Markaz House Views 2021

Opportunities and Outlook

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2020 Performance

Equities in the GCC witnessed a sharp decline early in the year following COVID-19 pandemic with S&P MENA index losing more than 23%. Regional markets were then able to shake off the bad start as the virus was contained following periods of lockdowns and curfews. The gradual opening of economies and positive developments related to COVID-19 vaccine led to the S&P MENA index ending 2020 with a yearly gain of 1.5%.

Exhibit 1: Performance of S&P equity indices in the MENA region

S&P indices	2020 returns
S&P MENA	1.5%
S&P KSA	6.9%
S&P Qatar	0.9%
S&P UAE	-2.4%
S&P Kuwait	-9.1%

Source: S&P

Performance within GCC countries was mixed with most of the improvement coming from KSA despite the government instituting austerity measures in the form of higher VAT, custom duties and suspension of cost of living allowance. On the other hand, Kuwait was the worst performer the in the GCC with the S&P Kuwait index declining 9% in 2020, despite MSCI's inclusion to the Emerging Market index. Lower stimulus compared to other economies and worse banking sector results compared to other GCC banks put a dent on the market's recovery.

Among sectors that performed well were defensives sectors such as food, groceries, utilities and insurance all of which significantly outperformed the benchmark indices. Healthcare was another outperformer as seen from the GCC Healthcare index, which was up 37% in 2020. Possibly, the pandemic has renewed investor focus on the healthcare sector.

Exhibit 2: PE Multiples of GCC stock markets from FY 2017 to FY 2022

PE Multiple	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021(Est.)	FY 2022 (Est.)
UAE	10.4x	9.7x	9.7x	11.9x	12.3x	10.5x
Qatar	11.8x	14.3x	15.0x	15.8x	14.3x	12.9x
Kuwait	15.4x	14.2x	17.1x	25.4x	19.3x	15.2x
Oman	6.0x	6.7x	7.2x	7.8x	7.7x	6.3x
KSA	17.8x	25.1x	23.4x	36.0x	18.9x	15.9x
	14.3x	16.7x	16.5x	22.7x	16.4x	13.9x

Source: Markaz Research

Challenges

While earnings are expected to recover in 2021, the level of profits are unlikely to revert to pre-pandemic levels until the end of 2022. The sectors that proved to be resilient in 2020 (food, groceries, utilities and insurance) are expected to underperform the market in 2021, as a result of rotation into deep value names and cyclical sectors such as financials, airlines, real estate and hospitality.

Banking sector earnings are expected to be under pressure during 2021 given the deterioration in asset quality due to COVID-19. Furthermore, lower interest rate could affect margins and expectations of lower credit growth due to economic uncertainty could influence overall earnings given the high concentration of banks in all GCC markets.

I. GCC Equities *(continued)*

Opportunities

The improvement in the geo-political situation in the GCC following the Al-Ula Summit led to KSA, UAE, Bahrain and Egypt removing the economic blockade on Qatar. This augurs well for the region's economy and non-oil stocks. Qatar investors are expected to boost real estate activity in the UAE, which has been hit hard by COVID-19. Some real estate stocks like Emaar Properties have already given double-digit returns in 2021. The re-opening of borders is also expected to increase trade volumes, which can be a positive for banking stocks that are a proxy for the economy as a whole in the GCC.

The other important development in the political front with economic implications is the Abraham accord, which refers to the normalization agreements between Israel and UAE first and then between Israel and Bahrain. The agreement is expected to strengthen economic ties between the respective nations. Abu Dhabi Investment Office (ADIO) has said that it plans to open a network of foreign offices, beginning with its first one in Tel Aviv, Israel. The areas of possible collaboration between the two countries include advanced technology and R&D across sectors such as agri-tech, biomedicine and advanced manufacturing.

2021 Outlook

The outlook for 2021 remains positive for GCC equities as the markets would be supported by improving corporate earnings and economic recovery from the COVID-19 downturn. GCC economies are expected to recover in 2021 with expected GDP growth of 2.6%, and 3.1% in 2022 from a decline of 6.6% in 2020 driven by higher oil production and an improvement in economic activities. GCC economies are likely to return to pre-pandemic levels by 2023.

