ISSUE 007

MAY 2017

MENA MARKETS REVIEW

HIGHLIGHTS

- President Trump's first international trip, deemed successful, helped US markets toward the end of the month
- French presidential election comes to an end with the win of Emmanuel Macron
- OPEC and non-OPEC countries extend production cuts through Q1 2018
- MENA markets were in the red across the board, except for Egypt
- Qatar and Oman's credit rating has been downgraded, while Kuwait and Abu Dhabi's outlook was revised upward to "stable"

NBK CAPITAL
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MAY 2017: FUNDAMENTALS AND MARKETS STEADY, RISKS STILL SMALL BUT RISING IN US

Low volatility has been the story in the financial markets so far this year, equities in advanced economies in particular. Unprecedented events, such as Mr. Trump assuming office early in the year or the election in May of a relatively unknown in France Mr. Macron, have left the markets relatively unfazed. Many factors may account for the low volatility, including technical reasons, such as the heavier reliance on passive-based investments (index funds, ETFs, etc.). Fundamentals, however, have also played a major role. We noted last month that the major economies, and thus their policy environments, had been remarkably stable for quite some time. I.e. steady growth worldwide, accompanied by gradual small upside surprises (primarily EU) leading to mild revisions upward, all accompanied by stable inflation that is in line with most central banks' expectations. In other words: nothing conducive to any major economic or policy reassessment. That may be about to change.

For now, early June, most equity markets are up on the year and nicely so, some hitting historic highs. Equities in advanced economies are up over 8% ytd; world markets are up some 9% ytd while emerging markets are up about 13%. The GCC are lagging significantly, down 2.3% ytd, after significant rallies by some late in 2016 (Saudi), or early in 2017 (Kuwait). In recent days, the Qatari trade and diplomatic flap with its GCC partners also started to take a toll on asset prices. Oil prices are not helping the region by struggling to hold at $50 pb (Brent basis), notwithstanding a recent agreement by OPEC and its partners to extend their current output cuts by another nine months until March 2018. The outlook for oil prices is quite uncertain, with recent forecast revisions going both ways. We are staying with gradually higher prices ahead and an average price of $55 pb for Brent this year, based on further OPEC cuts, shrinking inventories and the upcoming travel and driving season.

Consensus projections of 3-3.5% for world growth this year appear reasonable. The US is expected to grow 2-2.5%, the Eurozone a little under 2.0%, China 6.5%-plus, and Japan 1-1.5%. For these major economies and others, the data is coming in "steady"; in other words, with less volatility and fewer special factors than usual.

The same can be said of the inflation data, in particular since oil prices and energy prices have been relatively well behaved so far this year. The Fed is still expected to hike rates again, about twice this year, starting with June 14 (FOMC meeting).

The Fed is also expected to start "normalizing" policy further, by starting to bring down its enormous balance sheet ($4.3 trillion). The Fed should start, in December or early next year, to stop fully replacing maturing Treasuries in its portfolio. It would thus replace only a portion of maturing debt, letting the rest be subtracted from its outstanding portfolio. The ECB, which is still adding monthly to its portfolio (€60 billion monthly), will not discuss portfolio reduction yet, not even the prospect of raising rates, though that time is looming. Interest rates are still close to zero there, and the ECB still sounds very dovish, though in light of better than expected data from Europe, the markets are already sensing what is coming, as gradual and as belated as it may be (2018).

Germany and Mrs. Merkel are not thrilled with the low interest rate policy either. They said or intimated that the euro currency was undervalued, thus pressuring the ECB for its next move; this at a time when pensioners and savers have all but lost patience with near-zero returns on their fixed income investments. Japan's rates are, of course, still close to zero (10-year note, yields 5 bps). And, there are no expectations of any move away from the current super-ease; nothing on the horizon, as deflation remains a scary bugaboo. Japanese CPI inflation is near 0.5% y/y versus a 2% target.

