Monthly Review, Asset Allocation & Outlook

October 2023

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Highlights of the Month

- Risk assets witnessed a steep decline due to rise in 10-year US treasury real yield and geopolitical escalations
- Stronger than expected economic data in US and increased supply of treasuries drove higher the long end rates
- MSCI All Country World Index and MSCI EM Index fell 3.1% and 3.9%, respectively
- Barclays EM Aggregate Index fell 1.5% from widening spreads as 10-year yields flirted with 5%+ levels
- UST 2YR rose 4bps to 5.1%, while UST 10YR added 36bps to 4.9%, inversion further improved to -16bps
- Gold rallied 7.3% on its safe haven appeal
- MENA equities fell with S&P Pan Arab Composite Large Mid Cap Index down 4.3%
- We are overweight on fixed income and neutral on equities

Global Review

Global Equities: Equities witnessed their third consecutive month of decline on a sharp rise in bond yields and increase in geopolitical risk. MSCI All Country World Index dropped 3.1% MoM%. US 10-year and 30-year Treasury yields rose 36bps and 39bps to end the month at 4.93% and 5.09%, respectively. US 10-year real yield rose 28bps to end the month at 2.52%. Stronger than expected macroeconomic data reinforcing higher for longer rates expectation, increased supply of US treasuries on widening US government fiscal deficit and a continued quantitative tightening by the Fed were behind a sharp rise in the treasury yields. Yield curve steepened further with 10-2 spread rising 32bps to end the month at -16bps. The Fed's balance sheet fell below the $8 trillion threshold for the first time since mid-2021. Despite the rise in yields growth outperformed value with MSCI All Country World Growth Index falling 2.6% versus a fall of 3.6% for the Value Index. Global high yield credit spreads also widened 40bps to reach 5.21%.

Both Developed markets (DM) and emerging markets (EM) closed the month down with MSCI World Index dropping 3% and MSCI EM Index falling 3.9%. MSCI EM underperformed as key markets such as China Korea and Brazil dropping sharply. S&P 500 Index closed the month down declining 2.2%. The sell-off was broad with all sectors declining except for utilities. Energy, consumer discretionary and materials were the worst performing sectors, falling 6.1%, 4.5% and 3.2%, respectively.

The US 3Q 2023 real GDP expanded at an annualized rate of 4.9% above the consensus expectation of 4.3% growth and above 2Q growth of 2.1%. Consumer spending was the key driver behind the strong expansion in the GDP. Building of inventories also pushed the GDP higher. CPI increased 0.4% MoM and 3.7% YoY in September below expectation of 0.3% and 3.6%, respectively. As a comparison CPI rose 0.6% MoM and 3.7% YoY in August. Shelter prices were the key contributor to the CPI jumping 0.6% MoM.

Energy costs rose 1.5% MoM and food prices rose 0.2% MoM. New vehicle prices rose 0.3% and used vehicle prices were down 2.5%. Core CPI rose 0.3% MoM and 4.1% YoY, both data points came in line with expectations. As a comparison core CPI rose 0.3% MoM and 4.3% YoY in August. Super core inflation (Core CPI services less housing) increased 0.6% MoM. Core PCE Fed's preferred inflation gauge rose 0.3% MoM and 3.7% YoY; both measures were inline with the expectations.

US retail sales advanced 0.7% MoM in September vs 0.3% expected. US non-farm payrolls increased 336,000 in September significantly above consensus expectation of 170,000. Average hourly earnings increased 0.2% for the month and 4.2% from a year ago. Both were below the respective forecasts of 0.3% and 4.3%. Labor force participation and unemployment rate remained unchanged at 62.8% and 3.8%, respectively. Housing data was mixed in September as new home sales and housing starts rose 12.3% and 7%, respectively, while existing home sales and building permits fell 2% and 4.5%, respectively. Job openings increased totaling 9.61 million in August, a jump of nearly 700,000 from July. Consumer confidence fell to 102.6 in October, the lowest level since May 2023.

European equities fell with MSCI Europe ex-UK Index dropping 3.5%, a third consecutive month of decline on weakening economic growth and declining consumer confidence. Euro Zone October Manufacturing PMI continued to remain in contraction from last 16 months reaching 43 level and economic sentiment (93.3) remained at a 3-year low.

Services PMI fell to 47.8. European Central Bank maintained rates at 4% amid weakening inflation and slowing down economic growth. Eurozone CPI fell to 2.9% in October from 4.3% in September. UK equities fell with FTSE 100 Index dropping 3.8% on declining consumer confidence and fall in MoM retail sales. UK inflation remained unchanged at 6.7% in September. Core CPI fell to 6.1% from 6.2% in August. Wage growth continued to remain strong at 8.3% YoY in August, running above the inflation rate thereby keeping the higher for longer narrative intact.

Fixed Income: *Uneven consumer and wage inflation convey US economy in soft landing despite a robust GDP print from resilient consumer.* Core CPI was 0.30% m-o-m and 3.9% y-o-y as inflation momentum accelerated, as goods continue to see disinflation while rents stalled, and services inched up. Wages grew softly at 0.2% m-o-m while Q3 GDP rebounded strongly to 4.9% from 2.1% the prior quarter from consumer spending. It seems that an inverted yield curve, tightening credit conditions, contraction in temporary service jobs, and consumer under pressure from resumption in student debt payments was not enough to upend resilient consumption and drive economy into recession.

US hiring surges in October although may not be enough to justify another rate hike by year end. US September jobs reported earlier in October accelerated to +336,000 while hourly wages softened +0.2% m-o-m and unemployment rate remained steady at 3.8%. Job openings surprisingly rose +8.9% to 9.6mn in August after three consecutive declines, while the quit rate remained relatively unchanged at 2.3%, suggesting the labor market tightness remains, albeit softening. Downside risks include effects from possible labor strikes and postponed government shutdowns as Washington enters a presidential election year in 2024 and expects the Fed to seek confirmation of stronger trend before taking a stance towards another hike not done since last July's meeting.

