EYES ON MARKETS

GLOBAL MARKETS

The slump in oil prices and the disruptions generated by the spread of the coronavirus worldwide pose a clear and present danger of a deep, temporary global recession, whose end may not necessarily trigger a V-shaped recovery. Policymakers' massive stimulus aims at minimizing the risk of large-scale credit events. Global GDP growth may slow down to 1.0%-1.5% in 2020 (more than half than the already lower growth pace of 2.9% in 2019), however a stabilization is expected through Q3/Q4, giving way to a gradual rebound. Fiscal stimulus and FED's action should shore up consumer spending and credit availability for now. Europe, Japan and most of Asia are likely to have fallen into recession already during this first quarter, with the US economy on the brink with increasing downside risks caused by the increasing rate of contagions associated with the collapse in oil prices affecting the shale industry. The European Union has triggered the crisis clause in the Stability Pact, which allows Member States' governments to embark on extra-fiscal stimulus, on top of the already significant additional measures which are being taken by individual countries, with a similar approach adopted by UK.

Equity valuations have now fallen back to or below fair value for many regions, already pricing in a significant contraction in economic activity worldwide. In the US, valuations are around fair value at 14 times forward-looking Price/Earnings ratio, assuming a negative impact of aggregate earnings growth of -15% over a year ago. Europe is trading cheap at 10x P/E, as much as Japan, whose multiples are now below fair value at 11x forward P/E. And while Australia is suffering a shock from the sharp fall in industrial metals' prices, the slump in AUD may help accelerate the recovery. Finally, China is now ahead of other countries in the process of stabilisation after passing the peak in infections. The Chinese economy is starting a slow recover, also aided by the oil slump which acts a boon to growth. The local equity market trades at a multiple of 11x P/E, in line with past history, as Emerging Markets as a whole are at 10x earnings, below average.

Corporate credit spreads have widened to levels last seen in 2016 during the Chinese growth scare as yields rise on the back of the expected slump in oil revenues affecting the energy industry and aggravated by the dried-up liquidity after a great bull run.

As to market sentiment, risk appetite indicator are now at ore very close to panic levels, triggering contrarian buy signals which may hold only barring a major, unexpected "credit event" (like for instance Lehman Brothers' default back in 2008). Flows have been outsized, with the largest Investment Grade and High Yield Corporate bonds ever, the second-largest Emerging Market Debt outflows ever, and the largest US Government bond inflows on record. Safe havens such as precious metals have suffered too from panic selling caused by forced liquidations, with Gold crashing -15% from its recent peak. Three conditions are now required for markets to find a floor amid a still very high level of volatility: 1. a peak in infection rates, starting from Italy, then Europe and finally the US. This may not happen until the middle of the second quarter; 2. a trough in leading indicators (such as PMIs) during Q2, which are not yet fully discounting the reality of the sudden halt to economic activities; 3. a well-conceived, coordinated fiscal policy response from G7 countries in actual facts and beyond words. Until then, we keep our cautious underweight exposure to equities while starting to plan for future by gradually seizing the opportunity to add to risk at increasingly distressed valuations.

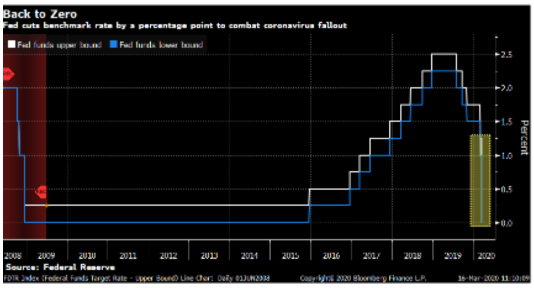
REGIONAL MARKETS

YTD S&P Sharia GCC Total Return Index was down 26.25% wherein Oman and Qatar were the best performers down 8% and 16% respectively while Kuwait and UAE were the worst performers down 34% and 32%. The fact that markets across the globe experienced capitulation led to this regional performance. Oman and Qatar being an underperformer YTD therefore did not loose that much as well in the downturn. S&P Saudi Shariah SAR Total Return Index (SPSHSART Index) declined by 25.9% as inflows in the Net Foreign Portfolio Investment (NFPI) remained flat. Point of Sale transactions value for January 2020 increased 33% YoY, inflation accelerated to 0.4% YoY for the month vs 0.3% last month, cement sales for the month grew 29% YoY and Loan To Deposit ratio for banks increased from 86% to 89%. However, Non-Oil Private Sector PMI decreased from 56.9 to 54.9 MoM and S&P forecast KSA fiscal deficit for 2020 at 7.4% of GDP and 8.1% of GDP in 2021 before the advent of recent oil price war.

Key developments included arrival of COVID-19 to the region, KSA government seeking expenditure reduction proposals from ministries as OPEC+ talks failed and KSA initiated full scale oil price war, temporary ban on pilgrims due to COVID-19, resumption of oil production from Saudi-Kuwait joint oil field, ARAMCO obtaining regulatory approvals for development of Jafurah gas field, issuance of 400K+ tourist visas since September and induction of ex-energy minister as the investment chief in the cabinet.

