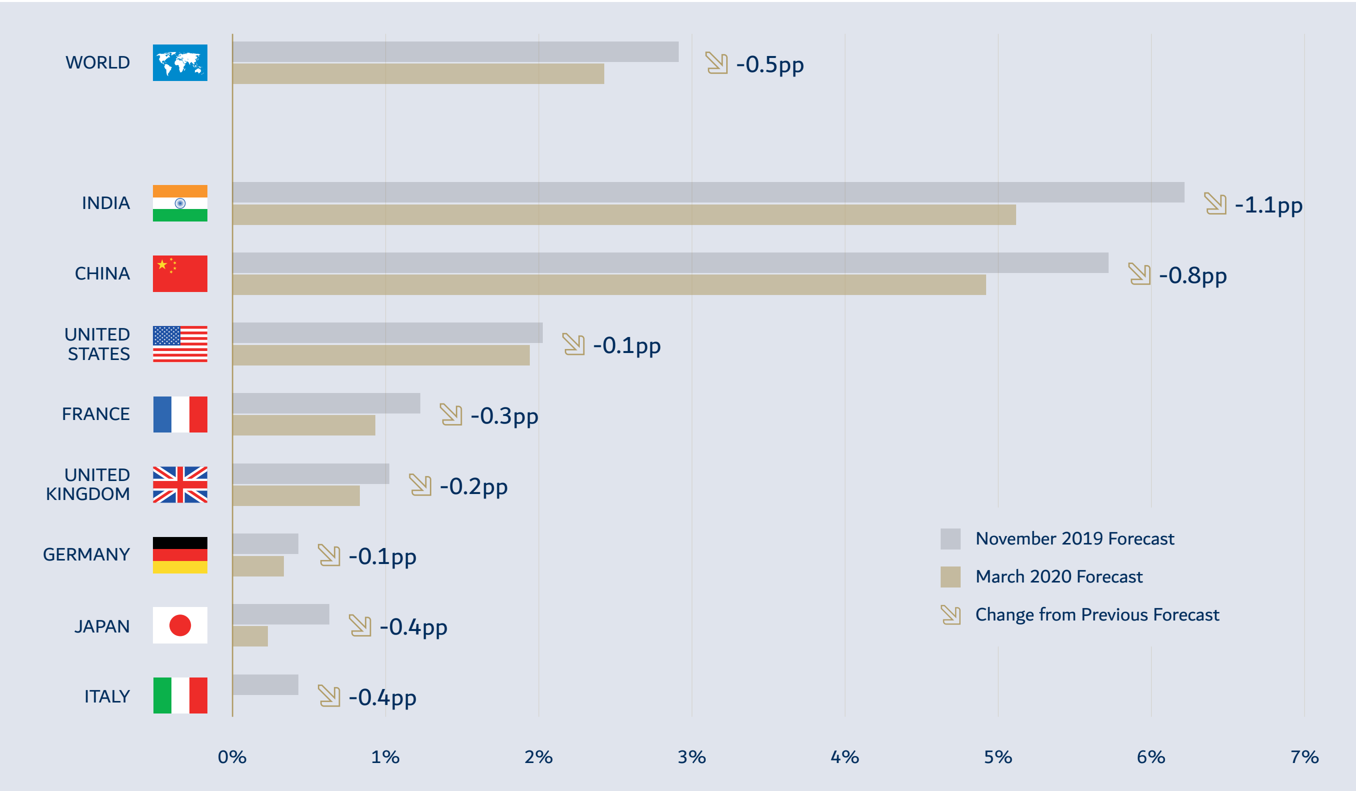
1. TEMPORARY ECONOMIC SHOCK: this is already happening, both on demand and supply which are NOT necessarily cancelled out but at least being delayed. More on this later;

2. FINANCIAL CONTAGION: for sure, risk assets are going through a rough bear market and as we know well, a financial market crash often takes place ahead of economic recession as negative feedback loop develops. It is however important to remember that most risk assets were expensive and extended before the start of the correction. For instance, the S&P 500 was 12% above its 200 days moving average which is historically very high. Moreover, algorithms-led systematic selling and margin calls seem to have played their role as well. This seems to suggest that some technical elements are also behind the current bear market. At this stage, it is premature to forecast a full-blown financial crisis similar to 2008. Credit spreads have widened but they remain historically tight; we haven't heard of any liquidity issues or bankruptcy having ripple effects, at least for now. To paraphrase Mohamed El Erian, the difference between Covid-19 crisis and Lehman crisis is that in 2008, people were running to ATMs as they feared there will be no cash left in the bank. With COVID-19, they are running to the supermarket to get foods just in case they might be quarantined. From this angle, 2020 seems to be less a problem than 2008;

3. LONG-TERM MACRO & MICRO EFFECTS: it is likely that COVID-19 will have some profound effects on globalization, supply chain, digitalization, e-commerce, etc. These themes are developed in the "Investment Strategy" section of Perspectives.

Coming back to the immediate (and most likely temporary) effect on global economic growth, the chart below summarizes OECD forecasts on World economic growth taking into account COVID-19. Overall, OECD believes that the virus will penalize 2020 real GDP growth by roughly -0.5% with countries such as India and China being the most affected from an absolute basis. But this looks very optimistic to our opinion and further downgrades are likely in the coming weeks.

Coronavirus: OECD Slashes Forecast for World Economy
GDP growth forecast for the world's largest economies in 2020. *Source: OECD.*



In terms of sequencing, Global Growth in the first quarter is likely to be impacted by 2% before rebounding in Q2. However, the longer the quarantine measures last, the higher the risk of additional lost output and thus of downward revisions to the outlook for global economic growth.

Upsets to the supply-demand equilibrium is a risk for the US economy. For sure, an intensification of supply chain disruptions would hit the manufacturing sector (11% of US GDP). But a mitigating factor for the US is the fact that supply chains are relatively well integrated within North America, i.e. with Mexico and Canada. The US economy is also less reliant on tourism. However, the US economy could be indirectly impacted by lower oil prices through the shale oil sector (see dedicated Oil section in the MENA equities article). On the political front, a slowdown in US growth could have an impact on November 2020 presidential election.

In terms of monetary stimulus, the US Federal Reserve has already brought its "bazooka" by lowering rates by 150 basis points to zero.. The Fed is also responding to the downturn by injecting more liquidity into the financial system (more on this in the "Hot Topic" section). Last but not least, targeted fiscal stimulus have been announced already.

In terms of sequencing, Global Growth in the first quarter is likely to be impacted by 2% before rebounding in Q2.

Euro area is likely to suffer and has limited room for easing

China and Asian economies in general are important trading partners for euro area countries, particularly for Germany. China also has a pivotal role in global supply chains. We also expect serious impact on the tourism industry with Italy being particularly hit.

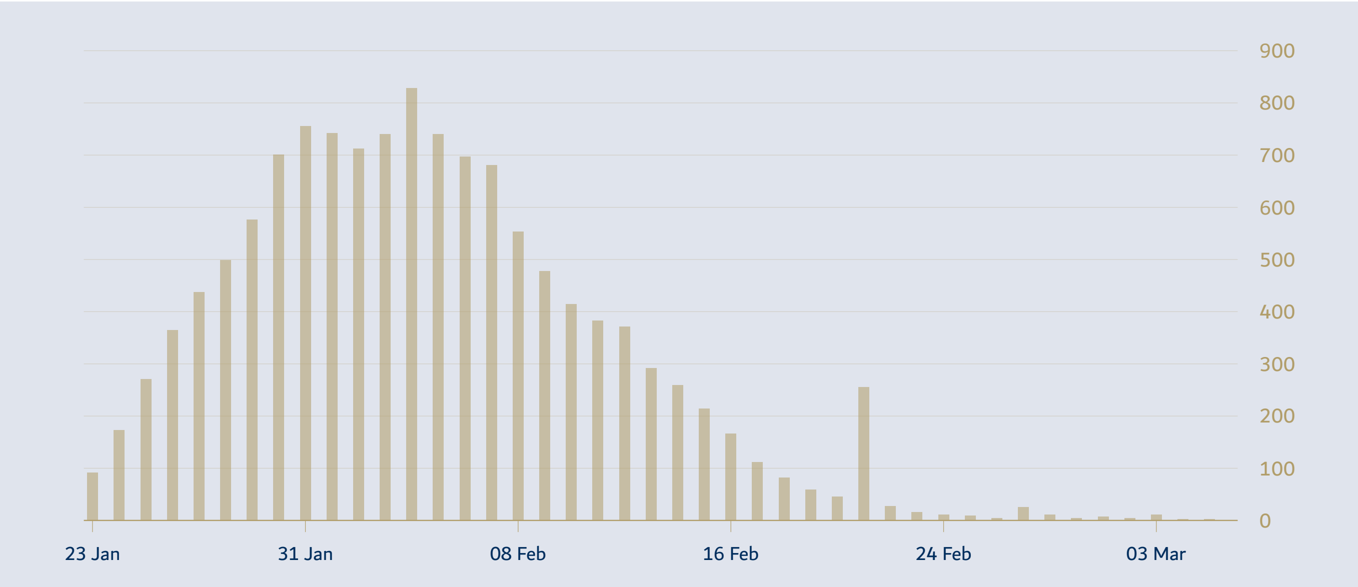
We expect the tone of ECB to turn more "dovish" but we do not expect policy action to be as spectacular than in the US as the negative interest policy has reached its limits. However, should the shock be more pronounced than expected initially, further expansion of the ECB balance sheet in Q2 should not be ruled out.

Targeted fiscal policy responses to the virus in Europe have already been announced and are likely to be more effective than further interest rate cuts. However, the ECB is expected to manage the yield curve, effectively monetizing EU debt. There could be considerable long-term costs with debt to GDP surging in countries such as France and Italy.

Asia: Expect improvement in China

China is the epicenter of the coronavirus outbreak but it looks like the Chinese government measures to contain the virus are bearing fruits. Recent data show that new cases of infection have decreased significantly especially outside Hubei province (see chart below – source: Pantheon Macroeconomics).

Number of new coronavirus cases, China ex-Hubei



The virus outbreak, combined with the unprecedented preventive measures taken by the government, have taken a heavy toll on the Chinese economy. Daily indicators such as coal consumption by power generators, number of property transactions and traffic in major cities suggest that capacity utilisation in China is still far below normal levels. At the current pace, it seems that the bulk of the economy will not be able return to its normal rhythm until the end of March.

While the Chinese government and the People's Bank of China (PBoC) have been swift in providing policy support to mitigate the impact of the outbreak, the slow pace at which production is resuming poses a further downside risk to Chinese GDP in 2020.

In a downside scenario where it takes much longer for capacity utilisation to return to its normal level (say well into Q2), the damage to the Chinese economy could be much greater than what is currently expected by most economists. China's status as a hub for global supply chains, an important factor to monitor for the global economy is the duration of the supply chain disruption in China. As a reminder, Asia (including Japan) accounts for over 85% of global exports of integrated circuits, 20% of automobiles and 25% of auto parts. One China specific risk is rising corporate credit defaults, especially in the property space where many developers are heavily leveraged. While we expect the central bank has already taken action in this regard, the potential damage to banks' asset quality could still be quite substantial.

Looking at the rest of Asia, the situation in South Korea and Japan is especially worrisome. In Japan, the virus concerns plus a disappointing Q4 is decreasing 2020 Japan GDP forecast meaningfully.

Effects on earnings

While the consensus was for the S&P 500 to grow by high single-digit in 2020, Goldman Sachs now expects 0% S&P 500 EPS growth in 2020. Their base case scenario (widespread but short-lived COVID-19 impact) implies $165 EPS in 2020 (previously $174) and $175 in 2021 (previously $183), representing 0% and 6% growth respectively. A recession scenario would translate into double-digit decline in EPS in 2020. In terms of market action, their base case is for the S&P 500 to through in Q2 before rebounding towards 3,400 by year-end. We will probably see more "top-down" downward revisions in the coming days (with year-end S&P 500 target being lowered as well) while "bottom-up" revisions might be revised more slowly.

Exhibit 3: Goldman Sachs top-down S&P 500 EPS forecasts. *Source: FactSet, Goldman Sachs Global Investment.*

WIDESPREAD BUT SHORT-LIVED COVID-19 IMPACT (BASELINE)	S&P 500 EPS			GROWTH	
	2019	2020	2021	2020	2021
Contained COVID-19 imact (upside)	$165	$170	$180	3%	5%
Widespread but short-lived COVID-19 impact (baseline)	**$165**	**$165**	**$175**	**0%**	**6%**
Recession (downside)	$165	$143	$158	(13)%	10%
Consensus bottom-up estimates	$165	$176	$196	7%	11%

U-shape and L-shape scenarios

As mentioned, our base case scenario is a V-shape recovery in the second quarter. But the probabilities of a U-shape (recovery postponed to the second half of 2020) or L-shape (recession) are rising by the day.

As shown on the table below (source: Pictet), the impact of COVID-19 on global GDP (and thus likelihood of U-Shape or L-shape economic trajectory) is likely to be driven by the spread and duration of the virus outbreak. The extent of financial contagion and the effects on business and consumer confidence of this crisis will also play an important role on the economic cycle.

