

Sell (the trade War) in May and Go Away?



Global Market Review:
Will the “everything” rally come to an end?

Behavioral Finance:
Seasonality and other stock market cycles

Hot Topic:
Will the dollar continue to smile?

Middle East Equities:
Opportunities and Challenges in Morocco

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Welcome to the 25th edition of Perspectives.

After a strong first quarter, risk assets continued their rally in April on the back of accommodative central banks, the expectation of a recovery in Chinese growth and a solid start to the Q1 US earnings season. Equity markets climbed across the regions, while high yield spreads narrowed further. But at the time of our writing, volatility is making a come-back on renewed trade tensions.

In this publication, we first discuss if the “everything” rally is coming to an end – in other words, should investors “sell the Trade war in May and go away”? Seasonality and other stock market cycles is the topic of the Behavioral Finance section. Based on the analysis of various cycle patterns, it seems that US equities might have further to go in 2019.

The “Hot topic” of the month is on the dollar which remains in the midst of a prolonged period of strength against the vast majority of global currencies. We highlight some of the reasons to be cautious on the dollar and why its fate is likely to shape financial markets in 2019.

In the last part of this publication, we look at the opportunities and challenges in Morocco, which is part of our universe within Middle East and North Africa equities. While the majority of the best growth stories do not match our strict liquidity requirement, we continue to monitor Morocco very closely as we consider this market as a source of alpha opportunities once valuations would become more attractive.

We hope you will enjoy this issue.

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Global Market Review: Will the "everything" rally come to an end?



A strong month of April for nearly all asset classes

The month of April saw a continuation of the “risk-on” rally with the S&P 500 posting a 4.0% total return following the strong 13.6% advance in the first quarter. The month ended with a mini “melt-up”, as the S&P 500 index set record highs four times in April on a closing basis, three of them in the last three trading days of the month. As of the end of April, the S&P 500 was up 26% since the December low and sat 2% above its prior high in September 2018.

With the exception of Oil (+6.4%) and Bitcoin (+28.6%), U.S. stocks outperformed other asset classes in April including bonds and cash. The VIX index fell 4% (down 48% since the start of the year), while gold slipped for the second straight month (-1.0% in April).

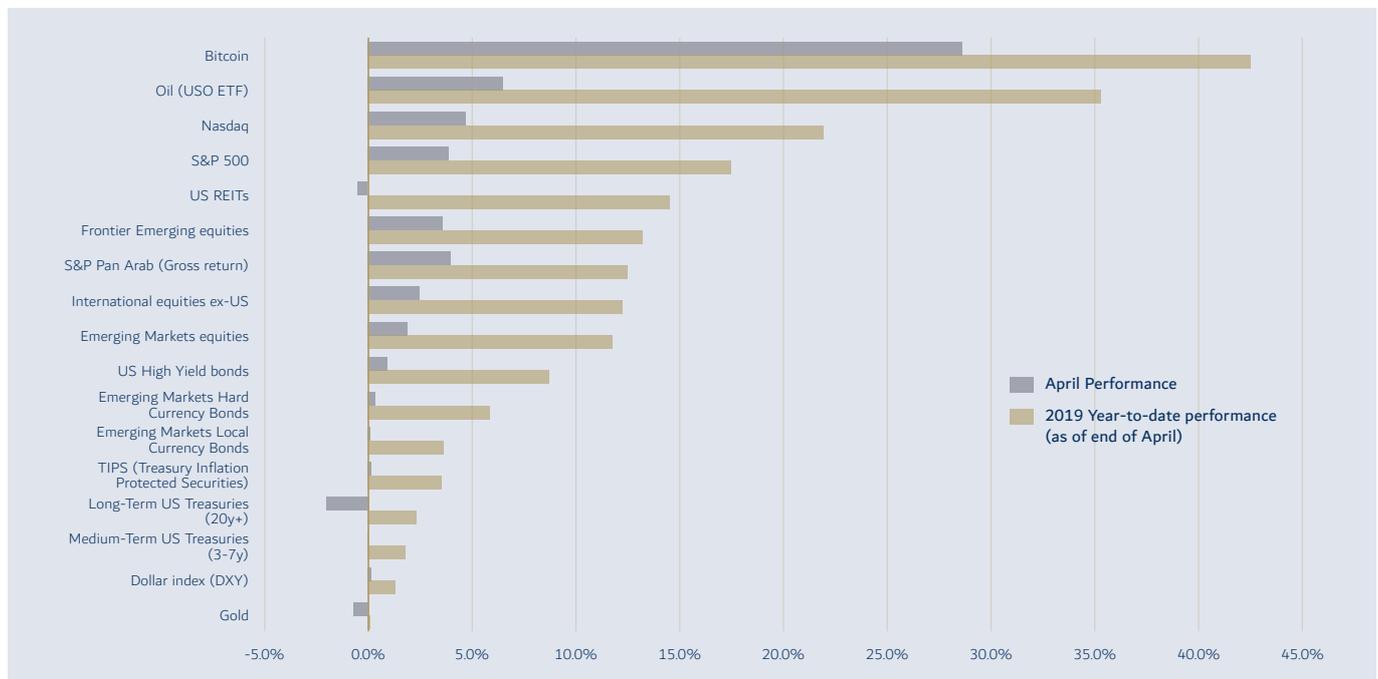
While they lagged the S&P 500, Global equities also posted strong gains, rising 3.7% in local currency terms and 3.4% in USD, with all MSCI regions gaining. The top spot went to European Banks, which returned +8.4% in local currency terms. A combination of a slight rise in bond yields, earnings, improving data and a general lag versus wider equity markets in the first quarter all appeared to play a role. That compares to a return of +3.9% for the broader STOXX 600 while the NASDAQ finished the month with a +4.8% gain while establishing a new historical

record high. Emerging Market equities lagged the rally, albeit still returning a solid +2.0%. In Asia, the Nikkei returned +5.0% and Hang Seng +2.3%. The Shanghai Composite was the big underperformer, falling -0.4%. The S&P Pan Arab posted another solid monthly gain (+4.1%).

On a year-to-date basis, all the main asset classes are in positive territory (see chart below). As recently highlighted in a note by Deutsche Bank, this is the strongest start to a year through the first four months of the year since 2007. In terms of the asset classes ranking, Bitcoin (+43%) and Oil (+35%) are leading. U.S. equities are outperforming the rest of the world; the Nasdaq index is up +22% since the start of the year while the S&P 500 gained +18.2%. It is worth mentioning that on a relative basis (versus S&P 500), the Nasdaq index is approaching the 2000 peak.

In dollar terms, International equities ex-US are up +12.5%, a performance which is similar to the S&P Pan Arab. Meanwhile, USD High Yield bonds are up +8.7%, outperforming Emerging Markets Hard currency bonds (+5.9%). Government bond markets are still delivering a positive return with medium-term Treasuries up +1.8%. There is only one asset which has the misfortune of being down this year and that goes to Silver (-3.5%).

Selected asset classes performance since the start of the year and in April 2019



As recently highlighted in a note by Deutsche Bank, this is the strongest start to a year through the first four months of the year since 2007.

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Besides those “headline” performance numbers mentioned on the previous page, there are three key takeaways from the market action so far this year.

Takeaway #1: The breadth of the market advance

As highlighted above, all asset classes – US equities, International equities, High Yield, Government bonds, Oil, Gold and Bitcoin – are in positive territory on a year-to-date basis. This is a very rare event and almost the exact opposite of what happened in 2018 when nearly 95% of the main asset classes ended the year in negative territory.

Global breadth can be seen as a positive – we like in particular to see the equity rally being validated by tighter credit spreads.

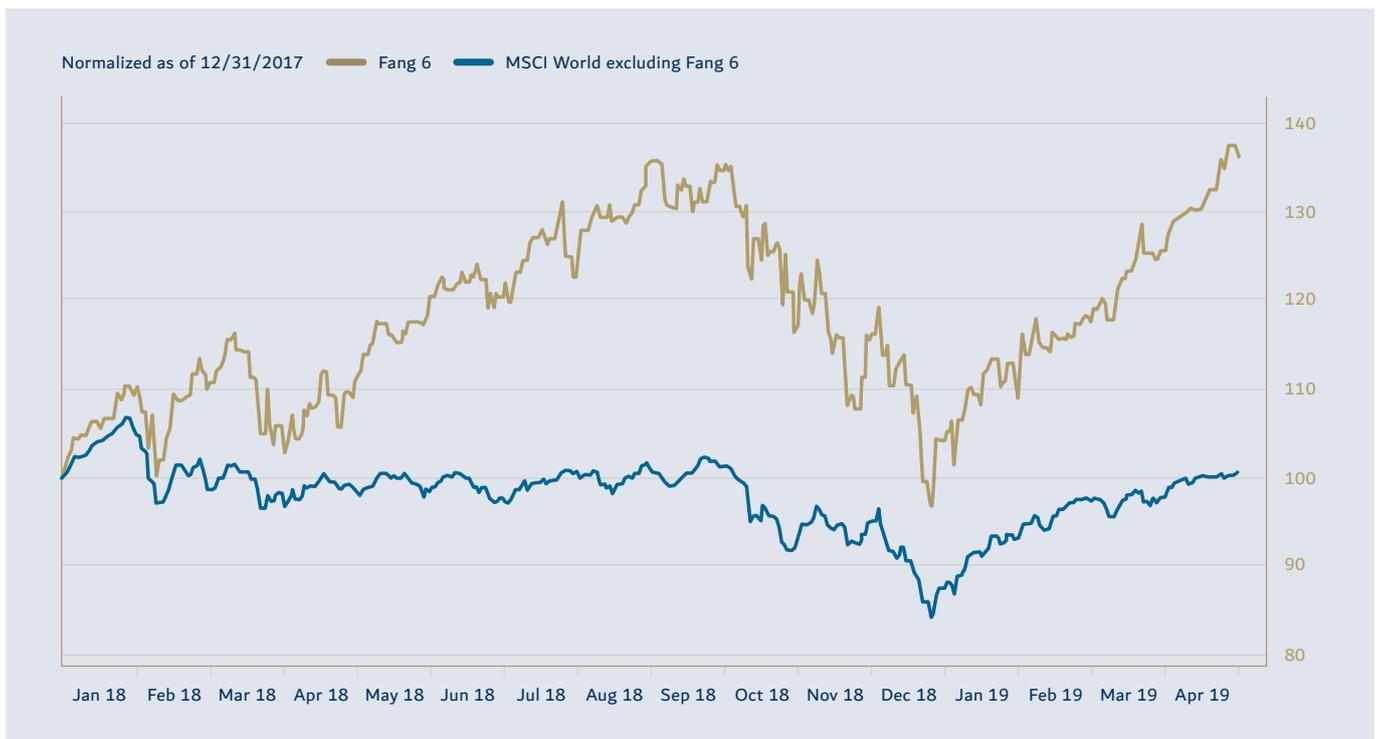
Still, it looks difficult to extrapolate the market action of the first four months of 2019 to the rest of the year. Moreover, looking underneath the surface can lead to a slightly different picture – see the next key takeaway.