Steady growth worldwide and steady inflation are translating into advancing equities, and steady interest rates, with fairly low volatility. Yes, interest rates are rising slightly in the short-end where the central bank is tightening (US Fed), but long rates are very steady thanks to a tame inflation outlook and to the thirst for yield. Or else, they are held down by quantitative easing (ECB with 10-year Bunds at 30 bps, BOJ with Japanese 10-year notes at 5 bps).

As mentioned above, some of the political events which were expected to rattle things, if only temporarily this year, came and went with little fanfare or addition to volatility. Even Trump's related scandals, or supposed scandals, have people inured, though some of his political difficulties are bound to delay important parts of his agenda, including tax reform and fixing the currently broken Obamacare system. Both of these endeavors are complex and will take time and political capital. It is hoped that running hearings and investigations (Russia, leaks…) and the like will not unduly delay things. But again, it is unlikely we will get anything on that front before yearend. To add insult to injury, by September, a budget battle and a debt extension battle will also need to be fought. The US markets are counting on all of this legislation going through without a hitch, even if delayed. The potential for a measure of disappointment is high and should be monitored carefully, given the importance of the US economy and its financial markets to the world economy.

Furthermore, after a long period of expecting two further Fed hikes this year, following the one in March, the most recent US employment report showed enough weakness to shed doubts on that outlook. May employment only added 138K new jobs, and previous revisions put the 3-month average at 121K, the lowest average in five years. The drop in the unemployment rate to 4.3% was a bit misleading. It fell because of a fall in the labor force, rather than rising employment. And wages in the same report posted a very steady 2.4% y/y advance.

Softer employment and steady wages: not surprising enough to derail an expected 25 bps hike by the Fed on 14 June, but enough to raise eyebrows regarding subsequent moves this year and next. This report further pushed the euro higher and the dollar lower, as investors reassess the course ahead for the Fed and as European numbers remain firmer than expected. A tighter ECB, even if after a while, is still not priced in the FX markets. The euro is also benefiting from some political developments, with two elections slated for early June. A UK election (8 June) where PM May seems to be losing her grip, if not the election, has pressured the GBP. While in France smooth Macron, so far, is expected to have a good chance at garnering a parliamentary majority on 11 June, all of which shores up the outlook for the EU and the euro.

It is thus still a scenario of "steady as goes the world economy", with some Fed tightness ahead, decent-to-good smooth Europe, no frills from China and Japan, leading the world economy on an uneventful cruise this year. However, the risks have just gone up slightly on a potentially weaker US or derailed reforms there, as well as on some European shenanigans following perhaps the UK election which could further cloud the Brexit outlook for both partners, especially if Mrs. May fails to win decisively. Oil is the other factor to watch in the next quarter, especially as it is crucial for the GCC outlook and markets.

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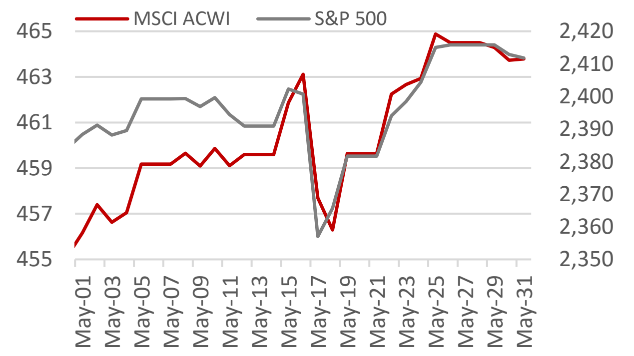
Global Equities

Global equities for the month of May posted a gain of 1.89% as measured by the MSCI All Country World Index. In the United States, the S&P 500 and Dow Jones continued their winning streak closing in the green at 1.16% and 0.33%, respectively. The US markets overall were unaffected by the mixed economic reports throughout the month. However, at mid-month equity markets and the US Dollar suffered a temporary setback as political turmoil surrounding President Trump and Russia increased. The success of his first international trip to the Middle East and Europe helped markets recover towards the end of the month and took the spotlight away from the troubles engulfing the White House.