VARIABLES	CORONAVIRUS SCENARIOS			
	Mild	Baseline	Serious	Worst Case
People affected (GDP-weighted)	5%	10%	20%	30%
Hours worked, % pre-virus	50%	50%	50%	50%
Productivity, % gain vs pre-virus	10%	10%	10%	10%
Duration of emergency (months)	1	2	3	6
Impact on Global GDP	**-0.2%**	**-0.5%**	**-2.0%**	**-6.0%**

Source: Pictet Asset Management Investment Strategy Team.

Bottom-line

At this stage of the epidemic, we are not changing our core scenario, which sees the world economy barely avoiding recession in 2020. Nevertheless, COVID-19 is hitting global activity both on the demand and supply side. It is denting business and consumer confidence and could well lead to some financial contagion. As such, the longer the crisis last, the more is our V-shape recovery scenario is at risk to be replaced by a U-shape or L-shape scenario. scenario where growth fails to recover in Q2.

The speed and efficacy of a sufficient policy response to the now wavering global consumer and business confidence will be key to assessing whether or not a negative feedback loop leads to a U-shape or L-shape economic scenario. Policymakers need to be much more proactive given the very real risk of a consumption collapse. **We believe that given the global nature of the epidemic there is a high likelihood of global and coordinated policy response to this crisis.**

Expected asset class performance

We believe that global markets are currently led by 2 key drivers:

- **The first driver is a SECULAR one: LIQUIDITY.** Indeed, even before the COVID-19 outbreak, global central banks were expected to print between $1 trillion and $1.5 trillion in 2020. The virus outbreak could lead to a flush of liquidity and monetary stimulus. This secular trend is pushing nearly all asset prices higher – hence the record inflows into both equity and fixed income funds. The virus crisis is likely to intensify the role played by liquidity from a cross assets perspective;

- **The second driver is a CYCLICAL one:** the volatility of the BUSINESS CYCLE. It is well documented that this business cycle is different than others. It is the longer lasting ever although it has already been going through several mini contractions (2011, 2015-16). While growth has been disappointing last year, business and trade activity were expected to re-accelerate in 2020. This should have led to a very different leadership than in 2019, i.e the cyclical segments of the market (value, smid-caps, emerging markets, high yield credit) were expected to outperform the winners of 2019 (i.e long duration bonds, defensive growth stocks, ultra-growth stories).

However, the COVID-19 is likely to postpone the (relative performance) recovery of the cyclical segments of the market as the SECULAR LIQUIDITY driver is expected to take the lead again. Needless saying that a U-shape or L-shape recovery (instead of a V-shape) would lead to even more outperformance by defensive segments.

Still, one trigger for a change of leadership could be a very pro-active stance by policy makers through both monetary and fiscal stimuli. A weakening of the dollar could also create the conditions for Emerging Markets outperformance.

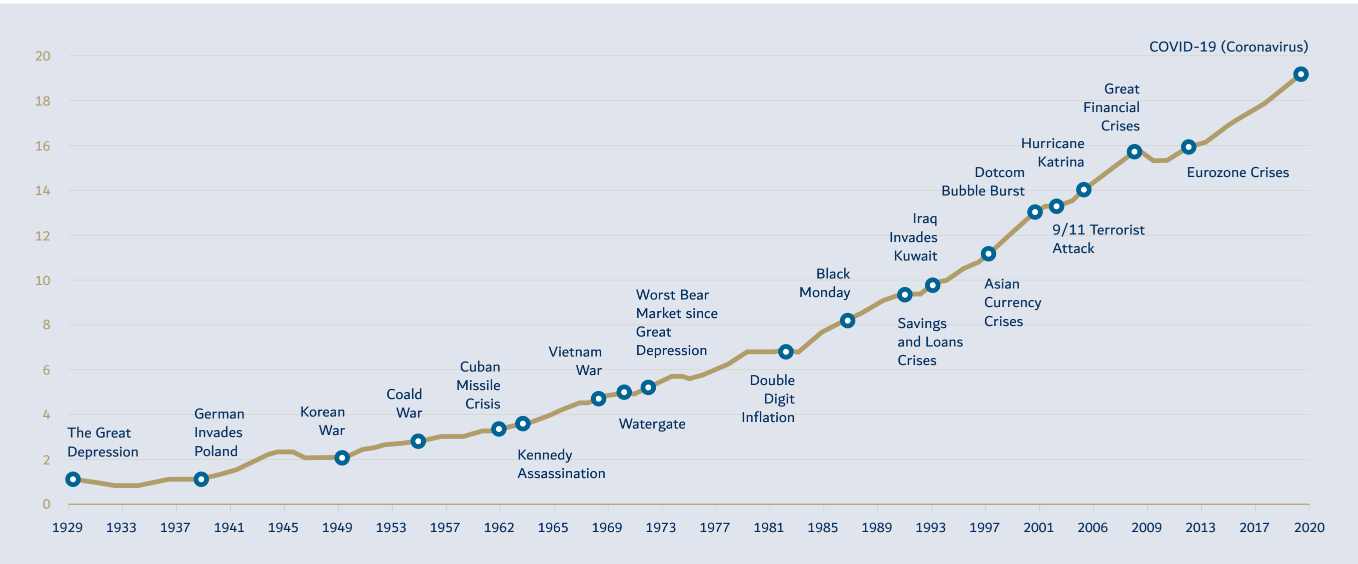
Selling on panic is not a good investment strategy

The brutality of the market correction at the end of February is leading many investors to rush to the exit door and sell their stock holdings.

As a reminder, the natural tendency for equity markets is to go up. Indeed, stocks are fractional shares of ownership in a business. These businesses are an integral part of the economy. For those who believe in progress, the global economy is expected to grow over the long-term.

The global economy has been hit by many disasters and crisis throughout the centuries: war, terrorist attacks, natural disasters, financial crises, inflation, deflation, etc. As shown on the chart below, despite all these crisis, US real GDP has kept growing over time. It is a testament to human's ability to strive for and create a better tomorrow. History taught us that it is actually very difficult to make money by betting against human progress.

U.S Real GDP since 1929. *Source: Multpl.com*



The growth of real GDP flows through from businesses to their owners and thus the shareholders. Over the course of modern history, U.S. stocks have had an annualized average return of 10.2%, doubling an investors money every seven or so years, on average.

This does not mean that investors should expect to see returns 10% every year. **While the economy and businesses are driven by fundamentals, the stock market is driven by fear and greed. Market sentiment pushes annual returns way above and way below the average. In fact, only 6 times in the last 94 years did we have an annual return that was even close to the average.**

Stocks are the best way to build wealth over one's lifetime, but there is a very real price to pay for these returns. That price is discomfort, anxiety, and a whole lot of pain.

Unfortunately, it is very difficult to predict when market crashes or large corrections will take place (who was expecting COVID-19?) This is why stocks are risky, and this is why people who can bear it usually get paid over the long run.

As shown on the next page, the vast majority of 10%+ decline of the S&P 500 led to decent returns in the 10, 30 and 90 days that followed (Lehman-crisis period being the exception).

Stocks are the best way to build wealth over one's lifetime, but there is a very real price to pay for these returns. That price is discomfort, anxiety, and a whole lot of pain.

Dates on which the S&P 500 declined by more than 19% and subsequent returns

DATES ON WICH DECLINE IN S&P 500 EXCEEDED 19%	ADDITIONAL % DECLINE TO S&P 500 LOW	SUBSEQUENT 12-MO. % CHG. IN S&P 500	ASSOCIATED WITH RECESSION?
October 21, 1957	-0.4%	31.0%	Yes
May 28, 1962	-5.7%	26.1%	No
August 29, 1966	-1.87%	24.6%	No
January 27, 1970	-20.9%	8.3%	Yes
November 26, 1973	-35.5%	-28.1%	Yes
March 6, 1978	0.0%	12.6%	No
September 25, 1981	-9.2%	9.4%	Yes
October 19, 1987	-0.4%	23.2%	No
October 11, 1990	0.0%	29.1%	Yes
August 31, 1998	0.0%	37.9%	No
March 2, 2001	-37.1%	-8.3%	Yes
July 2, 2008	-46.4%	-28.9%	Yes
October 3, 2011	0.0%	32.0%	No
December 24, 2018	0.0%	37.0%	No
March 11, 2020	**?**	**?**	**?**
AVERAGE	**-11.2%**	**14.7%**	
MEDIAN	**-1.1%**	**23.9%**	

Source: The Leuthold Group

Our global asset allocation views

Our base case is for global economy to avoid recession and rebound in the second half of the year. The global context – decent growth, low inflation, supportive central banks, Dividend Yields above bond yields – remain favorable to risk assets.

However, after the technical damage done to markets following February's sharp correction, equity markets will probably need some time to digest the move and build up support before they can start a sustainable recovery.

In the short-term, we indeed expect markets to stay volatile within a broad trading range. V-shape rebound are the exception to the norm; most of the time, bottoming-out is a process with the lows being broken or re-tested at least one or two times before the uptrend resumes.

While another downturn of risk assets is possible over the near-term, we could get a very positive mix later this year with monetary and fiscal stimuli being injected at the same time the virus start to disappear. As the crisis is global, we expect a global answer – e.g coordinated central bank action or G20 fiscal stimulus announcement. This is much more powerful than unilateral action as it avoids the risk of competitive devaluation. Overall, this would be long-term bullish for equities and credit.

We would however stress out that the situation is evolving rapidly and there remains a good deal of uncertainty which means that we must stay humble in our assumptions (see for instance unexpected developments in the oil market as commented in the MENA equities section) or the mis-functioning of US Treasury market.

Our one-year global asset allocation views are summarized below.

Asset Allocation Matrix

	Asset Class View	Bullish	Neutral	Bearish
Equities	Overweight	Emerging Markets U.S Small and Mid Caps	U.S Large Caps Japan U.K Europe	
Fixed Income	Underweight	Trade Finance U.S High Yield Emerging Markets Debt (in $) Emerging Markets Debt (in local currencies)	U.S Investment Grade Corporates	Sovereigns
Real Estate/ Illiquids	Neutral	Real Estate Gold	Hedge Funds Energy Industrial Metals	Private Equity Agriculture
Cash		Emerging Local Currencies Euro British Pound	U.S $ Yen Swiss Franc	

While another downturn of risk assets is possible over the near-term, we could get a very positive mix later this year with monetary and fiscal stimuli being injected at the same time the virus start to disappear.

Emergency Fed Rate Cuts: Is it Good or Bad?

On the 3rd of March, US Federal Reserve policy makers decided to cut interest rates by 50 basis points in order to shield the U.S. economy against the spreading coronavirus. This is the first time since 2008 the Fed is cutting rates outside their normal cycle of meetings.

Below we briefly review the history of the Fed Emergency rate shifts, discuss the potential reasons behind the (initial) negative market reaction and what is our main takeaway from this important monetary policy decision.

A Brief History of the Federal Reserve's Emergency Rate Shifts

The move by US Federal Reserve decision to cut interest rates outside the normal cycle of meetings is rare but not unprecedented.

Here's a brief history of when Fed officials have delivered an inter-meeting shift to monetary policy:

October 1998 – Russia / LTCM crisis: ✂ 25bp

As Russia's financial crisis and the collapse of Long-Term Capital Management threatened a credit crunch, the Fed cut by 25 basis points to 5%.

"Growing caution by lenders and unsettled conditions in financial markets more generally are likely to be restraining aggregate demand in the future," said the Fed.

January 2001 – Tech bubble implosion: ✂ 50bp

With the technology stock bubble having burst the previous year, the central bank began a new year cutting its benchmark by 50 basis points to 6%. It was quite a shift from a few weeks earlier when the Fed had said the economic risks leaned towards inflation.

"These actions were taken in light of further weakening of sales and production, and in the context of lower consumer confidence, tight conditions in some segments of financial markets, and high energy prices sapping household and business purchasing power," officials said.

April 2001 – Slumping economy: ✂ 50bp

Policy makers cut their benchmark interest rate by 50 basis points in an effort to shore up a slumping economy. It lowered its target rate for overnight loans between banks to 4.5% from 5%.

The Fed "has reviewed prospects for the economy in light of the information that has become available since its March meeting," the Fed said in a statement.

September 2001 – 9/11: ✂ 50bp

Days after the 9/11 attacks, the Fed cut its main rate by 50 basis points to 3% and promised to provide markets with "unusually large volumes of liquidity."

Central banks in Europe and Canada matched the action.

August 2007 – Subprime crisis: 50bp

The Fed lowered its discount rate -- the rate it charges banks -- by 50 basis points to 5.75% as the subprime-mortgage collapse continued to roil financial markets.

"The Federal Reserve is providing liquidity to facilitate the orderly functioning of financial markets," the statement said.

January 2008 – Stock crash: 75bp

The Fed cut its key rate by 75 basis points to 3.5% after stock markets tumbled amid increasing signs of a U.S. recession.

Policy makers said in a statement that they acted "in view of a weakening of the economic outlook and increasing downside risks to growth."

