MONTHLY INVESTMENT OVERVIEW

بنك الامارات للاستثمار

EMIRATES INVESTMENT BANK

Asset Class	View
Equities	Neutral
Fixed Income	Cautious
Real Estate	Neutral
Commodities	Neutral
Low Vol / Alternatives	Overweight
Cash	Favour

Overweight, Favour, Neutral, Cautious, Underweight

About Emirates Investment Bank

EIBank is a Dubai-based boutique dedicated to the service of an exclusive group of private and institutional clients. Private banking and investment banking needs are approached holistically.

In private banking, the bank prides itself on offering highly personalised investment solutions and one-on-one servicing by a professional team of wealth management specialists. EIBank's open platform provides clients with access to markets globally.

In investment banking, the bank provides clients with advice on mergers & acquisitions, access to capital markets and other corporate finance matters.

MONTH IN BRIEF

FEB 2017

- Signs of global stability and hopes for structural reforms in the US - individual and corporate tax cuts, expansionary fiscal policy and decreased banking regulation - kept global risk-appetite strong and contained volatility to relatively low levels, in spite of increased political risks.
- On the earnings front, with almost all of S&P500 companies reporting Q4 2016 results, the average earnings growth rate for the S&P500 came in at approximately 6.4% year-on-year (YoY), allowing the S&P500 to gain 3.7% in February.
- In Europe, despite anxiety over Eurosceptic presidential candidate Le Pen gaining popularity, France started 2017 on a solid footing with both businesses and households gaining momentum. The economy matched Germany's Q4 pace, growing at a respectable 0.4% in Q4.
- In the UK, the Parliament's Upper House voted for an amendment to force the government to guarantee protection of the rights of EU nationals living in the UK once the country officially leaves the EU. The bill will now be returned to the Lower House for deliberation, potentially delaying the Brexit process.
- Within emerging markets, investors are selectively starting to find value in equities, after several years of underperformance compared to their developed market peers.
- As for the MENA, investors are starting to eye Egypt again after a multi-year hiatus on the back of some meaningful structural reforms that allowed the country to seal a USD12 bn IMF loan in November. Meanwhile, an alternative equity market focusing on small and medium enterprises (SMEs) was launched in Saudi last month, which we believe is another step in the right direction.

MONTHLY INVESTMENT OVERVIEW

Despite elevated valuations by historical standards and the prospect of another rate hike as early as the 15th of March, US stock markets continued to scale new highs in February. The S&P500 gained 3.7% over the month and recorded its third consecutive monthly gain since the November 8th US elections, while the MSCI World delivered a total return of 2.8% in February alone and 5.3% year-to-date (YTD). Signs of global stability and hopes for structural reforms in the US - individual and corporate tax cuts, expansionary fiscal policy and decreased banking regulation - kept global risk-appetite strong and contained volatility to relatively low levels, in spite of increased political risks.

> "Bloomberg data on Fed fund futures implies a higher than 95% chance of a rate hike at the 15th of March FOMC meeting."

A stronger USD was a consensus view at the start of the year, albeit a crowded trade. The Fed was on course to raise rates at least twice in 2017, clearly diverging from other major central banks struggling with anaemic growth and subdued inflation. Politically too, the new Trump administration was set to unveil a fiscal stimulus to boost growth and reform tax policy to incentivise US firms to repatriate foreign earnings. Despite the odds heavily in favour of the USD at the start of the year, it retreated to hit twelve-week lows at the end of January on the back of political inconsistency and incoherence, in addition to the talk-down rhetoric of the Trump administration, which blamed a "too strong" USD for declining competitiveness of US companies against their Chinese and German peers.

However, by the end of February, the USD recovered some lost ground with the Dollar index recording a 1.6% monthly gain. Markets overlooked Trump's lack of policy details yet again in his first speech to Congress as President and shifted focus to hawkish commentary from Yellen as she expressed confidence over the prospects of the US economy. At the time of this writing, the onus of providing near-term market direction is at the Fed's doorstep with Bloomberg data on Fed fund futures implying a higher than 95% chance of a rate hike at the 15th of March FOMC meeting.

On the earnings front, with almost all of S&P500 companies reporting Q4 2016 results, the average earnings growth rate for the S&P500 came in at approximately 6.4% year-on-year (YoY). As per FactSet research, Q4 will mark the first time the index has seen YoY growth in earnings for two consecutive quarters since Q4 2014 and Q1 2015. Overall, we believe corporate tax cuts and banking deregulation have the potential to boost growth. However, fiscal stimulus may fall short of investor expectations as policy implementation risk remains high, while the possibility of more than two rate hikes this year continues to threaten the on-going reflation trade.