Chart 1 : MSCI ACWI & S&P 500 Performance

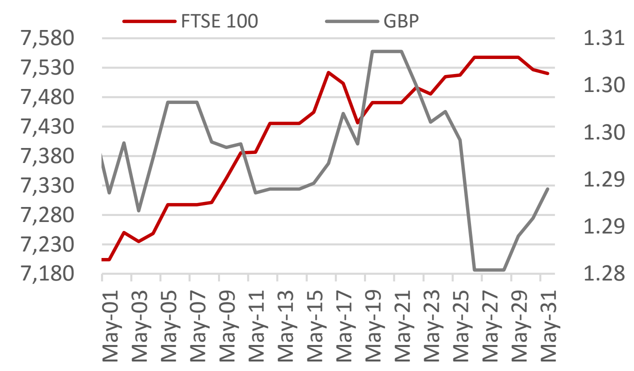


Source: Bloomberg

Across the Atlantic, the Stoxx Europe 600 Index performed relatively worse than the previous month, yet managed to post a gain of 0.75%. In Europe, the French election came to an end with Emmanuel Macron becoming the youngest French president in recent history; supporting the French equity market in reaching a nine year peak as well as the Euro. GDP numbers by region were released mid-month reflecting mixed performance. Greece has reported, for the second quarter straight, negative GDP numbers and finance ministers from across Europe were unable to agree on terms for Greece's bailout. The expectation going forward is that a deal will be reached in mid-June.

In the United Kingdom the FTSE 100 rose 4.39% in May reversing the losses sustained in April and registering the best full month performance for the year. Towards the end of May, the GBP dropped to a one-month low triggering a rally in the U.K. blue chips and causing the index to close at an all-time high of 7,547.63. Brexit continues to be a major discussion point both in the U.K. and across the European zone. Britain has threatened to abandon the talks related to exiting the union given the large "divorce bill" being put forward by the EU to the tune of EUR 100 billion.

Chart 2: FTSE 100 & GBP

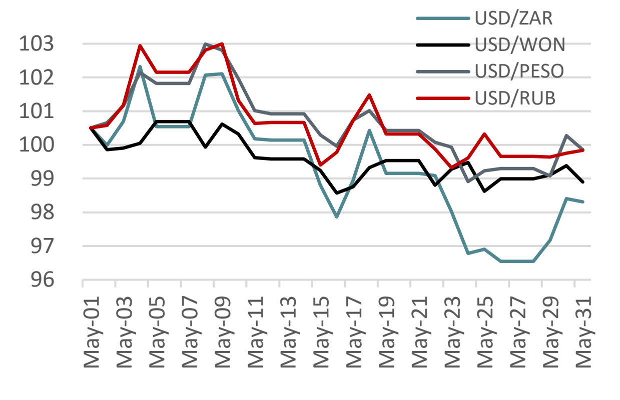


Source: Bloomberg

Japan's Nikkei 225 continued its rally through the month of May, posting a gain of 2.36%. The index's gains in April and May have reversed the losses registered in Q1 2017. Japan's top central banker has indicated that the economy, specifically the labor market, is undergoing a shift, which he believes will lead to higher wages and prices.

The MSCI EM Index increased by 2.80% during the month of May continuing its positive run for 5 straight months with a year-to-date gain of 16.59%. The index hit a 20-month high in early May. The rally comes on the back of lower geopolitical concerns related to North Korea, a rally in tech stocks, and a gain in major emerging currencies against the USD.