Regional stock markets are expected to provide returns in the high single digits in 2021 due to the following reasons:

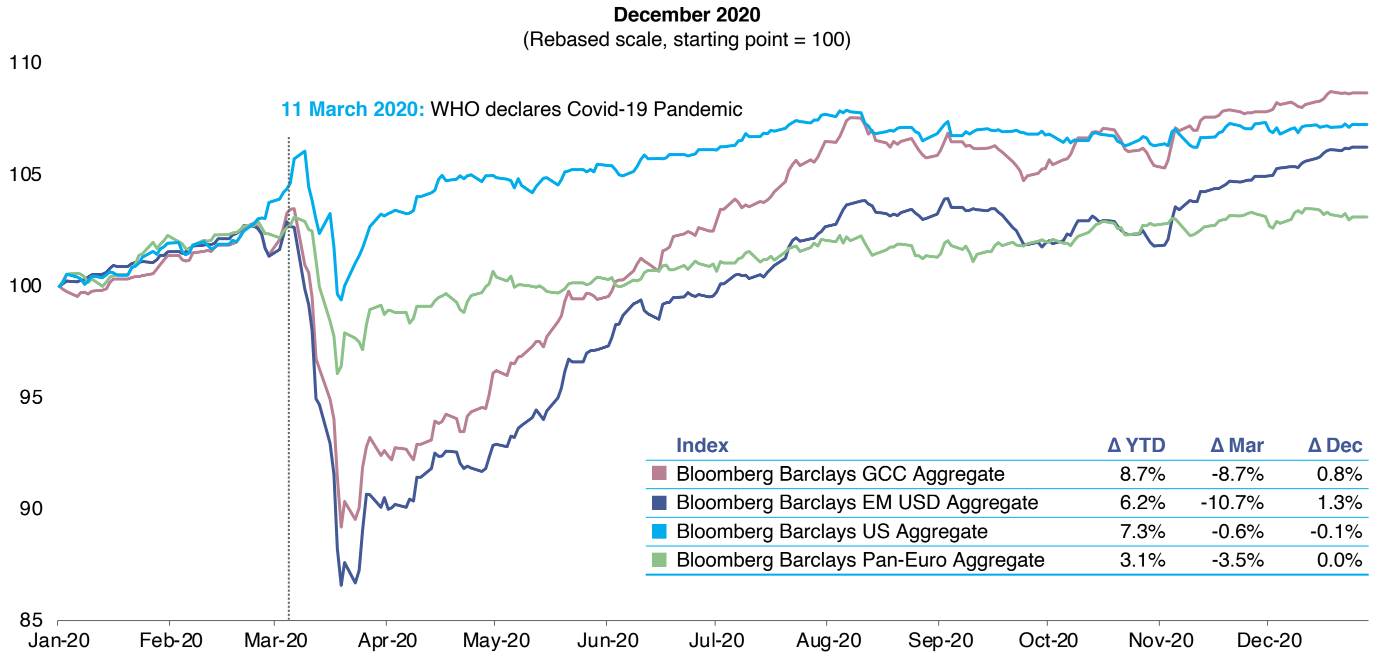
- Economic recovery driven by vaccine rollout resulting in easing of restrictions.
- Expectations of a bounce in commodity prices mainly oil and its derivatives because of higher demand and production cuts.
- Continuation of low interest rates and economic stimulus packages, particularly in developed economies.
- Lack of opportunities in other asset classes, particularly real estate and fixed income in the region.

II. GCC Fixed Income

Recap of 2020

A year of uncertainty mainly led by COVID-19 pandemic also had its effect on global and regional fixed income markets. However, post a massive drop in fixed income indices across the world during March of 2020, the recovery has been fast paced and most of the indices recovered above the pre-pandemic levels. Interestingly, Bloomberg Barclays GCC Aggregate index has outperformed developed and emerging market indices.