In Europe, despite anxiety over Eurosceptic presidential candidate Le Pen gaining popularity, France started 2017 on a solid footing with both businesses and households gaining momentum. The economy matched Germany's Q4 pace, growing at a respectable 0.4% in Q4. The French services sector, which accounts for more than three quarters of the economy, reported its best month in three years. On the back of this encouraging data, French-German government bond spreads tightened from multi-year highs hit on election-related concerns. Meanwhile, Germany posted a record budget surplus for 2016, reinforcing Trump's allegations that German firms unfairly benefit from a weak EUR and inviting fresh attention over whether it should do more to support the rest of the Eurozone fiscally.

MONTHLY INVESTMENT OVERVIEW

Overall, recent economic data suggest that the Eurozone's recovery continues to grind upwards. The Eurozone Composite PMI rose from January's 54.4 to 56.0 in February, close to a six-year high, underscoring a reflationary trend with inflation firming up. In February, headline Eurozone inflation, which is used by the ECB to set its monetary policy, accelerated to its highest level in four years, and hit the ECB's official target of 2.0% YoY. Despite the improving macro-economic climate, upcoming elections in Europe will likely side-track investor attention, sporadically weighing down on sentiment and the EUR.

"The IMF called Greece's debt burden unsustainable and urged some degree of debt forgiveness."

Meanwhile, in Greece, Eurogroup finance ministers are working with the IMF to finalize payment of the next tranche of the EUR 86 bn bailout package and meet a EUR7 bn debt repayment in July. A tentative deal reached earlier will have to be finalized with tough negotiations surrounding Greece's primary budget surplus, a widening of the tax base and labour market reforms. Earlier in February, the IMF called Greece's debt burden unsustainable and urged some degree of debt forgiveness. Unless an agreement is reached on the structural reforms to be implemented by Greece, the IMF will not join the Greek programme, undermining broad European Union (EU) political support for the bailout.

In the UK, the Parliament's Upper House voted for an amendment to force the government to guarantee protection of the rights of EU nationals living in the UK once the country officially leaves the EU. The bill will now be returned to the Lower House for deliberation, potentially delaying the Brexit process. Despite the setback, PM May insisted she is on course to trigger Article 50 at the end of March as envisaged earlier. Concerns about the nature of the UK's exit from the EU weighed on the GBP, which dropped 1.6% against USD in February, pushing the export-oriented FTSE100 to close to a record high. In Japan, the economy recorded a 1.2% growth on an annualized basis and 0.3% on a QoQ basis in Q4 2016, which came in slightly below consensus forecasts. The JPY, which fell close to 16% in Q4, spurred export and business investment gains. Despite soaring corporate profits and Japanese companies sitting on record cash piles, the average monthly pay for full-time employees came at JPY 304k (approximately USD 2.7k) in 2016, unchanged from the previous year and frustrating efforts by the government to push zero-bound inflation higher via wage increases. Meanwhile, Japan posted its first trade deficit in five months in January at about USD9.6 bn.

Within emerging markets, investors are selectively starting to find value in equities, after several years of underperformance compared to their developed market peers. In China, forex reserves fell for the seventh straight month in January to less than USD3 trillion, an almost six-year low, as the government continues to expend hard currency to support the CNY. The CNY fell almost 7.0% in 2016, but has stabilized so far this year around the 6.9 mark against the USD. The People's Bank of China (PBoC) attributed January's drop in reserves to its intervention in the foreign exchange markets and due to high foreign currency demand during the Lunar New Year holiday, which began in late January. With the Fed likely to hike rates in March, downward pressure on the CNY could resurface, potentially stoking capital outflows and derailing the stabilizing macro environment. Meanwhile, in Brazil, the Central Bank cut its benchmark rate by 75 bps to 12.25%, its lowest since March 2015. Although the Central Bank of Brazil (CBB) acknowledged stabilization in recent economic indicators, its statement remained fairly dovish, effectively leaving the door open for further rate cuts.

MONTHLY INVESTMENT OVERVIEW

In India, the Reserve Bank of India (RBI) surprisingly kept its key lending rate unchanged at a six-year low of 6.25%, citing elevated inflation expectations because of rising energy prices and a mild firming of global demand. The Bank is also wary of the impact on the INR of the imminent tightening monetary cycle in the US, while it awaits clarity on the impact of the cash clampdown in November 2016. Moreover, a report by India's statistics ministry stated the economy grew by an annualized 7.0% rate in the last quarter of 2016, only 0.4% slower than the previous quarter, while the February services PMI indicated that India's service sector grew for the first time in four months, adding to signs that the economy is bouncing back from the negative impact on growth from the cash clampdown.

> "US Shale oil production may delay but not derail the on-going "rebalancing" process in the energy markets."