Takeaway #2: “FANG 6” leadership

As shown below, the “FANG 6” (Facebook, Apple, Amazon, Netflix, Google and Microsoft) rule the global equity performance. Indeed, excluding the FANG 6, world stocks would have done

absolutely nothing over the last 16 months (see the blue line on the chart). In light of this, global equities “breadth” does not look strong, which is not a good sign.

Excluding the “FANG 6”, world equities have been becalmed for 16 months (source: Bloomberg)



Takeaway #3: The Ratio of S&P 500 to Global Equities (ex-US) is at a new all-time high

As shown below, US equities outperformance versus International equities is well in place as the institutional capital is getting concentrated back in the US.

S&P 500 versus MSCI World ex-US



While the outperformance of US equities looks over-extended in terms of amplitude and time, there are fundamental reasons behind this move, as already mentioned in our latest quarterly outlook. While European and Asia equities could at some

point regain leadership, it seems premature. True, China fiscal and monetary stimuli create opportunities in China and the rest of Asia. But some emerging markets continue to face fiscal issues.

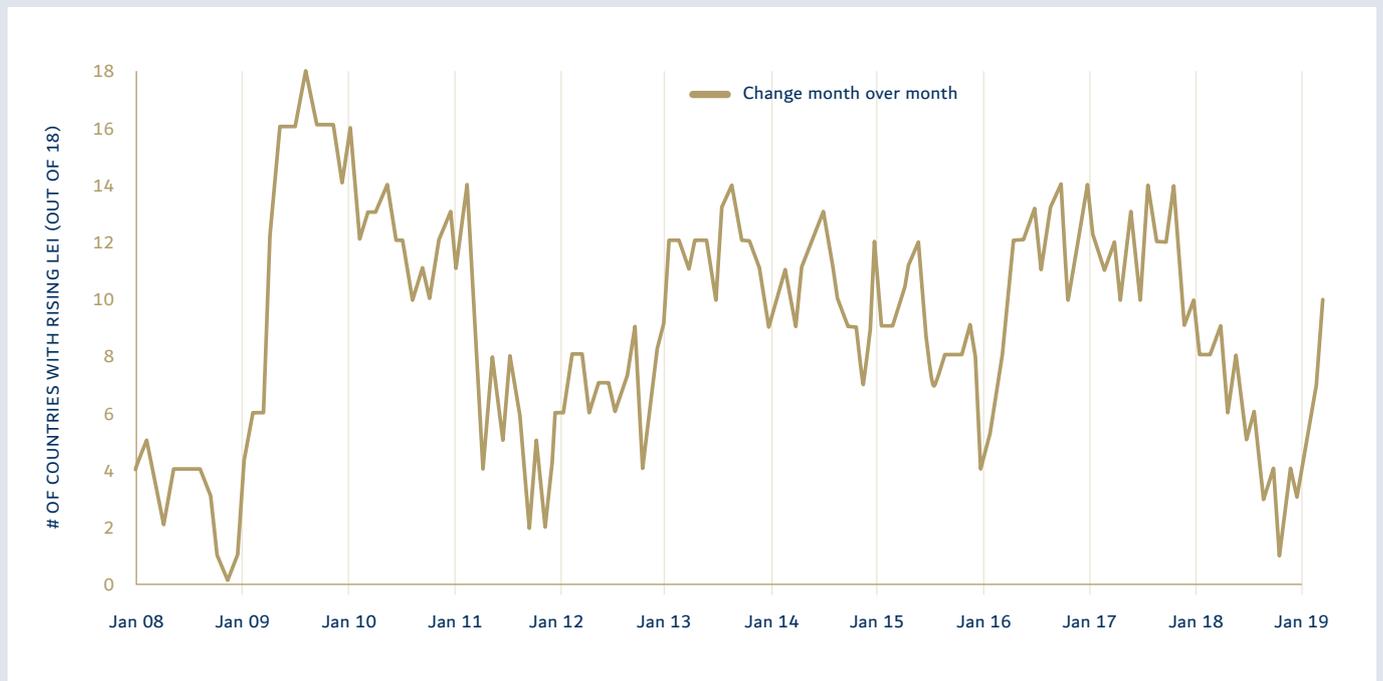
And when it comes to Europe, the relative cheapness of the market is offset by political uncertainties, exposure to trade war risks and sub-par economic growth. As such, we continue to favor US equities over International ex-US equities.

What are the factors behind the equity rally?

While central-bank stimulus has played a leading role over the past decade, the real superpower behind this bull market has been persistent, albeit sluggish at times, improvement in the fundamentals. Macroeconomic data last in April were consistent with that broad narrative, revealing that the economy and corporate profits remain surefooted while interest rates remain supportively low – a “Goldilocks” backdrop that can keep the

bull market's endgame at a distance a while longer. Specifically: After a soft patch at the end of last year, the number of countries with leading indicators improving is on the rise (see chart on the next page) which means that global economic growth might re-accelerate later this year. This includes China which is expected to turn around thanks to monetary and fiscal stimulus.

Leading indicators (LEI) have made the turn (Source: The Daily shot, Market Ethos, Richardson GMP)



In the U.S, the solid April jobs report highlighted the ongoing health of the labor market. Unemployment remains historically low and wages are rising, two key pillars of support for household spending, which is the lion's share of the U.S. economy. Historically, recessions have not emerged until unemployment rises. Labor force productivity growth is now at its highest level in more than a decade, a positive sign for the economy.

Corporate earnings results have come in ahead of expectations. As mentioned in our Q2 quarterly outlook (*"The Good, the Bad and the Ugly"*), downward earnings revision throughout the first quarter was too aggressive and we expected some good surprises during earnings season. In April, we have seen positive announcements from many corporate bellwethers, which indicates that profits are still healthy. With stocks trading at average valuation levels, earnings growth will be a key driver of market performance as we advance.

The Fed reiterated its patient approach. During April FOMC, the Fed held rates steady while citing an improving economy and below-target inflation as rationale for flexibility around future policy moves. While we believe the Fed might not be done with rates hike (see our Q2 Market outlook), we also think the Fed is likely to remain on "pause" with rates for the time being. This should keep interest rates from undercutting ongoing modest GDP growth. In the rest of the world, central banks are falling into a dovish line one-by-one, as data continue to favor this "goldilocks environment".

Watching for spoilers

Equity bull markets do not die from old age. They are brought down by a catalyst, typically overly tight monetary policy (Fed rate hikes) to quell an overheating economy / rising inflation or an exogenous shock that sparks a downturn. The current U.S framework of sub-3% GDP growth and sub-2% inflation suggests the economy is not imminently at risk of overheating. For sure, the financial repression has brought in many bubbles and imbalances that put at risk the global economy and whole financial system (this is the "Ugly" part of "The Good, the bad and the ugly" story we narrated in our Q2 outlook). While a

major shock cannot be ruled in the long-run, current conditions don't suggest the endgame is at hand.

By July 2019, the US expansion will be the longest in history. Meanwhile, the real Fed Funds Rate stands at +0.4%, which means that U.S Monetary policy remains extraordinarily easy, decreasing the probability of an imminent recession. At this stage, we believe only a Fed policy misstep or an unforeseen plunge in China growth could spoil the "party". For sure, political turmoil, Brexit, global sluggishness and trade

uncertainties are likely to trigger increased volatility and short-term pullbacks. Still, we don't believe they could spur an earnings downturn or a global economic recession.

At the time of our writing, global trade risk is coming back to the table as President Trump decided early May to reignite the "trade war" with China with incendiary tweets which threaten to 1/ raise levies on \$200 billion in Chinese imports

to 25% from 10% currently; 2/ impose 25% tariffs "shortly" on \$325 billion in Chinese goods that haven't yet been taxed.

This unexpected development could indeed trigger a comeback of volatility as investors were caught off guard by the renewed trade tensions. As shown on the chart below, "Trade war" was a key focus for investors last year but was taken out of the risk radar throughout the first quarter.

Our view on Trade War is that both U.S and China should be willing to avoid Trade War escalation. On the U.S side, a Tariffs hike on Chinese imports from 10% to 25% would have a \$100bn negative effect (through retaliation and higher import prices), which is equivalent to this year fiscal stimulus. When it comes to China, the economy has been under pressure as Tariffs hurt. To our opinion, the most likely outcome is agreements to take place with China buying U.S goods and tactically retreating from China 2025. But the deal is unlikely to decrease significantly China trade surplus with U.S. Moreover, key issues such as Technology transfer, IP enforcement or subsidies to SOEs are likely to stay. We thus believe there will be a deal, but we don't expect much substance to it or for China to honor it in the long run. Meanwhile, a pause in Tariffs and a delay in the deal suits China just fine – and the markets as well. But the "Trade War" risk is likely to stay.



To our opinion, another important point with regards to Trade War is that investors are too much focus on U.S-China trade deal at the expense of broader trade frictions that merit concern. For instance, a ratification of US-Mexico-Canada agreement is still far from certain. We also believe that trade tensions between U.S and E.U are particularly worrying and are likely to intensify by the end of year.

Investment conclusion

The “everything” bull market which took place during the first fourth months of the year is unlikely to continue at this pace. “Valuations are not cheap, the macro-economic cycle is considered to be “late-stage” and thus more volatile. Moreover, we are entering the weakest season of the year (see our article on stock market seasonality in this edition of Perspectives).

That being said, we continue to favor risk assets on a medium-term basis. Looking at equity markets through the four lenses, we don’t find enough evidence to turn outright bearish:

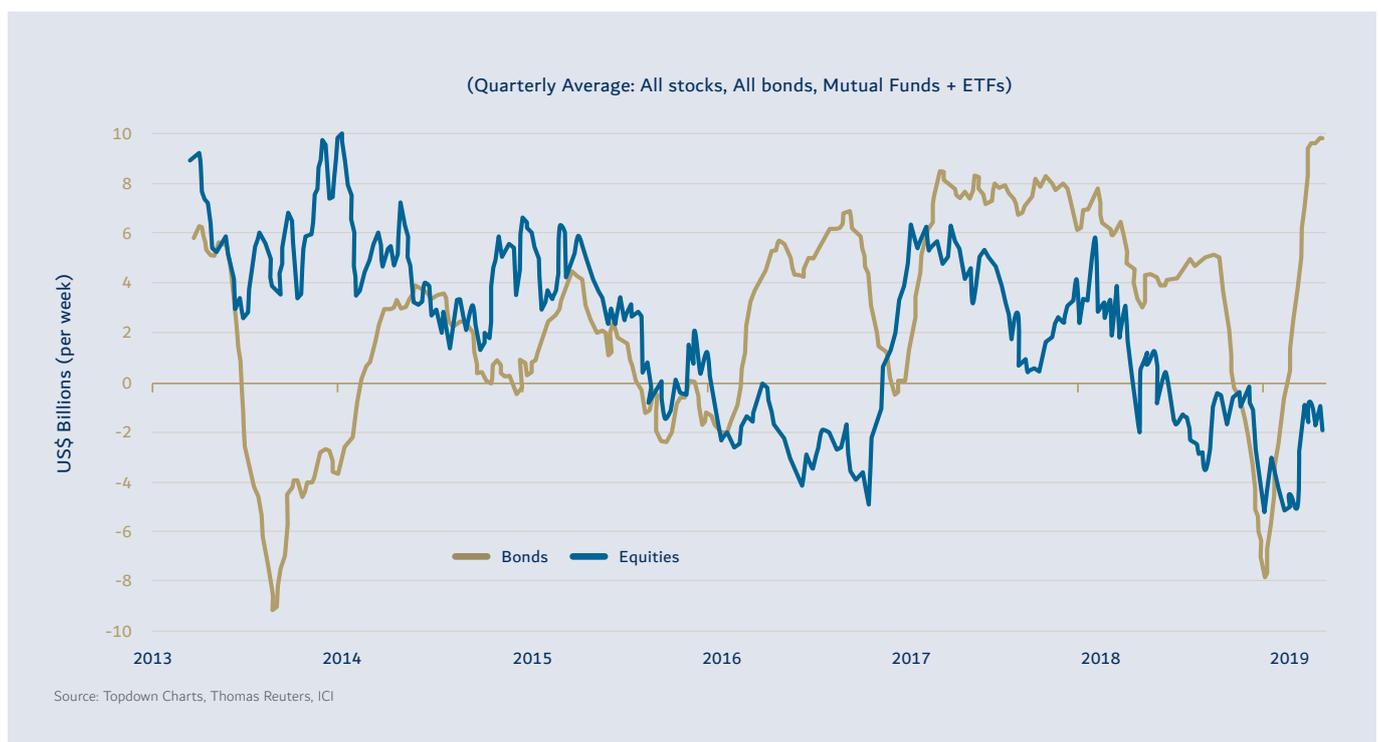
#1 Liquidity conditions remain supportive as central banks are easing (although we do not expect as much support as in Q1 going forward);

