Perspectives

February **2018**

A close eye on Middle East Opportunities

GLOBAL MARKETS REVIEW | ALTERNATIVE ASSETS | INVESTMENT THEME | SPECIAL REPORT | INVESTMENT SOLUTIONS

Contents

Welcome to the 12th edition of Perspectives.

As mentioned in the January 2018 edition of Perspectives, we expect this year to be more volatile than 2017. While the first month of the year was characterized by very strong momentum across asset classes and happened to be the best January since 1997, the start of February looks much more different.

In our markets review section, we look at the triggers for the come-back of volatility on financial markets. We also share the opinion that this looks more like a correction than the start of a bear market.

In the context of a much less predictable bond market, and as the search for yield continues, we highlight one alternative fixed income segment – CAT bonds. This was probably one of the worst performing debt instrument last year but the timing of entry could now be interesting. As always, it pays to be contrarian.

Al Mal MENA Equity Fund

+10%*

year to date performance

Al Mal MENA Equity Fund is up

+29.5%*

between the 1st of January 2017 and mid-February 2018

While February is up to a rough start for global equity markets, our flagship Al Mal MENA equity Fund was able to protect investors' capital during the correction, thus keeping the 10% year to date performance intact. It is interesting to note that between the 1st of January 2017 and mid-February 2018, Al Mal Mena Equity fund is up +29.5% versus +19.2% for the S&P 500, the US reference index. In the last section of Perspectives, we highlight the 10 reasons why we believe our flagship fund should still be considered as an attractive investment solution.

In the two other sections, we present some thematic ideas in MENA – the monthly investment theme is about picking the winners from "Saudization". The Special focus looks at opportunities in Egypt within Pharma distribution.

We hope you will enjoy this issue.

* past results are not a guarantee of future performance

The come-back of volatility

In January 2018, US average hourly earnings increased 2.9% year on year,

+2.9%

the fastest pace since 2009

10-year US Treasury yield climbed to

+2.84%

the highest level in four years

The first month of the year was characterized by very strong momentum across asset classes with oil up, the dollar down, equities and bond yields up.

Meanwhile, the average correlation between these asset classes rose to 90%, which was a sign of extreme contagion risk. It became apparent that investors were getting complacent, as most sentiment surveys seem to indicate too much optimism, hence increasing the risk of correction.

This is indeed what happened in early February. While the stock market had tolerated bond yield increasing for some time, stocks and bonds suddenly started to strongly correlate as a further 15 basis points rise in the US 10-year Treasury bond yield was one of the triggers for the first -10% correction for the S&P 500 (see chart below).

The first -10% correction in two years for US equities (source: Strategas)

And the weakness was not confined to US markets as the China's Shanghai Company had its worst week since Dec 2016 and the Germany's DAX index had its worst week since Feb 2016. There were not that many places to hide as High Yield, Gold, Silver and crypto currencies all had a very difficult month as well. Meanwhile, the VIX index of implied volatility reached its highest level in over a year.

What are the triggers of the market decline?

The primary trigger for this regime change appears to be concerns of higher inflation and tighter central bank policy after data showed that US average hourly earnings increased 2.9% in the year to January, the fastest pace since 2009.

The 10-year US Treasury yield climbed to 2.84%, the highest level in four years, raising the risk that borrowing costs could dampen growth.

But there are also some factors behind the correction observed in early February. Although concern about tighter policy is an important factor, stocks had already started to fall on the last day of January after several top technology and energy firms missed earnings estimates.

And we should also keep in mind that we are coming out of an exceptional environment. The S&P 500 had its best January since 1997. It has been more than 400 trading days since a greater than 5% drawdown, the longest run since the 1950s.

A consequence of this unusually calm market environment has been for investors to become too complacent. This was already visible when looking at investment sentiment surveys but also through the large inflows into leveraged ETFs.

As shown on the chart on next page, the first few percent of market correction triggered some panic among the leveraged ETFs holders as they rushed to the exit door, as the assets under management of these instruments cleared out overnight back to levels from 2012-2013.

We expect global GDP growth in 2018 to be even stronger than last year, which, in a counter-intuitive way, could translate into lower returns for risk assets than in 2017.

2018

Assets under management on leveraged exchange traded products

Is it a correction or the start of a bear market?

From our perspective, we find it difficult to label this more than a correction. Looking at US equities as a proxy, many of the typical signs of the start of a bear market are NOT present. For instance, market leadership has remained cyclical, earnings and cash flows are poised to increase markedly this year, and credit spreads, as a result, remain tight.

As mentioned in the January 2018 edition of Perspectives, we expect this year to be more volatile than last year. History shows that during a bull market we should ordinarily expect five days per year with greater than 2% drops – which was obviously not the case last year.

We also shared the view that we expect global GDP growth in 2018 to be even stronger than last year, which, in a counter-intuitive way, could translate into lower returns for risk assets than in 2017. In a sense, we are back into a real business cycle, where US monetary policy is in the process of normalizing after a period of unusually ultra-easy monetary policy and record-low bond yields.

Should the recent rise in bond yields moderate, we believe that market conditions will somewhat normalize. So far, economic data suggests this should be the case as inflation releases around the world have been relatively benign.

Why we do NOT believe that now is a time to reduce exposure to risk assets?

Global growth and earnings remain strong, with the recent tax cuts providing a boost to growth. Despite some disappointments, the fourth quarter earnings season in the US has surpassed expectations. Emerging markets continue to perform well and the recent weakness of the US dollar should keep financial conditions in emerging markets favorable.

That being said, macro data and key market indicators need to be monitored carefully. If bond yields continue to rise at the recent pace, if credit spreads start to widen, if inflation data starts to accelerate further, or if central banks start to send more hawkish signals, we might have to revisit our outlook.

CAT Bonds

Catastrophe Strikes

Investor loses principle. The money pays for the damage. Pay-out can be triggered by a specific event, for example, when an issuer's losses reach an agreed amount, or when wind speeds exceeds a particular threshold. Independent monitoring is crucial.

No Catastrophe

No catastrophe between the agreed dates (usually 1-3 year period)? The principle returns to the investor with a whopping 9% interest on average.

In the November 2017 edition of Al Mal Perspectives *("Investment theme: the $8 trillion debt bubble")*, we mentioned that we have started to see indicators of irrational exuberance on the fixed income markets. This included obvious signs of complacency when it comes to the direction of yields and spreads. Leveraged fixed income, light covenants junk papers and highly illiquid papers continue to be accumulated regardless of the true risk-reward profile of the underlying securities.

Another source of concern was the US Treasury market where an unexpected rise of inflation and/or reduction of the Fed balance sheet could trigger a sudden rise in bond yields.

As discussed in the Market review, the rise of the 10-year US bond yield since the start of the year has been identified as one of the trigger for the recent market correction.

Given the very low level of yield offered by investment grade bonds and in light of the risk of principal loss, which would result from a rise in bond yields, what are the potential alternatives offered to investors looking for income?

As we highlighted in the January 2018 edition of Perspectives, CAT bonds are one of the viable option to be considered on the fixed income market.

What are CAT Bonds?