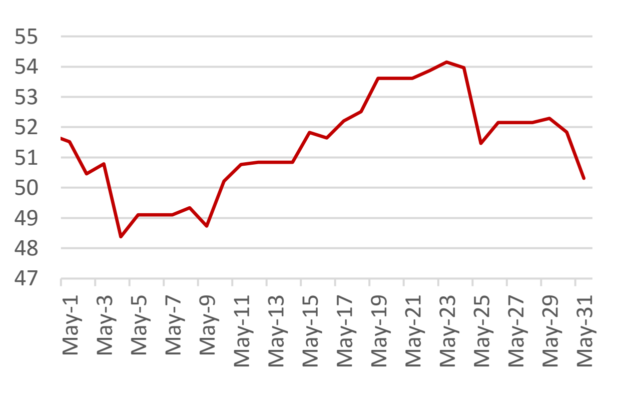
Chart 3: Performance of Emerging Currencies



Source: Bloomberg *(figures normalized)*

Brent oil posted a loss of 2.75% in May continuing its monthly losing streak since the start of the year. Up through the last day of trading oil was up marginally for the month by approximately 0.2%; however it dropped 2.95% in the last day of trading. The drop may be attributed to data released showing OPEC's production has increased for the first time in 2017 on the back of Libya and Nigeria's production. During the month, OPEC and non-OPEC countries met and agreed to continue with the production cuts for an additional nine months leading into Q1 2018 in hope of reducing global crude stocks and supporting prices. Saudi Arabia's Energy Minister Khalid Al-Falih indicated that cuts could be extended beyond March 2018, if deemed necessary, at the next OPEC meeting in November of this year.

Chart 4: Oil Prices – USD per Barrel (BRENT)



Source: Bloomberg

Regional Equities

MENA equities continue their losing streak for four months straight with the S&P Pan Arab Composite posting a loss of 0.97% for the month of May. The index's components were all down with the exception of Egypt. Further impacting performance during the month of May was the low volumes and shorter trading hours associated with the holy month of Ramadan.

The Saudi Tadawul All Share Index reversed the gains accumulated in March and April by posting a loss of 2.03% for the month of May. President Trump's first international trip entailed a visit to Saudi Arabia, which yielded bilateral agreements worth over USD 300 billion involving Aramaco and the Public Investment Fund. Last month the IMF downgraded Saudi Arabia's growth but in May issued a report noting the efforts of the government in stimulating the private sector and being more transparent in terms of issuing quarterly fiscal data.

The Qatar Exchange Index was down for the month of May 1.62% making this the third consecutive month with negative performance. Qatar's credit rating was downgraded from Aa2 to Aa3 by Moody's given the rise in their debt to GDP ratio to 150% from approximately 111%. The country has become the second within the GCC, following Saudi Arabia, to formally embrace the VAT implementation.

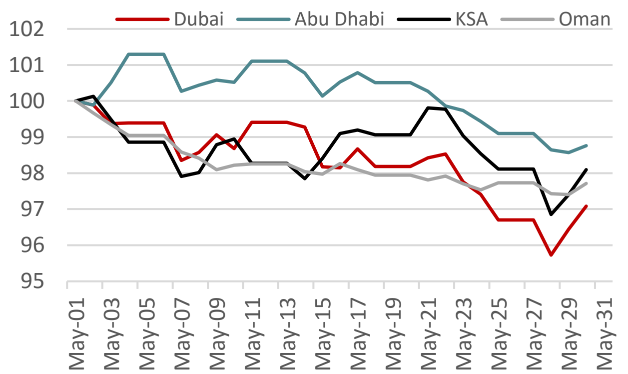
The Kuwait Weighted Index posted a loss of 0.94%, making this the fourth consecutive month of closing in the red. At the start of the year, the index was the top performer and as a result, the YTD performance is still in the green. Moody's, while maintaining their credit rating for Kuwait at Aa2, upgraded their outlook from negative to stable. Government revenues are expected to increase by approximately KWD 45 million in the next fiscal year given the increase in rates charged by the Ministry of Electricity and Water. This is part of the government's plan to reduce subsidies in an effort to better balance the budget in light of lower oil prices.