GCC vs Regional Fixed Income Indices[1]



Index	Δ YTD	Δ Mar	Δ Dec
Bloomberg Barclays GCC Aggregate	8.7%	-8.7%	0.8%
Bloomberg Barclays EM USD Aggregate	6.2%	-10.7%	1.3%
Bloomberg Barclays US Aggregate	7.3%	-0.6%	-0.1%
Bloomberg Barclays Pan-Euro Aggregate	3.1%	-3.5%	0.0%

Source: Bloomberg, Markaz Analysis

Record GCC Primary Issuances

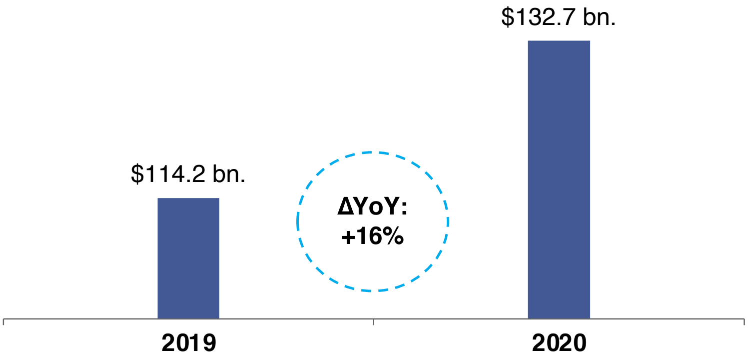
COVID-19 infused a decline in economic activity that led to a drop in demand for oil, resulting in lower oil revenues for the oil dependent GCC economies and disturbing its fiscal balances. In the GCC, Bonds and Sukuk primary issuances increased by 16% YoY to USD 132.7billion in 2020 mainly led by UAE and Saudi Arabia.

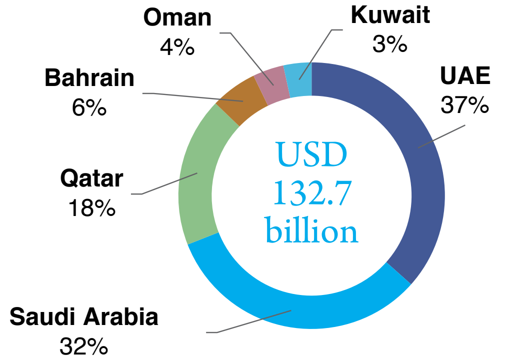
Kuwaiti corporate issuers were driven by lower rates and ample investor demand as well. Total issuances by Kuwaiti corporates in USD denominated bonds amounted to USD 3.45billion and KWD 365million issued in Kuwaiti Dinars (USD 1.2billion) in 2020.

[1] *FI Indices: Bloomberg Barclays – GCC Aggregate (BGCCTRUU:IND), Emerging Markets Aggregate (EMUSTRUU:IND), Pan-European Aggregate (LP06TREU:IND), US Aggregate (LBUSTRUU:IND).*

II. GCC Fixed Income *(continued)*

GCC Primary Issuances





Source: Bloomberg, Markaz Analysis

Rating agencies in action in 2020

During the peak of the pandemic, as economic activity slowed and oil prices plummeted rating agencies came in action by downgrading Bahrain, Kuwait, Oman while Moody's cut Saudi Arabia's outlook to negative. These downgrades were mainly due to expectations of lower oil revenues, which eventually would strain the fiscal balance of these oil dependent economies. According to Fitch Ratings, GCC corporates reduced their capex budgets in 2020, and a gradual increase in 2021 is expected. Stability in oil prices and expected improvement in GDP growth in 2021 over 2020 reflects a stable outlook for GCC corporates. In terms of economic growth, S&P Global Ratings expects a modest economic recovery for the GCC over 2021-2023, with real GDP growth of 2.5%, after a contraction of about 6% in 2020.

GCC Credit Rating Downgrades

	Moody's			S&P			Fitch		
Kuwait	**Aa2** Stable Outlook	➡	**A1** Stable Outlook	**AA** Stable Outlook	➡	**AA-** Negative Outlook	**AA** Stable Outlook		
Bahrain	**B2** Stable Outlook			**B+** Stable Outlook			**BB-** Stable Outlook	➡	**B+** Stable Outlook
Oman	**Ba1** Negative Outlook	➡	**Ba3** Negative Outlook	**BB** Stable Outlook	➡	**B+** Stable Outlook	**BB+** Stable Outlook	➡	**BB-** Negative Outlook

Source: Bloomberg, Markaz Analysis

Credit Default Swap spreads and interest rate cuts

Credit Default Swap (CDS) spreads, a measure largely regarded as an indicator of default for sovereign countries, spiked across all GCC countries during March and gradually reverted by the year-end. In terms of interest rates, 1H 2020 had witnessed cuts across the board ranging from 125 bps to 175 bps following US Fed rate cuts. These cuts were implemented to support economic activity and growth post the deterring impact of the pandemic. While in 2H 2020, interest rates have been stable.