October 2008 – Lehman crisis: 50bp

As the September collapse of Lehman Brothers Holdings Inc. roiled financial markets and raised recession fears, the Fed cut the federal funds rate by 50 basis points to 1.5% as part of a coordinated action.

"The Committee took this action in light of evidence pointing to a weakening of economic activity and a reduction in inflationary pressures," the Federal Open Market Committee said. It would go on to ultimately cut its main rate as low as 0.25%.

March 2020 – Covid19: 50bp

The Fed cut its key rate by 50 basis points to a range of 1%-1.25%

"The coronavirus poses evolving risks to economic activity," the Fed said in a statement. "In light of these risks and in support of achieving its maximum employment and price stability goals, the Federal Open Market Committee decided today to lower the target range for the federal funds rate by 1/2 percentage point."

The central bank also said it is "closely monitoring developments and their implications for the economic outlook and will use its tools and act as appropriate to support the economy."

The coronavirus poses evolving risks to economic activity.

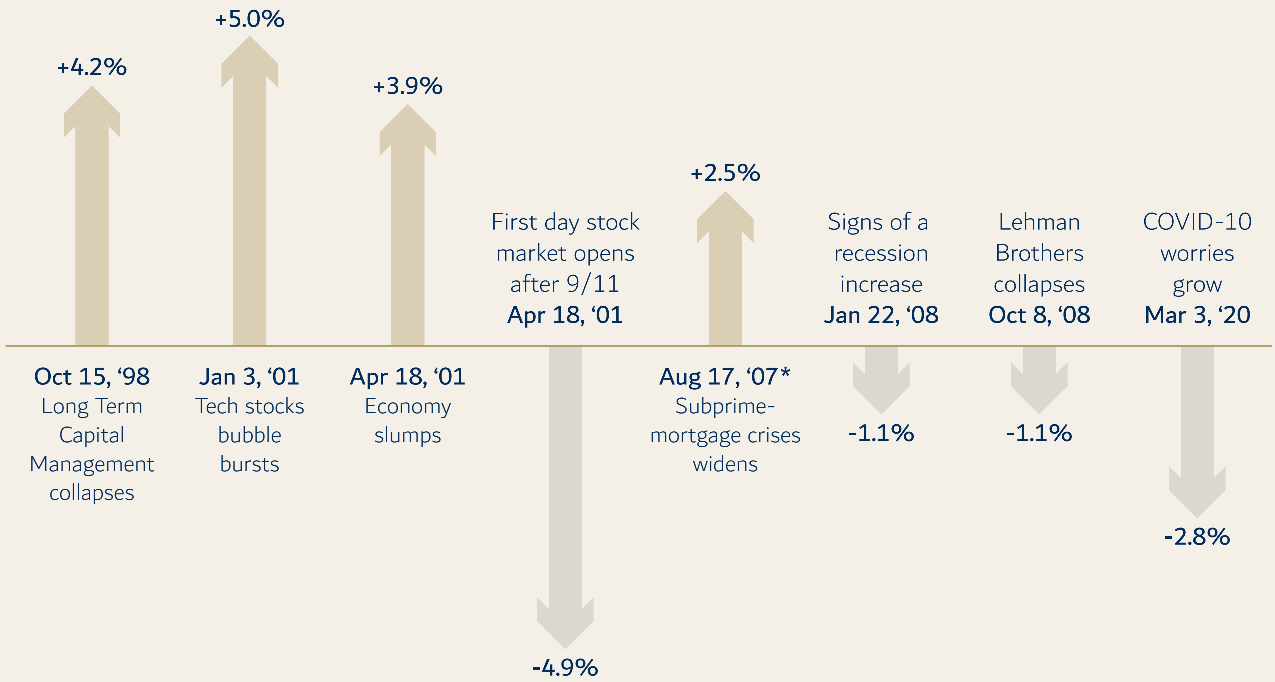
Why did equity markets react negatively on the announcement?

US equity markets did not react well following Fed announcement which took place during a trading day (Tuesday 3rd of March). The Dow Jones industrial average sank nearly 3 percent and the yield on the U.S. 10-year Treasury bond briefly fell below 1 percent, before recovering slightly, as investors fled equities for the safety of bonds.

With the exception of 9/11 rate cut (the market was reopening that day after being closed a week due to the terror attack), it was actually the worst market reaction to any emergency rate cut which took place over the last 2 decades (see chart below).

How Markets React to Emergency Rate Cuts

Over the last two decades, stocks have had a mixed response on the day of surprise Fed actions, a sign that the central bank's support is not always enough to overcome a risky backdrop.



*Cuts in the discount rate; all others are cuts in the fed funds rate. Source: Federal Reserve (rate cuts); Refinitiv (stock market data)

There are **several reasons which could explain this (initial) negative reaction**. First, this emergency cut was somewhat anticipated by the market which was pricing in almost 4 rate cuts in 2020 the day before the Fed announcement. This explains partly the strong performance of the Dow Jones the day before the announcement (the Dow Jones Index finished up 1,294 points, or 5.1%, making it its best one-day point gain on record).

Moreover, the repo market showed renewed signs of stress at the time of the emergency rate cut as for the second day in a row the overnight funding operation was oversubscribed, with the full $100 million amount repo accepted. This was taken by the market as a clear signal to the Fed that it needs not just cutting rates but also do something to further ease interbank lending conditions.

Furthermore, investors continue to be worried that the spreading outbreak will upend the global economy and end the decade-long expansion. The market reaction probably means that they want to see more than 50 basis points rate cuts.

Last but not least, investors are aware that emergency rate cuts are not always followed by strong market returns – far from it. Indeed, a look at historical S&P 500 index performance following emergency rate cuts confirms that while the near-term impact was largely favorable, the longer term was clearly negative. As shown on the table below, the median performance after a month is positive but the median return after 6 months and one year are both clearly negative.

S&P 500 returns in periods after the Fed emergency rate cuts. *Source: DB, Bloomberg.*

Cut Size	Emergency Rate Cut Date by Fed	1 Week	6 Months	1 Year
50bps	8th October 2008	-8.9%	-17.2%	7.0%
75bps	22nd January 2008	2.8%	-3.6%	-37.6%
50bps	17th August 2007	4.8%	-4.3%	-9.4%
50bps	17th September 2001	-8.2%	6.7%	-20.0%
50bps	18th April 2001	3.1%	-9.6%	-5.7%
50bps	3rd January 2001	2.3%	-5.0%	-9.2%
25bps	15th October 1998	7.3%	31.6%	24.1%
Average		**0.5%**	**-0.2%**	**-7.3%**
Median		**2.8%**	**-4.3%**	**-9.2%**

There is one notable upside outlier: while most emergency rate cuts saw a sharp drop in stocks 1 year out, 1998 was the big positive outlier as one didn't see a subsequent recession while Mr Greenspan added extra stimulus in response to LTCM and the Asian Crisis, and the Y2K liquidity spike shortly after.

While history doesn't necessary repeat itself, this is probably what will drive the market going forward: 1. Will the economy avoid falling into recession and 2. Will we see more policy action.

Our take

As discussed earlier in this edition of Perspectives, there is no doubt that COVID-19 will have a very negative impact on global economic growth and earnings revision in the medium-term. There is indeed a risk for the expected "V-shaped" recovery in global growth to become "U-shaped", (i.e. with coronavirus-related difficulties persisting well into Q2 2020) or L-shaped (recession).

To our opinion, the key to prevent such a "U-shaped" scenario will be the speed and efficacy of the policy response to the now wavering global consumer and business confidence. In order to avoid a negative feedback loop leads to a global recession, policymakers need to be much more proactive given the very real risk of a consumption collapse.

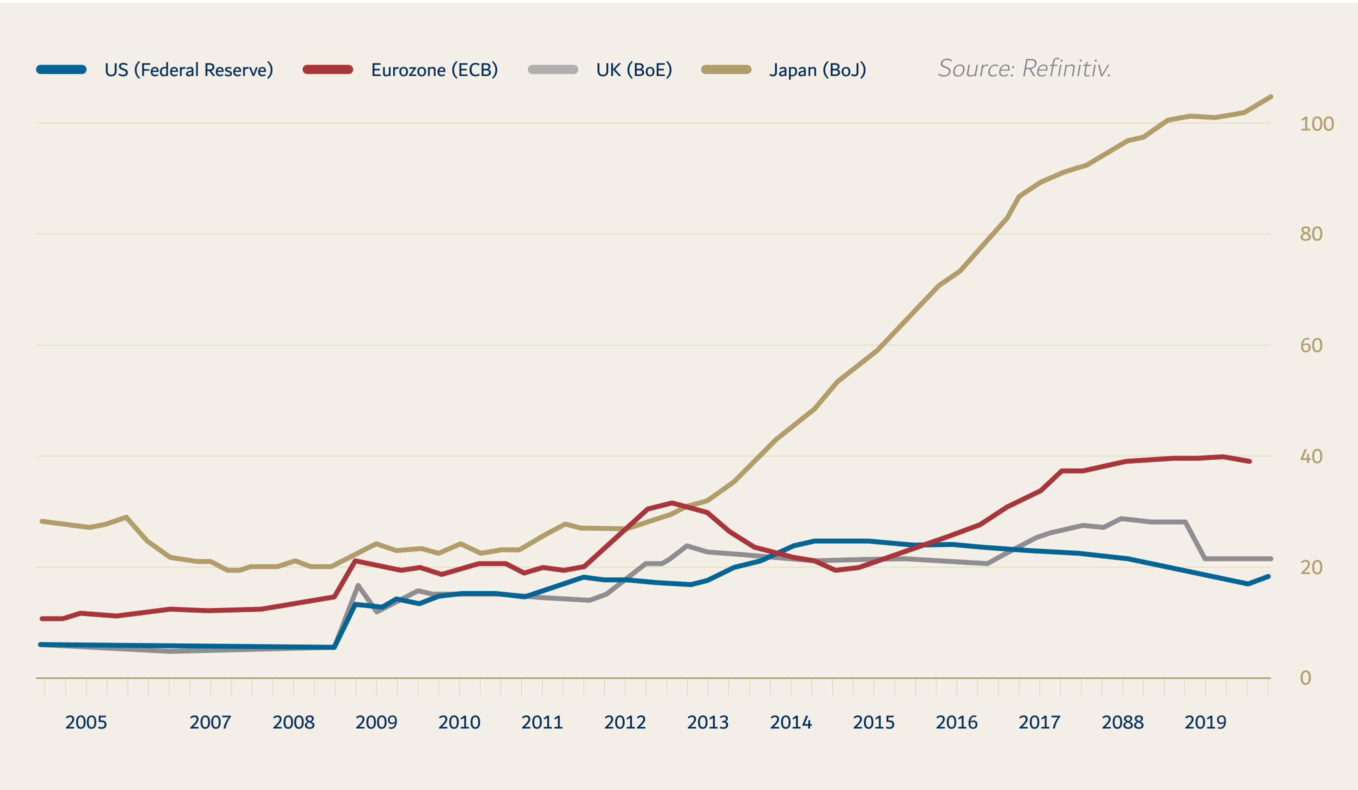
On the US monetary policy side, the three main reasons behind the Federal Reserve's emergency interest rate cuts help explain why the central bank decided to bring out its bazooka on the 15th of March, i.e another 100 basis points cut, $700 billion of quantitative easing and open swap lines with major central bank. This announcement came after a giant $5 trillion repo operations the week before. The Fed hopes to boost public confidence, prevent financial conditions from worsening and cushion the U.S. economy against a global growth downturn. Going forward, we expect the Fed to foster a liquidity avalanche to prevent financial conditions to worsen and then led to a full-blown recession. US Fiscal policy is also likely to provide support first in the form of further tax cuts.

Outside the US, Bank of Japan pledged to monitor markets closely and protect monetary stability. The Central Bank of Australia and the BoE cut rates, Italy announced fiscal package while the IMF announced a $50 billion aid package Wednesday to help fight the coronavirus and being made available "immediately" for low-income and emerging market countries, etc.

The "good" news about the Covid-19 crisis being global is that we can expect a global answer – e.g coordinated central bank action and G20 fiscal stimulus announcement. On the monetary side, we are also forecasting rate cuts by most other G10 (and some EM) central banks, including, Australia, India, South Korea as well in the Euro area and Switzerland.

A global answer to the crisis is much more powerful than unilateral action as it avoids the risk of competitive devaluation. Still, note every country has the same leeway be it on the fiscal side or on the monetary side (see below chart showing that some central banks have more capacity for asset purchases than others). This should create some relative value opportunities across equity, fixed income and currency markets.

Some central banks have more capacity for asset purchases than others - Central bank assets as a % of GDP



Investment Strategy: COVID-19 Winners and Losers

As mentioned in the "Global Markets" section, there are 3 channels by which COVID-19 filters into the real economy:

- **Direct link through global supply chain;**
- **Direct link through postponed or permanently destroyed demand;**
- **Indirect link through a confidence shock.**

Below, we review the asset classes, sectors and types of companies which either be penalized or benefit from COVID-19 by making a distinction between short-term and long-term winners and losers.

We then highlight some tactical opportunities and remind our readers about the benefits of diversification.