Resilient Consumer Drives Robust Spending and Helps Stabilize Manufacturing. US personal spending rises to 0.7% in September while personal income edges lower to 0.3% m-o-m as core PCE deflator drop to 3.7% y-o-y. Advance retail sales grew +0.6% m-o-m in September ex-auto and gas from +0.3% the prior month, helping to shore up manufacturing with factory orders +1.2% in August. We believe US economic resiliency remains narrow based, championed by the consumer which faces rising gasoline prices, dwindling savings, rising credit card debts, resumption in student loan repayments, and softening job prospects.

US Fed Delivered Another Pause as Markets Virtually Eliminated December Hike. Fed met November 1st and unanimously held policy rates at current 5.0% - 5.25% and withheld guiding for another imminent hike, despite stronger data, pushing market expectations for a 20% probability of December hike. It seems the Fed is willing to be patient to determine the effects of stronger macro data and tighter financial conditions, driven by higher long-term yields, recognizing restrictive policy's effects on activity and inflation. While the Fed has been pleased with the progress on softening labor, and moderating inflation, we note the upside risks from labor disruptions, rising oil/commodities and food prices, which could drive additional volatility. A premature pivot lower or an additional hike can have detrimental effect on current soft-landing environment and as such warrants caution by Fed to assess the full effects of previous hikes.

From Hawkish Hold to Dovish Pause while Return of Term Premium Continues to Normalize Inversion. US 2YR yields edged +4bp higher to 5.09%, anchored as policy remains on hold, while US 10YR rose +36bps to 4.93%, earlier breaching 5% levels, as market priced a higher for longer Fed stance coupled with weakening US fiscal fundamentals, surge in coupon treasury supply, and reassessment of long-run equilibrium rates. As time passes and Fed remains on pause, expect to see the dis-inversion continue as the market still partially prices rate hike in short term, while the Fed sees tighter financial conditions weighing on economic activity. The recent bear steepening in the yield curve reflects the upgrade in growth expectations in addition to credit downgrade, announced USD 1trn treasury supply, short positioning, and ramifications from policy changes in Japan / China, feeding into the bearish narrative on longer end as short-end stalls with more dovish Fed guidance.

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Stronger Data, Higher for Longer, and Weaker Government Finances Biased Rates Higher While Weaker Sentiment Driven by Geopolitical Tensions Widened Spreads. Rout in fixed income carried into October as higher rates and widening spreads hurt broad based bond returns spanning government, investment grade, high yield, and emerging markets. Sentiment had soured following the October conflict in Middle East, with outflows in riskier debt seeing refuge in typical safe havens including USD and gold.

EM Bond Index Nearly Wipes Year-To-Date Gains as Longer End Rises and Risk Aversion Returns. Barclays Emerging Markets Aggregate Index (EMUSTRUU Index) fell –1.48% m-o-m and into negative YTD territory 0.58%, to yield 8.37% (OAS up 17bps m-o-m +336bps) as US benchmark rates rose, risk sentiment weakened, and rate volatility spiked. Barclays EM GCC Credit Index followed suit, declining –1.87% m-o-m as OAS spreads widened +16bps to 126bps to yield 6.25%.

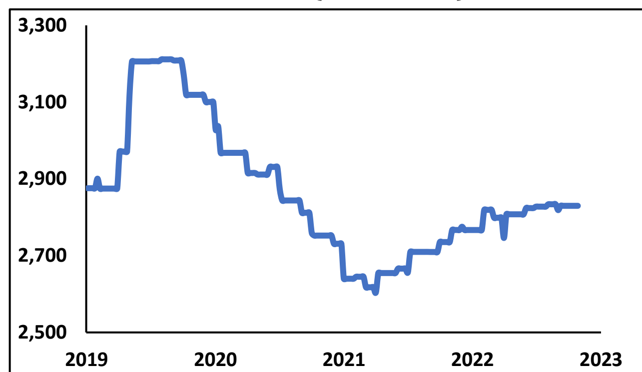
EM Equities: MSCI EM Index fell 3.9% in October. MSCI LATAM, Asia and EMEA fell by 5.0%, 4.0% and 3.0% respectively. IT heavy MSCI Korea fell by 7.0% during the month, on a strengthening USD, rising yields and risk off sentiment. MSCI China pulled back 4.4% due to a continued outflow of foreign funds amid persistent disappointing economic data. Exports fell for a sixth consecutive month while the country slipped back into deflation as consumer prices fell 0.2% and factory-gate costs declined 2.6%.

Commodities: Oil: Brent oil closed at USD 87.4/bbl, down 8.3% MoM. Oil rallied initially on the back of heightened geopolitical tensions but gave up the war risk premium by the end of the month. Moreover, demand concerns continued to offset supply cuts by OPEC+. **Natural gas**: Henry hub prices rose by 22.1% MoM to reach USD 3.6/mmbtu, as traders assessed demand outlook with winter approaching.

Petchems: SE Asia LLDPE, LDPE, PP and HDPE fell by 3.9%, 2.8%, 2.5% and 1.9% respectively. SE Asia MEG was flat MoM.

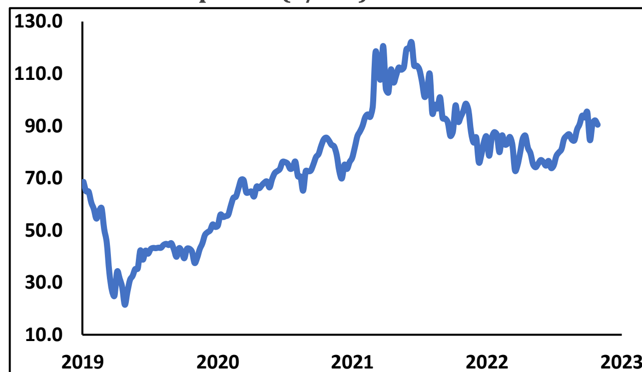
Metals: Aluminum, nickle and copper fell by 3.9%, 2.9%, and 2.2% MoM, respectively on demand worries from China. **Precious metals**: Gold prices rose by 7.3% as investors rushed to the safe haven due to geopolitical tensions.