II. GCC Fixed Income *(continued)*

GCC & U.S Benchmark Rate Cuts – FY 2020

	2.75% Jan 2020	-25 bps March 4th	-100 bps March 16th	-	1.50% Dec 2020
	2.25% Jan 2020	-50 bps March 3rd	-75 bps March 16th	-	1.00% Dec 2020
	4.25% Jan 2020	-75 bps March 4th	-100 bps March 16th	-	2.50% Dec 2020
	2.00% Jan 2020	-50 bps March 4th	-75 bps March 16th	-15 bps July 16th	0.60% Dec 2020
	2.00% Jan 2020	-50 bps March 4th	-75 bps March 16th	-	0.75% Dec 2020
	2.281% Jan 2020	-42 bps March 3rd	-63 bps March 10th	-73 bps Mar - Dec	0.50% Dec 2020
	1.75% Jan 2020	-50 bps March 3rd	-100 bps March 16th	-	0.25% Dec 2020

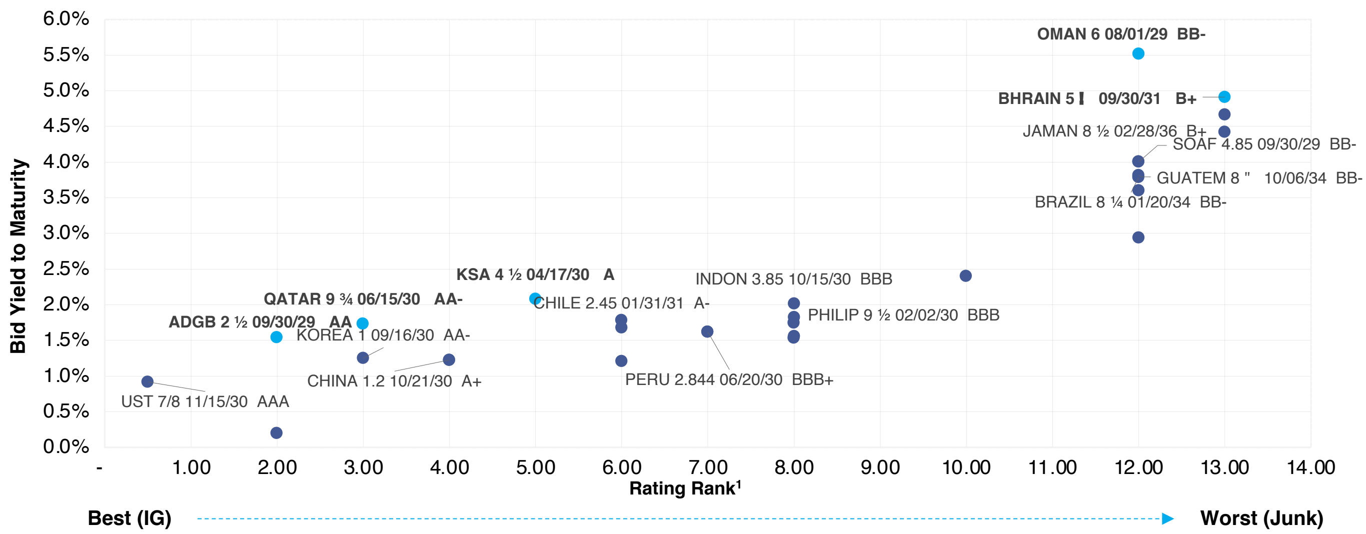
Source: Bloomberg and Markaz Analysis

Outlook 2021

GCC bond markets is expected to be an attractive asset class in the year 2021 and will offer a yield pick up to investors with tolerable duration and credit risk levels.

- Attractive Yield: 10-year US Treasury bond yield is expected to be capped at 1%-1.25% due to commitment of Fed to maintain policy rate on hold. This is expected to raise the appeal of GCC bonds and Sukuk given the attractive yield differential between GCC sovereigns and US and other emerging markets
- Liquid market: With an outstanding issuance of about USD 665.33billion, GCC bond issuances is expected to increase in 2021 due to rising funding demands of GREs and Banks (Basel III). This is also supported by increasing international demand since inclusion in the JPM emerging bonds index.
- Strong credit ratings: Despite the recent downgrades, the GCC region enjoys relatively high investment-grade average rating.
- Resilient market: The GCC bonds and Sukuk market proved to be resilient during uncertainties, due to real domestic demand.