COVID-19 short-term winners and losers

By affecting both demand and supply, COVID-19 has de facto a negative effect on global growth. As such, it is no surprise to see most risk assets being penalized by investors. Economies being more dependent on external demand are likely to suffer the most which explains the underperformance of Europe and Japan versus US. Emerging Markets are a mixed bag as China equity market was among the very few to post a positive performance in February. This could be explained by the extraordinary efforts by local authorities and the strict containment measures put into place.

From a cross-asset class perspectives, risk assets (equity, credit, commodities) are sharply underperforming whereas defensive assets (US Treasuries, Bund, Swiss France, Yen, Gold) are outperforming. Quality (strong free cash flow, low debt) companies are outperforming lower quality. The longer the crisis last, the higher the number of "zombie" companies will go bankrupt. We also note that volatility has been spiking across nearly all asset classes (including US Treasuries).

From an industrial standpoint, the obvious "losers" affected by lower demand in the short-run are Travel & leisure (Airlines, cruise line companies, hotel), Luxury goods & Discretionary retailers (affected by the drop of tourism and lower consumption in China), Insurance company (events cancellation, healthcare coverage, etc.), Banks (SMEs going under, lower net interest margins, etc.), Oil & Gas (collapse of oil prices).

Short-term supply chain disruption is hitting Technology, Electronics and Communications as well the Auto & Auto-components sector.

The short-term winners of the COVID-19 epidemic includes defensive stocks such as Utilities (stable cash flows and beneficiaries of lower interest rates) and Consumer Staples (as some customers have been rushing to supermarkets and groceries in order to accumulate essential goods).

Another short-term winning theme is the "stay at home" type of business which includes the favorite entertainment and services products that don't call for public gatherings:

- Video games: Activision Blizzard, Tencent Music Entertainment and Zynga
- Home entertainment: Peloton, Netflix
- Social media: Facebook, Match Group, Yelp
- Work-at-home: Citrix, Atlassian, Slack and Zoom Video
- Consumer shopping and Food delivery: Amazon, Alibaba, eBay, JD.com, Blue Apron and GrubHub

Other short-term winners include:

- Disinfectant: Clorox
- Protective masks and/or suits: 3M, Lakeland
- Home protection systems: Ruger, Alarm.com
- Vaccine: Moderna

The short-term winners of the COVID-19 epidemic includes defensive stocks such as Utilities and Consumer Staples.

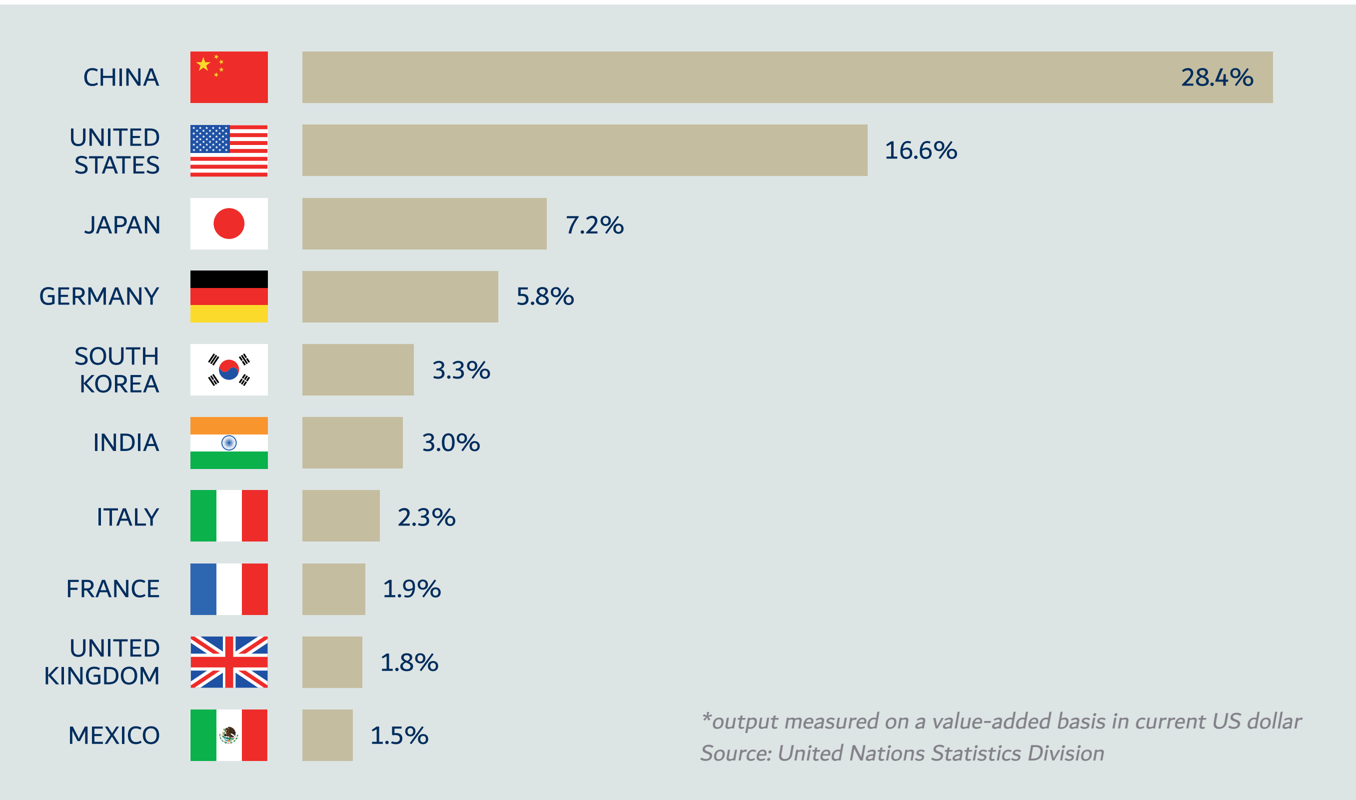
The COVID-19 outbreak could very well end up being the final curtain on China's nearly 30-year role, as the world's leading manufacturer.

Long-term winners and losers

Some of the short-term winners highlighted earlier could very well benefit in the long-run as well as the sudden interest for their products and services (e.g work-at-home) could potentially create some change of business and consumer behavior. It reminds us of the long-term benefits enjoyed by CNN as TV watchers discovered the channel during the first gulf war and became addicted to live news feed.

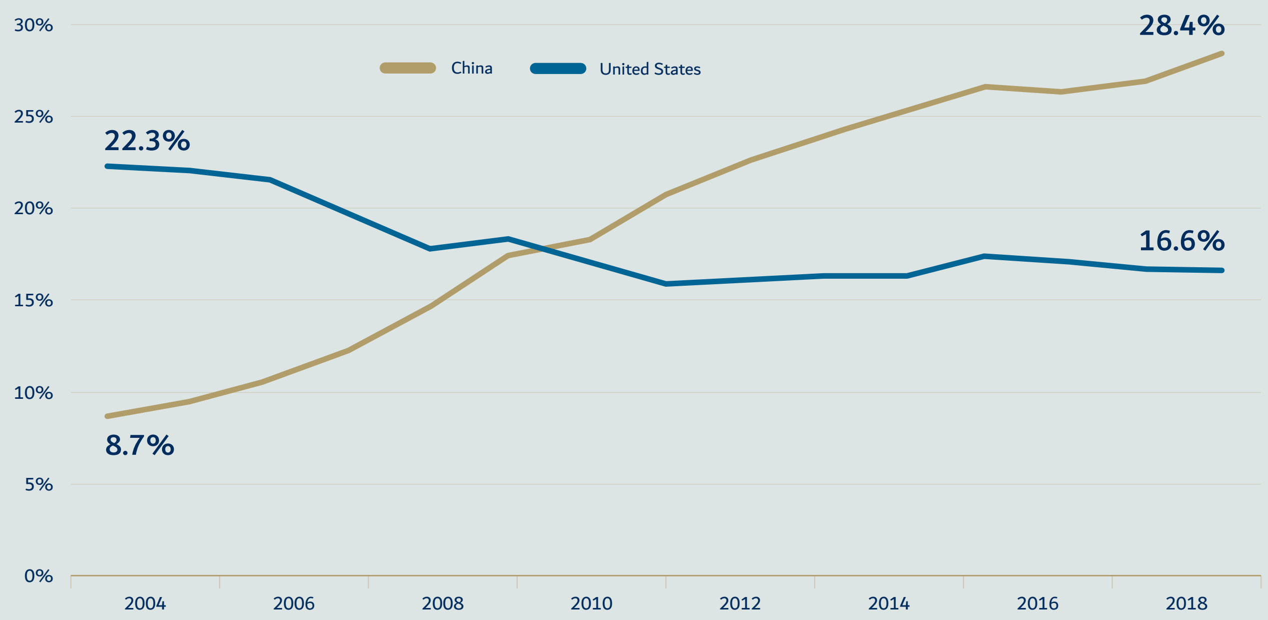
We also believe that the COVID-19 outbreak could have some consequences on globalization as consumers and businesses realize that a globalized world can suddenly come to a stop due to an unexpected and uncontrollable event. A key aspect of globalization is the outsourcing of the supply chain. Over the last 20 years, companies have been searching the world to find the lowest costs of production. The big winner being China, thereby becoming a Global Manufacturing Hub (see charts below).

China is the World's Manufacturing Superpower – Top 10 countries by share of global manufacturing output in 2018*



**output measured on a value-added basis in current US dollar*
Source: United Nations Statistics Division

Chinese and US share of global manufacturing output*



*output measured on a value-added basis in current US dollar. Source: United Nations Statistics Division

The COVID-19 outbreak could very well end up being the final curtain on China's, nearly 30-year role, as the world's leading manufacturer. Because of the virus outbreak, Chinese auto manufacturers and chemical plants have reported more closures than other sectors. Shipping and logistics companies have reported higher closure rates than the national average. The ripple effects of this severe disruption will be felt through the global auto parts, electronics, and pharmaceutical supply chains for months to come.

Under the Trump administration, US companies didn't like the uncertainty of tariffs and started to source elsewhere. Their Chinese partners moved to Vietnam, Bangladesh and throughout southeast Asia. The COVID-19 outbreak might accelerate the move towards picking new manufacturing hubs for US and European companies and this might be countries closer to home.

In the case of the US, picking a new manufacturing hub might not be easy. No country has the logistic set up like China has. Few big countries have the tax rates that China has. Brazil surely doesn't. India does but the quality of logistics is not good enough at this stage.

We believe Mexico could become the new manufacturing hub for US companies and this for several reasons. First, U.S. and Mexico recently signed a Trade agreement (USMCA). Moreover, the US and Mexico are neighbors. Their president Andres Manuel Lopez Obrador wants to oversee a blue-collar boom in his country. This would be welcome by the US as well, if it means less Central Americans coming into the US and depressing wages for American blue-collar workers. A recent survey shows that US automotive and technology sectors said they intended to move business to Mexico from other countries – and they plan on doing so within the next one to five years. Mexico manufactures complex items like airplane engines and micro semiconductors. Mexico is ranked the 8th in terms of engineering degrees by country. Multinational companies are already established in Mexico, these include General Electric, Boeing, etc. Thanks to over 25 years of NAFTA, Mexico has become a top exporter and producer of trucks, cars, electronics, televisions, and computers. Shipping a container from Mexico to New York takes five days. It takes 40 days from Shanghai.

Mexico could thus become the biggest long-term beneficiary of COVID-19. Being the only low- cost border country with a free trade deal with the United States, Mexico is best positioned to take advantage of the long-term geopolitical rift between the U.S. and China.

Diversification as the only "free-lunch" in Portfolio Management

There is a lesson to be learned from each crisis. As it has often been the case in the past, the COVID-19 outbreak is a harsh remainder for investors that diversification is the only free lunch in investing.

Indeed, while the equity markets pullback has been quite severe by historical standards, any investor holding a diversified portfolio which included US Treasuries and/or Gold has most likely been able to cushion losses since the start of the crisis as the two aforementioned asset classes have been performing well recently.