Catastrophe bonds, also known as CAT bonds, are investment securities that work like insurance products for the purpose of reducing the greatest risks associated with insuring catastrophic events, such as major hurricanes and earthquakes.

These insurance-linked investment securities are unlike conventional bonds. When you buy an individual bond, you are essentially lending your money to the entity for a stated period of time. In exchange for your loan, the entity will pay you interest until the end of the period (the maturity date) when you will receive the original investment or loan amount (the principal).

In the case of catastrophe bonds, the issuing entity is an insurance company. CAT bond investors will allow the issuing company to hold their principal in return for interest paid by the issuing company. In the event of a catastrophe, the issuing company may stop interest payments or they may not be responsible for paying back the principal at all (the principal is forgiven).

Like conventional bonds, catastrophe bonds are typically held until maturity. From the purchase of the bond up to the maturity date, the investor receives interest (fixed income) for a specified period of time, such as three months, one year, five years, 10 years, 20 years or more. Most catastrophe bonds have relatively short maturities, such as three- to five-year terms.

There is no "loss" of principal as long as the investor holds the bond until maturity and there is no catastrophe, which would enable the issuing company to defer interest payments or repayment of principal. Again, in some cases, the principal amount may be completely forgiven.

An example of a catastrophe bond would work something like this:

The issuing entity, XYZ Insurance Company, issues three-year catastrophe bonds at $1,000 face amount and pays 9 percent interest. The CAT bond investor buys 10 bonds and sends the $10,000 to XYZ Insurance Company (or the entity that makes the market for the bond) and gets a bond certificate in return. The bond investor gets 9 percent per year ($900) for three years. That is, unless there is a catastrophe (see opposite).

Risks of Investing in Catastrophe Bonds

The most obvious risk of investing in catastrophe bonds is that a catastrophe would occur and the investor may not receive their interest or principal. However, like other investment securities, the investor is rewarded with higher yields in exchange for taking the risk.

The relatively short maturity periods mitigate the risk somewhat but catastrophic events are more difficult to forecast than capital markets.

Therefore, buying catastrophe bonds is not unlike making a bet that a major catastrophic event will not take place in the next few years. That's like betting against a stock market crash—it's not a matter of IF but a matter of WHEN.

Buying Catastrophe Bonds

Most catastrophe bond investors are hedge funds, pension funds, and other institutional investors. Individual investors are not commonly purchasers of CAT bonds.

Individual investors looking for exposure to CAT bonds may consider buying bond funds that hold them. This way, the investor can hold a basket of cat bonds, rather than buying one or a few, which would entail greater market risk.

Above all, investors are wise to maintain a properly diversified portfolio of investments that is suitable for the individual investor's objectives and tolerance for risk.

Who are the CAT bond issuers?

7 of the top 10 U.S. insurance companies issue CAT bonds, like Chubb, Travelers, AIG and USAA. Furthermore, 7 out of the top 10 global reinsurers issue cat bonds, including Munich Re, Swiss Re, Lloyd's and China Re. Generally, anybody with major exposure to catastrophe risk is a candidate for cat bond issuance.

What are the recent developments in the CAT bond market globally?

Historically, the global CAT bond market has grown at a rate of 15-20% per annum. It totaled $89 billion in June 2017, compared with $516 billion in traditional reinsurance, according to broker Aon Benfield.

Historically, the global cat bond market has grown at a rate of

15-20%

per annum

Why can catastrophe bonds be an option for investors in a low yield environment?

In this low yield environment, CAT bonds are a legitimate option for any investors seeking immunization from credit exposure and interest rate volatility without resorting to cash holdings which produce zero or negative returns in many instances. CAT bonds are not risk-free investments, but they allow an investor to earn a fair return against risks that are quantifiable and unaffected by volatile global market conditions in a low yield environment.

2017, a catastrophic year for CAT bonds

As Hurricane Irma battered Puerto Rico after slamming smaller Caribbean islands, and after wildfires in California and earthquakes in Mexico, some CAT bonds suffer cataclysmic losses in 2017. The Swiss Re catastrophe bond price return index suffered its biggest drop since at least 2002, tumbling 16 percent the week after Irma.

Some investors said 2017 was the CAT bond version of the 2008 global financial crisis as it was the steepest losses on record for CAT bond hedge funds in more than a decade.

Across the industry, hurricanes alone could lead to losses of $100 billion in 2017, according to risk modeling agencies and reinsurers. That compares with losses of about $74 billion caused by Hurricane Katrina, which hit New Orleans in 2005.

In 2017 hurricanes alone could lead to losses of

$100 billion

Why this time could be the best one to invest into CAT bonds?

The year that follows a year with major natural disasters is usually the best time to invest into CAT bonds. Why?

A costly year for insurance losses from natural disasters usually clear a path for higher reinsurance rates. Indeed, **reinsurance rates were expected to rise up to 20% when the January 1st renewals came around due to greater demand for cover after the major disasters which took place last year.**

That should translate into higher CAT bond yields, potentially drawing in new return-seeking investors, industry specialists say.

"Yields have risen and business is getting done on much better terms than we have seen since 2013. It's the only credit-like market where yields are rising and won't be round historic lows going into next year." ***Farquhar at Cambridge.***

Conclusion

We do have access to a list of mutual funds investing into CAT bonds. The liquidity terms offered to investors are usually monthly or better. Thanks to high diversification, they are able to generate very decent yields while reducing idiosyncratic risk.

We would encourage investors to have a look at this attractive niche segment.