GCC 10Y Sovereign Bond Yields vs. Peers



[1] Rating scale used; 0.5=AAA and 14=B
Source: Bloomberg, Markaz Analysis

III. GCC Real Estate

Over the course of 2020, even as COVID-19 related lockdowns, travel bans and visa restrictions dimmed the sector in 2020, its future prospects have lightened up due to its favourable position in the market cycle and supportive policy developments

Review of 2020

COVID-19 and the low oil price environment had led to a demand shock in the region by effecting business contraction and repatriation of expats. The ability and willingness to spend has also been affected. In GCC real estate sector, collections, occupancy, rental rates and valuation have declined.

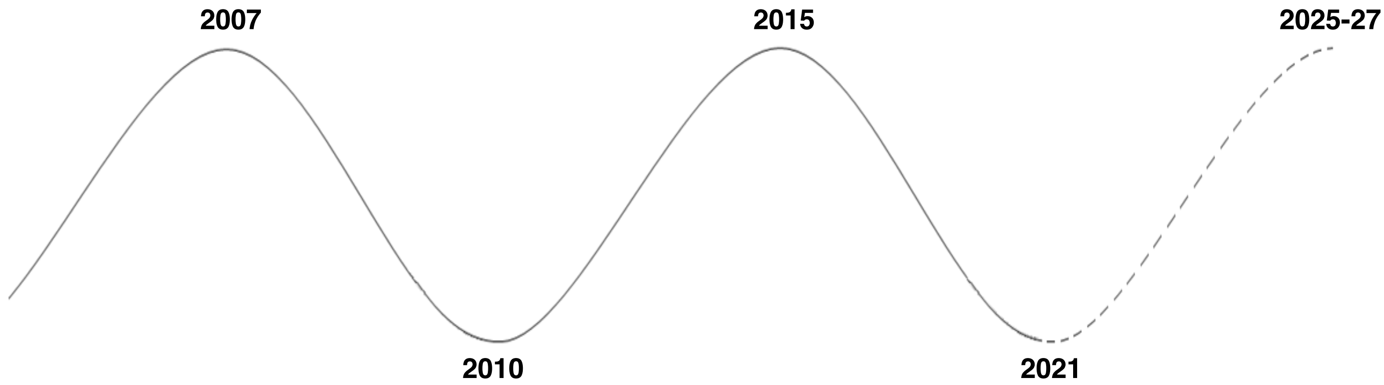
- Collections had dropped from pre-COVID average of above 95% to as low as 25% in some segments, before recovering to about 85%.
- Occupancy rates had dropped from pre-COVID average of above 95% to 80% in some segments, before recovering to about 85%.
- Rental rates and valuations had dropped in the range of 5% to 15%, with signs of stability emerging in Q4.

Rental rates in commercial retail segment were the hardest hit as reduced business activity amid lockdowns led to reduction in rent, deferrals etc. Valuation was the hardest hit in mid-to-low residential segment in UAE, commercial real estate in Saudi Arabia and expat areas in Kuwait.

In 2020, real estate sales and deal value in UAE had declined by 10.6% y-o-y.[2] As of December 2020, ValuStrat's Price Index (VPI) for residential real estate in Dubai had declined by 13.8% y-o-y. In Q4 2020, rental rates for residential segment in Dubai had declined by 12% y-o-y and those in Abu Dhabi fell by 3%.[3] The secondary market had reportedly seen good activity in the last few months in 2020 with November recording highest secondary/ready market transactions in seven years.

In Saudi Arabia, year to date value of residential transactions as of Q3 2020, decreased by 38% y-o-y.[4] In Kuwait, as of Q3 2020, real estate sales had dropped by 40% y-o-y. This was mainly due to the steep drop in activity in Q2 2020 following widespread economic lockdown and curfew measures. In Q3 2020, though overall sales had declined by 20% y-o-y due to weakness in commercial and investment sector, residential sector sales increased by 21% y-o-y.[5]

Figure: Recent Market Cycles in GCC Real Estate



Source: Markaz

[2] *DataFinder*
[3] *JLL*
[4] *Knight Frank*
[5] *Ministry of Justice*

III. GCC Real Estate *(continued)*

Opportunities

The real estate prices in GCC are currently at attractive levels. As the market cycle nears its bottom, this is an opportune time for investing in distressed assets. Additionally, investing in income generating real estate generates monthly cash distributions in addition to the potential upside from going into the real estate market at the current point in the cycle.