Bahrain Bourse All Share Index continues to shed the gains registered in Q1 2017 by posting a loss of 1.19%

in May. Overall, YTD performance of 5 months stands at 8.14% compared to the Q1's performance of 11.11%

Both major markets within the UAE performed poorly during the month of May. The Dubai DFM General Index was the worst performer for the month within the GCC posting a loss of 2.21%. The Abu Dhabi ADSM General Index performed slightly better than its counterpart in Dubai posting a loss of 2.11%. During the month, Moody's affirmed Abu Dhabi's credit rating at Aa2 and upgraded its outlook to stable given the diversified revenue stream of the emirate and indications of an economic rebound.

Chart 5: Performance of Dubai, Abu Dhabi, KSA & Oman

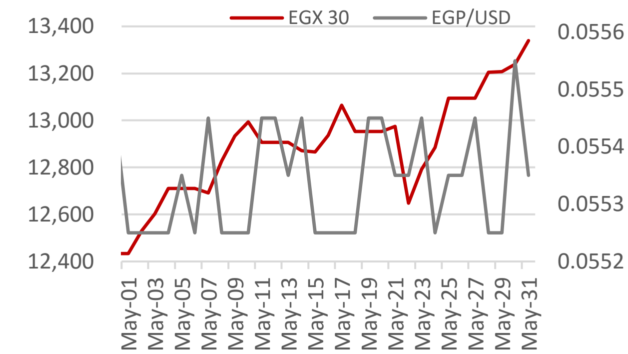


Source: Bloomberg *(figures normalized)*

Oman's MSM 30 Index closed for the month of May in the red, losing 1.66%. This continued negative performance is a result of weak oil prices and may be related to the downgrade by S&P of the country's credit rating from BBB- to BB+, effectively stripping it of its investment grade status. The IMF recently projected that growth would be flat for 2017 and estimated the budget deficit at 12% of GDP. In an effort to finance its deficit, Oman sold a $2 billion sukuk. The 7-year sukuk was priced at 4.397%, as the order book was more than three times oversubscribed allowing Oman to tighten pricing.

Egypt's EGX 30 reversed the losses posted in April of 4.32%, closing in the green 7.29% in May. The Central Bank of Egypt increased its key policy rates by 200 bps adhering to the IMF's call but contrary to analyst expectations. In terms of bond issuances, the country raised USD 3 billion, almost double its target, in Eurodollar bonds with maturities of 5, 10, and 30 years.

Chart 6: EGX 30 Index & EGP/USD



Source: Bloomberg

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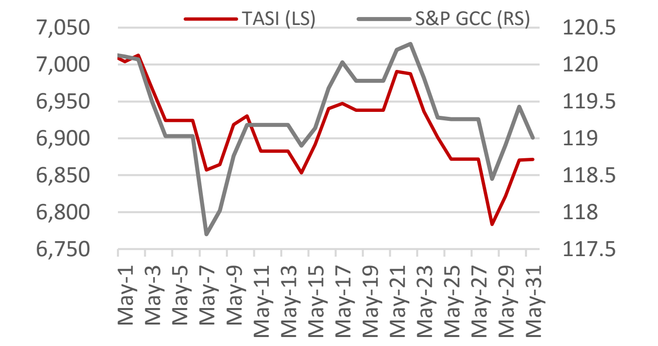
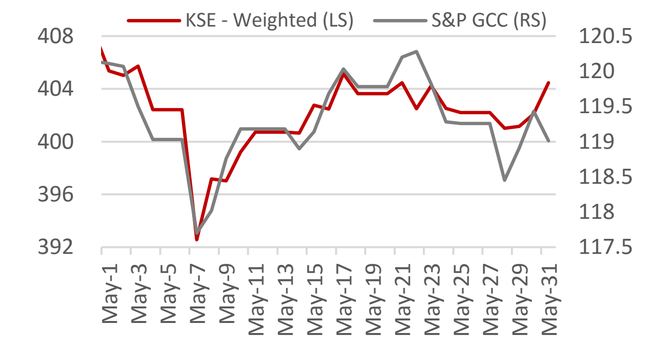
Stock Market Performance – *as of May 31, 2017:*