As for the MENA, after allowing the EGP to float last year as it grappled with an economic slowdown and hard currency shortage, the Egyptian government also decided to increase VAT and slash energy subsidies to seal a USD12 bn IMF package in November. On the back of these meaningful structural reforms, investor interest has returned to the country. The EGP rose about 9% YTD against the USD, as the government continues to increase its resources of hard cash. Meanwhile, the Central Bank left its key interest rate unchanged at 14.75%, as the core CPI rate temporarily soared to 31% YoY in January, citing a rebounding currency and weak consumer demand.

Meanwhile, the Saudi market (Tadawul) launched an alternative equity market, "Nomu-Parallel market" with less stringent listing requirements compared to the main market, to enable small and medium enterprises (SMEs) to gain access to efficient equity capital. We believe this is a step in the right direction as the country tries to deepen its stock market through a reform process that should allow a larger section of smaller companies enhance their visibility and contribute to the overall development of the real economy.

As far as oil is concerned, US crude oil production rose close to a twelve-month high, with producers pumping nearly 9 million barrels per day. Despite faster-than-anticipated US shale resurgence, supply cuts from OPEC and other major oil producers continue to have an impact on oil fundamentals. OPEC's 90% compliance rates have meant that any increase in US Shale oil production may delay but not derail the on-going "rebalancing" process. Further gains in the price of oil would depend on the level of adherence by oil exporters.

Asset Class Views

Asset Class	January	February	View / Rationale
Equities	↔	↔	
US	↔	↔	A 6.4% earnings growth rate for S&P 500 companies in Q4 supports elevated valuations.
Europe	↔	↔	An improving macro backdrop with upcoming elections sporadically side-tracking investor attention away from the positive developments.
UK	↘	↘	Parliamentary logjam over Brexit shouldn't delay triggering of Article 50 by much; weaker GBP should continue to support Brexit negotiation shocks.
Japan	↗	↗	Structural reforms are starting to be introduced with the loosening of permanent residency regulation, as Japan looks to attract/retain high-skilled labour.
China	↔	↔	Stabilization in PMIs indicates China gradually shifts towards a more sustainable footing.
India	↔	↔	Positive effects of demonetization in the medium/long term but is having an adverse short term impact.
Brazil	↘	↘	Another 75bps interest rate cut in February confirmed the Brazilian authorities' desire to revive the economy.
Russia	↔	↔	A potentially better relationship with the US, stable oil prices and currency should help economic growth after two years of deep recession.
MENA	↘	↘	Investors are starting to eye Egypt again after a multi-year hiatus.
Asset Class	**January**	**February**	**View / Rationale**
Fixed Income	↘	↘	
US	↔	↔	March rate hike certainty alongside a strong jobs report continues to raise interest rate risk.
Europe	↘	↘	ECB to remain dovish till election uncertainty is out of the way; core inflation remains benign despite spike in headline figures.
UK	↘	↘	Parliamentary logjam shouldn't delay triggering of Article 50 significantly.
Japan	↘	↘	BoJ remains accommodative for the foreseeable future.
China	↔	↔	Sovereign debt yields are attractive but selectivity remains key.
India	↔	↔	The Reserve Bank of India changed its stance to neutral, from accommodative, as it held rates steady in February.
Brazil	↔	↔	Another 75bps interest rate cut in February continues to highlight the desire to revive the economy by the Brazilian authorities.
Russia	↔	↔	Economics are stabilizing after two years of deep recession.
MENA	↔	↔	Risk-adjusted credit metrics continue to be attractive relative to fixed-income elsewhere.

↑ Overweight, ↗ Favour, ↔ Neutral, ↘ Cautious, ↓ Underweight

Asset Class Views

Asset Class	January	February	View / Rationale *
Currencies	NM	NM	
USD / EUR	↗	↗	March rate hike certainty has raised prospect of three rate hikes in 2017; USD strength may still cap Fed's 2017 rate increases to two.
USD / CHF	↗	↗	March rate hike certainty has raised prospect of three rate hikes in 2017; USD strength may still cap Fed's 2017 rate increases to two.
USD / GBP	↗	↗	Parliamentary logjam shouldn't delay triggering of Article 50 by much.
USD / JPY	↗	↗	Continue to Favour the USD in light of BoJ's resolve to revive inflation via devaluation.
EUR / CHF	↘	↘	The CHF remains the safer bet until the eventual tapering of the ECB bond purchase program later this year/beginning of 2018.
EUR / GBP	↔	↗	Favour the EUR over the GBP due to less political and economic uncertainty.
EUR / JPY	↗	↗	Favour the EUR over the JPY as the EUR has more room to strengthen.
CHF / GBP	↔	↔	GBP may pose more upside potential but not without potential associated risks.
CHF / JPY	↗	↗	Favour the CHF over the JPY but the risk/return payoff is not as attractive as before.
GBP / JPY	↑	↑	GBP has more room to strengthen against the JPY.

* Reference currency is the USD

↑ Overweight, ↗ Favour, ↔ Neutral, ↘ Cautious, ↓ Underweight

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