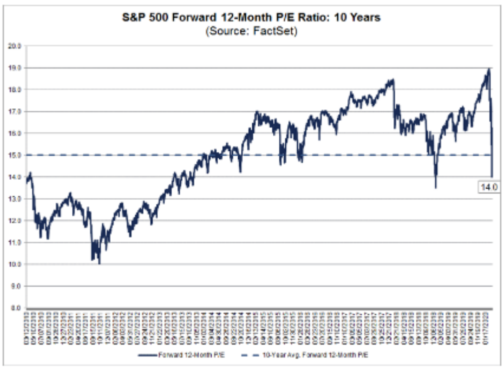
Similar headwinds were witnessed across the region as UAE and Kuwait experienced sudden surge in COVID-19 victims and took stricter quarantine measures that led to stifling economic activity. KSA also continued on the similar tangent but staggered the measures over couple of weeks. Non–oil PMI in UAE went down to 49 from 50, Qatar announced suspension of political reconciliation related talks and Oman experienced marginal increase in January 2020 inflation. Brent oil dropped 48% during the last 30 days while MSCI World Index decreased 30% days while MSCI World Index decreased 30% reflecting the realization of battered 1H 2020 fundamentals due to COVID-19. After emerging markets, mainly China, developed markets (Italy, Germany, UK, USA, Singapore) also witnessed arrival of COVID-19 in a big way and spill over to the regional business sentiment was unavoidable. Combination of COVID-19 and Oil price war is deadly for the macro economic environment of the region. Everything is likely to be hit in terms of profitability significantly. understand that COVID-19 may be resolved by 3Q 2020 the outcome of Oil Price War may extend well into 2021 if Russia and KSA remain committed to wiping out Shale and small producers. understand that COVID-19 may be resolved by 3Q 2020 the outcome of Oil Price War may extend well into 2021 if Russia and KSA remain committed to wiping out Shale and small producers. Such an action require general austerity across KSA for short term but may cause a windfall after 18 months as large oil producers start reaping benefits of recovered oil prices on higher market share after the demise of Shale and small oil producers. Therefore, only COVID-19 affected companies may recover first fundamentally while oil and fiscal growth linked plays have to wait.

US Policy – Limit-Down



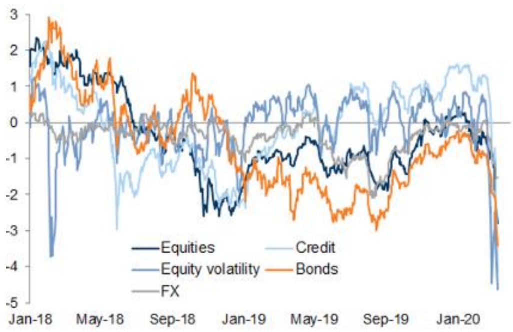
Source: Bloomberg

US Equity Valuations – Below and Beyond



Source: FactSect

Risk Appetite



Source: Goldman Sachs

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GLOBAL MARKET INDICES

Region/sector	Index	Quote	MTD	YTD	1Y	2Y	3Y	5Y	10Y	2016	2017	2018
World	DJIM World TR	4778.0	(17.8)	(23.7)	(11.7)	(5.0)	3.0	3.9	6.7	27.0	(7.0)	30.9
Developed	DJIDEV TR	2625.6	(18.0)	(24.2)	(11.9)	(4.5)	3.0	3.9	7.2	25.6	(6.2)	31.6
Emerging Markets	DJIEMG TR	3598.9	(15.4)	(19.5)	(10.6)	(10.9)	2.6	2.9	2.8	43.3	(15.0)	22.7
Saudi	TASI	5959.7	(21.9)	(29.0)	(30.6)	(12.5)	(4.5)	(8.8)	(1.0)	0.2	8.3	7.2
NAREIT	All REITS (EM Inc) TR	2172.8	(24.8)	(30.7)	(24.0)	(8.8)	(3.3)	(1.0)	4.7	15.0	(5.5)	23.6
GSCI	All Commodities	279.0	(22.2)	(36.0)	(35.5)	(20.8)	(10.0)	(6.5)	(6.1)	11.1	(15.4)	16.5
Currencies	Euro	1.1183	1.4	(0.3)	(1.3)	(4.6)	1.3	1.1	(2.1)	14.1	(4.5)	(2.2)
	Yen	105.83	1.9	2.6	5.3	0.1	2.3	2.8	(1.6)	3.8	2.7	1.0
	GBP	1.2271	(4.3)	(7.4)	(7.7)	(6.2)	(0.2)	1.2	1.1	9.5	(5.6)	3.9

Source: Bloomberg / Global Data as of 16 March 20. Saudi Market Data as of 16 March 20

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