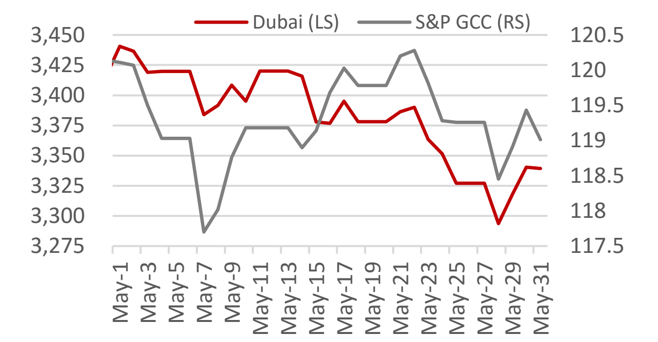
Saudi Arabia



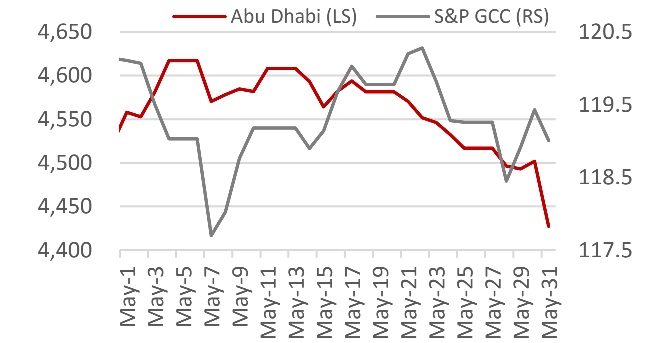
Kuwait



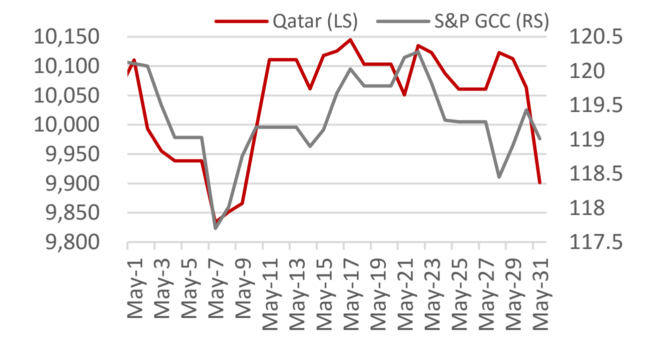
Dubai



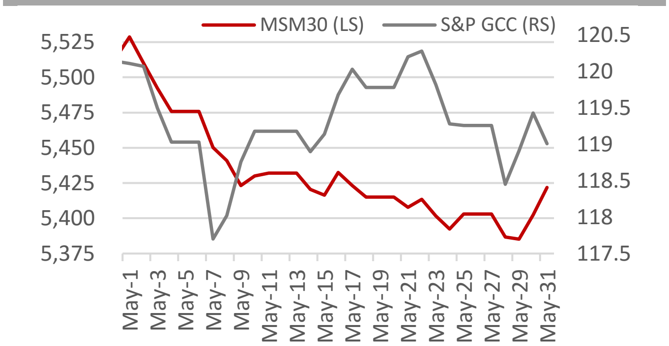
Abu Dhabi



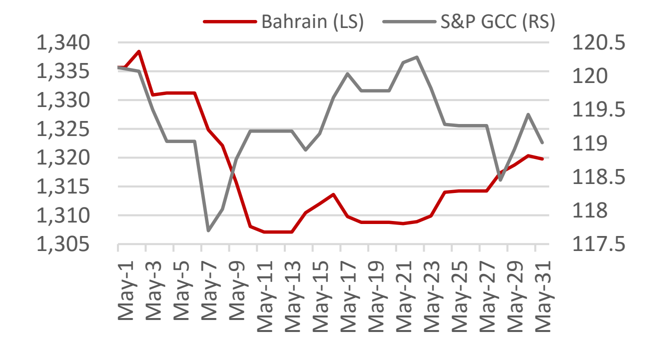
Qatar



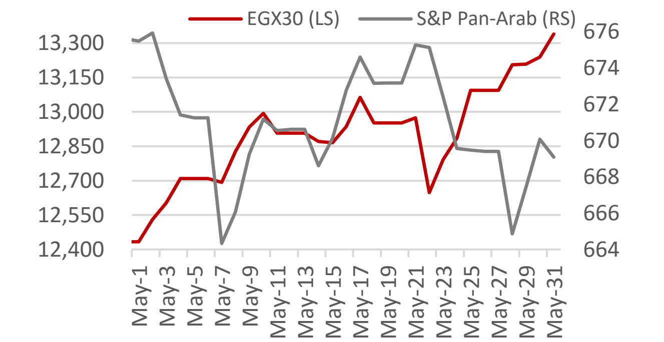
Oman



Bahrain



Egypt



LS: Left-side
RS: Right-side
All indices are in local currencies, except for the S&P GCC and S&P Pan Arab which are denominated in USD.

Market Data – *as of May 31, 2017:*

Equity*	Last Price	% Change			
		Monthly	Quarterly	YTD	1Yr Trailing
Global					
MSCI AC World Index (USD)	463.79	1.89%	3.32%	9.94%	15.21%
MSCI EAFE (USD)	1,890.06	3.07%	5.41%	12.24%	13.32%
MSCI EM (USD)	1,005.33	2.80%	4.90%	16.59%	24.51%
US					
S&P 500 Index	2,411.80	1.16%	2.08%	7.73%	15.01%
Dow Jones Industrial Average	21,008.65	0.33%	1.67%	6.31%	18.11%
NASDAQ Composite Index	6,198.52	2.50%	4.85%	15.15%	25.27%
Russell 2000 Index	1,370.21	-2.16%	-1.13%	0.96%	18.65%
Developed					
Euro Stoxx 600	389.99	0.75%	2.32%	7.90%	12.24%
FTSE 100 Index	7,519.95	4.39%	2.69%	5.28%	20.69%
DAX Index	12,615.06	1.42%	2.45%	9.88%	22.92%
CAC 40 Index	5,283.63	0.31%	3.15%	8.67%	17.27%
Nikkei 225	19,650.57	2.36%	3.92%	2.81%	14.02%