Saudization Drive – Picking the winners

More than

85%

of Saudis employed by the public sector

Unemployment rate at

12.8%

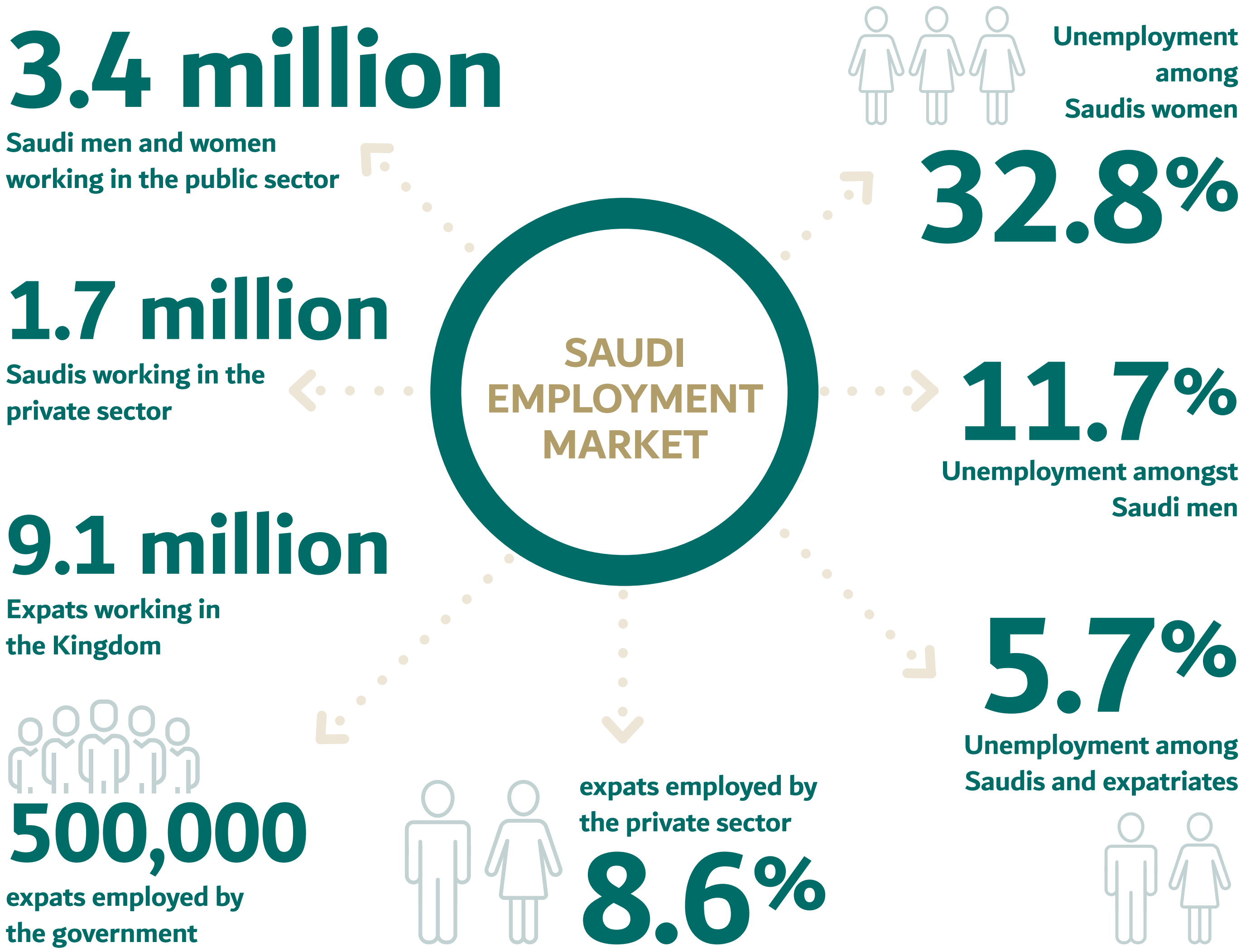
amongst Saudis

‘Vision 2030’ targets a 7% unemployment rate.

The oil price correction which took place in 2014-2016 had many consequences on Saudi Arabia from a political, economic and societal perspective. When it comes to the private sector, one of the most felt changes has been the government's zero tolerance stance when it comes to "Saudization", i.e the policy whereby Saudi companies and enterprises are required to fill up their workforce with Saudi nationals up to certain levels.

Indeed, with more than 85% of Saudis employed by the public sector (SAR480 billion wage bill), a double-digit fiscal deficit, high employment rates among youth and around 10 million expats the government re-introduced the whole program to a totally new stricter level, forcing the private sector to absorb more locals.

Unemployment rate among Saudis stands at 12.8% but according to a study by a local university, the rate among younger people is much higher at 35%. As part of its national transformation plan (NTP), the Kingdom has declared plans to increase Saudization levels and reduce unemployment. The "Vision 2030" targets a 7% rate.



Saudization: Introducing Nitaqat

Created in 2011, the Nitaqat system introduced some major labor reforms. It classifies organizations into 6 categories - Platinum, Green (High, Medium, Low), Yellow and Red depending on the size of the entity and the ratio of Saudi nationals versus expatriate employees in their workforce.

According to this classification, only the organizations within the Platinum and High Green categories are able to apply for new block visas while organizations within the remaining categories are only able to obtain visas for expatriate employees through a transfer of sponsorship. This means that companies that fall in categories Medium Green, Low Green, Yellow and Red may be limited to hiring expatriates who are already in the KSA and have work authorization with an existing employer.

The kingdom has passed several orders, including one that terminates all contracts pertaining to expatriate workers in governments and ministries within three years.

In addition to Saudization, four new employment support programs, are introduced – a Freelance Program, a Part-time Job Program, working women's 'Children Hospitality Program' called 'Qurrat', and a program for transportation of working women called "Wusool".

BLUE VIP	GREEN Excellent	YELLOW Poor compliance	RED Non-compliance
Incentives: Can hire employees from any country Easier visa processing **Condition-free visa transfer:** Can hire employees from Red zone and Yellow zones, and transfer their visas without the permission of their current employers	**Incentives:** Can apply for new visas once every two months Can change their foreign workers' profession except to those restricted to Saudis	**Punitive Measures:** Cannot apply for new visas Can get only one visa after the departure of two expatriates Cannot transfer visa and change professions **Grace Period:** Nine months to improve their status	**Punitive Measures:** Banned from change of profession, transfer of visas, issuance of new visas and opening files for new branches

Jobs reserved 'only for Saudis'

A list of sales activities (retail) will be considered off-limits for non-Saudis from September 2018 – among them watches, eyewear, medical equipment and devices, electrical and electronic appliances, auto parts, building materials, carpets, cars and motorcycles, home and office furniture, children's clothing and men's accessories, home kitchenware, and confectioneries.

It is worth mentioning that almost 60% of work visa (Iqama) applications for foreign nationals were rejected in 2016 to encourage local hiring.

Levies on Expats & their dependents

Companies with a Saudi workforce of 50% or more will pay a levy of SR300 per month per expatriate worker in 2018. For companies employing more expatriates than Saudis, the monthly levy will be SR400 for the year. In 2019, this fee will increase to SR500 and SR600, respectively and in 2020 it will reach SR700 and SR800, respectively.

Fees on Expats

JAN

For companies where expat workers outnumber Saudis

2018	2019	2020
SR400 per month per worker	SR600 per month per worker	SR800 per month per worker

JAN

For companies where expat and Saudi workers are in equal number

2018	2019	2020
SR300 per month per worker	SR500 per month per worker	SR700 per month per worker

JUL

Fees to be paid by expats for dependents

2017	2018	2019	2020
SR100 per month per dependent	SR200 per month per dependent	SR300 per month per dependent	SR400 per month per dependent

Saifi initiative

In addition, the Human Resources Development Fund (HRDF) have recently made the 'Saifi' training initiative a mandatory requirement for all private companies with 25 or more employees. Saifi is the student training program for national's aged 17 & above, who wish to train & gain work experience during the summer holiday.

Companies are required to select interns for four weeks and the trainees should be paid a minimum amount of SAR 1500 per month in stipend.

It is worth mentioning that almost 60% of work visa (Iqama) applications for foreign nationals were rejected in 2016 to encourage local hiring.

Picking the winners

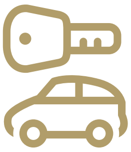
As investment managers, one of our tasks is to try identifying some actionable investment ideas which could arise from such an important theme. Below, we outline some short-term and medium-term opportunities.

Short term winners

1. Banks

With more Saudis being employed, retail banking is likely to benefit through rising demand for bank accounts, loans, mortgages and credit cards.

This will also bring in huge amounts of money which is currently being remitted out of the country (total remittances by expatriates reached more than SR752 billion over the last five years).