Challenges

Roadblocks in vaccine rollouts, oversupply by real estate players and weak consumer sentiments are the key risks that could further delay recovery. In Kuwait, retail real estate is expected to bear the pain in the near future, as consumer sentiment remains weak. Legislation on reducing expat numbers might also affect demand.

Outlook for 2021

In UAE, office and residential real estate segments are bottoming out. In line with global trends, retail and hospitality are likely to underperform in the near term. In addition to vaccine optimism, UAE is set to benefit from World Expo that had been postponed to October 2021 and initiatives such as Golden Visa and retirement visa programme. Recent restoration of diplomatic ties with Israel and Qatar could benefit the sector in terms of investment flows.

In Kuwait, real estate could be expected to bottom out in 6-12 months. Stable activity in residential real estate and improvement in commercial and investment sectors on the back of recovery in business environment could lend support to the sector.

Saudi Arabia's exemption of property from VAT and levying of lower property tax and bearing of tax burden by the government for properties up to SAR 1 million (USD 267 thousand), Qatar's relaxation of foreign property ownership rules are a few other measures that could support real estate in the respective countries.

After peaking in 2015, GCC real estate has seen a severe correction in the range of 20% to 40% over the last five years. This has led to investors moving towards stable and liquid developed markets. However, the market is expected to hit the trough in 2021 and is likely to stabilize over the next 6-12 months. This would most likely be followed by a recovery marking the beginning of a new cycle.

IV. International Real Estate

The structural shifts and uneven impact brought about by COVID-19 pandemic has reflected particularly well in the real estate sector. While some sub-segments benefitted from the policy responses to the pandemic, the lockdowns and social distancing disadvantaged others.

Industrial segment was a key beneficiary as mobility restrictions accelerated the transition of businesses towards the e-commerce sector, thereby increasing demand for industrial space such as warehouses and logistics parks. Multi-family offices have also shown resilience during the year. Retail continued its secular decline due to growth in e-commerce, with the trend becoming more pronounced due to the pandemic. In the office segment, as companies adopted to working from home, rent, occupancy and capital values are down across the board in all major cities.

Opportunities

Of the segments negatively affected by COVID-19, impact on retail and office seem to be structural, while the impact on hotels and hospitality segment seems to be transient. Though hotels and hospitality segment has been severely discounted with decline in leisure and business travels, demand is expected to return to 2019 levels over the next 3 to 5 years. The segment could yield double-digit returns as demand reverts to historic trends. The present times also provide opportunities to acquire assets at a discount or below replacement cost owing it to the challenges presented by COVID-19.

Challenges

In the current scenario, retail segment faces higher risk, particularly in U.S and Europe. This is followed by hospitality and office that face moderate risk. The primary challenge for the sector continues to be the uncertainty on the timing of the demand recovery. A resurgence in cases as seen recently and the subsequent restrictions imposed by the governments could restrain economic activity and growth. While developments in the vaccine front set an optimistic tone, a recovery may be reached earlier than expected. For example, with a portion of workforce working from home, recovery of office real estate could be long drawn-out. Yet, another downside risk could be a prolonged recession that could hamper returns.

Table: Risk Profiles across Geographies and Real Estate Segments

Geography	Industrial	Multifamily	Office	Retail	Hospitality
Global	Low	Low	Moderate	High	Moderate
United States	Very Low	Very Low	Low	Very High	Low
Overall Europe	Low	Low	Moderate	Very High	Low
Emerging EU Market	Low	Low	Very Low	High	Moderate
United Kingdom	Very Low	Low	Moderate	High	Moderate

Very Low · Low · Moderate · High · Very High

Source: Markaz

Outlook for 2021

Moving into 2021, much of the trends set afoot in 2020 are likely to continue. While industrial and multi-family would continue their positive trend, hospitality and office space could take time to recover. Retail might not recover to pre-pandemic levels as e-commerce continues to gain traction. The following table presents our outlook for the year.