#2 Earnings revisions are now stabilizing and there is even room for potential positive surprises. Earnings are likely to be the main equity markets driver going forward

#3 Valuations are more expensive than at the start of Q1 but remains attractive relative to bonds.

#4 Sentiment has not reached over-optimistic levels. While indicators such as the VIX index was exhibiting some complacency at the end of April, we note that retail investors have barely participated in the start of the year rally (see chart below) – which is a positive sign from a contrarian view.

US Fund flows show that investors are positioning for a recession, i.e selling equities and piling into bonds



Overall, we continue to favor **EQUITIES** over **BONDS** but we urge our clients not to extrapolate recent strong returns to the rest of the year. We think the path for risk assets is becoming narrower and we expect a come-back of volatility very soon.



For investors, this means staying invested and making prudent adjustments (like proactive rebalancing) as the market cycle continues to mature. Quality investments, proper diversification and a long-term perspective can give your portfolio the power it needs to reach your investment return targets.

As shown in the asset allocation matrix below, we continue to favor US equities over the rest of the world. Japan and Emerging markets come next. Within Europe, there might be attractive trading opportunities at a micro level within countries and sectors, especially in case of some resolution on the ongoing trade disputes.

We continue to be cautious on Fixed Income. With \$11 trillion of bonds still trading in negative yield territory, the asset class remains too expensive. We favor higher-quality US investment grade corporates as well as hard-currency EM debt. We also continue to favor alternative fixed income such as trade finance funds. Long duration U.S Treasuries could be bought as portfolio diversifiers.

Amid so much geopolitical and policy uncertainty, investors should consider being more opportunistic. We are at the stage of the cycle where investors need to add flexibility to portfolios

and take advantage of alpha opportunities through actively managed funds.

Within real assets and illiquids, we are constructive on real estate as the search for yield is likely to stay intact. We also believe that hedge funds will deliver better returns going forward as they should take advantage of the rise in volatility and a more selective context. Private equity has become overcrowded with the amount of “dry powder” reaching record levels. Nevertheless, there are some attractive direct co-investment growth opportunities.

On the currency side, we believe there is still some modest upside on the dollar. Emerging currencies are expected to become more stable but the “Fragile 5” needs to be monitored closely. The Swiss Franc and the Japanese Yen can be used as a portfolio diversifier, i.e it should do relatively well in case of market turmoil.

Asset Allocation Matrix

	Asset Class View	Bullish	Neutral	Bearish
Equities	Overweight	<ul style="list-style-type: none"> • US Large Caps 	<ul style="list-style-type: none"> • US Small and Mid Caps • Japan • Emerging Markets 	<ul style="list-style-type: none"> • UK • Europe
Fixed Income	Underweight	<ul style="list-style-type: none"> • Trade Finance • US Investment Grade Corporates • Emerging Markets Debt (in \$) 	<ul style="list-style-type: none"> • Emerging Markets Debt (in local currencies) • US High Yield 	<ul style="list-style-type: none"> • Sovereigns
Real Estate/ Illiquids	Neutral	<ul style="list-style-type: none"> • Real Estate 	<ul style="list-style-type: none"> • Private Equity • Commodities • Hedge Funds 	<ul style="list-style-type: none"> • Agriculture
Cash		<ul style="list-style-type: none"> • US \$ 	<ul style="list-style-type: none"> • Emerging Local Currencies • Yen • Swiss Franc • British Pound 	<ul style="list-style-type: none"> • Euro

Behavioral Finance: Seasonality and other Stock Market Cycles



The adage "Sell in May and go away" is one of the most recognized on Wall Street. And for a good reason: it often pans out.

Indeed, many of the worst six-month periods have occurred around summer. The 27.3% decline between May 1 and October 31, 2008 is a recent example of a big market crash you would have avoided had you sold in May. Also there were similar drawdowns in 2002 and 2001 when stocks fell nearly 16% in those periods.

So what is equity market seasonality about? Do empirical studies confirm the adage? If yes, are there any fundamental reasons for this behavioral bias?

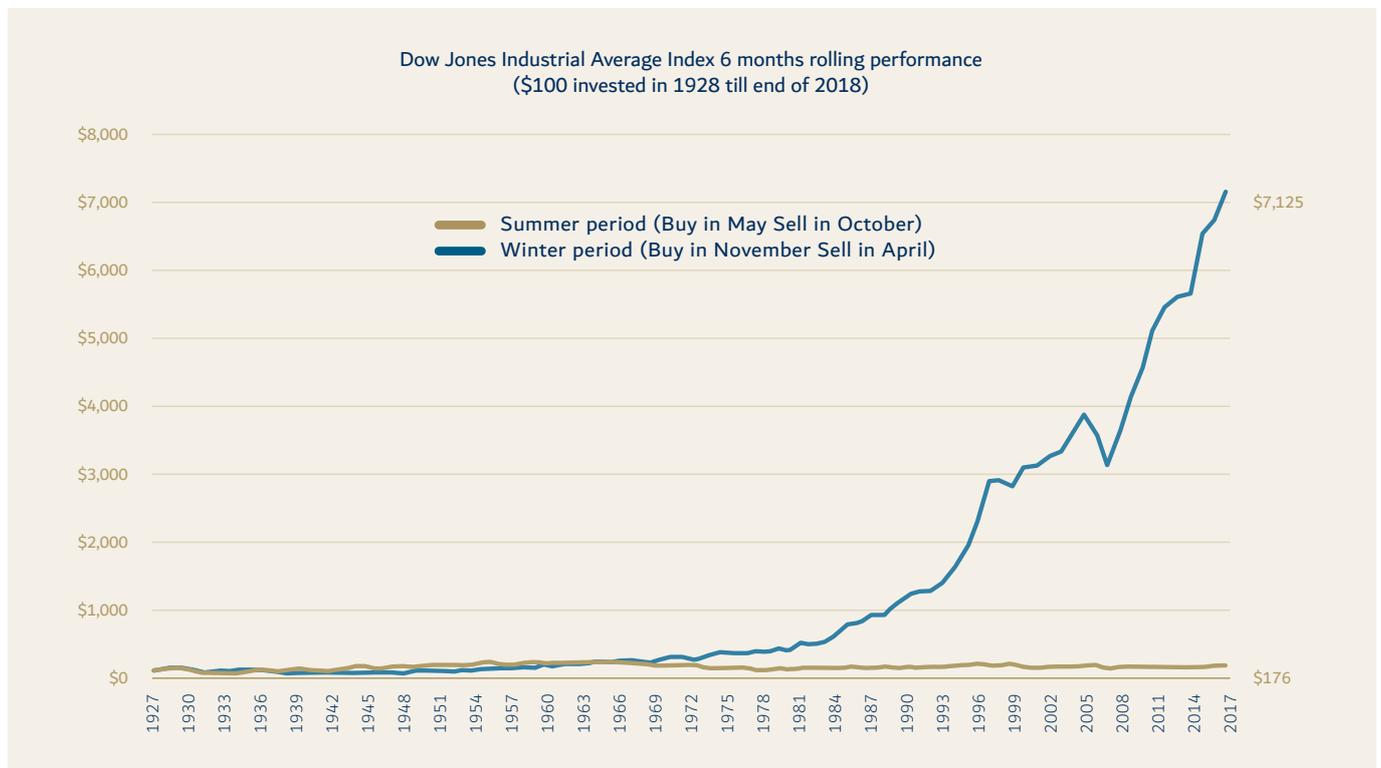
About equity markets seasonality

Equity markets seasonality is also known as the "one-year cycle", which divides the year into 2 parts: winter (from November 1st to April 30th) and summer (1st of May to October 31st).

History shows that individuals invested in the Dow Jones Industrials Index from 1 November to 30 April every year from 1928 to 2018 – the 'winter season' – and holding cash in their

account for the remainder of each year would have recorded a cumulated gain of 7025% If, over the same 91-year period, investors had invested in the same index from 1 May to 31 October – the 'summer season' – and held cash in their account for the remainder of each year, their performance (gross of dividends, taxes and interests earned on cash) would have been a meagre 76% (see chart below).

DJIA index (Price return) since 1928 – "Winter" performance vs. "Summer" performance



This translated into a 0.6% annualized performance for summer and a 4.8% annualized for winter. 'Summer' periods produced an average gain of 1.4%, versus 5.6% for 'winter' periods.

However, it is worth highlighting that the best 6 months rolling performance took place during the summer season (+35.9%

in 1938) whereas the worst 6 months rolling performance happened during the winter (-46.2% in 1931-1932).

Still, historical cumulated performance clearly shows that the best season of the year to be long the stock market has been the winter season (buy in early November and sell late April).

Wall Street has long been aware of this seasonality trend and one would thus have expected that investment managers would have exploited this market inefficiency, thus reducing the seasonality effect.

But an analysis of the last 5 years, 10 years and 50 years data shows that the seasonality bias remains strong (see chart below).

Dow Jones Industrial Average Index cumulated 6-month periods annualized performance during winter and summer (Source: Dow Jones data)



Furthermore, researchers have found that this seasonal impact is pervasive – present in numerous countries, significant in size and statistically robust over time.

There are technical and behavioral factors behind seasonal trends

First, money flows and liquidity are more favorable towards year-end and the first quarter than during the summer. Indeed, volume tends to dry up in the summer months.

On the other hand, the end and the beginning of a year are rather active months and benefit from dividend distributions from corporations, payment of bonuses, contributions to 401k, etc.

But this seasonal pattern is also due to the fact that investors, governments, CEOs, etc. are more optimistic during 'winter' than in 'summer'.

For instance, governments and economists tend to upgrade forecasts for the next year as year-end approaches; but they then tend to adjust their forecasts downward as the year progresses. Furthermore, asset allocators and hedge fund managers tend to take more risk at the beginning of a period.