2. Car rental

Expats will be banned from working in car rental businesses from March 2018 this year onwards.

Large and efficient players such as BUDGET should benefit from this law, as they will grab market share and stand out as a winner from the consolidation that should happen in the sector (they are currently more than 800 small players). Moreover, the decision to allow women to obtain driving licenses should support vehicle resale prices for these car rental operators.

Medium to long term

3. Organized Retail

The Government is progressively implementing plans to ban foreign workers from all grocery and confectionery stores. An Arab newspaper reported that a draft decision had been made to put 100% Saudization for all shops selling consumer goods. If implemented, the plan will create 20,000 jobs for Saudis in the first year. Similar Saudization plans were implemented in 2016 in the mobile shop sector and it created 8,000 jobs for Saudis. The most efficient retailers should outperform in this context.

4. Fashion retail

With a higher proportion of women in the workforce aided by the ability to drive, retailers who cater for women's needs are likely to benefit. Still, it will take some time before we the higher disposable income to be in the hands of women. We should also keep in mind that discretionary spending is facing some short-term headwinds such as higher utility costs & new taxes (VAT).

Conclusion:

Navigating through the Saudization process can prove to be tricky for investors over the short to medium term. But from a long-term perspective, this trend is likely to provide a huge boost to the Kingdom's economy with more skilled and trained labor, lower remittances and higher consumption power.

At this junction we are selective on Banks, Insurance and like **BUDGET** in the transportation sector.

Opportunities in Egypt - Pharma Distribution

Egypt's Healthcare expenditure

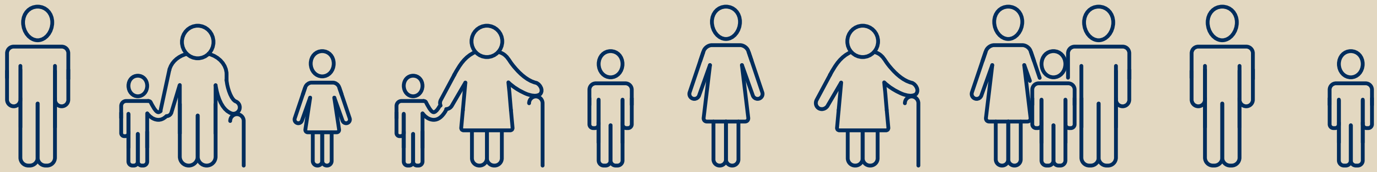
5.6% of GDP

<

Global Average

10.7% of GDP

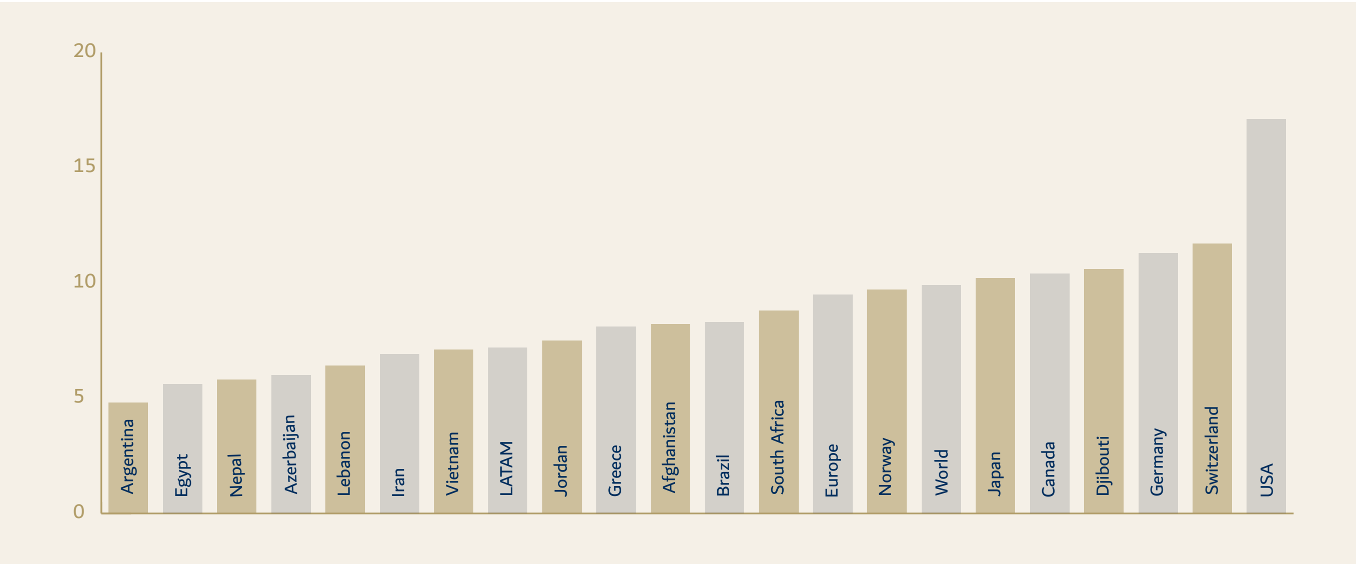
Egypt has the largest consumer pool in the Middle East North Africa region with +90 million population



As already outlined in previous editions of Perspectives, we have been able to identify plenty of attractive investment opportunities in Egypt – and this includes the Healthcare sector.

At this stage, Egypt's expenditure on healthcare as a percentage of GDP is among the lowest in the world (see chart below). Indeed, Healthcare expenditures only stand at 5.6% of GDP, which is significantly lower than the emerging markets' average of 6.5% and the global average of 10.7%. This sub-par number can be attributed to lower GDP per capita and a challenging macro-economic environment which make essential items such as food a priority for the government. But even on per capita basis, these expenditures are significantly low at USD150 p.a., a 15% discount to the peer average. After some major reforms to the subsidy system being implemented over the past four years, the government is finally addressing the Healthcare issues by introducing the Healthcare act in January of this year.

Healthcare Expenditure as % of GDP



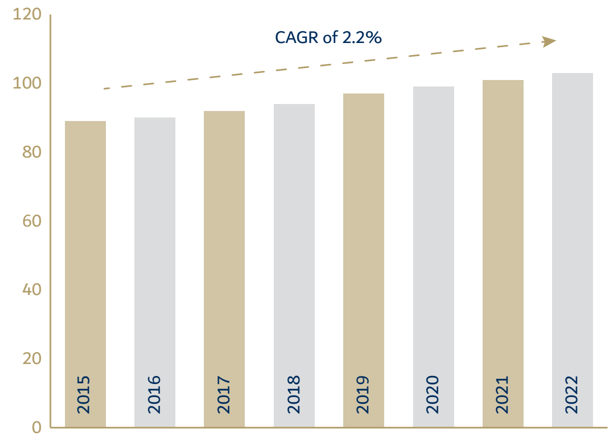
A strong growth profile backed by real growth in demand

Egypt has the largest consumer pool in the Middle East North Africa region with +90 million population. Moreover, we expect the demand for healthcare to increase due to: i) high prevalence of lifestyle diseases; ii) relatively old population; iii) improving life expectancy; iv) increased urbanisation and; v) low quality of service offered by public sector hospitals and the most recent Healthcare act.