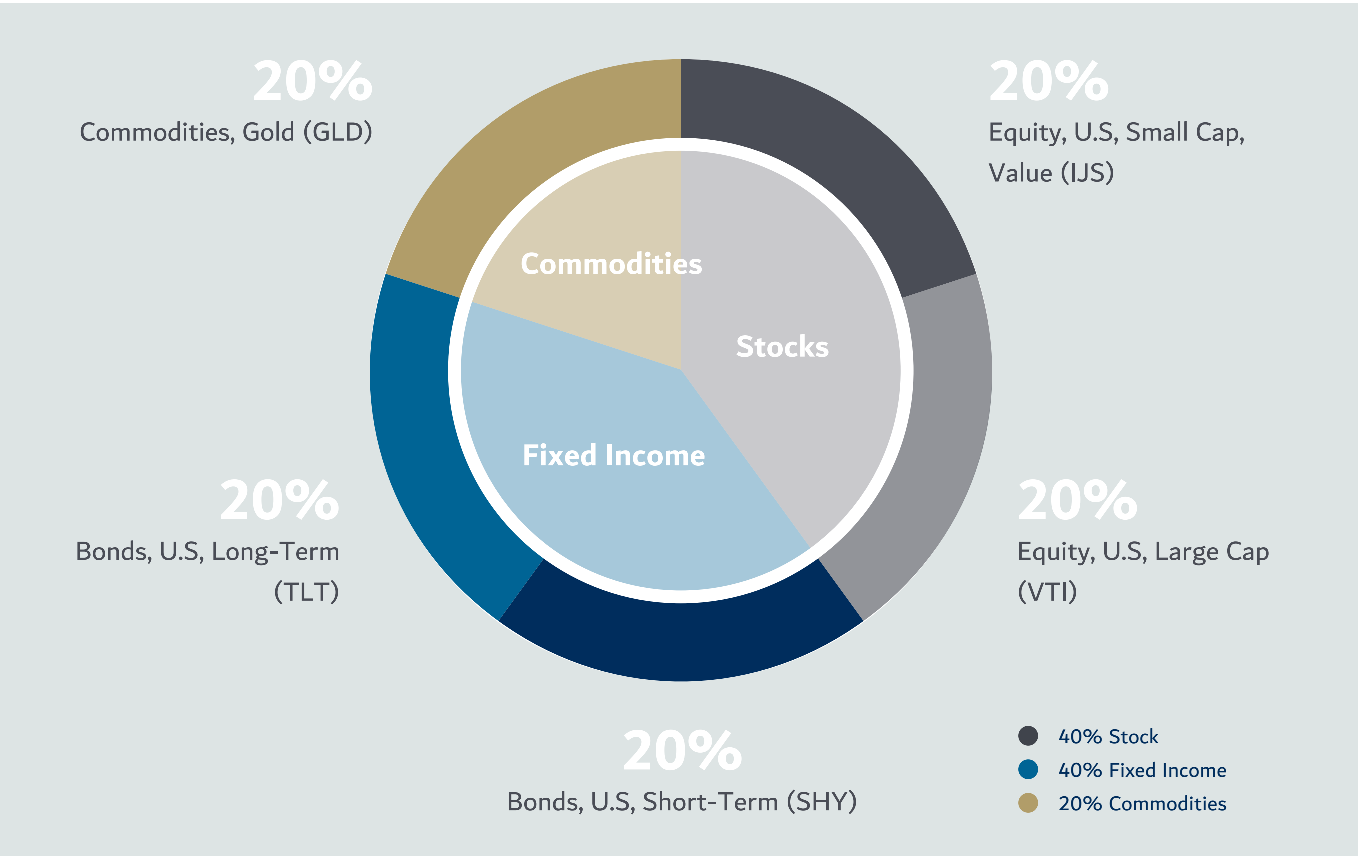
One example of the benefits of diversification for investors can be exemplified by the "Golden Butterfly Portfolio". This very simple strategy is invested 40% in stocks, 40% in US Treasuries and 20% in gold. It can be replicated with only 5 ETFs and belongs to the "lazy portfolio" category – i.e it is a low-cost portfolio with low maintenance as it requires only 5 minutes of your time once a year to rebalance.

As we can see on the table below, despite a very bad month of February for risk assets, the portfolio was down "only" -2% in February. This follows a strong performance in 2019 (+18%). Over the last 10 years, the portfolio recorded a 7.7% compound annual return with a standard deviation of 6.3% and a maximum drawdown of -6.4% (Sept 2018-Dec 2018). Moreover, all positions can be redeemed intraday and the portfolio is fully transparent.

These very decent numbers show that diversification is the only "free lunch" in investing. It enables savers with a long-term view to grow their capital while sleeping well at night (although we all know that past performance might not get replicated in the future).

Of course, these results can be further enhanced through optimized Strategic Asset Allocation (SAA), opportunistic Tactical Asset Allocation (TAA) and astute manager / stock selection.

The Golden Butterfly Portfolio has the following asset allocations:



The Golden Butterfly Portfolio Yearly Returns – Monthly Returns Heatmap

YEAR	RETURN	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
2020	-0.75%	1.3	-2.0										
2019	+18.03	4.9	1.3	0.3	1.3	-1.8	4.8	0.6	2.4	0.1	1.2	0.6	1.3
2018	-4.03%	1.3	-2.6	0.6	-0.2	2.0	-0.3	0.5	1.3	-1.3	-3.9	1.0	-2.3
2017	+10.96%	1.4	2.0	-0.3	1.0	0.1	04	0.9	1.1	0.9	0.4	1.6	1.0
2016	+10.82%	0.0	3.4	2.9	1.5	-0.5	3.7	2.6	-0.7	0.1	-2.7	0.0	0.7
2015	-3.71%	2.2	-0.5	-0.2	-1.0	0.1	-1.4	-0.6	-1.7	-1.2	3.1	-0.9	-1.6
2014	+9.13%	0.7	3.2	-0.2	0.1	0.6	2.5	-2.0	2.8	-3.3	2.0	1.2	1.4
2013	+6.26%	1.4	-0.1	1.8	-0.1	-1.0	-2.8	3.6	-1.0	1.8	2.1	0.4	0.1
2012	+8.84%	4.5	0.1	0.2	0.3	-2.4	4.5	1.0	2.1	1.6	-1.5	0.7	0.1
2011	+8.86%	-1.5	3.1	0.5	3.1	-0.2	-1.7	1.6	2.0	-3.0	4.7	0.9	-1.0
2010	+16.54%	-0.8	2.2	2.3	3.7	-1.8	-1.0	1.3	0.6	4.2	1.4	0.7	2.9
2009	+10.77%	-6.0	-4.4	3.1	3.3	12.8	-0.7	4.5	2.0	3.5	-1.5	5.0	-0.5
2008	-4.18%	0.9	0.2	-0.9	-0.2	0.7	-1.7	0.1	-0.2	-1.4	-10.3	2.9	6.6

The benefits of diversification for investors can be exemplified by the “Golden Butterfly Portfolio”. This very simple strategy is invested 40% in stocks, 40% in US Treasuries and 20% in gold.

MENA Equities: COVID-19 and falling Oil Prices

A novel coronavirus is wreaking havoc across Global Equity markets. The Middle East has not escaped the contagion with more than 12,000 cases at the time of writing – Iran being the worst hit. All Gulf states have suspended flights to the country in addition to China & Italy, furthermore, Kuwait & Bahrain have stopped flying to Dubai.

Concerts and sporting events in the region have been cancelled or postponed and countries have stepped up health screening measures. Saudi Arabia has even suspended the Umrah pilgrimage to Mecca for foreigners, citizens and residents. In the UAE, all schools and universities are closed for a period of four weeks in an effort to contain the spread of COVID-19. At the time of our writing, UAE gyms, nightclubs, parks, etc. are being closed.

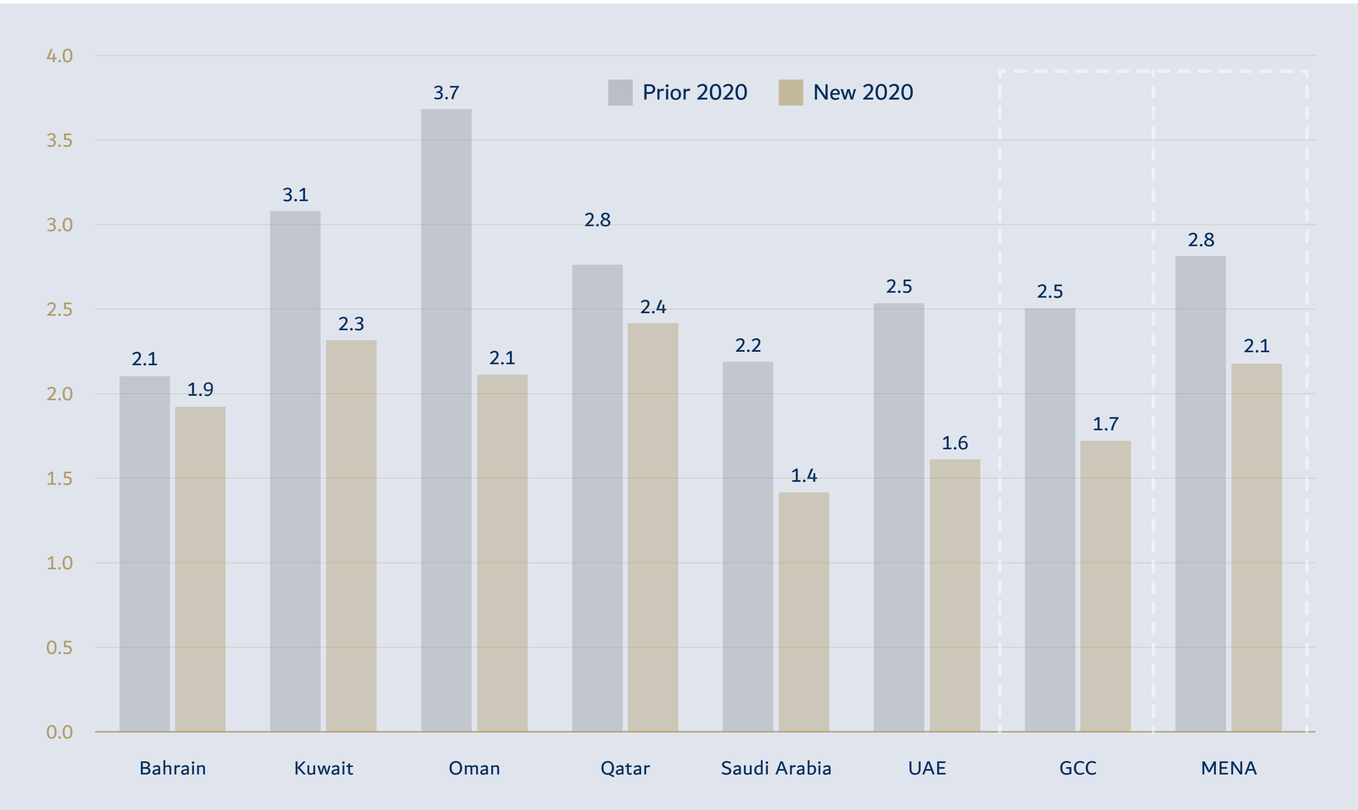
Another key development hit the news wire on the 6th of March as OPEC's pact with Russia fell appart in Vienna, sending oil into tailspin.

Below, we first review the potential effects on MENA's economy. We then share a list of potential winners and losers from this crisis. Finally, we discuss the oil situation following OPEC's meeting surprising announcement.

COVID 19 - what does this mean for the MENA Economy

Given the dominant share of the hydrocarbon sector, and the downward revisions to expected Oil prices for the year (more on this later), GDP growth forecasts have been slashed throughout the MENA region.

GCC and MENA regional real GDP growth in 2020 (%). *Source: MUFG MENA Research*



From a sector perspective, Travel and Hospitality has been substantially impacted. According to the International Air Transport Association, Global airlines stand to lose $113 billion in sales if the coronavirus continues to spread - analogous to those experienced by the industry during the global financial crisis of 2008.

Not to mention, hotels have seen mass cancellations and the rooms are now being offered at large markdowns. Malls are seeing scarcer footfall and retailers are experiencing a drop of sales in consumer discretionary products. With China being at the center of the global supply chain for several manufactured products especially electronics, shortages are expected.

Dubai Expo 2020

Dubai is set to host the global Expo (starting October this year) and expect to attract 25 million visitors over the six-month period. Most analysts expect the virus outbreak to be contained much ahead of the event and is therefore unlikely to impact the event or visitor numbers.

MENA equity market Performance

Unsurprisingly, stocks were in retreat in February. Within the region, none of the major markets were spared of the wrath of COVID-19. Outside of Lebanon, which is facing its own hurdles, Saudi Arabia, Qatar and Dubai have been impacted most. On the other hand, Oman and Bahrain are holding up relatively well, presumably on account of low valuations compounded by low trading liquidity within the markets. However, the sell-off has materially accelerated during the first two weeks of March.

Selected indices performance during the first 2 months of 2020

	January	February	First 2 months of 2020
US S&P 500	0.0%	-8.2%	-8.3%
MSCI EM	-4.7%	-5.3%	-9.7%
Oil	-11.9%	-13.1%	-23.5%
S&P Pan Arab	0.7%	-6.2%	-5.6%
Lebanon	-10.3%	-10.6%	-19.8%
Qatar	0.2%	-8.0%	-7.9%
Saudi Arabia	-1.7%	-7.5%	-9.0%
Dubai	0.9%	-7.2%	-6.3%
Egypt	-0.3%	-6.5%	-6.8%
Abu Dhabi	1.6%	-4.9%	-3.4%
Kuwait	0.7%	-4.0%	-3.3%
Morocco	3.1%	-2.2%	0.9%
Jordan	2.9%	-1.7%	1.2%
Bahrain	2.9%	0.2%	3.1%
Oman	2.5%	1.3%	3.8%

5 stocks to avoid and 5 stocks to own in MENA

Sell the Obvious

SELL

AIR ARABIA

The Airlines industry, as discussed earlier, is perhaps the most vulnerable to the virus outbreak. Even though the Sharjah based airline does not have direct flights to China, the overall load factor is expected to compress and profitability and in turn yields will see downward pressure. Air Arabia reported a stellar Q4 with earnings of almost AED 200m as a result of two contributing factors, yield enhancement caused by the collapse of India's Jet Airways and excellent cost management. Furthermore, the Abu Dhabi Joint Venture has a lot of potential and one can expect them to penetrate the largely underserved, low cost flying industry within the Emirate.