OECD crude inventories (mn barrels)



Source: Bloomberg, Daman Investments

Brent crude oil prices ($/bbl)



Source: Bloomberg, Daman Investments

Currencies: EM currencies (MSCI EM Currency Index) rose by 0.1%, while the US Dollar (DXY Index) rose by 0.5%. The Russian Ruble (+4.5%) and Polish Zloty (+3.9%) were the best performing EM currencies. The Mexican Peso (-3.5%) and Turkish Lira (-3.1%) were the worst performing ones.

Given our expectation of a slowdown in global economic growth, we continue to avoid exposure to base metals. We remain cautious on petrochemicals due to a slowdown in the global economy. We expect Brent oil price to average $85/bbl in Q4 2023. With peak demand behind us due to the travel season ending, we expect prices to remain volatile due to geopolitics, interest rates hikes and global growth uncertainties. However OPEC has put a floor on Brent crude oil prices around $75/bbl due to its voluntary production cuts.

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MENA Equities: Regional markets plunged during the month of October on the back of rising treasury yields and heightened geopolitical tensions, with the S&P Pan Arab Composite Large Mid Cap Index falling 4.3%. Within the GCC, the Qatar Exchange Index was the worst hit, sinking by 7.1%, followed by the DFMGI which was down 6.9% and the Boursa Kuwait All Share Index which dropped 5.2%. The FTSE ADX General Index tumbled 4.5% while Saudi's Tadawul All Share Index fell by 3.3%. Regionally, Egypt's EGX30 Index and Pakistan's KSE 100 Index outperformed, rising by 11.8% and 12.4% respectively, while Turkey's XU100 Index underperformed, dropping by 9.8%.

In the UAE, banks posted a good set of results for Q3, with NIMs widening, loan book growing and provisioning under control. In Dubai, ENBD's reported Q3 earnings were up 38% YoY. NIMs rose to 4.08%, growing by 21bps QoQ, mainly due to DenizBank, while loan growth was 3% QoQ, taking YTD growth to 8%. CASA fell to 63% while provisioning stood at 45bps for the quarter. We continue to like the name given its exposure to Dubai's growth story, improving RoE, and attractive valuation, given that the stock trades at 1.2x P/B. A return to orthodox policymaking in Turkey provides further comfort, given that 20% of the loan book is exposed to Turkey. DIB's Q3 earnings were up 20% YoY, on the back of widening NIMs (+4bps QoQ), strong loan growth (+5% QoQ), and improved non-interest income.

In Abu Dhabi, FAB's Q3 earnings grew 46% YoY due to wider NIMs (+5bps QoQ), robust non-interest income and lower provisioning (46bps). The bank's management was cautiously optimistic on loan growth, given elevated repayments by GREs. ADCB's earnings grew 22% YoY on the back of improved NIMs (+11bps QoQ) and solid loan growth (+4.5% QoQ).

In Saudi, Rajhi recorded stronger NIMs (+7bps QoQ) during Q3, loan growth picked up (+2% QoQ), cost discipline remained strong (flat Opex YoY), provisioning continued to be low (CoR of 26bps) while credit quality was stable (NPLs at 0.6%). We like Al Rajhi Bank as we believe its RoE and NIMs will continue to trend upwards as it benefits from delayed asset and from stable/declining cost of funding moving forward. Moreover, macro indicators, including consumption spending (less on goods, more on services), unemployment rates (8.3% among Saudis) and female labor force participation (c.40%) are all favorable for retail loan growth.

We also like SNB, who recorded stronger NIMs (+5bps QoQ) during Q3, which compensated for lower-than-expected non-interest income. Loan growth picked up (+3% QoQ), and provisioning was negative (CoR of-5bps) due to net recoveries. SNB's balanced loan book exposure between corporate and retail means the bank is well positioned to benefit from mega projects linked to Saudi Vision 2030, as well as retail growth associated with personal loans and mortgages.

In Qatar, QNB recorded a solid improvement in its NIMs, good growth in non-interest income (mainly Turkey), while loan growth was muted. In Kuwait, NBK's earnings were up 14% YoY due to better net interest income and a decline in provisioning.

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Major Indices Performance

Major Indices Performance	Value	MTD Return	YTD Return	PE (x) 1Yr Fwd	PB (x) 1Yr Fwd	Div. Yield 1Yr Fwd
Saudi Arabia - TASI	10,690	-3.3%	2.0%	17.5	2.2	3.8%
Dubai - DFMGI	3,877	-6.9%	16.2%	8.4	1.2	4.7%
Abu Dhabi - FADGI	9,344	-4.5%	-8.5%	17.9	2.3	3.3%
Qatar - DSM	9,524	-7.1%	-10.8%	11.9	1.4	4.7%
Kuwait - All Share	6,532	-5.2%	-10.4%	14.1	0.5	4.5%
Oman - MSM30	4,545	-2.8%	-6.4%	7.5	0.7	4.9%
Bahrain - BHSEASI	1,929	-0.5%	1.8%	8.1	0.7	6.6%
Egypt - EGX30	22,551	11.8%	54.5%	8.5	2.4	3.9%
Morocco - MOSENEW	12,022	1.3%	12.1%	18.3	2.2	3.7%
S&P Pan Arab Composite	150	-4.3%	-6.0%	14.3	1.8	3.9%
Israel - TA35	1,647	-10.7%	-8.4%	7.7	1.4	3.1%
Turkey - XU100	7,514	-9.8%	36.4%	5.4	1.9	2.8%
Pakistan - KSE100	51,976	12.4%	28.6%	4.4	0.8	10.3%
S&P 500	4,194	-2.2%	9.2%	20.3	4.0	1.6%
STOXX 600	434	-3.7%	2.1%	12.5	1.7	3.7%
MSCI EM	915	-3.9%	-4.3%	13.4	1.5	3.2%
MSCI All Country World	637	-3.1%	5.2%	17.1	2.6	2.2%
MSCI World	2,769	-3.0%	6.4%	17.7	2.8	2.1%