Hang Seng Index	25,660.65	4.25%	6.42%	16.64%	23.28%
Emerging Markets					
Russia Stock Exchange	1,900.38	-5.77%	-4.79%	-14.88%	0.07%
Turkey - Borsa Istanbul 100 Index	97,541.58	3.05%	9.66%	24.83%	25.37%
MSCI Asia ex Japan	618.47	4.08%	6.27%	20.25%	25.11%
Shanghai Composite	3,117.18	-1.19%	-3.27%	0.44%	6.88%
India - NIFTY 50	9,621.25	3.41%	4.88%	17.54%	17.91%
Taiwan Stock Exchange	10,040.72	1.71%	2.34%	8.51%	17.63%
Brazil Ibovespa Index	62,711.47	-4.12%	-3.50%	4.12%	29.38%
Mexico Stock Exchange	48,788.44	-0.96%	0.51%	6.89%	7.32%
MENA					
S&P Pan Arab (USD)	669.09	-0.97%	-1.51%	-2.02%	6.62%
S&P GCC Composite (USD)	119.01	-0.94%	-1.19%	-2.23%	8.48%
KSA - Tadawul All Share Index	6,871.24	-2.03%	-1.86%	-4.70%	6.56%
Dubai - DFM General Index	3,339.37	-2.21%	-4.05%	-5.42%	0.77%
Abu Dhabi - ADX General Index	4,427.30	-2.11%	-0.37%	-2.62%	4.17%
Qatar Exchange Index	9,901.38	-1.62%	-4.71%	-5.13%	3.80%
Kuwait Weighted Index	404.46	-0.94%	-2.13%	6.41%	13.17%
Oman - Muscat Securities Market 30 Index	5,421.95	-1.66%	-2.32%	-6.24%	-6.69%
Bahrain Bourse All Share Index	1,319.75	-1.19%	-2.67%	8.14%	18.73%
Egypt - EGX 30	13,339.63	7.29%	2.65%	8.06%	78.25%
Morocco - MADEX	9,441.74	-0.51%	1.92%	-1.11%	18.52%
Jordan - ASE Index	2,175.18	-0.46%	-3.33%	0.23%	2.68%