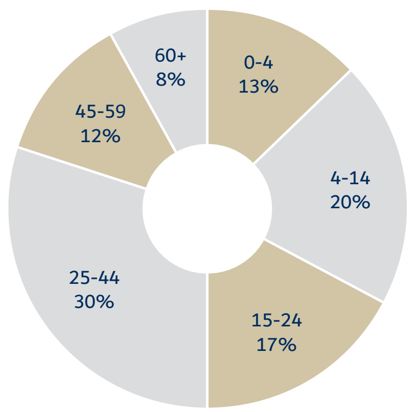
For the time being, the lack of a compulsory insurance plan forces patients to pay the bulk of healthcare expenditure as out-of-pocket.

The government's allocation for the healthcare sector in the FY2016-17 budget stands at EGP53.3bn. But the Minister of Finance announced plans to increase expenditure on healthcare, education, and scientific research to reach 10% of GDP by 2018. Over the short to medium-term, we expect private expenditure to have a larger share of total expenditure, on the back of insurance and structural reforms, as some of the financial burden would start to shift towards the private sector.

Egypt population expected to grow at CAGR of 2.2%



Egypt population breakdown by age bracket



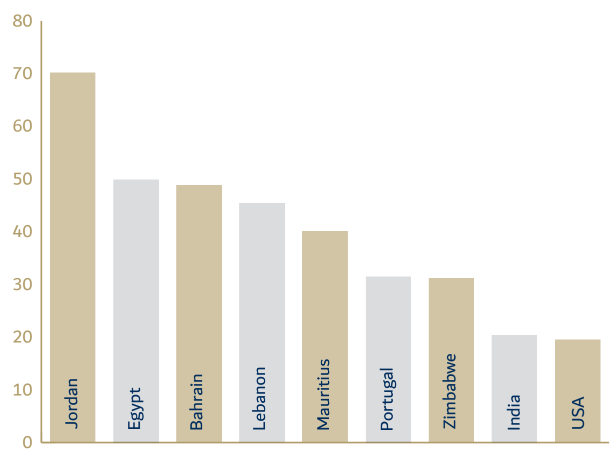
Strong demand drivers over the long term

Demographics: As highlighted above, Egypt has a strong demographic profile with one of the largest population (90+mn people) in the region growing at a healthy rate of 2.2% CAGR. This aging population which is more urbanised fuels the demand for superior healthcare system making Egypt the region's largest consumer market, ensuring healthy growth levels for health expenditure.

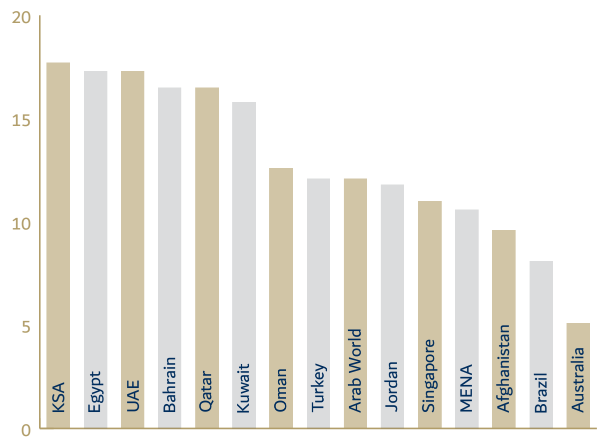
Prevalence of lifestyle diseases: Due to the country's demographics, socio-cultural setup, high prevalence of smoking, inactive lifestyles, unhealthy eating habits, along with other factors have contributed to a rapid increase in the prevalence of lifestyle diseases, such as diabetes and obesity.

Increasing Insurance penetration: According to the latest report from CAMPAS, the health insurance penetration in Egypt stands at 58%. As per our understanding of the socio-economic setup of the country we believe this number is significantly inflated. Moreover, the recent introduction of the Universal Healthcare Insurance Act aims to expand this healthcare penetration to reach 100% by 2032. This Act should help in improving the insurance penetration significantly and will further stimulate the spending by the population which was not able to avail healthcare services due to high costs associated with it.

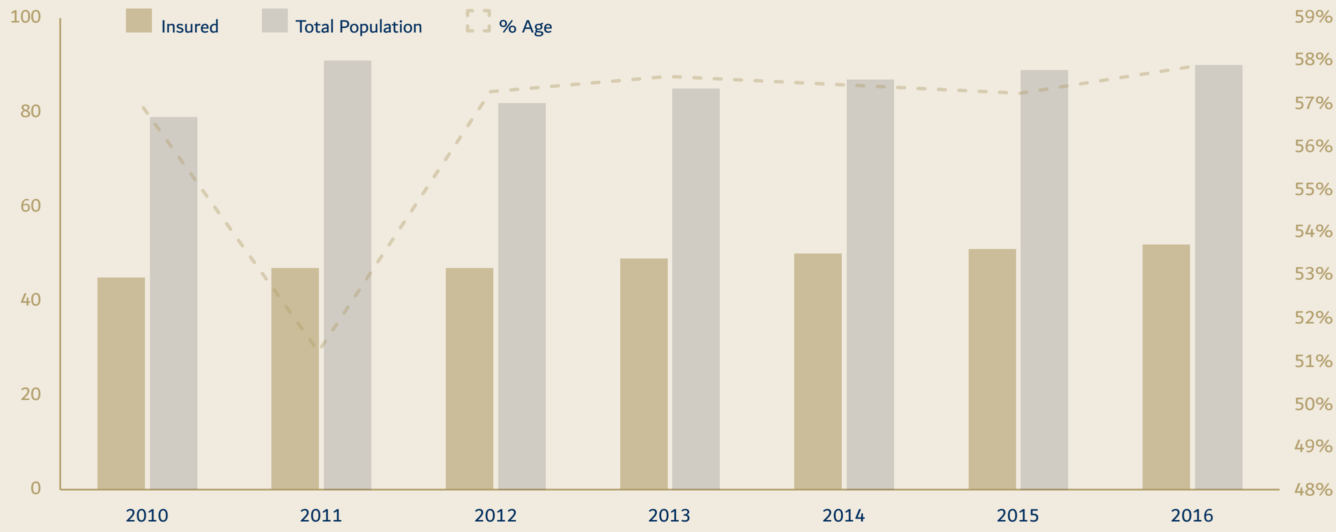
Relatively higher prevalence of smoking among person ages >15



Prevalence of Diabetes



Healthcare insurance penetration in Egypt (2010-2016)