Should investors take seasonality seriously and invest portfolios accordingly?

First, investors shouldn't assume it's a law of nature. It is the cumulative gain over time that is impressive but there is no guarantee that investors in a 'winter season' will generate gains. Indeed, seasonality doesn't always work. Stocks fell 12.4% and 8% between November 1 and April 30 in 2008

and 2007 respectively. That means escaping the market during summer months doesn't protect you from all downside.

Moreover, nothing can replace thorough fundamental research when it comes to assessing markets and company growth prospects and valuations.

Furthermore, there are other cycles and behavioral biases that need to be taken into account. Indeed, there are at least two other cycles prevalent that need to be considered for US equities: the Presidential cycle (the “4 year cycle”) and the decennial cycle (or the “10 year cycle”).

On the next page, we look in more details at these two cycles and how they can be combined together with the seasonality cycle.



The 4-year Cycle (or “presidential” cycle)

This cycle refers to the effect of the US presidential 4-year term on the stock market, real estate, bonds and commodities. The theory about this cycle states that economic sacrifices are generally made during the first two years of a president's mandate. As the election draws nearer, administrations have a habit of doing everything they can to stimulate the economy so that voters go to the polls with jobs and a feeling of economic wellbeing.

Interest rates are generally lower in the year of an election, so experienced mortgage brokers and real estate agents often advise clients to schedule mortgages to come due just prior to an election. This strategy has worked quite well during the last

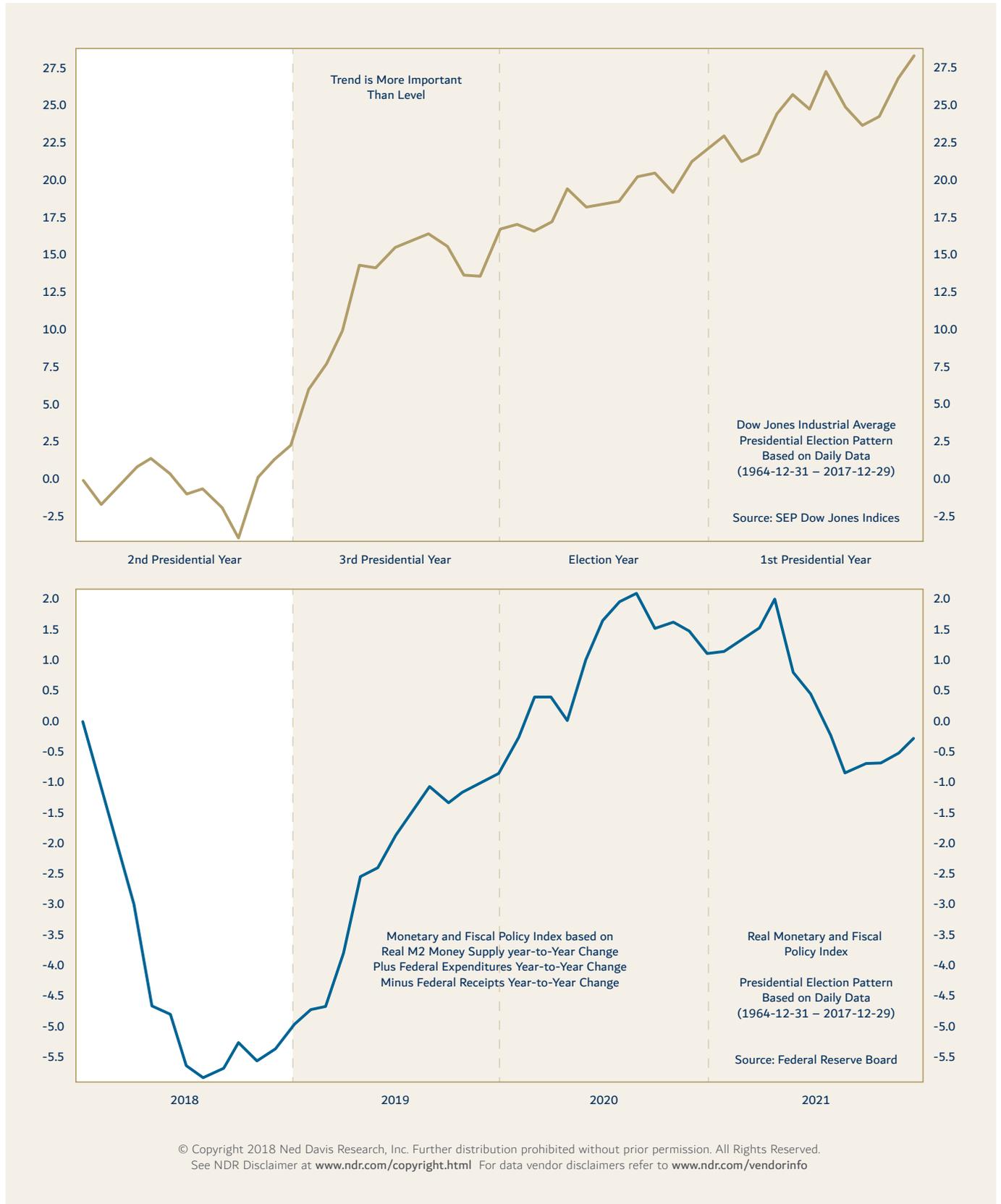
18 years. The stock market has also benefited from increased spending and decreased interest rates leading up to an election, as was certainly the case in the 1996 and 2000 elections. Presidents know that if voters are not happy about the economy when they go to the polls, chances for re-election are slim to none, as George Bush Sr. learned the hard way in 1992.

As shown on the chart on right, markets usually record strong returns in the months that follow the election. But returns start to fade after a few quarters which means that year 1 and year 2 have historically been the weakest ones for market returns whereas year 3 and year 4 have been the best ones.



It is interesting to see that both monetary and fiscal policy are rather accommodative in the U.S as we have entered Year 3 of the Presidential cycle. If history repeats itself, this could create tailwinds for the stock market this year and in the first part of 2020.

DJIA Index and Fiscal & Monetary Policy Presidential Cycle (based on data from 1964 through 2017)
Source: Ned Davis Research



The 10-year cycle (or “decennial” cycle)

In his book *Tides and the Affairs of Men* (1939), Edgar Lawrence Smith presented the notion of a ten-year stock market cycle, where he demonstrated that there appeared to be a price pattern in the stock market that had similar characteristics every ten years. This pattern has since been called the “decennial pattern.”

The decennial pattern theory states that years ending in 3, 7, and 10 (and sometimes 6) are often down years. Years ending in 5, 8 and most of 9 are advancing years (see chart below). Smith did not follow the normal calendar year beginning in January but found that counting the beginning of a year in October was more reliable. He attempted to find the reason behind the decennial pattern and looked at sunspots and solar radiation, average rainfall, barometric pressure, and other weather-causing conditions, believing that weather patterns were the most likely cause of change in human psychology. It was then well accepted that weather had some effect on health

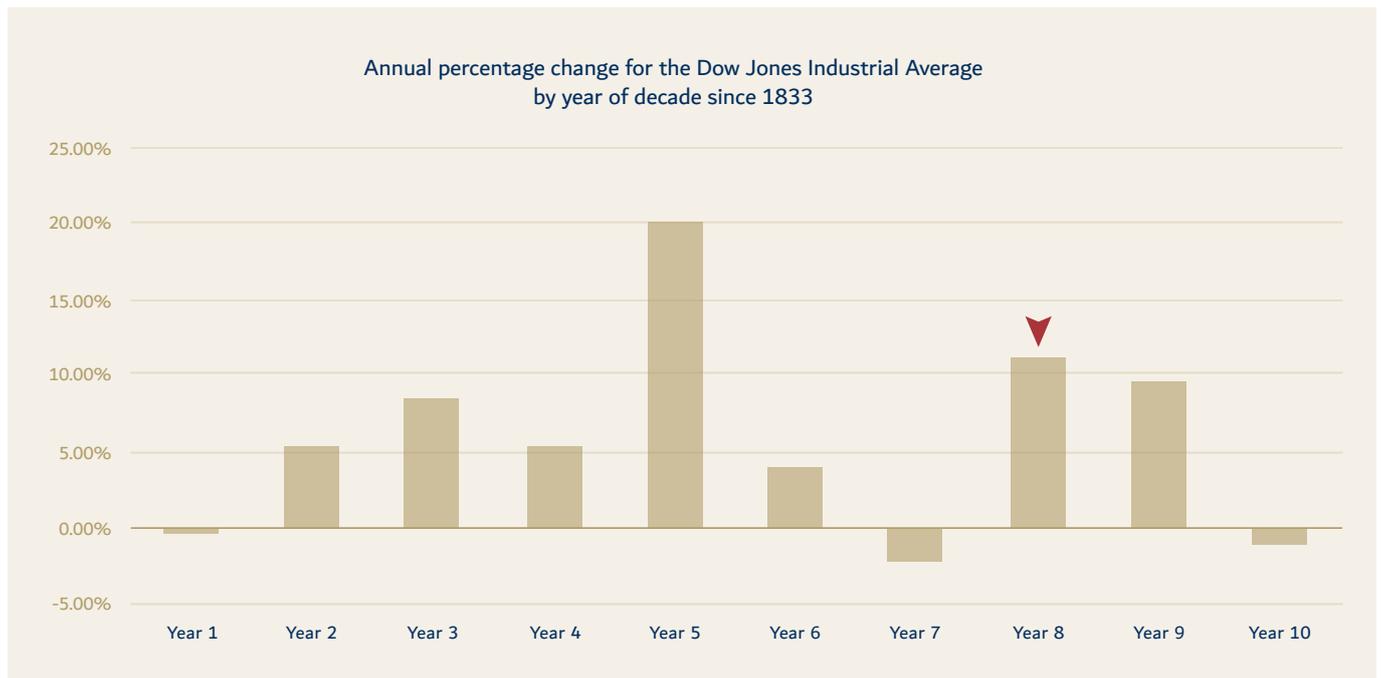
and disease, and thus on optimism and pessimism, an observation first mentioned by Hippocrates.

The decennial pattern continues to have an excellent history. For example, the fifth-year advance has been observed well over 100 years and never failed 12 out of 12 times.

One problem with the theory is that a large enough sample is not possible yet, and that such projections could be the result of chance. It is something to keep in the back of an investor's mind but not something to use alone to commit funds to the stock market.

For instance, the 10-year cycle did not work at all over the last 2 years. While years ending by 7 are supposed to be negative years, 2017 proved to be a very strong year for U.S equities. Inversely, years ending by 8 are supposed to be strong ones; 2018 proved to be a negative one for the S&P 500.