IV. International Real Estate *(continued)*

Real Estate Outlook 2021

Sector	Outlook
Industrial	• Resilient to COVID-19 impact due to e-commerce factor • Net absorption projected to outpace historical annual average • Rent growth is expected to continue in 2021 feeding existing demand
Multi-family	• Held up strong against COVID-19 impact (2nd to Industrial) • Class A was hard-hit while more affordable Class B & C projects maintained low vacancy rates • Vacancy rates should return to pre-COVID levels as demand to rebounds during recovery stage
Office	• High density office markets could struggle to recover in 2021 due to COVID-19 constraints • Suburban office should recover quicker due to fewer logistical barriers • Lower office space demand could be compensated by increase in office space per person. • Office vacancy is likely to remain high. However positive net absorption may resume later in 2021
Retail	• Pressures from e-commerce as tenants continue to switch their business models • Retail store closures in 2020 and 2021 are forecasted to exceed 2019 numbers • Reuse and conversion of Class B & C malls is expected to take place beginning in 2021
Hospitality	• Limited-service hotels have performed the strongest this year in low populated areas and due to low overheads • Upper midscale hotel chains could recover from 2022 • Luxury chains would take longer to recover, possibly from 2024

Source: Various

With interest rates expected to remain low for the near future, capital and liquidity is available in plenty for real estate – especially for industrials and multifamily segment. Recent improvement in degree of stability in U.S political climate is a favourable development, even as the change in administration could bring about policy changes. Though economic outlook remains uncertain, mass administration of COVID-19 vaccines and willingness of governments to introduce additional stimulus measures in the event of deterioration of economic health would stem the impact of COVID-19, making way for a better 2021.

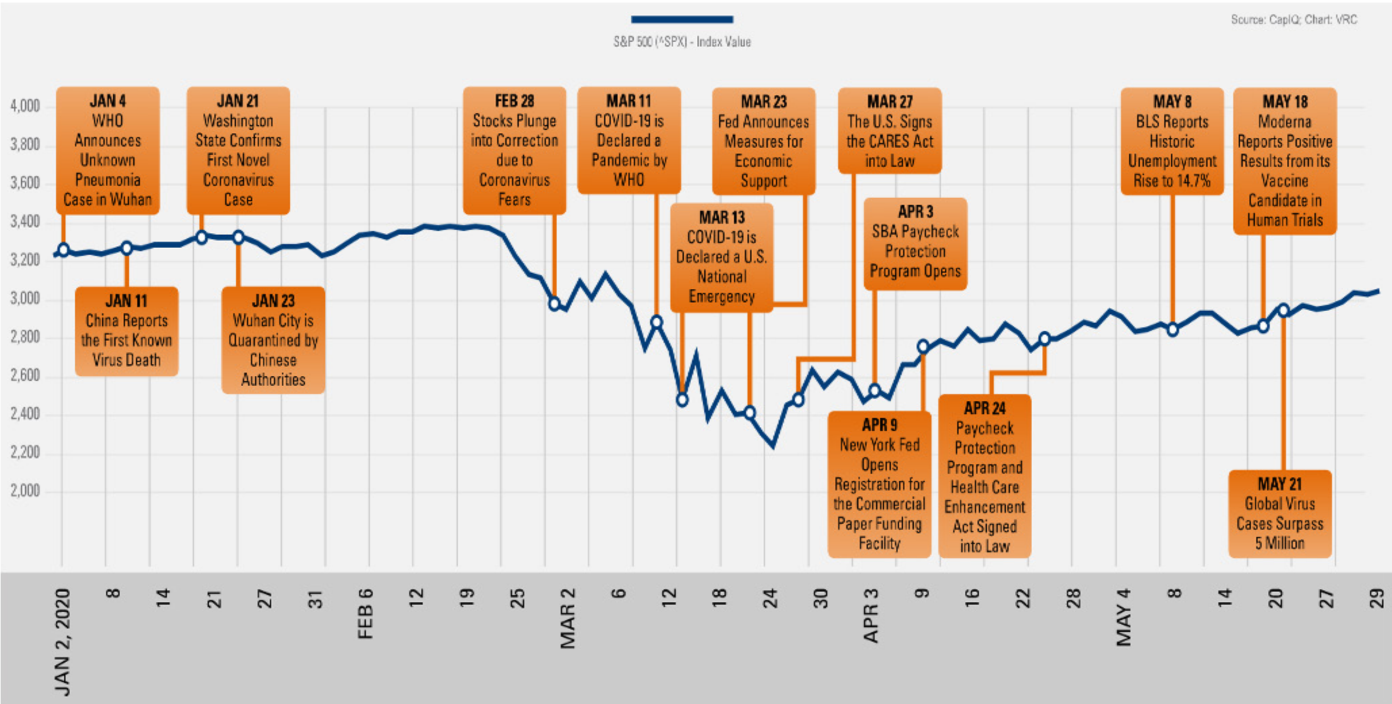
V. International Investments *(continued)*