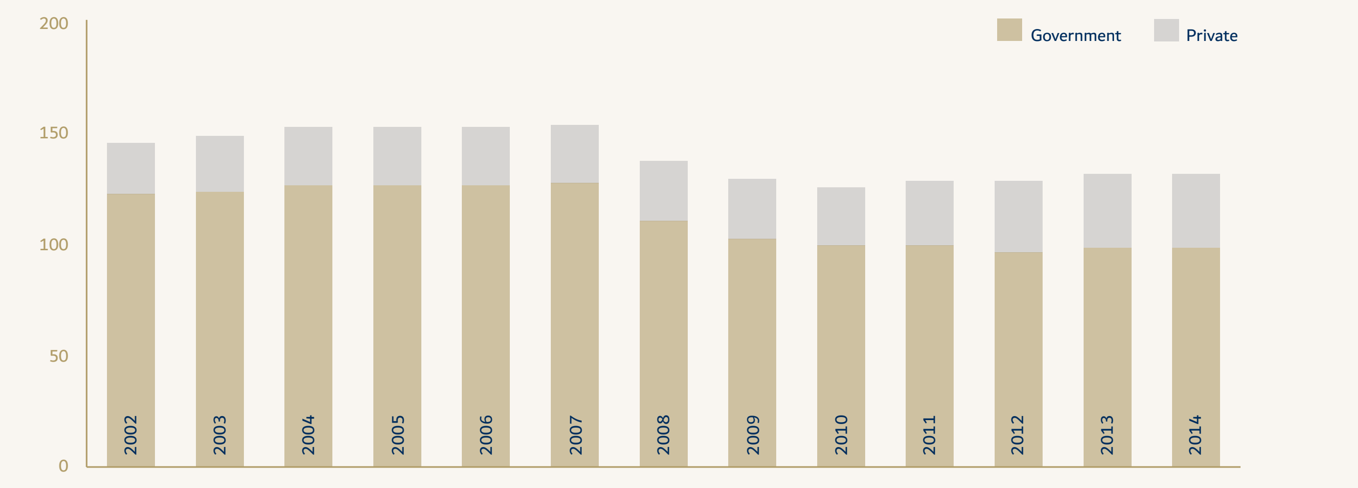


Increase in private sector contribution: Aiming to enhance the level of service provided, narrow the healthcare percentage supply gap, and partly lift the burden on the government budget, the government has been undertaking a number of initiatives to promote private sector participation in infrastructure enhancement.

2.2%

The region is growing at a healthy rate of 2.2% CAGR. This aging population which is more urbanised fuels the demand for superior healthcare system.

Total Number of Hospital beds in Egypt ('000)

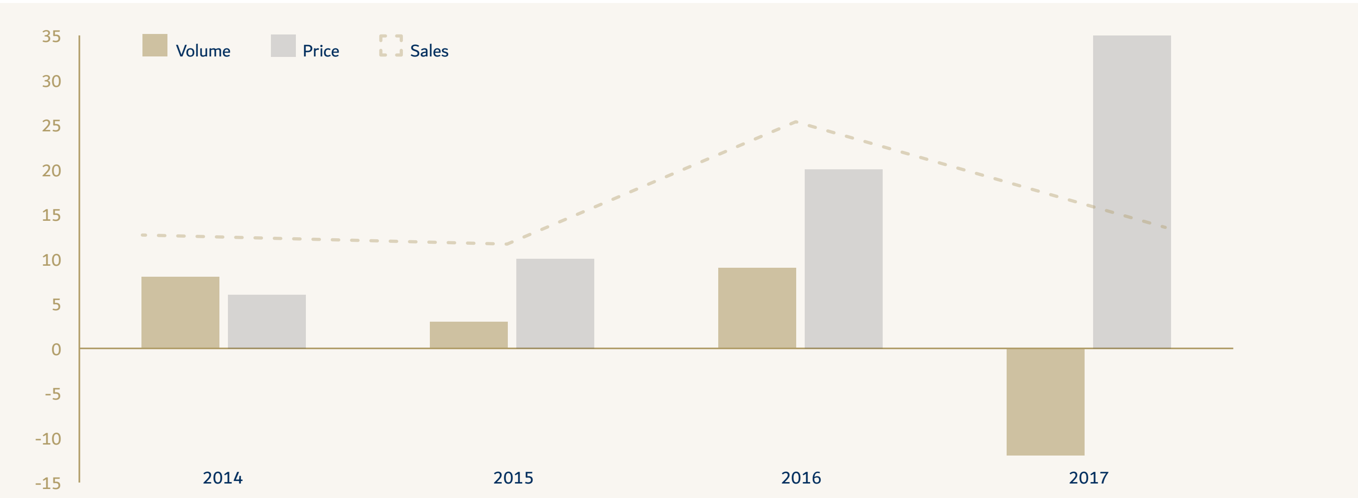


A highly regulated drugs market with fixed margins

Since the 1950s, drug pricing has been strictly regulated and controlled by the government. The latest decree which took effect mid-2016 sets prices of newly registered drugs based on a basket of 36 countries, revised every 5 years or when foreign exchange rate varies by 15% during a year. The regulation fix the margins for distributors and pharmacies at roughly 8% and 25%, respectively. Any request for price increase since then has been rejected by the government in order to keep the cost of basic needs low in this hyperinflationary environment. However, in May 2016, following the first round of EGP devaluation, a 20% increase on drugs sold for EGP30 or less was sanctioned, directly impacting around 6.7k SKU's (stock keeping unit). A second round of price adjustment happened in January 2017 post the flotation of EGP in November 2016, affecting roughly three thousands products (around 15% of local products in the market and 20% of imported products). The government is planning to streamline this price adjustment by changing it from a fixed price to Cost plus margins system which will make these price adjustments much more smoother in case of high inflationary environment. This adjustment in pricing model will significantly improve the pricing dilemma situation and will thus boost the investment in the sector by international players.

	Essential medicine	Imported Medicine	Wholesale
% of ex-Factory price	7.86%	8.8% of Medicine Below EGP 500 and 6.4% of Medicine above EGP 500	8.80%