The Decennial cycle

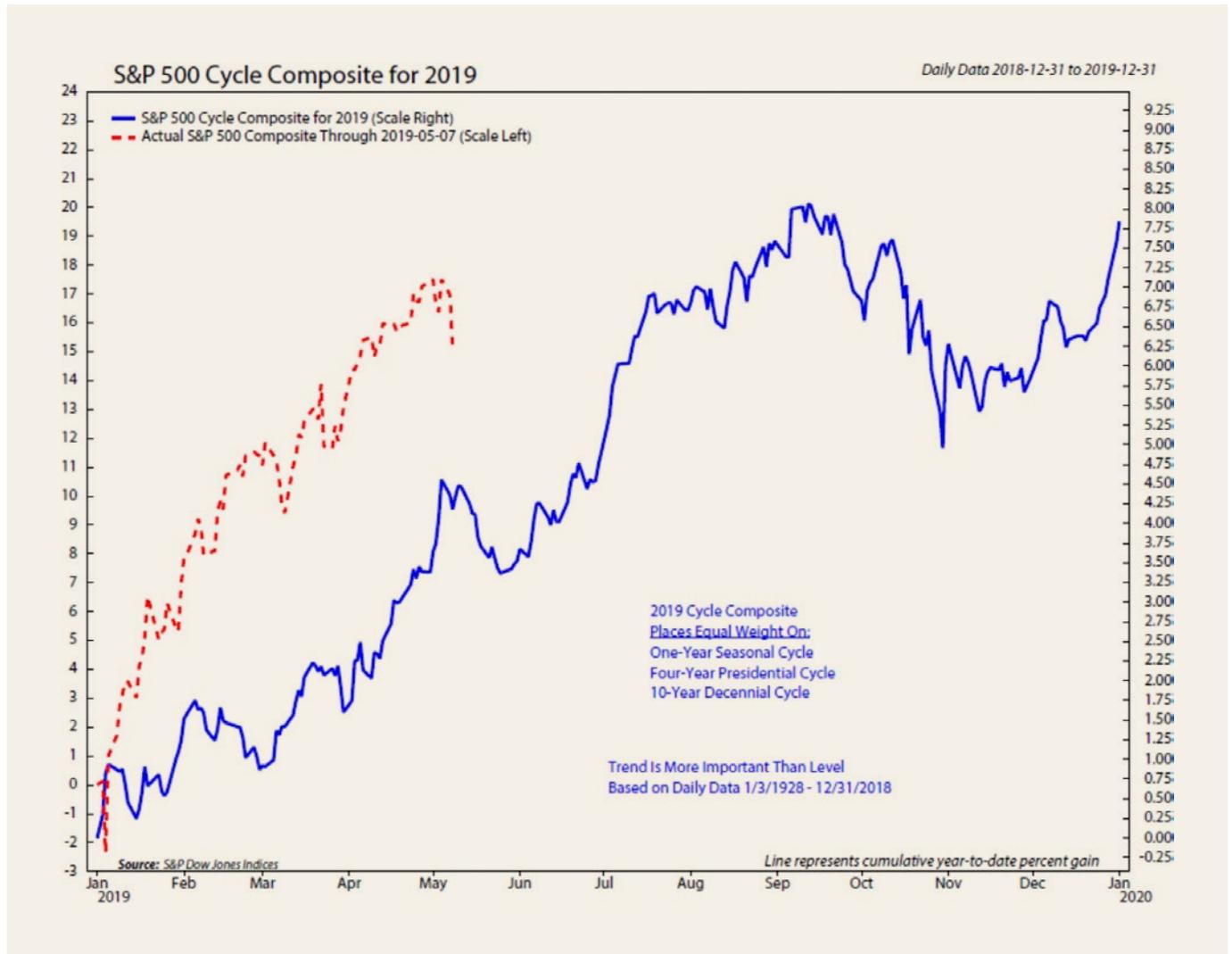


The Cycle composite

There is obviously a temptation to combine the 3 cycles mentioned earlier. This is precisely what Ned Davis Research is doing by creating a Cycle composite which takes into account the 1 year, 4-year and 10-year cycles.

Based on this composite cycle, we can try to anticipate what could be the stock market pattern for a given year, as shown on the chart on the right. So far, the S&P 500 has been following the Cycle Composite and this upward trend is expected to continue until mid-September. A correction should then occur by the end of the 3rd quarter or the start of the 4th quarter (the trend is more important than level).

The cycle composite (Seasonality + Presidential cycle + Decennial cycle) – Source: Ned Davis



CONCLUSION: Should we sell US equities in May and go away? Based on the analysis of 3 strong cycle patterns, it seems that US equities might have further to go in 2019.

Obviously, cycle analysis is only one forecasting methodology among others. But as mentioned above, investors' average behavior provide some rationale explanations on the way these cycles work. We thus encourage investors to integrate cycle analysis in their overall investment decision process.

Hot Topic: Will the Dollar Continue to Smile?



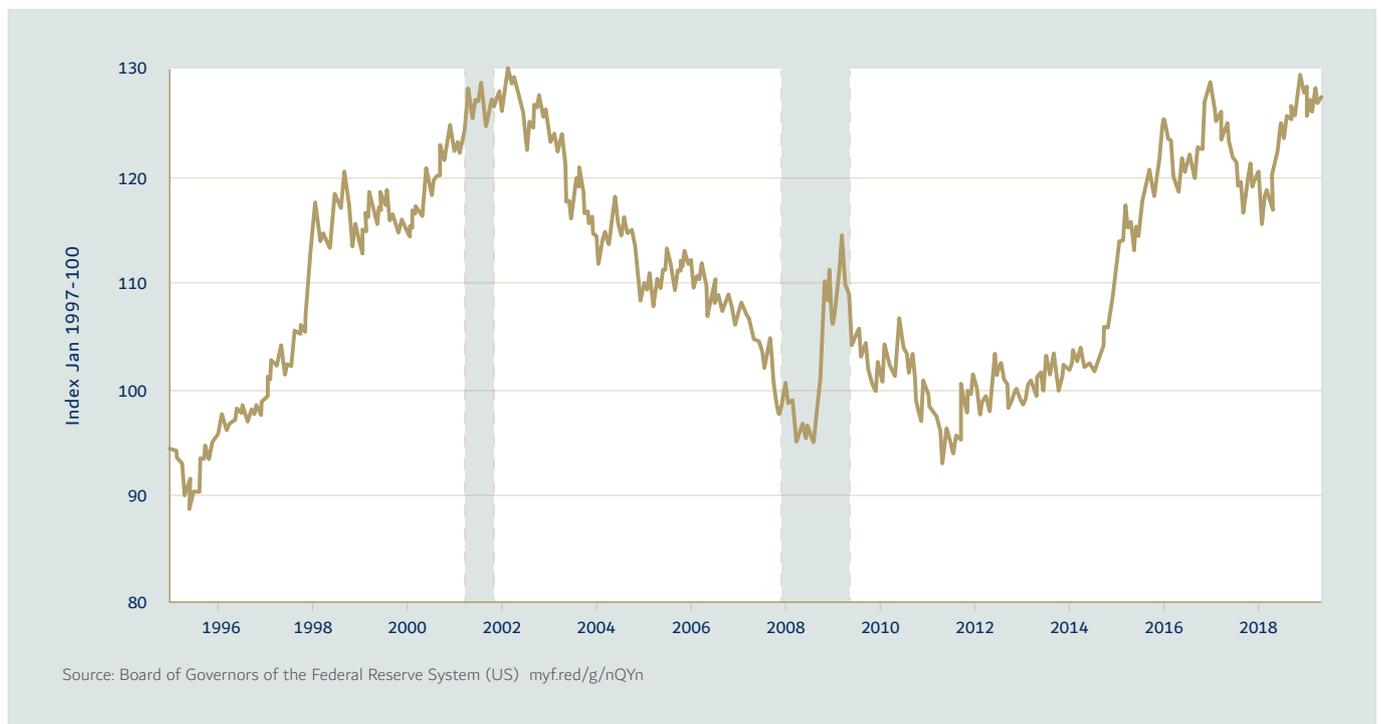
The resilient “King dollar”

The US dollar remains in the midst of a prolonged period of strength against the vast majority of global currencies. As shown on the chart below, this period of outperformance started in 2014, when the Trade-weighted dollar surged as the U.S economy strengthened and as the Federal Reserve monetary policy started to become slightly less accommodative. This upward move has been enhanced by continuing weakness and uncertainty in the rest of the world. Many investors now perceive the U.S economy as an oasis of (relative) stability and thus view the U.S dollar as safe haven. Furthermore, widening interest differential between the U.S and the rest of the developed world (especially E.U and Japan) have been attracting

foreign flows. And while the death of the dollar as the world reserve currency has been proclaimed many times, there is still no serious challengers to the greenback hegemony.

The dollar index was up +7% last year and the start of 2019 looks strong as well. Indeed, as of April 30th, the dollar has already appreciated by 2% against the yen and euro, by 3.5% against the Swiss Franc and by 4.5% against the Korea Won since the start of the year. Some of the “fragile 5” have seen their currencies considerably weakening since the start of 2019; for instance, the Turkish Lira is already down nearly -12% as of end of April while the Argentina Peso is down -15%.

The Trade-weighted dollar since 1996 (source: FRED)



For many analysts, the dollar is likely to stay strong for at least the next couple of years. This is due to a number of factors. One key factor is the fact the global economy appears to be entering a period of relative instability and less robust growth, a development that will favor safe haven currencies such as the dollar (see the last section of this article). The factors that are driving this

instability and slower global growth include subpar economic growth in Europe, the Brexit saga, uncertainty about the health of the Chinese economy and the lingering threats of a trade war.

But despite the current strength of the US dollar, some threats to the “bull run” are emerging.

As of April 30th, the dollar has already appreciated by 2% against the yen and euro, by 3.5% against the Swiss Franc and by 4.5% against the Korea Won since the start of the year.