Major Indices Performance	Value	MTD Change	YTD Change
Barclays GCC Credit +HY Index	166	-1.9%	-2.4%
FTSE MENA Broad Bond Index	149	-2.3%	-3.8%
Dow Jones Sukuk	94	-1.2%	-3.0%
Barclays Global Aggregate Index	431	-1.2%	-3.4%
Barclays Global High Yield Index	1,389	-0.9%	4.1%
Barclays US Treasury Index	2,129	-1.2%	-2.7%
Barclays US Corporate Index	2,913	-1.9%	-1.9%
Barclays US Corporate High Yield index	2,287	-1.2%	4.6%
JPM EM Global Bond Index	511	-1.5%	-0.5%
Bloomberg Barclays Emerging Markets Hard Currency Aggregate Index	1,067	-1.48%	-0.6%
Bloomberg Barclays US Aggregate Bond Index	1,992	-1.6%	-2.8%
Markit CDX Emerging Markets Index	95	0.0%	0.4%
Barclays EM High yield	1,259	-0.9%	2.2%
Barclays EM Corporate Index	259	-1.7%	-0.8%
10-year US Treasury yield* (%)	4.93	36	106
30-year US Treasury yield* (%)	5.09	39	113
US Treasury 2-10 Spread*	-16.08	32	40
US Treasury 2-30 Spread*	0.16	35	47
10-year US Treasury Real yield* (%)	2.52	28	94
10-year Germany Treasury yield* (%)	2.81	-3	24
US Breakeven 10 Year*	2.42	8	12
10-year Saudi Arabia Govt USD Bond yield* (%)	5.79	30	104
8-year Abu Dhabi Govt USD Bond yield* (%)	5.34	33	110
4-year Kuwait Govt USD Bond yield* (%)	5.20	12	159
9-year Oman Govt USD Bond yield* (%)	6.78	27	61
10-year Bahrain Govt USD Bond yield* (%)	8.06	60	69
7-year Qatar Govt USD Bond yield* (%)	5.39	41	101
10-year Egypt Govt USD Bond yield* (%)	16.65	22	448
EIBOR 3M* (%)	5.45	16	114
QAIBOR 3M* (%)	6.00	0	72
Dubai 5 Year CDS* (bps)	43	4	-5
Qatar 5 Year CDS* (bps)	58	20	10
2-year US Treasury yield* (%)	5.09	4	66

Source: Bloomberg, Daman Investments AssetManagement *Note: *In basis points*

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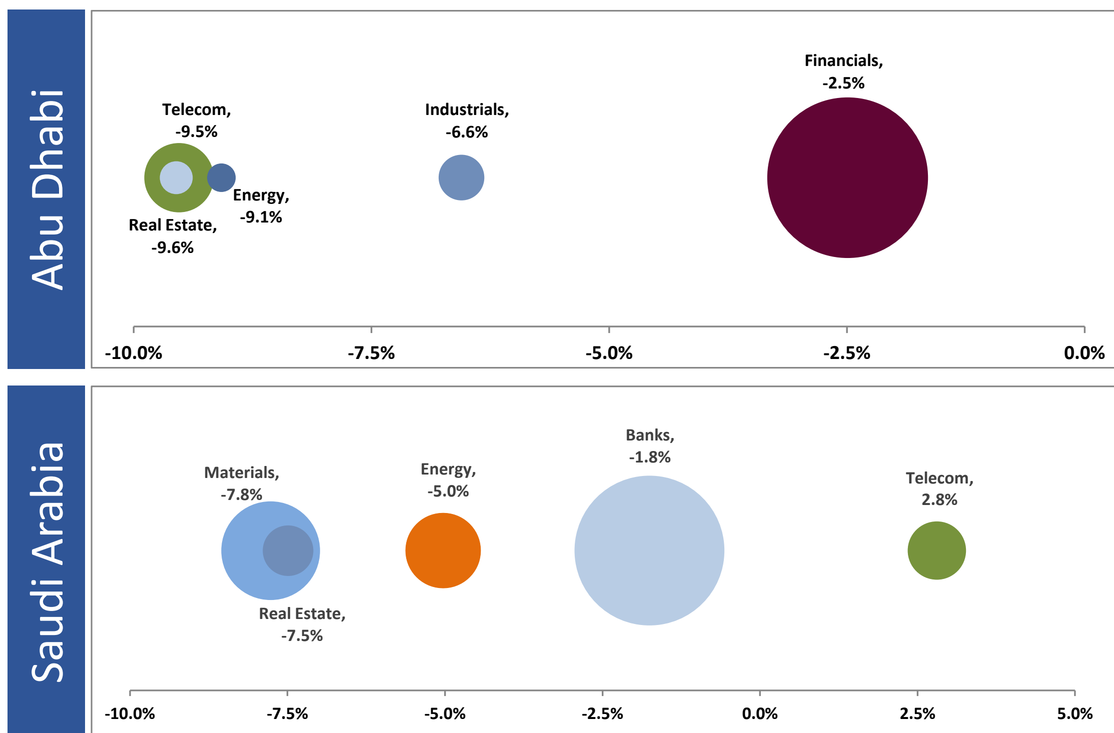
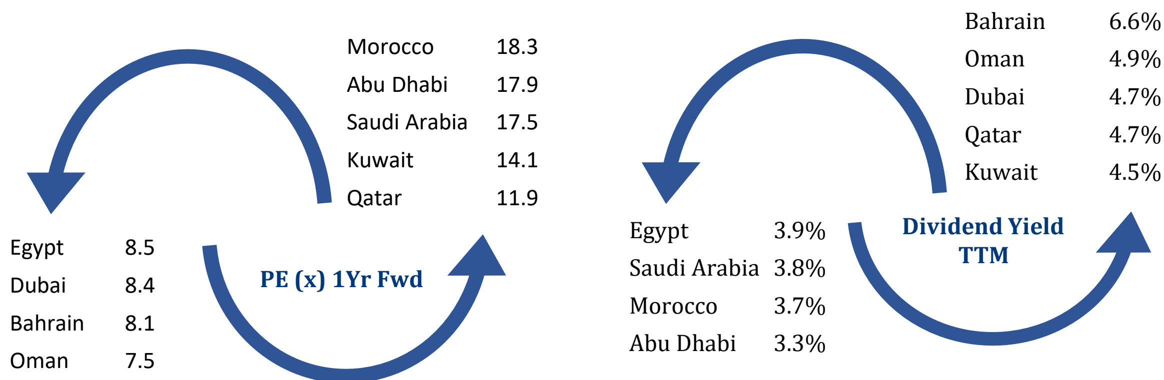
Sectors Performance of Key MENA Indices (MoM Change)