Price and volume growth of medicines in Egypt

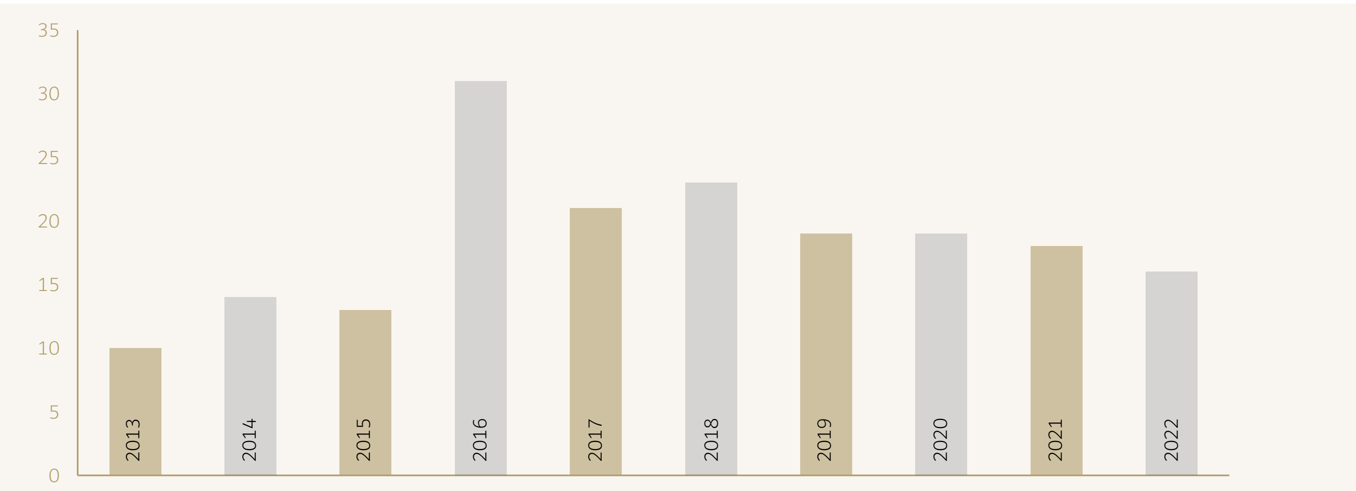


A game changer: The Universal Healthcare Insurance Act

The President approved the Universal Healthcare Insurance Act in January 2018, with implementation set to begin at the start of FY18/19. The act is aiming to increase by 2032 the insurance penetration to 100% of population compared to the current 58%. The bill is expected to cost EGP9bn in the first year of implementation, and should gradually increase to EGP600bn by 2032 as the programme rolls out nationwide. The government is planning to fund this plan using various mechanism including collecting premiums from the masses ranging from 1 to 4% of their salary, surcharge on tolls and other governmental services. A part of it will also be funded by increased taxes on tobacco.

Implementing the Universal Healthcare Insurance Act will naturally increase spending on the sector, by including the section of the population (~40%) which was not able to access healthcare services due to higher cost. While this move will benefit all the players in the value chain, we believe Pharma distributors should be the key beneficiaries as they are already regulated in terms of pricing and will be thus directly benefit from increased volumes. The impact on private hospitals is still unclear, as pricing for these services are not regulated and government might force them to reduce margins on the backdrop of higher volumes. We expect the pharmaceutical sector to grow at a CAGR (compound annual growth rate) of 21% during 2018-22e vs. 19% during 2013-17a. This growth acceleration mainly stems from the implementation of the Universal Healthcare Act but is also supported by Egypt's favourable demographic profile, the prevalence of lifestyle diseases, increasing insurance penetration, increased private sector contribution and higher life expectancy.

Egypt Pharma sector aggregate growth in value terms



What about currency risk

Demand in this industry is highly inelastic. While there is a risk of further depreciation in the EGP, distributors should not be directly impacted by foreign currency changes as they purchase and sell in local currency. Still, they will be indirectly impacted from drug manufacturers who might reduce their capacity by removing loss making SKU's and exiting the market to cut losses in case the pricing is not adjusted in line with inflation and exchange rates.

Conclusion:

Generally speaking, we do have a favourable view on the Healthcare sector due to its defensive nature and the specialised expertise which is required to run Healthcare companies. However, we shy away from general hospitals and generic pharmaceutical manufacturers due to intense competition and prefer players with unique offering, experience and specialities.

One of the best ways to get exposure to the Egypt pharma sector would be IBNSINA Pharma. The company has been gaining market share exhibiting above sector growth profile and is well positioned to benefit from the implementation of the Universal healthcare act.

Al Mal MENA Equity fund

Between the 1st of January 2017 and mid-February 2018 the fund has achieved a return of

+29.5%*

Against 3.8% for the S&P Pan Arab index

The cumulative alpha in 13 months stood at

+25.7%*

As shown on the chart opposite.

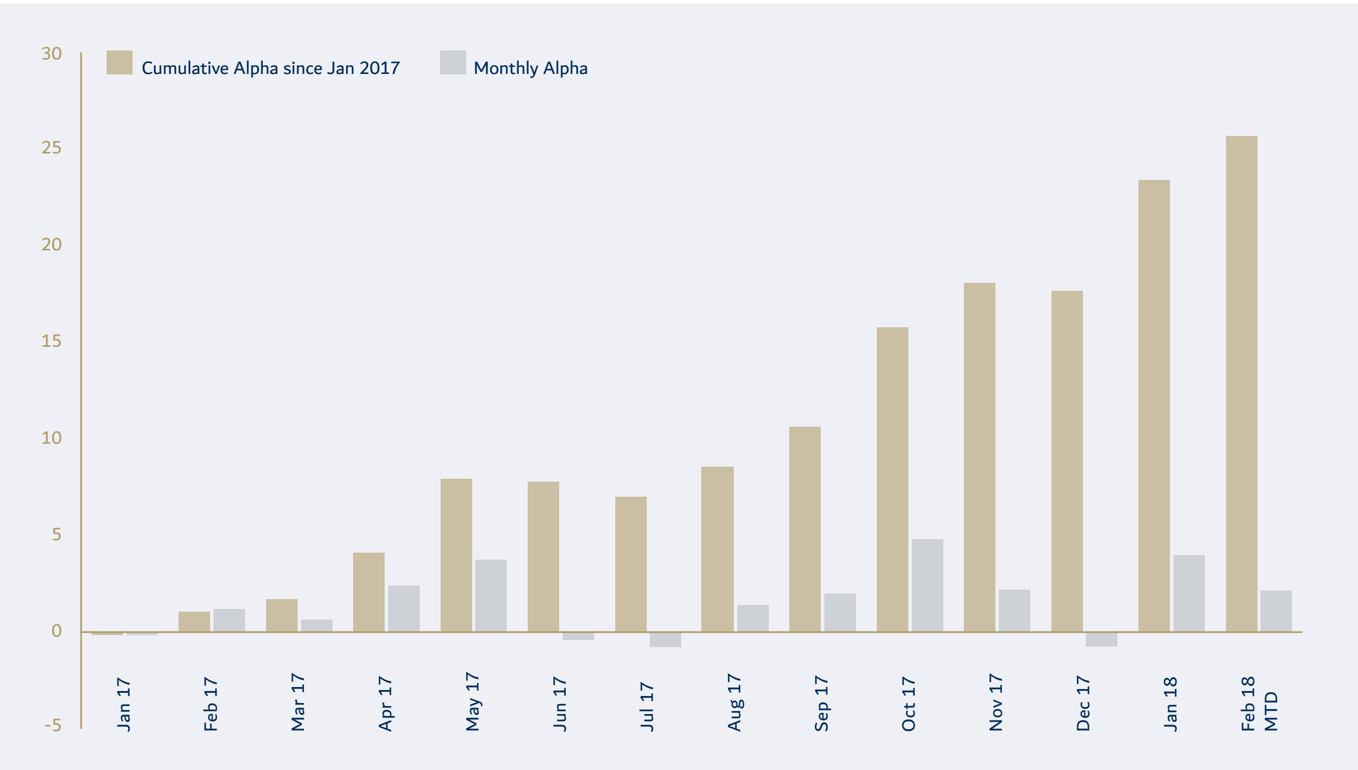
* past results are not a guarantee of future performance

It has been a full year now since the investment approach and management team of Al Mal MENA Equity fund has been revamped. Early last year, the team was indeed reinforced with the arrival of a new lead fund manager and a co-fund manager.

The investment strategy for Middle East & UAE equities was changed to focus more on the dynamics behind the companies we invest in. This new investment approach focuses on our highest conviction names, based on deep fundamental research and value, with a 3 to 5 years investment horizon.