Global Equities: 2020 Performance

International equity markets saw massive falls in March as the COVID-19 outbreak was declared an epidemic by WHO. The end of 2019 saw the first report of a new virus in Wuhan, China. Equity markets initially shrugged off concerns and rose to record highs in early February 2020. However, equities fell in March as the COVID-19 outbreak spread across the globe and situation became serious.

To stabilize the markets, U.S Federal Reserve and other central banks announced monetary easing while governments announced trillions in stimulus measures. These measures helped global equity markets make a swift recovery. The S&P 500 reached new highs in November as successful vaccine trials and approval by governments led to hopes of a swift recovery in economic activity and corporate earnings.

Exhibit: Timeline of the crisis from January to May 2020 and actions taken



Source: CapIQ

'Stay at home' stocks aided the initial recovery in global equity markets particularly the U.S with Zoom, Peloton, Docusign, Netflix, witnessing big gains. The 'big tech' stocks like Apple, Amazon, Netflix, Google, Facebook and Microsoft stocks also saw huge gains. Other areas of the market that reaped the benefits of this environment included Electric Vehicles (Tesla, Nio, Xpeng), clean energy (also a derivative of Biden presidency) and popular tech-related SPACs & IPOs (AirBnb, DoorDash, C3.ai, Snowflake, Palantir)

2021 Outlook: Opportunities

The S&P 500 and Dow Jones are expected to continue their gains in 2021. U.S Small caps are expected to flourish as investor psychology shifts and structural growth trends deviate from value to growth stocks. Besides Joe Biden's win and the prospect of increased fiscal stimulus due to Democrats capturing the Senate, is expected to aid small caps.

Emerging market equities would be beneficiaries of a global economic upswing in 2021 led by China. They can also benefit from flat-to-weaker U.S. dollar and more stable trade policies under a Biden administration. Chinese equities look attractive as its tech-orientation allows it to benefit from structural growth trends and its excellent handling of the pandemic has ensured its GDP did not contract in 2020 unlike other major economies.

V. International Investments

Challenges

The U.S. tech sector is expected to underperform the broader markets due to high valuations and prospects of more regulation. Slow roll out of COVID-19 vaccine leading to a delay in economic recovery and political unrest in the U.S. are other major challenges facing US equities.

European equities are constrained due to relatively high exposure to financials amid low rates. However, the ECB's handling of the pandemic so far and potential for 'catch-up' growth from a vaccine-led revival make them attractive. U.K's FTSE, which lagged behind other markets in 2020, is expected to rebound after a successful Brexit deal, provided the COVID-19 situation is brought under control.

Global Fixed Income: 2020 Performance

The decades-long bull market in bonds continued in 2020. Bond markets rose in the initial stages of the pandemic and the yields of U.S. 10-year treasuries fell below 1% bottoming at 0.52% in August. Yields rose steadily since then and rose above 1% in January 2021. Meanwhile, global high yield or 'junk' bond issuances soared to above USD 500billion as the Federal Reserve began purchasing corporate bond ETFs.

2021 Outlook

U.S Treasuries is expected to see muted returns in 2021 due to yield compression arising from low rates. However, Treasury Inflation-Protected Securities (T.I.P.S) have potential for gains due to higher inflation expectations on the back of structurally accommodative monetary policies and increasing production costs.

Challenges

Investment grade credit is expected to underperform, as there is little room for further yield spread compression. As the new Biden administration borrows more to fund the stimulus, inflation is expected to go up which is a negative for bonds.

Opportunities

Global high yield (junk) bonds remains an attractive source of income in a yield-starved world. Asia fixed income is another one to watch due to attractive valuations and due to the fact that Asian economies have done better at containing the virus and are further ahead in the economic restart. Uptick in inflation towards the Federal Reserve's target rate will have a positive residual effect on assets such as ILBs (inflation-linked bonds) and alternative storage of value away from the U.S dollar, such as gold, cryptocurrencies and foreign currencies.