Source: Bloomberg, Daman Investments Asset Management - Note: Size of the bubbles represent weight of the sectors in the respective index

MENA Valuations



Source: Bloomberg, Daman Investments Asset Management

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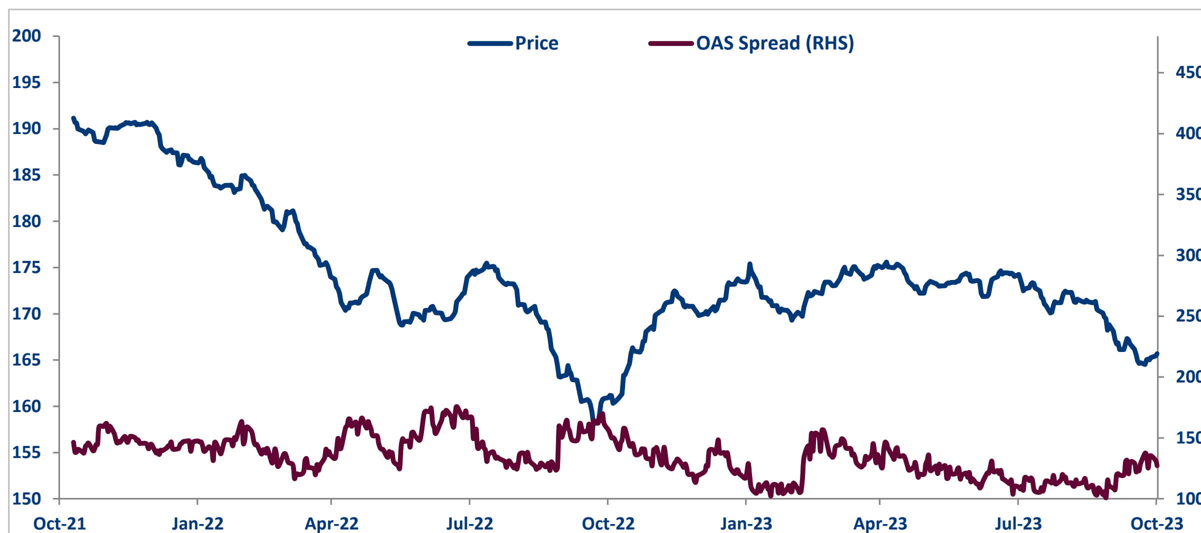
Barclays GCC Credit +HY Index



Source: Bloomberg, Daman Investments Asset Management

Major Commodities and Currencies

Performance

	Value	MTD Change	YTD Change
Brent crude oil (USD/bbl)	87.41	-8.3%	1.7%
Natural Gas (USD/mmbtu)	3.58	22.1%	-20.1%
Gold (USD/Ounce)	1,984	7.3%	8.8%
Copper (USD/MT)	8,029	-2.2%	-4.0%
Aluminium (USD/MT)	2,240	-3.9%	-4.7%
Nickel (USD/MT)	17,903	-2.9%	-40.1%
Urea Middle East (USD/MT)	386	0.8%	-19.7%
Methanol China (USD/MT)	277	-1.4%	-9.5%
SE Asia Polyethylene (USD/MT)	1,030	-1.9%	1.0%
Polypropylene (USD/MT)	975	-2.5%	-1.5%
US Dollar Index	106.66	0.5%	3.0%
MSCI EM Currency index	1,671.08	0.1%	0.6%
JPM EM Currency index	46.95	-0.2%	-5.9%
EGP/USD	0.03	0.0%	-19.8%
TRY/USD	0.035	-3.1%	-33.9%
PKR/USD	0.356	2.4%	-19.4%
ILS/USD	0.247	-5.6%	-13.0%
EUR/USD	1.06	0.0%	-1.2%
GBP/USD	1.22	-0.4%	0.6%
USD/JPY	151.68	1.5%	15.7%

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Global Asset Allocation and Outlook

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Global Asset Allocation and Outlook

Post a correction over the last 3 months, risk assets witnessed a strong rally during the first week of November, on a decline in bond yields. 10-year US treasury yield fell almost 40bps to reach 4.6% on a goldilocks job report, Fed sounding dovish as Powell talked about proceeding carefully and US treasury indicating relatively more issuances of shorted dated paper. October payrolls came in at 150k, below the estimate of 180k, thereby reflecting a cooling labor market and at the same time not signaling recessionary concerns. We believe in the near-term long-term US treasury yields will remain volatile as any stronger than expected inflation data would cause volatility in yields as this could strengthen the probability of a rate hike in December and push further the start of the rate cut (currently expected in June 2024). We will also watch for consumer confidence and wage growth to understand the strength of the US consumer. Inflation and consumer confidence are important data points to get a view on whether we can get a soft landing.

Despite the near-term uncertainty, we continue to remain invested, however, advocate maintaining a preference towards names with strong balance sheets, low leverages and highly visible near-term cash flows. We continue to maintain an overweight on fixed income as we see yields and rates close to a peak and the **current high yields present an attractive opportunity to lock in returns** in names where we expect the credit quality to remain strong and cash flows to remain resilient.

Also fixed income valuation remains quite attractive vs equities as differential between global equities' earnings yield (E/P) and global bond yield are below their historical average by 2 standard deviations. For us to be more constructive on equities we need to see further evidence of the soft landing in next couple of month data points, as this will strengthen the case for earnings growth in 2024, as current real yields of 2.3% act as a valuation cap on equities if earnings do not rebound.