SELL

EMAAR MALLS

Lower footfalls, as a result of lower tourists compounded by increasing precaution by residents alongside an expected reduction in discretionary spending are not good news for retailers. The company, we think, will face strong headwinds in the near term. On the positive side, the company has reported flat revenue figures for 2019 despite an already tough market. The dividend yield after the recent correction stands at almost 7%.

SELL

SABIC

A large portion of the Petrochemicals produced in the region, and subsequently exported, get exported to China. With demand being under pressure, margins, as measured by the spreads that the companies make – are quickly narrowing. The stock, along with other Saudi large caps rallied as the market was being included in Emerging market Indices of MSCI & FTSE – only to give back all the last 4-year gains. We still think it is not at an attractive price point to make an entry.

SELL

EXTRA (UNITED ELECTRONICS)

Consumer Electronics purchases, just like other discretionary spending, is generally an expense that can be delayed, as customers take necessary precautions to avoid public spaces. This has been one of our top ideas since 2017 – the stock has since, nearly tripled, recently aided by consolidation in KSA on account of Saudization.

SELL

ORASCOM HOTELS

Tourism is being hurt everywhere and Egypt would not be an exception. The company has hotels and holiday homes in El Gouna. Pre-sales for 9m-2019 grew 140%, even as the EGP appreciated. At 4.0, the stock trades at a 66% discount to its NAV estimate of 12.0.

Buy the Defensives

BUY

HUMAN SOFT

This Higher Education service provider in Kuwait should face limited threat to its revenues. **The stock is cheap at a P/E of 10.5x and currently yields a dividend of 6.2%.** The stock should also benefit from the market's inclusion in global EM Indices.

BUY

TABREED

MENA's largest district cooling utility provider has most of its EBITDA from capacity charges through off take agreements with clients. **We don't see this to change too much with the COVID-19 and remains attractive with Free Cash Flow Yields above 12%.**

BUY

MOUWASAT

Hospitals and clinics should generally see more patient visits amid fears of the virus spreading. We like Mouwasat, arguably the Kingdom's best known, diversified healthcare service provider with 1300+ beds. **It has consistently delivered healthy earnings growth.**

BUY

EASTERN TOBACCO

Yet another stable business is consumption of tobacco. Cigarettes are inelastic in nature and Egypt's monopoly produces 84 billion cigarette sticks annually. **The Government receives 75% of the retail price of the pack as excise tax and therefore should protect the margins.**

BUY

AL MARAI

Classic consumer staple company selling dairy and bakery products is our final name on the list. We prefer this over supermarkets – who have an element of downside given the increasing trend of ordering grocery online. **Al Marai on the other hand, will see rising demands as imports of global names will see some disruption.**

The Airlines industry is perhaps the most vulnerable to the virus outbreak.

OPEC's pact with Russia falls apart, sending oil into tailspin and opening the door to an *oil war*

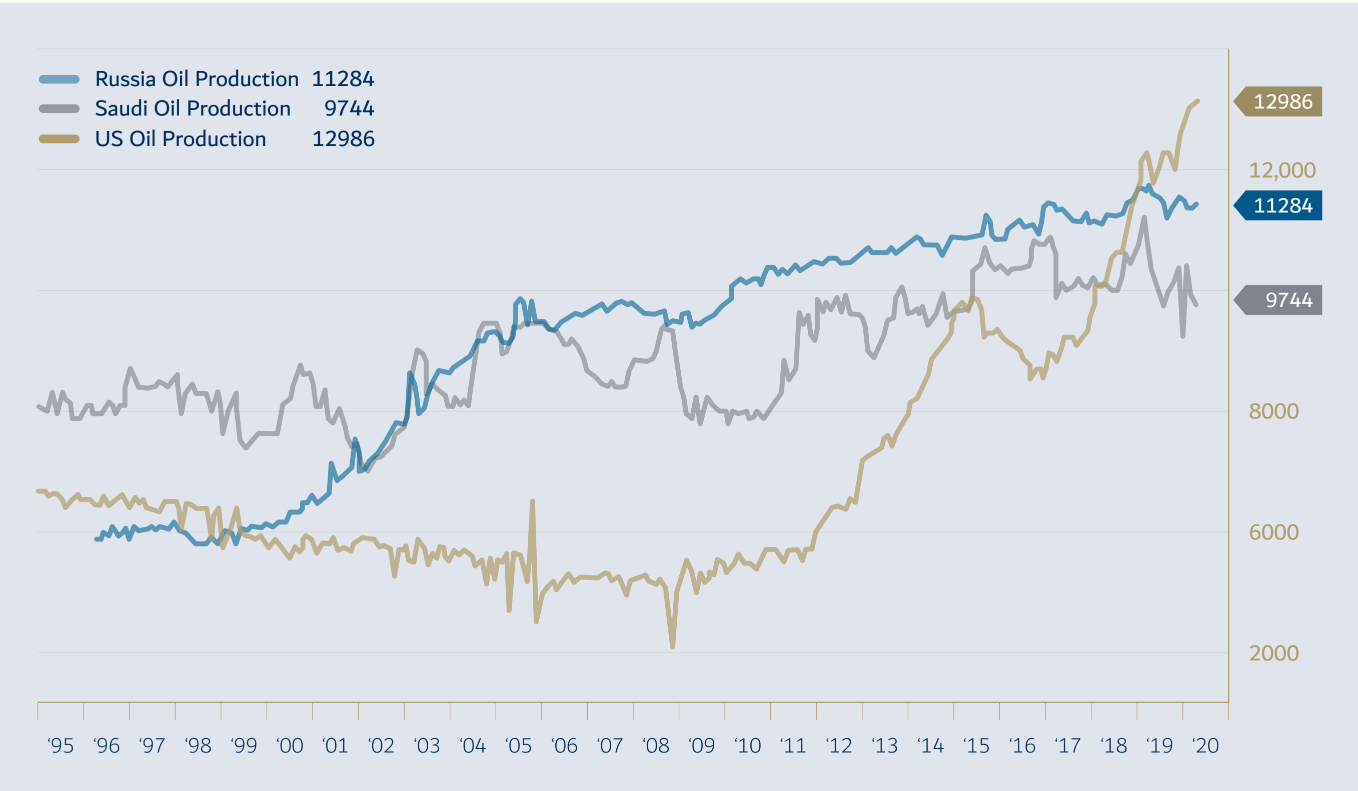
A three-year pact between OPEC and Russia ended in acrimony on March 6th after Moscow refused to support deeper oil cuts to cope with the outbreak of coronavirus and OPEC responded by removing all limits on its own production. Oil prices plunged 10% the same day as the development revived fears of a 2014 price crash, when Saudi Arabia and Russia fought for market share with U.S. shale oil producers, which have never participated in output limiting pacts.

For over three years, President Vladimir Putin had kept Russia inside the OPEC+ coalition, allying with Saudi Arabia and the other members of the OPEC countries to curb oil production and support prices. On top of helping Russia's treasury – energy exports are the largest source of state revenue – the alliance brought foreign policy gains, creating a bond with Saudi Arabia's Crown Prince Mohammed bin Salman.

But the OPEC+ deal also aided America's shale industry and Russia was increasingly angry with the Trump administration's willingness to employ energy as a political and economic tool. It was especially irked by the U.S.'s use of sanctions to prevent the completion of a pipeline linking Siberia's gas fields with Germany, known as Nord Stream 2. The White House has also targeted the Venezuelan business of Russia's state-oil producer Rosneft.

As the virus spread and analysts forecast the worst year for oil demand since the global financial crisis, the Saudi camp was hopeful Moscow could be won over at this round at the March OPEC meeting and agree to 1.5 million b/d in further oil production cuts. The Russians didn't rule out deepening cuts but kept making the point that shale producers should be made to share the pain and thus cut production as well (see chart below which exhibits oil production for various countries).

US, Russia and Saudi Oil Production (in '000 b/d)

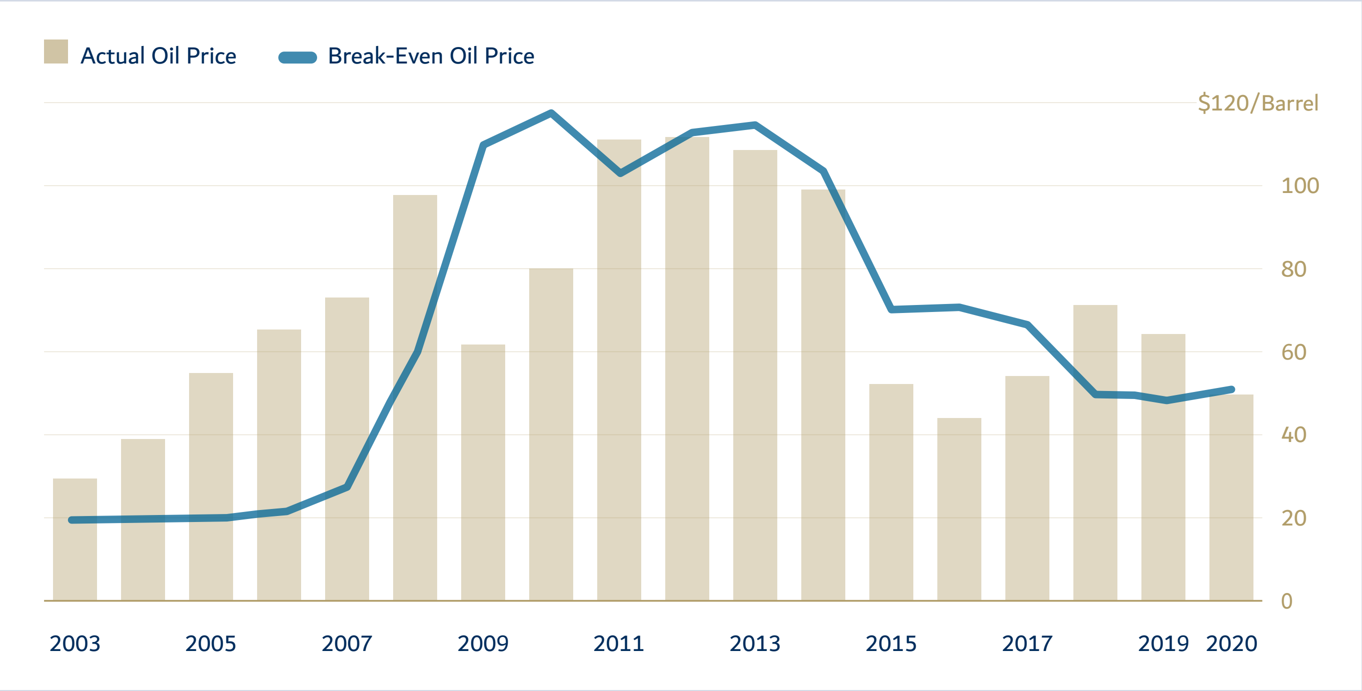


As ministers gathered in Vienna, Saudi Arabia made a final effort to force Russia's hand. They persuaded the core OPEC group to support a deep production cut of 1.5 million barrels a day, but made it contingent on Russia and the other OPEC+ countries joining in. But Alexander Novak, Russia's energy minister, turned up last at the Vienna headquarters and refused to budge as Russia decided to sacrifice OPEC+ to stop U.S. shale producers and punish the U.S. for messing with Nord Stream 2.

However, the decision to play "hard ball" with US shale oil producer could backfire. While many drillers in Texas and other shale regions look vulnerable, as they're overly indebted and already battered by rock-bottom natural gas prices, significant declines in U.S. production may take time. The largest American oil companies Exxon and Chevron now control many shale wells and have the balance sheets to withstand lower prices. Some smaller drillers may go out of business, but many will have bought financial hedges against the drop in crude oil.

In the short run, Russia is in a good position to withstand an oil price slump. The budget breaks even at a price of $42 a barrel – so much lower than in 2014/2015 (see chart below). Nonetheless, the coronavirus's impact on the global economy is still unclear and with millions more barrels poised to flood the market, some analysts are warning oil could test recent lows of $26 a barrel.

Breathing Space – Russia's budget is better prepared for lower oil than six years ago. *Source: Nordea Bank*



In Saudi Arabia, where the government is almost entirely dependent on oil to fund government spending, the economic impact will be immediate.

This probably explains why the day which followed the collapse of OPEC+ pact, Saudi Arabia kick started what Bloomberg called an "all-out oil war", slashing official pricing for its crude and making the deepest cuts in at least 20 years on its main grades, in an effort to push as many barrels into the market as possible.

Saudi state producer Aramco, which successfully IPOed just before the price of oil cratered, launched unprecedented discounts and cut its April pricing afor crude sales to Asia by $4-$6 a barrel and to the U.S. by a whopping $7 a barrel in attempts to steal market share from 3rd party sources, according to a copy of the announcement seen by Bloomberg.