Reasons to be cautious on the dollar

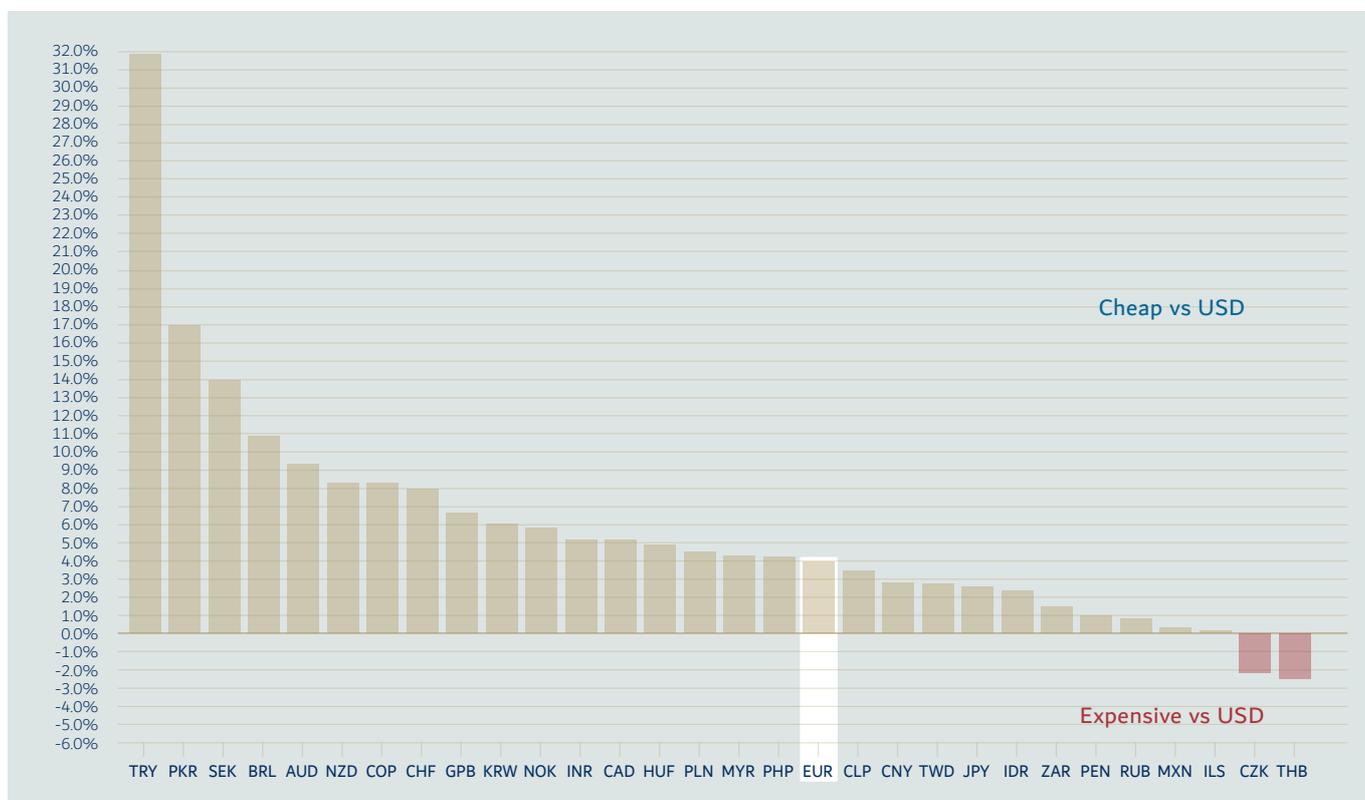
#1: Over-valuation

The increased dollar risk is reflected by its overvalued condition based on Purchasing Power Parity. As shown on the chart below (courtesy of Ned Davis research), not only is the dollar overvalued against euro, it looks expensive against the vast majority of currencies. This over-valuation of the greenback is

also apparent when using other currency valuation metrics such as Big Mac index, etc.

While valuation is not a good timing tool, the level of over-valuation increases the amplitude of the downside risk once sentiment will start to turn less positive.

Selected currencies over/under valuation against the dollar based on a PPP basis – Moving average approach (source: Ned Davis Research)



#2: Sentiment

Amid signs of investors’ over-optimism on the dollar, speculators increased their net long U.S. dollar bets in April to the highest level since December 2015, according to calculations by Reuters and U.S. Commodity Futures Trading Commission data released

late April. The value of the net long dollar position was \$37.21 billion in the week ended April 23.

Any downward reversal from extremely optimistic sentiment would magnify any dollar decline.

The value of the net long dollar position was \$37.21 billion in the week ended April 23.

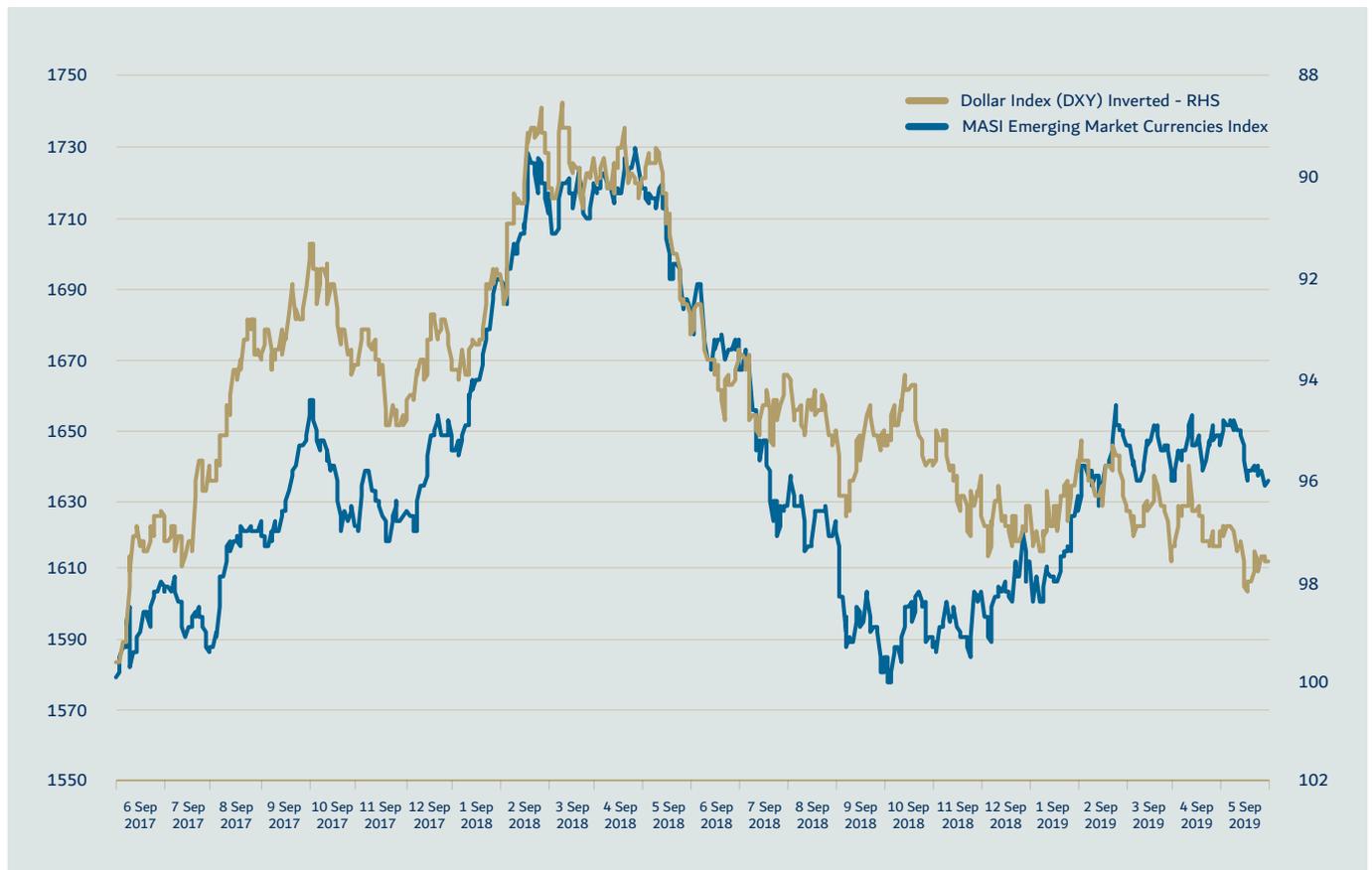
#3: Negative divergence

While the Dollar index is flirting with new highs, it is interesting to see that the dollar bull-run in 2019 is very different from the one which took place in Q2 and Q3 of last year. This time, dollar highs are not confirmed by a large number of currency lows. With the euro accounting for 57% of the dollar index weight, euro weakness has been a major contributor to the dollar strength. However, and unlike in Q2/Q3 of 2018,

emerging market currencies are not making new lows, as shown on the chart below.

Indeed, some emerging market currencies have been performing decently well against the dollar since the start of the year. This is especially the case for high yielding Emerging Markets currencies such as the Russian Rubble (+7.9%) or the Mexican Peso (+3.7%).

Dollar Index (inverted) versus MSCI Emerging Market Currencies index



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The non-confirmation of last year lows is not a phenomenon restricted to emerging market currencies. While the Swiss Franc and the Swedish Krona have been trading in a similar way than the euro (i.e they are making new lows), the pound, yen, the Canadian and the Australian dollar all remain above the lows reached at the end of last year or later.

Last but not least, Gold price pattern is also creating a negative divergence. The yellow metal, which historically correlates negatively with the dollar, has been able to slightly appreciate in price so far this year despite dollar strength.

The lack of breadth in the dollar advance should thus be interpreted as a negative signal for the greenback.

#4: Deteriorating long-term fundamentals

While US Economy superior real GDP growth rate is a short-term positive for the dollar, some of U.S long term fundamentals continue to deteriorate.

Based on S&P Global Economists' analysis of tax cuts and increase in government expenditures in the pipeline, the U.S. fiscal deficit will likely expand to \$991 billion by 2020. According to S&P review, the current account deficit, a broader measure of trade, will be \$700 billion by 2020.

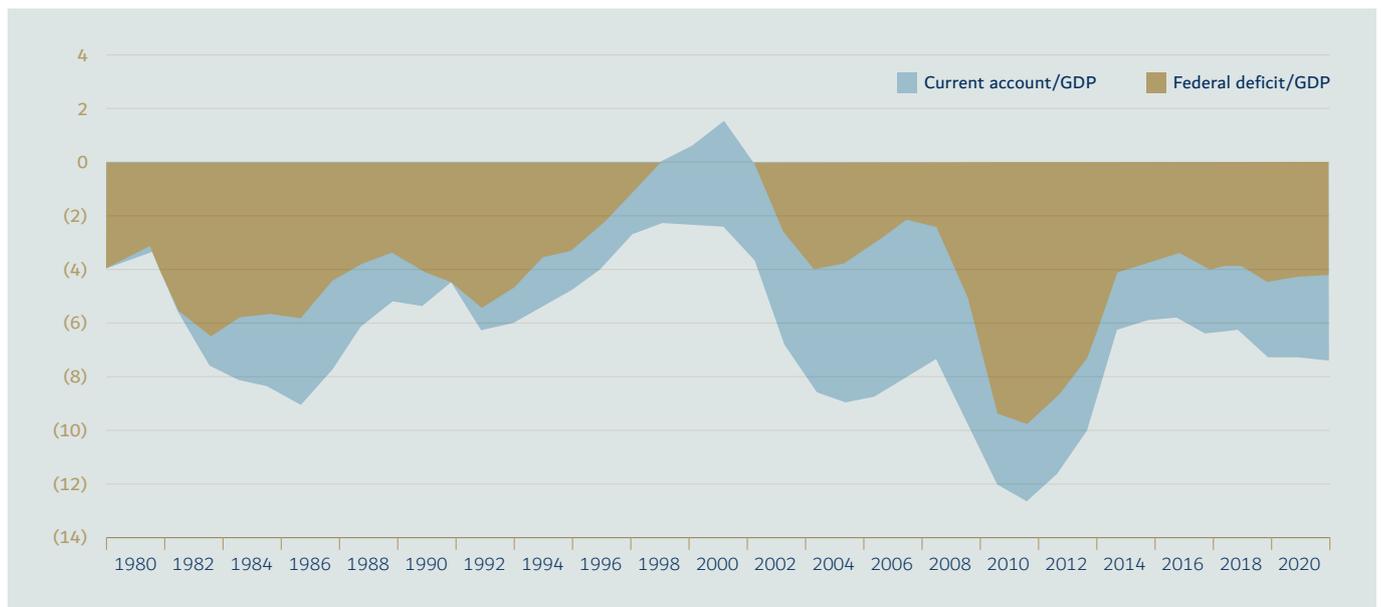
Free trade isn't necessarily to blame for this and protectionist policies may not be the answer. Helping fuel the twin deficits is low domestic productivity, which propels the purchase of cheap foreign products.

Since the U.S. consistently spend more than it saves, Uncle

Sam will likely become more reliant on foreign capital inflows to fund its deficit. While deficits aren't necessarily bad, the debt necessary to finance the deficit may create large and persistent imbalances, increasing risks of reaching unsustainable levels.