Asset Allocation

	Underweight	Neutral	Overweight
By Asset class:			
Equities		■	
Fixed Income			■
Alternatives		■	
Cash	■		
Equities - by region:			
DM	■		
US		■	
Japan			■
Euro Area	■		
EM			■
EM Asia			■
EM Europe	■		
EM MENA			■
EM LatAm		■	
Fixed Income - by region:			
South Asia			■
Far East Asia		■	
Latin America			■
GCC		■	
Africa	■		
Eastern Europe	■		
Central Europe	■		
Fixed Income - Rates vs Spreads:			
Rates			■
Spreads		■	
Fixed Income - Credit:			
Global Investment Grade		■	
Global High Yield		■	

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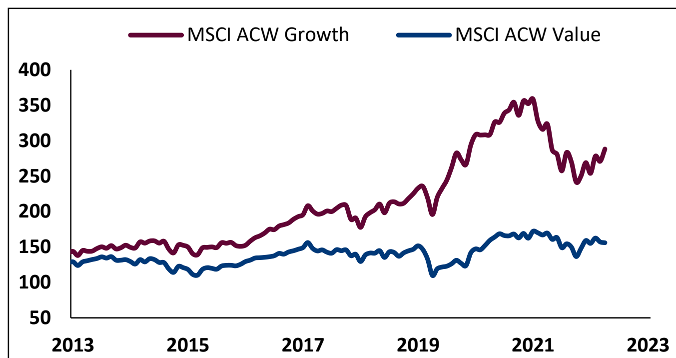
Global Asset Allocation and Outlook

Global Equites: In equities, we believe a proper bottom-up analysis is important to own **quality stocks with strong pricing power, solid balance sheets, high free cash flows and low leverage** to protect from market volatility. We avoid long duration technology names on a weaker cash flow profile. We see a diversified portfolio with a dividend yield cushion to be better equipped to face market volatility.

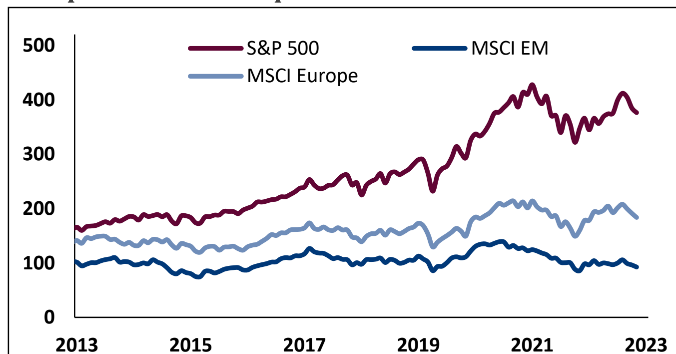
We maintain **equal weight on the US and underweight on Europe.** We see the US economy as holding up better than Europe in the current restrictive rate environment and the core inflation is much lower than Europe, which creates a bar much lower for the fed to stop hiking. **We prefer value and cyclical sectors in US as they trade at an attractive valuation vs the growth sectors.** Only selective technology and communication services names offer value at current levels. We **remain overweight on Japan** given the start of a strong capex cycle - driven by both domestic and foreign driven investment, and expectation of a strong corporate profit growth.

MSCI All Country World Value vs Growth



Source: Bloomberg, Daman Investments

Europe and EM underperformance vs US



Source: Bloomberg, Daman Investments

We stay overweight on EMs as EM economic growth trends are diverging from the DM and there are strong structural domestically driven economic growth stories such as India, Indonesia and Brazil. MSCI EM index is trading at a 25% discount to MSCI World Index on a forward PE basis vs a long-term average discount of 25%, despite EM economies having better growth prospects than DM. **Within Asia we prefer an exposure to India and Indonesia**. Chinese market price in a lot of negativities and can surprise on the upside if the stimulus measure can be sizeable and boost the property market and consumer spending. We remain overweight on India as a strong consumer spending is leading to start of a new capex cycle due to the companies reaching optimum capacity utilizations. This would lead to a strong pickup in credit growth along with a benign asset quality environment.

We remain **neutral on Korea and Taiwan** post a strong rally YTD. Within Latam we like Mexico as the country is a key beneficiary of the near shoring theme. We also like Brazil as the central bank is well placed to continue with a rate cut cycle, which it started last week, due to declining inflation which would benefit the consumer and cyclical plays. We stay **overweight on MENA** on OPEC+ managing the oil over supply risks given global macro concerns, and we continue to see strong bottom-up stock picking opportunities on structural growth driven by economic diversification. MENA markets trade at a 6.5% premium to EM which is below the long-term average of 10%. Recent correction in Saudi and UAE equities has exposed value in certain names which continue to report strong earnings growth and non-oil GDP growth for both the countries will remain strong at north of 4%.

Global Fixed Income: With cash and short rates yielding c.5%+, investors are content with their high nominal yields without assuming undue credit, term, and EM risks under the current challenging backdrop. While there is the issue of reinvestment risk, the lack of visibility on the eventual turn in monetary cycle can continue to displease investors that are sizeably long duration and should bias demand towards cash, MMFs, and short treasuries at expense of longer/riskier parts of fixed income. As term premium rises to compensate for duration and as curve inversion eases, expect to see improved positioning in longer-end in Treasuries, while credit and EM should remain at mercy of global risk appetite and liquidity movements.

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Global Asset Allocation and Outlook

Maturing Economic and Monetary Cycle Brings Spread Volatility. History shows that economic data is favourable towards the end of an economic cycle when credit spreads tighten. While monetary policy should accommodate a sizeable growth slowdown, spreads typically rise on rising credit risks, partially mitigated in the current cycle given higher all-in yields for investors, and better credit profile from non-financial corporates (including lowest albeit still high debt levels at c.140% of GDP in last seven years, and relatively high S&P 500 profitability at c.12% margins).

Entering A Possible Third Year of Losses for Fixed Income. We are now heading for a third year of consecutive losses, which were first year driven by rising inflationary expectations and then met in second year with aggressive higher rate policy response. The bond market has struggled with weaker liquidity and sentiment given challenging macro backdrop and tightening conditions. As investors gain a better grasp of the end of tightening, rising fiscal deficits, met with attractive real rates, expect to see recovery in prices with opportunity to lock in high income over medium term.