In the most significant move, Aramco widened the discount for its flagship Arab Light crude to refiners in north-west Europe by a hefty $8 a barrel, offering it at $10.25 a barrel under the Brent benchmark. In contrast, Urals, the Russian flagship crude blend, trades at a discount of about $2 a barrel under Brent. Traders said the Saudi move was a direct attack at the ability of Russian companies to sell crude in Europe.

The draconian cuts in monthly pricing by state prouder Saudi Aramco are the first and clearest indication of how the Saudis will respond to the break-up of the alliance between OPEC and Russia, and the second indication that the OPEC oil cartel is now effectively dead, came a few hours later when Bloomberg again reported that **in addition to huge price cuts, Saudi Arabia was set to flood the market with a glut of oil to steal market share** and capitalize on its just announced massive price cuts as the kingdom plans to increase oil output next month, going well above 10 million barrels a day.

Saudi Arabia has privately told some market participants it could raise production much higher if needed, even going to a record of 12 million barrels a day, according to Bloomberg sources. **But before hitting a stunning 12mb/d, Saudi production will first rise above 10 million barrels a day in April, from about 9.7 million a day this month.**

According to some analysts, the Saudi strategy could be an attempt to impose maximum pain in the quickest possible way to both Russia and other producers, most notably US shale, in an effort to bring them back to the negotiating table, and then quickly reverse the production surge and start cutting output if a deal is achieved.

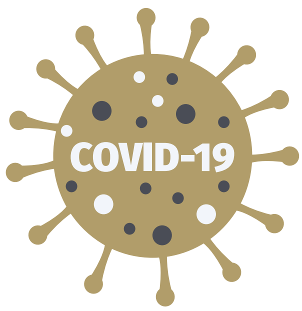
But there is no guarantee for this strategy to work. Given the demand shock as a result of COVID 19 and a supply shock from Saudi slashing oil prices and raising production volumes, we could very well see oil prices falling to much lower levels.

CONCLUSION

The COVID-19 situation and the recent developments on oil markets will obviously have important consequences for the MENA economy, stock markets and our investment portfolios.

As of the end of February, the S&P Pan Arab index was down -7.1%. Thanks to our defensive positioning, the Al Mal Mena equity Fund was able to limit the drawdown with a performance of -3.4% (+370 basis points outperformance).

At the time of our writing, we are assessing the impacts of the aforementioned news on our current portfolio holdings. While our investment approach is mainly bottom-up, "top-down" inputs are also part of our decision-making process.

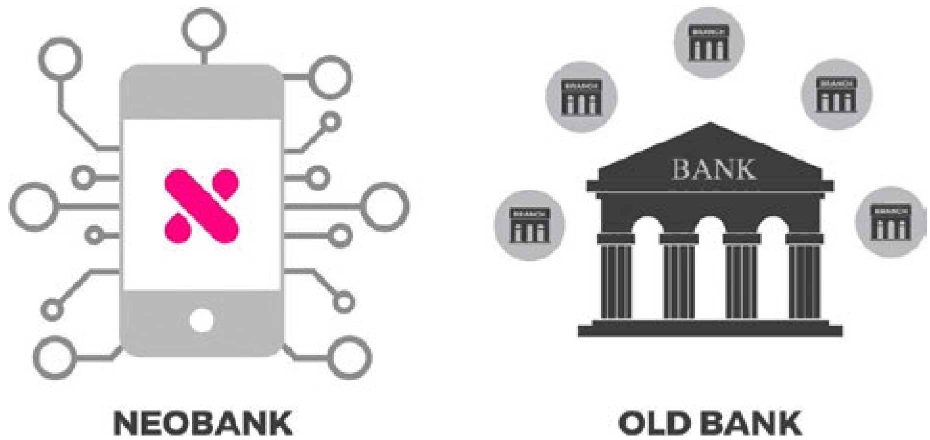


Innovation: The rise of the Neobanks

With the dawn of the internet era through the 20th century to today, technology has already disrupted a large number of industries and led to a major revamping of many products and services. The traditional banking industry is probably one of the few industries which has not gone through major disruption – at least for the time being. Until the crisis of 2008, banks garnered extraordinary returns which have since subsided as a result of reregulation, recapitalization and the growing threat of Neobanks, a subset within the FinTech space.

What is a Neobank?

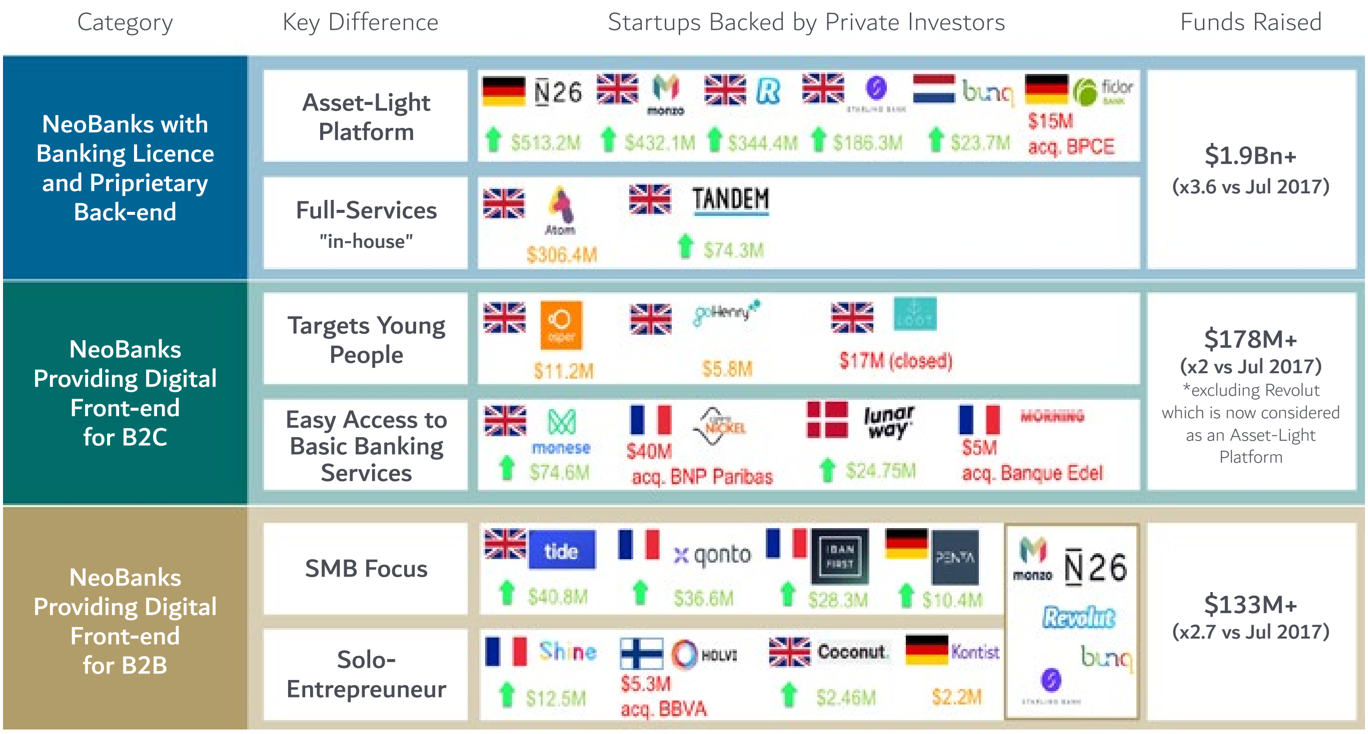
Neobanks, as the term suggests are new banks which aim to reinvent the world of traditional, retail banking by way of innovation across the entire value chain thereby challenging traditional retail banks across the globe. Neobanks operate exclusively online with the focus being on providing streamlined banking services designed for mobile phones. For the vast majority, Neobanks do not have a physical / branch network presence. Neobanks offer traditional banking services such as saving accounts, money transfer services, loans for individuals and small businesses along with newer, technology driven services such as money management analytics, budgeting tools and robo advisory offerings.



It is also important to understand the scope of Neobanks. Some may be Full Stack while others are Front End. The difference between the two is that Full Stack controls most of the value chain as opposed to Front-End which do not have a banking license and tend to partner with a larger/established bank thereby not being as much of a threat to large banks. Neobanks that fall into the Full Stack category often have their own bank license and provide services which are "traditional" by nature (e.g current accounts, debit/credit cards etc). Examples of such Neobanks are N26, Revolut and Monzo.

On the other end of the spectrum, Front-End Neobanks offer financial services which have more to do with the provision of analytic tools, money management and budgeting. Examples of Front-end Neobanks are Chime Bank and Yolt. Within this spectrum of Full Stack to Front End, there are some companies that offer bank like services such as e-money or payments services. These include companies such as PayPal, one of the earliest examples of what could be considered a Neobanks.

European Neobanks Landscape–in almost 2 years the level of funding has been multiplied by 2.0x, from about $750M+ in July 2017 to $2.2Bn+ in June 2019.



The growth of Neobanks

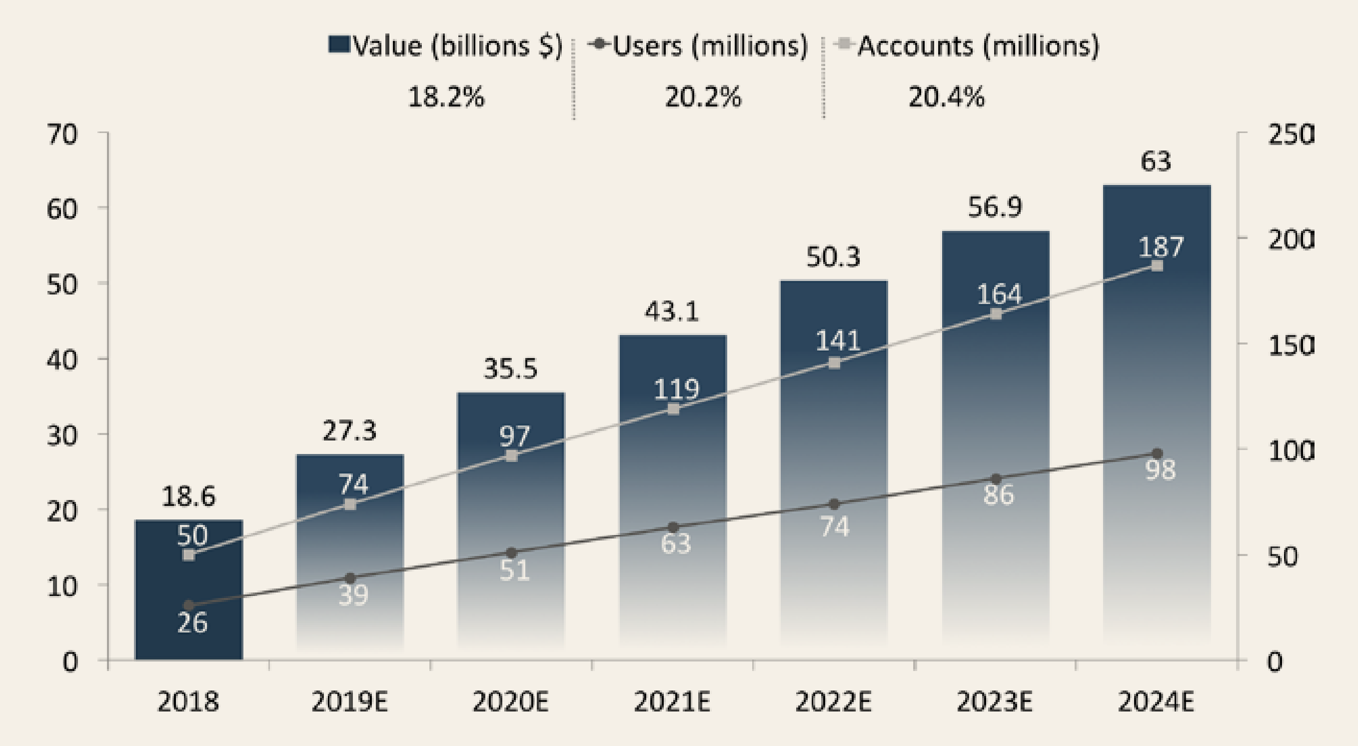
Neobanks are significantly growing within the consumer banking sector. Neobanks such as Chime and Revolut have already acquired over a million users and transactional value ranging from $4-$18m dollars.

Neobanks are expected to grow at CAGRs greater than 50% with the global market set to reach $356 million dollars by 2025. Key opportunities for the space the ability to penetrate within emerging economies. While digital banking is well accepted within Western Economies, Key threats to this rising growth remains their ability to generate profits. Neobanks on average lose $11 per customer and are in a net loss phase, with growth supported by VC funding. However, the freemium model and new avenues of monetization are set to remain key to their ability to make profits. Furthermore, increased non-interest income through 3rd party partnerships and other value-added services can also help in their quest to turn profitable.