This vicious circle should be seen as dollar negative, particularly if the U.S find it more difficult to attract foreign flows. Indeed, China will soon move from a current account surplus to a current account deficit and might thus be less likely to purchase U.S Treasuries. Meanwhile, central banks around the world plan to diversify their foreign currency reserves away from the dollar in order to increase their exposure to the yuan, the euro or gold.

U.S “Twin” deficits look to grow again in the coming years (source: S&P and Oxford Economics)



Watch out the “dollar smile”

While all the points mentioned above should be seen as serious headwinds for the dollar, they do not give much hint regarding the direction of the dollar in the near-term. As mentioned in the introduction, the dollar is currently the winner by default, i.e the fundamentals are less than rosy but it is much worst elsewhere.

The dollar smile is a framework developed by Nordea through which to understand the direction of the dollar – see chart on the right. In the leftmost part of the smile, the US outperforms the rest of the world. The Fed is relatively hawkish, which reduces global USD liquidity. This is bad news for risk appetite

but good news for the USD. In the rightmost part of the smile, global growth is slowing. Risk appetite weakens, USD liquidity becomes increasingly scarce. This is good news for safe-havens (USD, JPY, CHF). In the lowest part, global growth is more evenly distributed and robust, risk appetite is solid and global USD liquidity is rising because of improving global trade. This is bad news for the dollar but good news for riskier currencies.

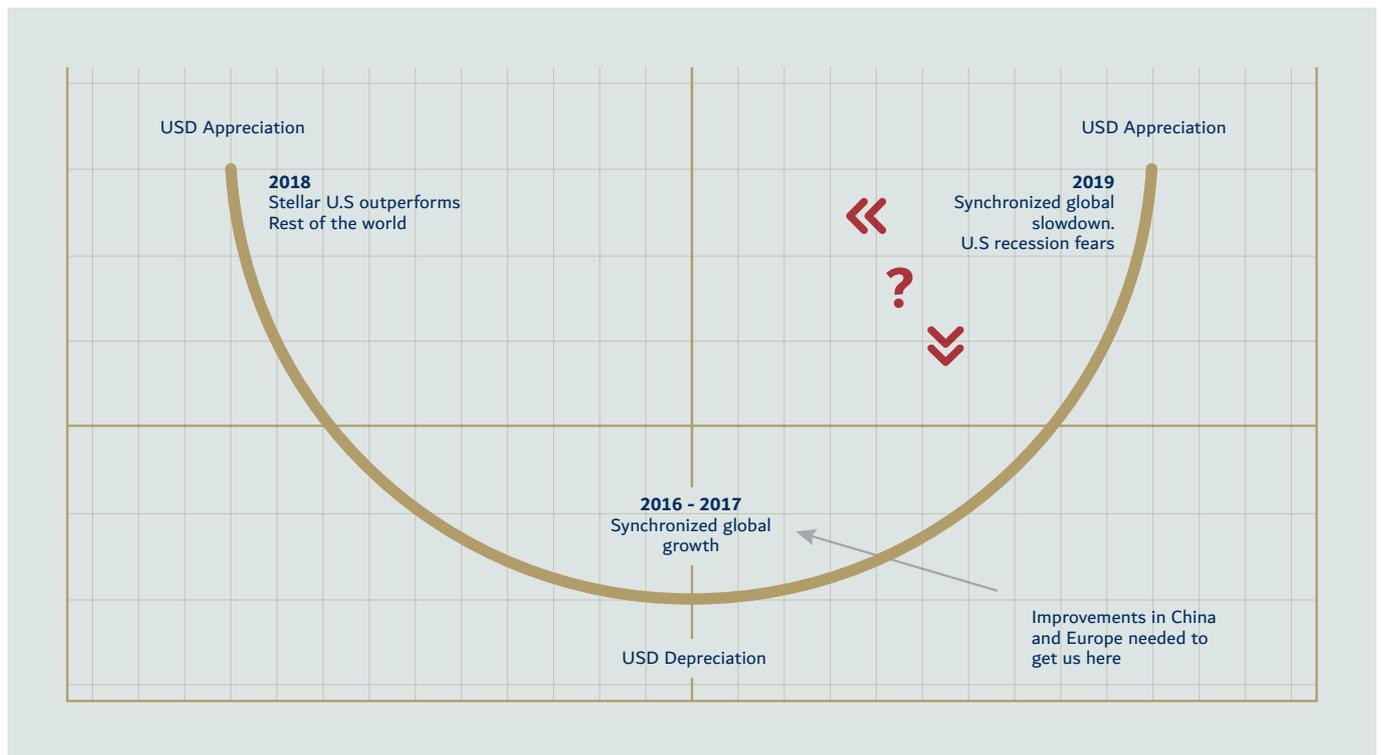
We have lately been in the top-right part of the smile. The hope of dollar “bears” was that we would move towards a lower quadrant due to macroeconomic improvements in China

and eventually also a pick-up in the Euro-area. Alas, there are yet no clear signs that a weaker EUR is paving the way for improving Euro-area growth. Moreover, while China monetary and fiscal stimulus already have some positive impacts on

some leading macro-economic indicators, renewed trade war tensions are not encouraging.

As such, despite some serious challenges ahead, the strong U.S dollar is likely to stay in the near-term.

The dollar smile (source: Nordea and Macrobond)



INVESTMENT CONCLUSION:

The fate of the dollar will shape financial markets in 2019. A weaker dollar could clear the way to a turnaround in terms of relative performance for International ex-US equities, including Emerging markets. It would also be a positive for commodities and potentially trigger a recovery of some cyclical sectors such as resources or energy.

However, new highs for the dollar could create a similar vicious circle than last summer when a “dollar shortage” triggered a panic move on emerging markets and other risk assets.

We would thus advise our clients to watch dollar moves very closely.

MENA Equities: Opportunities and Challenges in Morocco

Morocco is part of our Middle East and North Africa (MENA) equity investment universe. While our equity portfolios do not have any exposure to Morocco at this stage, we consider this country as a destination of capital provided we can invest in the most liquid stocks with a margin of safety.

On the next pages we briefly review the country's profile, the Casablanca stock market exchange and discuss potential opportunities we could consider in the foreseeable future.



Morocco at a glance

Morocco, officially the Kingdom of Morocco is a country located in the Maghreb region of North West Africa with an area of 710,850 km². In 1912, Morocco was divided into French and Spanish protectorates, with an international zone in Tangier. It regained its independence in 1956 and has since remained comparatively stable and prosperous by regional standards.

The unitary sovereign state of Morocco is a constitutional monarchy with an elected parliament. The King of Morocco holds vast executive and legislative powers, especially over the military, foreign policy and religious affairs. Executive power is exercised by the government while legislative power is vested in both the government and the two chambers of parliament, the Assembly of Representatives and the Assembly of Councilors. The King can issue decrees called dahirs, which have the force of law. He can also dissolve the parliament after consulting the Prime Minister and the president of the constitutional court.

Islam is the official religion of the State and 99% of the population is Muslim. King Mohammed VI is the head of the country's religious community.

Arabic and Berber are the official languages of Morocco. The latter became an official language in 2011 and was the native language of Morocco before the Muslim conquest. The Moroccan dialect of Arabic, referred to as Darija, and French are also widely spoken. Moroccan culture is a blend of Berber, Arab, Sephardi Jews, West African and European influences.

With regards to population, Morocco has about 36 million inhabitants in 2019 with a median age of 29 years. The unemployment rate is around 9.5%. The minimum salary is 2,570 Dh per month (\$265) while the median monthly gross salary is \$405.

While neighboring countries have been experiencing upheavals over the last decade, Morocco has recently established itself as an economic leader by liberalizing its economy and attracting foreign investment, thanks also to its very advantageous geographical position. It has recently joined the African Union and has strengthened its ties with the Gulf countries and China.

Casablanca is the economic capital of the country while Rabat is the administrative capital. Fez is the largest medieval city; Tangier, known for its large harbor is the industrial center of Morocco. Marrakech and Agadir are the largest tourism destination of the Kingdom. All these cities should be seen as the strength of the Kingdom which shares its borders with Algeria, Mauritania and the Spanish enclaves.

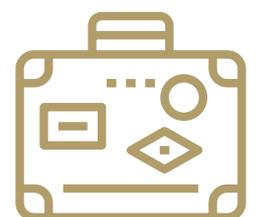
Morocco's economy is considered a relatively liberal economy governed by the law of supply and demand. Since 1993, the country has followed a policy of privatisation of certain economic sectors which used to be in the hands of the government. Morocco has become a major player in African economic affairs and is the 5th African economy by GDP (PPP). Morocco was ranked as the first African country by the Economist Intelligence Unit's quality-of-life index, ahead of South Africa.

The strength of Morocco's economy comes from agriculture (15% of Morocco's GDP although they employ 45% of the workforce), manufacturing (automotive, aeronautics and textile industries contribute to 23% of GDP) and outsourcing thanks to its proximity to Europe, well-educated population and low labor costs. The diaspora also contributes to economic strength. Tourism, for its part, generates around 8 billion dollars of revenues thanks to around 12 million of visitors per year.



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Morocco's overall inflation has been moderating over the recent years but has been slightly picking up from 0.7% in 2017 to 1.5% in 2018. It is expected to reach 1.9% in 2019.

Morocco's economic relationship with its trading partners reinforces investments, as exemplified by the establishment of the Tangier Med port, which has strengthened competitiveness.

Morocco has nearly 500,000 small and medium-sized enterprises, which represent the core of the Kingdom's economy thanks to known improvements in the economic field. Export was facilitated by the bilateral free trade agreement with the United States in 2004 and an advanced status agreement with the EU signed in 2004.

Morocco has nearly 75% of the world's phosphate reserves but does not have oil or natural gas reserves unlike its neighbors. Morocco cover 42% of its energy needs with renewable resources.

67% of the land used is for agricultural purposes, with cereals, grapes, citrus fruits and olives as the main crops. Fish and seafood have also become increasingly important.



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An oasis of stability

Morocco's reputation for stability and economic openness has served the Kingdom during turbulent time. Indeed, Morocco did not experience a seismic change in regime during the Arab spring as demonstrations were much less intense than in the rest of North Africa. In February 2011, marches were held to demand the limitation of the Monarchy's power. The King Mohammed VI announced his decision to amend the constitution to ensure the country's full transition into a constitutional monarchy, with an independent parliament and an executive power shared between the Prime Minister and the King.

The parliament is composed of the House of Representatives, which has 395 seats, and the House of Councilors, which has 120 seats. The next elections will take place in 2021. Today there are more than 30 political parties active in Morocco, but power is consolidated in three groups. In 2016, Morocco experienced a political crisis; one party failed to form a government due to internal struggles between parties of

shared loyalty. A new coalition government was officially appointed by the King who replaced the head of government.

As long as the Kingdom is able to maintain a good balance between freedom and security, Morocco is expected to remain a regional power at the time where its neighbors are much less stable.

Strong international relationship

Morocco has consolidated its attractiveness to foreign capital, with an increase in Foreign Direct Investments of 23% in 2017, making it the 5th largest FDI host country in Africa, after Egypt, Ethiopia, Nigeria and Ghana. In terms of geographical breakdown, France remains the leading investor country with 27% of total foreign investment received by Morocco in 2017. It is followed by the United States (17% of total FDI), the United Arab Emirates (10%) and the United Kingdom (6%).