Maintain Defensive Stance and Focus on Quality to Manage Challenges. Fixed income, and markets in general, have performed well so far this year despite macro challenges, tight monetary policy, geopolitical tensions, and rates and commodity volatility, among others. Navigating markets have been difficult given that economies are rebalancing post the global pandemic, with sectors expanding while others clearly in contraction. As this rebalancing continues, we continue to position defensively across sectors, and focus on higher quality issuers with stronger cash flow and balance sheet dynamics. Whether we end with a scenario of sub-trend economic expansion or mild recession, high quality fixed income tends to outperform lower parts in the quality spectrum and can represent a hedge for investors.

Next Focus Will Be on Credit Risks as Monetary Policy Nears End. With peak inflation rates likely behind us, and monetary policy nearing an inflection point, we believe risks will transition from interest rate to credit risks in the next cycle reflecting economic weakness, tighter credit conditions, and lessened investor sentiment. While markets have been on recession watch for the past six months, we see scope for the continuation of the current rolling recession where economic cycles differ at the sector level as some expand while others contract, at least until the end of the current rate cycle.

We note that sample of hiking cycles over past seven decades has resulted in a recession three quarters of the time once the cycle had ended and we remain vigilant that history does not repeat itself.

Continue to Position with Barbell Approach for Carry in Short End and High-Quality Duration on Longer End. With current short term yields providing investors with positive real returns, while sheltering investors from additional term and liquidity risks, we continue to reinforce barbell-ing short duration lesser quality credit with adding duration exposure via high grade government or similarly rated corporates, while maintaining some liquidity for mispriced sectors and securities, e.g. adequate yield to compensate for additional credit widening or volatility.

Pull Back Over Past Months Represents Opportunity to Lock in Rates. The sell off since August across treasuries, credit, and riskier assets was a healthy reset from the buildup in froth as markets climbed successive walls of worry and printed higher. With the likelihood that volatility may return with smaller corrections, we believe there is scope to be opportunistic and buy the pullbacks as to lock in these high yields over medium-term horizon particularly as major central banks including US, UK, ECB & BOE have likely reached their peak in current cycle albeit higher rates may persist for longer.

GCC and LATAM Outperformers Losing Their Shine from Geopolitical Tensions Next Door and Tired Consensus Trade Respectively. While EM USD Aggregate sold off 1.48% in October, LATAM and GCC declined -1.84% and -1.87%, respectively as spreads widened from rising geopolitical tensions, global macro worries, and softer commodity prices, including energy down -8% in the month after several months of declines. GCC spreads are still well above pre-Oct 7 Middle East tensions, while US HY and US EM have mostly recovered.

Bonds and Stocks Correlate as Investors Shun Risk from Geopolitical Tensions while Spreads and Rates Decorrelate as Growth Rises Rather Than Inflation or Monetary Policy. Outside of safe-haven treasuries and precious metals, sell off in risk assets in October drove correlations together across credit, HY, and EM. Stronger than expected growth has also biased rates higher and tightened spreads which have driven correlations negative again, which helps cushion bond investors in rising rate environments.

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Select EM Regions Have Been More Resilient Through Summer Doldrums. Select parts of EM including GCC, have been resilient through the summer bond selloff. Barclays EM GCC USD declined -3.1% over past two months vs EM USD AGG at -3.5%. High oil prices and non-oil growth have supported GCC markets, while commodity exporters and structural growth stories have helped parts of Latin America and Asia including Mexico, Brazil, and India. While parts of LATAM were a consensus trade, they still enjoy high real rates coupled with favourable external accounts, manageable political risks, and policy improvements. Mexico and India are examples of near and friend shoring, which should help them integrate further with US and global economies, support production and indirectly shore up demand.

India Bonds See Demand on Pending Index Inclusion. India government bonds will be included in the JP Morgan GBI EM index from June 2024, phased over ten months, reaching a weight of 10%, and representing GBI EM flows of USD 20-22bn with potential upside from inclusion from subsequent EM index peers. While government bonds have already reacted favorably to the news, the inclusion should bring corporates closer to the radar of global investors. Names we like include Adani Ports, India Toll Roads, JSW, GMR Airport, Shiram & Tata.

EM Local Currency Debt Continues to Weaken on Higher Core Rates and Stronger Dollar. EM local debt has underperformed facing an unpleasant mix of higher US rates and stronger USD as US real 10-year yields near 2.5%. The EM carry consensus trade into higher yielding local currencies stalled over the summer as investors question whether EM central banks can front run the Fed and not risk foreign exchange instability particularly as downtrend in headline inflation loses momentum given rising food and energy prices. While EM hard currency debt looks more appealing and should help shield investors from f/x volatility, the fact that high global core rates and global central bank balance sheet contractions (QT) should contract global liquidity into 2024 and wage performance closer to risk appetite.

HY and EM Corporates Offer Diversification as Rate Volatility Spikes. With the ongoing turbulence in rate volatility, HY and EM has seen interest in helping dampen volatility in portfolios while also benefiting from negative correlation on spreads vs rates, and cushion returns from benefit of high coupons. While EM followed negative cues in September, EM USD HY outperformed sovereigns & IG corporates, and local currency peers as latter remain expensive against US treasuries.

MENA Outlook: Given the global macro headwinds tied to higher real yields and rates, we have barbelled our equity portfolio by adding high dividend yield names with high beta names to reduce volatility and to provide defense to our portfolios during the market selloffs. We utilized our cash position to enter into high quality names (Emaar, ADNOC Drilling, ADNOC Gas, Salik, Budget) which took a beating due to the escalation of the geopolitical risks. Currently, MENA markets trade at a 7% premium to the MSCI EM Index on a 1-year forward PE basis, which is below the long-term average premium of 10%. If oil trades above USD 70/bbl, we believe the MENA market will continue to trade at a premium to EM and this premium would further expand.