Finally, regulatory threats exist within this nascent industry. On that front, larger, traditional full-service banks hold a key advantage over Neobanks. Some countries have established pathways for the industry by protecting consumers savings registered with the app but with financial institutions being SIFIs – Systematically Important Financial Institutions - only time will tell if regulatory changes and transformations will be a boon, or a curse to the industry.

Neobanks are expected to grow at CAGRs greater than 50% with the global market set to reach $356 million dollars by 2025.

Global Neobanks Value (in $ billion, l.h), Users and Accounts (in million, r.h)



Business models and competitive levers

Neobanks are challenging the traditional retail banking model by way of cost efficiencies, diversified revenue streams, focus on a customer centric experience, more advanced technology along with the use of artificial intelligence, and the ability to provide for insightful analytics.

As a result of their lack of physical presence, they operate at very low costs and are able to pass on these low costs to their consumers providing for a major competitive advantage vs traditional retail banks. Their strong cost efficiencies are further enhanced by less complex IT systems, simpler product distribution and more streamlined operating models. Moreover, Neobanks also spend less on customer acquisition as their efforts are largely driven through social media, as opposed to traditional retail banks and the role of relationship managers and business development personnel. Furthermore, Front End Neobanks are able to expand their user base by already using the bank's existing user base while Full Stack Neobanks use third party platforms to integrate and unify their service offerings. For instance, Monzo integrated their service offerings with TransferWise enabling them to yield commissions on currency transfers made from their apps.

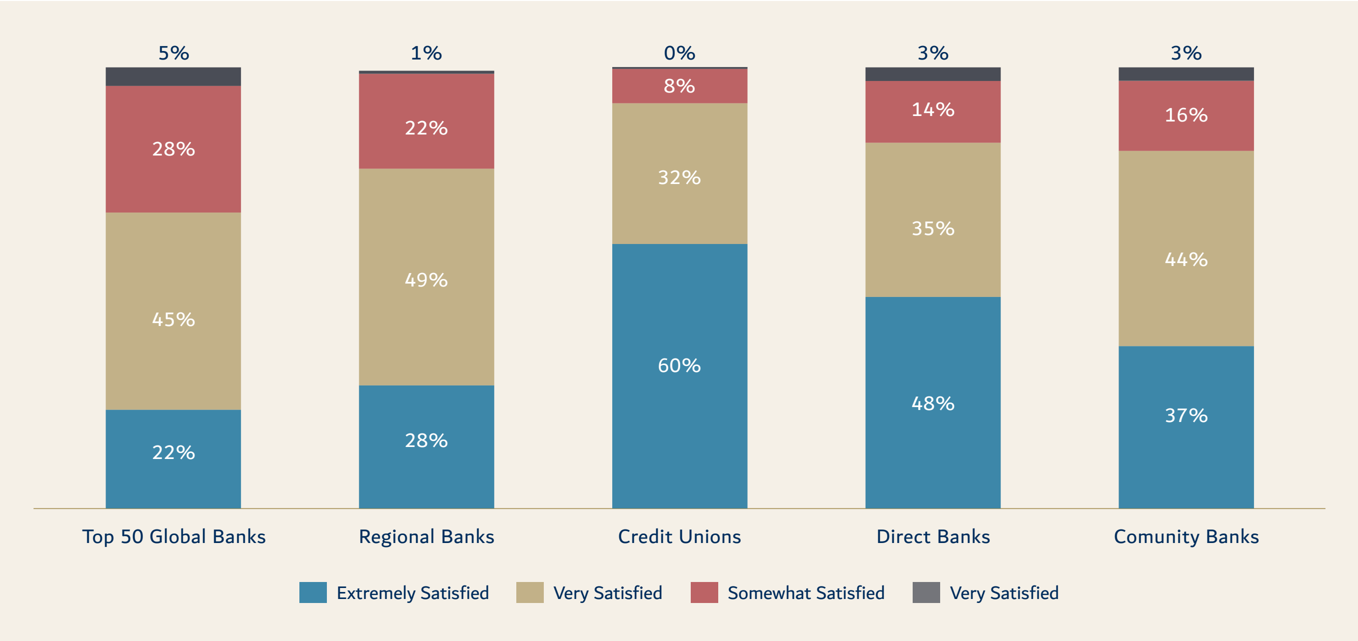
Neobanks also source their revenue from alternative sources such as interchange fees from merchants, monetization of financial data sourced from their customer base and charging for premium services such as international spending, free international ATM withdrawals and support for multi-currency transactions. This helps Neobanks seek less revenue from traditional retail banking, customer facing, revenue streams such as minimum balance requirements, overdraft fees and monthly fees. They are also able to pay higher savings rates vs traditional banks, as a result of these cost efficiencies and diversified revenue streams. Consumers are willing to experiment with digital banking in order to save money, with all fees that do get passed on, transparent in nature.

The customer centric nature and model of the Neo Bank way of business adds many competitive levers. These banks exist 100% on a digital and mobile platform and are feature rich, offering various tools and analytics to users. Neobanks offer personalized money management insights, and leverage this data received as an alternative source of revenue.

From a B2B angle, Neobanks are quickly growing in the SME, gig economy space. These banks offer automated, real time accounting services by way of bookkeeping, balance sheets, profit and loss statements and even taxation services. They can also provide valuable, easy to understand insights for business owners and aid them in reducing costs, increasing productivity and revenue. Some Neobanks are also tapping into the microfinance space, offering small business owners loans and short-term financing services.

Customer satisfaction metrics attest the attention Neobanks pay to Customer Experience. According to a US Directs bank survey, customers are 83% satisfied as against 67% satisfaction rate for Top 50 Global Banks.

Customer Satisfaction by Bank Type–US



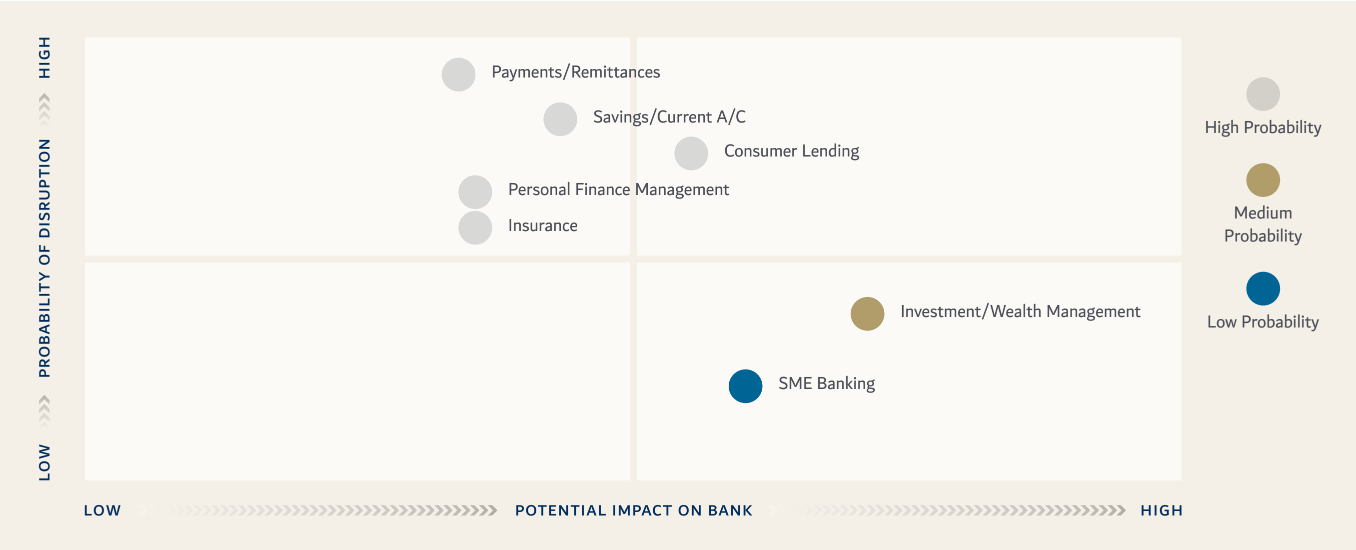
Customer support is another area where Neobanks are "reinventing the wheel" especially in the retail banking space. Chatbots offer real time customer service; a low cost, efficient alternative to the traditionally bureaucratic and cumbersome nature of customer service in the traditional retail banking space. With human interaction being eliminated, it might not be as personal as traditional services. However, it is a seemingly small price to pay for the benefits which come in the form of cost savings and time efficiencies. Some Neobanks that offer credit even use Alternative Intelligence and analytic models to speed up credit worthiness decisions with transparent, upfront repayment schedules and fee structures. Account opening processes are reinvented as one can open an account by simply taking pictures of ID's and a video of yourself.

They can also provide advantages when it comes to security and fraud prevention with their use of artificial intelligence. Monzo recently noticed a data breach on ticketing platform Ticketmaster and immediately replaced all cards that used Ticketmaster, without waiting to receive customer requests.

How disruptive are they to mainstream banks?

Over the short term, the ability for Digital Banks to disrupt the retail banking sector remains largely for services which are transactional by nature. Elements of the traditional banking sector that will be more difficult to disrupt remain services that require greater human know how, such as Wealth and Asset Management, and Corporate/Institutional Banking. Nonetheless, with the rising use of AI (Artificial Intelligence) within these sectors, it will not be long before Digital Banking disrupts these areas too. Robo advisory within the Asset Management space is growing quickly and some Neobanks even offer consumers savings options that could potentially include robo advisory. AI is also being used to evaluate credit scores, and with a larger number of SME's using Digital Banks, the reach for these banks is only going to get bigger. To further penetrate the market, value could be added within the space of micro financing and short-term lending.

Disruption: Impact vs Probability Matrix



Full Stack Neobanks pose a bigger threat in comparison to Front-End Neobanks. The difference between the two is that full stack controls most of the value chain as opposed to front-end that do not have a banking license and tend to partner with a larger/established bank thereby not being as much of a threat. Nonetheless, this nascent industry can always be integrated within traditional banks and acquisitions within the vertical is not uncommon.

HOLVI	fidor BANK	COMPTE NICKEL
N.A	125,000 users	500,000 users
Acquired in 2016	Acquired for €100m in 2016	Acquired for €200m in 2017
BBVA	GROUPE BPCE	BNP PARIBAS

CONCLUSION

Neo banking, while still in its nascent stages, is expected to go through a period of fast growth especially for key performance indicators such as number of users, throughput values and rising customer satisfaction. All generations except baby boomers turn to their mobile phones first when interacting with their bank; more than desktop PCs, ATMs or bank branches. This trend is led by millennials, with 76% of digital bank interactions conducted via mobile, while only 21% prefer desktops and laptops. For baby boomers, or those over the age of 53, desktops and laptops remain the preferred channel at 66%. Millennials and generations to come will see the benefits and are likely to adapt to new technology as mobile phone and internet penetration rises. Emerging markets, which have not been exposed to the traditional banking model could adapt quicker to this technology as the need for a formal banking system rises within these geographies.

The benefits are there to stay for the long run while the threats to the industry will be eliminated over time as adaptation to this technology increases globally.

As a final note, the current COVID-19 crisis is likely to test the viability of these new business models. In order to grow, the neobanks need access to abundant funding. While it has been the case so far, this could change with the crisis. Moreover, the temporary shut down of Robinhood application on March 3rd (a day of heavy stock selling) could put at risk the credibility of these newcomers.

Equity and credit markets have declined with unusual velocity. Investors hate uncertainty and they are currently facing three major unknows:

1) A Health crisis: while there are encouraging developments in China, no one knows how long the pandemic will last, its extent and potential recurrence;

2) Unprecedented economic damage: it is impossible to estimate what will be the short-term and long-term impacts of the global lockdown the economy needs to deal with. While monetary policy and targeted fiscal stimulus are likely to limit the impact and help the global economy to ultimately recover, a V-shaped recovery is not a given as U-shaped or L-shaped are plausible scenarios;

3) Financial contagion: Dysfunctional markets, wild swings, and a lack of executable bids and offers suggest a liquidity crunch and forced sellers. This is all happening in an environment of large debt overhangs and over-regulated banks. Meanwhile, central banks are losing credibility and lack ammunitions at the time the economy and markets need them the most. The longer the pandemic lasts, the greater the risk that the sharp economic downturn morphs into a full-blown financial crisis with all bubbles bursting.

What should investors do?

While it is never easy to navigate through a market meltdown, we have learned that this is a good time to be long-term, active investors. Ultimately, the economy and financial markets will be able to go through this crisis as they have in the past.

However, picking the bottom of the market is impossible. And while markets look oversold at this stage, further losses for equity markets cannot be ruled out.

We thus advise investors to buy risk assets but only gradually and not in an indiscriminate basis. This is an environment where ONLY THE FITTEST COMPANIES (solid Free Cash Flow generation and balance sheets) will survive and then thrive.

While our forecasts and views are always subject to change, our commitment to serve our clients is not. We remain at your full disposal for any specific issues you would like to discuss, so please do not hesitate to contact us.

During this difficult period of time, our first wish is that you, your loved ones, colleagues and family stay in good health, hoping that the situation will become better as soon as possible.

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