Morocco's external trade and financial performance is the result of the Kingdom's diversified partnership with several developed, emerging and developing countries. These performances also stem from the privileged cooperation relations that Morocco has been able to develop with regional and international organizations, particularly in terms of mobilizing the necessary financing to support the structural transformation process of the Moroccan economy.

As the most politically and economically stable country in North Africa, Morocco is increasingly engaged with its West African neighbors despite the challenges of the Sahara. In 1984, the Kingdom left the African Union due to a disagreement over the status of the Morocco/Sahara region

but reintegrated the Union 33 years later. Moroccan authorities aim to strengthen Africa's voice at the international level and ambition to strengthen economic ties with other countries on the continent, especially with West Africa. King Mohammed VI of Morocco made official visits to several African countries (Ghana, Côte d'Ivoire, Guinea, Zambia...) to show Morocco's willingness to cooperate with its African neighbors in the economic field by signing several conventions.

The European Union (EU) is an essential source of political and economic aid for Morocco as the Kingdom benefits from EU funds to improve social and democratic services. EU and Morocco cooperate on migration issues as well.

In 2017, Morocco celebrated the 230th anniversary of the friendship treaty signed between the United States and Morocco in 1787. The United States is helping Morocco to maintain national security and political and economic stability.

With China, Morocco is strengthening this relationship through increased Chinese financing and investment in Morocco. The Kingdom has abolished Visa from China.

Known as one of the most stable and moderate countries in the MENA region, Morocco maintains favorable relations with several countries on different continents.

Exchange Rate

The Moroccan dirham is pegged most closely to the euro, but as a step towards greater flexibility, the central bank reduced in 2017 the euro weighting of the exchange rate to 60 percent from 80 percent and raised the U.S. dollar weighting to 40 percent from 20 percent. It was the first change to Morocco's currency basket in a decade and followed an increase in trade with the United States, China and the rest of Africa but a fall in trade with the euro zone.

The central bank, known as Bank al-Maghrib, also intervenes through regular auctions for the dollar, and other currencies when it sees the need.

Unlike some other countries in the region, Morocco has managed to avoid a big drop in foreign investments since the global financial crisis and the Arab Spring uprisings of 2011, partly by marketing

itself as an export base for Europe, the Middle East and Africa.

Moroccan exports have been growing since the country attracted heavyweights in the automotive and aeronautic industries, which helped to offset big post-2011 deficits.

A strong euro is usually seen as a positive for Morocco as it helps the tourism sector and remittances from the 4.5 million Moroccans living abroad, mostly in the euro zone.

Rising commodity prices is a risk for Morocco as it could raise inflation in a country that is one of the region's biggest energy importers. That would put the government in a delicate position as it is already faces strong protests over economic hardship in remote areas. Bank al-Maghrib is therefore simultaneously targeting inflation alongside the economic liberalisation process.

Morocco is home to one of the largest exchange in Africa

The Casablanca Stock Exchange (CSE) is Africa's third largest Bourse after Johannesburg Stock Exchange (South Africa) and Nigerian Stock Exchange in Lagos. It was established in

1929 and currently has 19 members and 81 listed securities with a total market capitalisation of around \$60 billion as of May 2019, which is equivalent to around 55% of GDP.

Largest market capitalisations on the CSE (as of May 2019)

Total Market Capitalisation (in MAD) 572 455 177 387

BEST 10 CAPITALISATIONS

Company	Capitalisation (MAD)
Itissalat Al-Maghrib	128 831 422 077, 00
Attijari Wafabank	92 128 399 081, 00
BCP	48 297 483 840, 00
LafargeHolcim Maroc	37 489 984 000, 00
BMCE Bank	33 918 580 710, 00
Ciments du Maroc	21 538 517 968, 00
TAQA Morocco	20 581 002 895, 00
Cosumar	18 051 768 670, 15
SODEP-Marsa Maroc	13 541 488 200, 00
Afriquia Gaz	11 759 687 500, 00

According to the CSE, in early 2018, Maroc Telecom (Itissalat Al-Maghrib) is the largest market capitalization (\$13 billion),

followed by the largest bank in the Kingdom Attijari Wafabank (\$9.5 billion) and the Banque Centrale Populaire (\$5 billion).

The 10 largest market capitalizations represent around 75% of the CSE Total market capitalization.

The Morocco Casablanca Stock Exchange MASI Index is the main stock market index in Morocco; the MASI tracks the performance of all companies listed on the Casablanca Stock Exchange. It is a free-float, capitalization-weighted index. The MASI index had a base value of 1000 as of December 31, 1991.

The FTSE CSE Morocco 15 was launched in January 2011 (base value of 10,000). With regards to Morocco equity market performance, the MASI index has been strongly performing since

the end of 2001 (see chart below) with a 353% total return which is a +9.1% annualized return. While the MASI index lags the Dow Jones Arabian Titans 50 Index since the end of 2001, it has been less volatile.

Over the last 5 years, the MASI Index Total return is +43.7% (as of end of April 2019), which is a +7.5% annualized performance. The index total return was -5.2% in 2018, +10.2% in 2017 and +36.8% in 2016.

MASI Index versus Dow Jones Arabian Titans 50 index since 31/12/2011 (Initial value: 100)



This strong performance of the Casablanca stock exchange is attracting new entrants while the new stock market law allows for the launch of ETFs – index-tracking investment funds, which offer diversified holdings, can be traded like a share and generally offer lower costs than other mutual funds.

However, although the CSE's new trading platform is capable of hosting such a market, further legislative reform, in the form of changes to the law on mutual funds, is required before trading can begin.



On the corporate bond market side, the Casablanca exchange has 44 instruments with a combined value of MAD 9.6 billion (around \$1 billion), including 29 banks representing around \$600 million of value.

Low liquidity

Overall market liquidity on the CSE is poor and has ranged between USD 10 to 15 million per day for the last 10 years (see table). The Bulk of the activity is concentrated in 3 stocks – Attijariwafa Bank, Maroc Tel and Banque Centrale Populaire.

Average daily value traded on the Casablanca Stock Exchange (CSE)

Average daily value traded (USD mn)	
2009	12.43
2010	33.56
2011	17.21
2012	13.81
2013	12.61
2014	12.83
2015	11.61
2016	13.00
2017	16.22
2018	15.71

Expensive stock valuations

The MASI Index trades at a rich price to earnings multiple of 19 times while the aggregate earnings per share growth hovers around mid-single digit growth. This is partly due to the fact that local liquidity is trapped as institutions must keep up to 95% of assets onshore and maintain low risk-free rate.

Largest market capitalization on the CSE

Name	Sector	Mcap (\$m)	PE	FY1 PE	FY2 PE	PB	TTM DY
Maroc Telecom	Communication Services	13,323	21.4	20.8	20.1	8.2	4.4%
Attijariwafa Bank	Financials	9,520	16.1	14.7	14.7	2.1	2.8%
Banque Centrale Populaire	Financials	4,995	16.4	16.1	16.1	1.7	2.5%
LafargeHolcim Maroc SA	Materials	3,986	24.3	24.6	24.6	3.9	4.0%
BMCE Bank	Financials	3,489	18.4	16.8	16.8	1.8	2.7%
Ciments du Maroc	Materials	2,227	21.3	20.3	20.3	4.4	6.7%
Taq Morocco	Utilities	2,130	19.6	18.9	18.9	3.8	4.6%
Cosumar	Consumer Staples	1,874	24.6	17.8	17.8	3.5	3.5%
Societe d'Exploitation des Ports	Industrials	1,400	24.4	22.2	22.2	5.9	5.8%
Wafa Assurance	Financials	1,220	19.4	14.8	14.8	2.0	3.6%
Afrika Gaz	Energy	1,216	17.9	16.5	16.5	4.4	3.7%
TOTAL Maroc SA	Consumer Discretionary	1,047	12.6	12.6	12.6	4.4	5.0%
Managem SA	Materials	930	24.3	30.9	30.9	1.7	2.6%
Credit Immobilier et Hotelier	Financials	784	16.7	15.5	15.5	1.6	5.6%
Societe Des Boissons du Maroc	Consumer Staples	746	22.5	16.9	16.9	4.5	5.3%
Credit du Maroc SA	Financials	679	11.1	12.6	12.6	1.3	1.2%
Label Vie	Consumer Staples	646	21.9	18.5	18.5	3.4	2.4%
Saham Assurance	Financials	497	16.2	9.5	9.5	1.1	3.4%
Lesieur Cristal	Consumer Staples	426	90.7	22.0	22.0	2.5	3.4%
Douja Promotion	Real Estate	384	9.8	7.2	7.2	0.4	10.4%
MOSENEW Index			19.1	17.0	17.0	2.4	4.0%



INVESTMENT CONCLUSION:

Investing into Morocco requires a bottom-up fundamental approach in order to identify stocks which offer growth at a reasonable price. These opportunities are most likely to be found within the Midcaps segment as large-caps remain quite expensive. Unfortunately, the vast majority of midcaps do not match our strict liquidity requirements. This explains why we do not have any Morocco holdings in our main MENA equity long-only strategy. That being said, we continue to monitor Morocco very closely as we consider this market as a source of alpha opportunities once valuations would become more attractive.

Appendix

Population

34.49^m

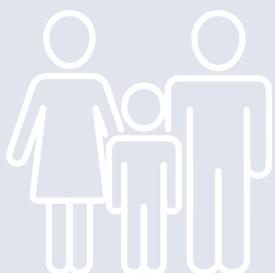
Total Population
(in million inhabitants)

75.82^{yrs}

Life expectancy at birth

61.91%

Urbanization



Economy

103.35^{bn} USD

Gross domestic product (GDP) in current prices
(in billion U.S dollars)

2.996.65^{USD}

Gross domestic product (GDP) per capita in current prices
(in U.S dollars)

0.75%

Inflation rate (compared to the previous year)

9.33% Unemployment rate

44.92^{bn} USD

Imports of goods (in billion U.S dollars)

25.33^{bn} USD

Export of goods (in billion U.S dollars)

-19.59^{bn} USD

Trade balance (in billion U.S dollars)

Spain Morocco's main import partner

Spain Morocco's main export partner

National Finances

30.05%

Ratio of government expenditure to gross domestic product (GDP)

65.11%

National debt in relation to gross domestic product (GDP)

-3.49%

Budget balance in relation to (GDP)



FINAL WORDS

As discussed in this edition of Perspectives, we continue to favor risk assets over the medium-term but urge our clients not to extrapolate recent strong returns to the rest of the year. We think the path for risk assets is becoming narrower and as mentioned in our Q2 Market outlook, we expect volatility to come back with a vengeance.

For investors, this means staying invested with a long-term perspective while maintaining proper diversification and focusing on quality. These are the necessary steps to reach decent returns in a highly uncertain market context.

As a side note, Al Mal regional equity funds continue to perform well. As of the end of April, our MENA equity fund was up 12.9% year-to-date while the UAE equity fund was up 10.3%. The Middle East and North Africa region is full of challenges but opportunities continue to abound.

While our forecasts and views are always subject to changes, 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.



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