We continue to see selective opportunities in the Saudi and UAE due to their government's commitment towards economic diversification leading to a sustained spending on infrastructure, industrial, oil and gas and tourism projects. Recent correction in Saudi and UAE equities has exposed value in certain names which continue to report strong earnings growth and non-oil GDP growth for both countries will remain strong at north of 4%. Turkey is another markets providing us with idiosyncratic opportunities. With a reinstatement of orthodox policy makers, we see a step change in the macro policy in Turkey. However, we are waiting for a significant portion of the FX devaluation to happen before we enter the local stock market. We continue to avoid Pakistan on political uncertainty tied to the upcoming elections and continued devaluation. For us to be more constructive on Egypt, we need to see steps towards a possible devaluation, FDI and reforms to improve private sector contribution to the GDP. We do not see strong upside catalysts in Qatar and Kuwait, barring a few idiosyncratic names.

Our preferred plays include:

Well capitalized banks with corporate exposure and strong loan growth prospects *(Rajhi, SNB, ENBD)*

Consumer discretionary names which will benefit from better travel & tourism *(SGS, Seera, Budget)*

High dividend yield plays within the telecom, utilities and real estate sectors *(DEWA, Empower, TECOM, Yahsat, ADNOC Drilling, ADNOC Gas, Salik)*

Real estate names which are witnessing strong off plan sales, have low execution risk and are also seeing impact of strong tourism & economic growth *(Aldar, Emaar and Emaar Dev)*

Names to benefit from the improvement in trade with EM countries *(AD Ports)*

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Performance of our Funds

Concerto IS Daman MENA UCITS Fund
The aim of this strategy is to achieve medium to long-term capital appreciation by investing primarily in securities of issuers listed in the MENAPT Region or investing in securities of issuers listed outside of the MENAPT Region but deriving most of their revenues from the MENAPT Region.

	2023	Inception (30 Jul 2020) (Class I)
Total Return*	5.5%	67.0%
Annualized Return	6.5%	17.0%
Annualized Volatility	5.9%	8.5%
Sharpe Ratio	0.4	1.7

** NAV as of November 2nd, 2023*

The fund lost 1.0% during the month. In terms of asset class, equities were mainly responsible for this loss. Geographically, UAE contributed to nearly all of this loss and was offset by gains in Saudi Arabia.

In equities, we participated in the IPOs of ADES, SAL and OQGN, with all names rallying post listing. We realized certain gains in the region due to heighted geopolitical risks. Towards the end of the month, we initiated positions in names such as ADNOC Drilling, ADNOC Gas and Salik, which had corrected strongly after the war began and where we felt value had been exposed.

In fixed income, BROPAG ’25, EGYPT ’24 were strongest contributors, while JORDAN ‘30, SOBHA ‘28, and QPETRO ‘31 were the strongest detractors. We purchased T-Bills to generate income on its liquidity.

Daman Balanced High Income Fund
The aim of this fund is to generate income along with achieving medium to long-term capital appreciation, by investing principally in securities of issuers located in, or deriving at least 50% of their revenue from the MENA region, South Asia and Turkey. Portfolio diversification is further achieved by adding high yield fixed income securities where market is overpricing systematic and/or idiosyncratic risks.

	2023	Inception (May 2021)
Total Return*	7.8%	16.7%
Annualized Return	9.4%	6.5%
Annualized Volatility	6.2%	7.1%
Shape Ratio	0.9	0.5

** NAV as of October 31st, 2023*

The fund gained 2.6% during the month. In terms of asset class, equities was mainly responsible for this loss. Geographically, besides Egypt, all other countries were in the red, with UAE contributing the most to these losses.

In equities, we participated in the IPOs of ADES and OQGN, with both names rallying post listing. We realized certain gains in the region due to heighted geopolitical risks. Towards the end of the month, we initiated positions in names such as ADNOC Gas and Salik, which had corrected strongly.

In fixed income, BROPAG ’25, EGYPT ‘24, and Egypt ‘33 were strongest contributors, while JORDAN ‘30, QPETRO ‘31, and SOBHA ‘28 were strongest detractors. The fund closed FAB Sukuk and Qatar Energy in favor of INDTLL ‘24 (India Toll Roads) in fixed income.

Daman UAE IPO Fund
The Fund’s investment objective is to generate medium term capital growth by investing in securities issued by companies that are undertaking an initial public offering or by investing in companies that have listed on UAE exchanges in the previous 24 months.

	2023	Inception (Aug 2022)
Total Return*	3.3%	6.6%
Annualized Return	3.9%	5.3%
Annualized Volatility	9.4%	9.0%
Shape Ratio	0.0	0.2

** NAV as of November 3rd 2023*

The fund lost 4.4% during the month as markets corrected strongly due to heighted geopolitical risks.

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Performance of our Funds

Concerto IS Daman Global Sukuk Fund

The Daman Global Sukuk Fund seeks to maximize total returns over the medium to long term through a prudent combination of moderate-income generation and capital appreciation by investing in Global Sukuk.

	2023	Inception (Jan 2022)
Total Return*	-0.3%	-8.5%
Average Rating	BBB-	-
Average YTM**	7.7%	-
Average Duration**	2.5 years	-
Annualized Volatility	-	1.4%

** NAV as of October 27, 2023*
** Excludes cash balance*

Fund total return during the month was -0.9%. Among sovereigns, TURKSK ‘25 was a contributor while EGYSK ’26 was a detractor during the month. GFHSUK ‘25, FABUH ’24, and DUBAEE ‘26 were highest three contributors during the month, while SOBHA ‘28, BHRAIN ‘29, and DAMAC ‘26 were the highest three detractors.

Fund total returns declined -0.9%, although outperformed the -1.2% monthly performance of the Dow Jones Sukuk Index, as credit spreads widened from weakened risk sentiment, and rates rose across the longer end of the yield curve as macro strengthened and term premium rose.

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About Daman Investments

Daman Asset Management is a dedicated MENA specialist offering mutual funds strategies and bespoke investment products, which have been built on our independent research insights and backed with a proven track record of delivering superior risk-adjusted returns which have substantially outperformed peers and regional benchmarks. Our experienced team manages investments on behalf of local and regional institutions, family offices and high net worth individuals.

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