**All Indices are in local currency, unless otherwise noted.*
Source: Bloomberg

Market Data – *as of May 31, 2017:*

Fixed Income	Last Price	% Change Monthly	% Change Quarterly	% Change YTD	% Change 1Yr Trailing
Bond Indices					
J.P. Morgan Global Agg Bond (USD)	554.90	1.52%	2.71%	4.22%	0.83%
Barclays US Agg Bond	2,023.34	0.77%	1.55%	2.38%	1.58%
Bloomberg US Gov Bond Index	126.04	0.65%	1.32%	2.02%	0.08%
Bloomberg Barclays US Corp Bond Index	2,821.68	1.15%	2.23%	3.48%	4.26%
Bloomberg Barclays US Corp High Yield Bond Index	1,900.70	0.87%	2.03%	4.79%	13.58%
Bloomberg Global Dev Gov Bond Index ex - US (USD)	106.85	1.87%	3.43%	5.77%	-1.19%
Bloomberg Global Corp Bond Index ex US (USD)	129.78	1.85%	3.19%	4.72%	3.58%
JPM Emerging Market Bond Index (USD)	786.91	0.83%	2.47%	6.47%	9.74%
Bloomberg Barclays EM High Yield Bond Index (USD)	1,275.43	0.54%	2.54%	6.53%	14.21%
US Treasury Yields (%)	**Current**		**3 M ago**	**6 M ago**	**12 M ago**
3 Month Yield	0.97		0.66	0.46	0.28
2 Year Yield	1.28		1.31	1.10	0.88
5 Year Yield	1.75		2.02	1.82	1.37
10 Year Yield	2.20		2.48	2.38	1.85
30 Year Yield	2.86		3.07	3.06	2.65
Global Treasury Yields (%)	**Current**		**3 M ago**	**6 M ago**	**12 M ago**
British 10 Year Gilt	1.05		1.21	1.38	1.43
German 10 Year Bund	0.30		0.32	0.28	0.14
Japan 10 Year Treasury	0.05		0.07	0.04	-0.11

Commodities	Last Price	% Change Monthly	% Change Quarterly	% Change YTD	% Change 1Yr Trailing
Precious Metals					
Gold Spot	1,268.92	0.05%	1.58%	10.58%	4.41%
Silver Spot	17.33	0.65%	-5.14%	8.79%	8.33%
Energy					
WTI Crude	48.32	-2.05%	-4.51%	-10.05%	-1.59%
Brent Crude	50.31	-2.75%	-4.77%	-11.46%	1.25%
Natural Gas	3.07	-6.26%	-3.73%	-17.53%	34.22%

Currencies	Last Price	% Change Monthly	% Change Quarterly	% Change YTD	% Change 1Yr Trailing
EUR-USD X-RATE	1.12	3.20%	5.56%	6.91%	1.01%
GBP-USD X-RATE	1.29	-0.47%	2.71%	4.46%	-11.00%
USD-JPY X-RATE	110.78	-0.64%	-0.55%	-5.28%	0.05%
KWD-USD X-RATE	3.30	0.39%	0.48%	0.71%	-0.36%

Interbank Rates (%)	1M	3M	6M	12M
London Interbank	1.05	1.20	1.41	1.72
Saudi Interbank	1.28	1.72	2.00	2.20
Emirates Interbank	1.10	1.49	1.69	2.12
Qatar Interbank	1.67	1.94	2.23	2.69
Kuwait Interbank	1.38	1.63	1.81	2.19

Source: Bloomberg

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