Fast forward to February 2018, this new strategy is starting to bear its fruits as the performance since January 2017 has been very encouraging. Indeed, the fund has been adding alpha against the reference index on a regular basis. At the time of our writing, the fund has achieved a return of 29.5% between the 1st of January and mid-February (after fees) against 3.8% for the S&P Pan Arab index. The cumulative alpha in 13 months thus stood at 25.7%, as shown on the chart below.

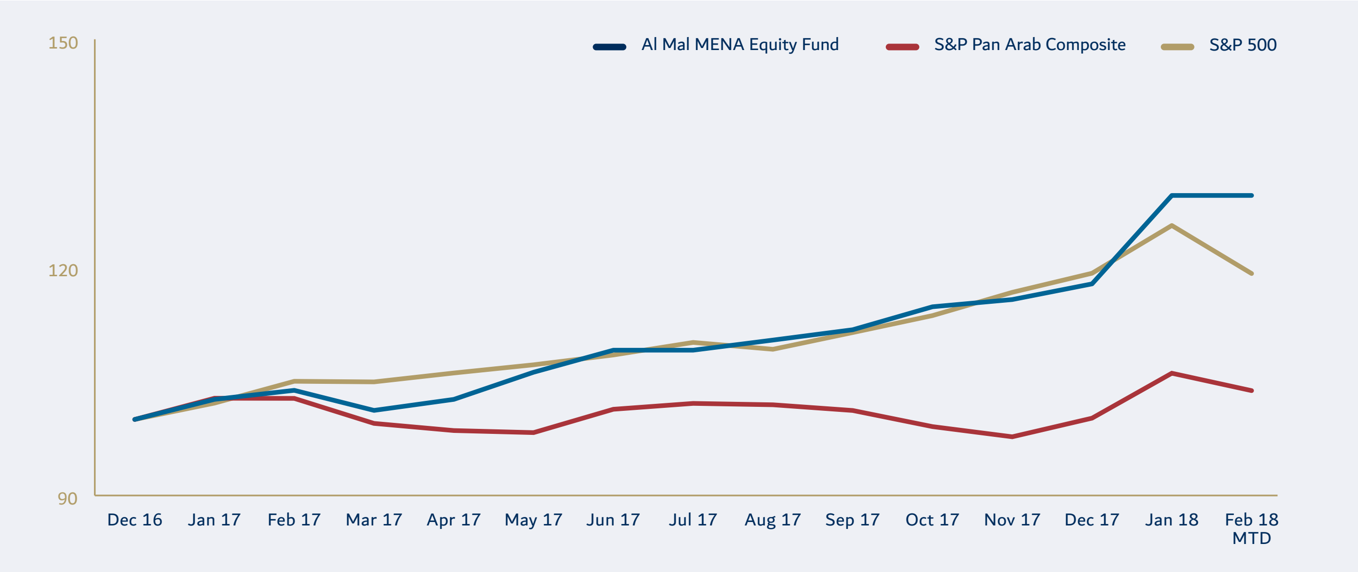
Al Mal Mena Equity fund cumulative and monthly Alpha (as of 7th of February 2018)*



With the benefit of hindsight, 2017 was not the easiest year to start implementing a new strategy as last year happened to be a challenging year for Middle East equities. Indeed, oil prices volatility, a hectic geopolitical agenda and concerns over capital flight weighed on MENA investors' sentiment. While most world equity indices have been up between 20% and 30% since the start of last year, our regional markets are almost flat over the same period. But despite this disappointing performance for Middle Equities, Al Mal MENA equity was able to perform strongly. It is indeed interesting to note that since the start of last year, investors have made more money investing into our fund instead of allocating into the S&P 500, an index which has made lots of euphoric headlines over the period.

* past results are not a guarantee of future performance

Indexed performance of Al Mal Mena equity fund versus S&P 500 and S&P Pan Arab composite since 1st of January 2017 (as of 7th of February 2018)*



How can a fund investing into a market which has strongly underperformed US equities since early 2017 outperform the S&P 500?

As we have often highlighted in previous editions of Perspectives, our investment approach is not to "trade the market" but invest into companies from a pure bottom-up, fundamental perspective and in an unconstrained way.

While the macro picture has been challenging in the Middle East, it is still possible to find a very decent number of strong companies in our regional markets. And the good news is that very often, these market leaders trade at attractive multiples and remain underappreciated by most investors. As they deliver on shareholder value creation and earnings growth, market prices need to adjust to the economic reality. As the fund managers have been able to identify such investment opportunities, the fund performance has been reflecting these winning bets with no or low correlation to the reference index performance.

After nearly 30% of performance after 13 months, is it too late for investors to "jump into bandwagon?"

We don't think so. While it is always difficult to write about its own product, we cannot help to share with our readers and clients our enthusiasm regarding Al Mal flagship fund.

Indeed, we do see at least 10 strong reasons to consider it as an investment vehicle of choice for asset allocators.

Reason #1: Al Mal commitment

While the MENA equities team has been revamped in early 2017, the involvement of Al Mal Capital in regional equities fund management is more than 10 years old. Indeed, Al Mal UAE equity fund was created in April 2006 whereas Al Mal MENA equity fund was launched in June 2008.

At a time when many regional financial firms are leaving the segment and most international asset managers continue to shun the space, Al Mal Capital is investing and expanding into Middle East equities. This is the best proof of Al Mal Capital level of commitment and conviction on our regional markets.

Al Mal Capital has been of the very few long-standing MENA equity specialist and has a strong objective to be seen among the worldwide leaders in this space.

Reason #2: The strong backing of Dubai Investments

In 2015, Dubai Investments increased its ownership to obtain a majority shareholding in Al Mal Capital. Our main shareholder has been a strong supporter of Al Mal asset management team and is backing our MENA equities ambition, for instance by seeding our newly created funds.

* past results are not a guarantee of future performance

Reason #3: the upcoming launch of the fund under a UCITS format

One of the missions of Al Mal Asset Management team is to promote MENA equities as a destination of capital for international investors. As such, we need to provide them with a fund structure which is investable. Al Mal MENA equities Fund is currently registered in Bahrain. While this fund domicile provides the manager with many advantages (including direct access to Saudi market), it is not investable for most international investors, would they be institutional or retail.

In October of last year, Al Mal Capital and Azimut Group, one of the largest European asset manager, have signed a partnership agreement to jointly launch a Middle Eastern equity UCITS fund.

The strong regulation of UCITS and the resulting high level of investor protection have made them popular with supervisory authorities and investors all over the world. The UCITS brand and, particularly, Luxembourg UCITS have a large market share in a number of non-EU countries, e.g. Asia, Latin American and MENA countries.

This newly established Fund is expected to be launched by the end of the first quarter 2018 and will be co-branded by Al Mal Capital and Azimut. With more than USD 50 billion in Assets under management, Azimut is one of the largest and fastest growing asset managers in Europe. And thanks to Azimut UCITS umbrella platform and their global distribution footprint, Al Mal highly successful MENA equity strategy will now be accessible to institutional and private investors around the world.

Reason #4: A unique investment approach and process

As already mentioned above, we believe that our investment approach and process are pretty unique.

Our investment strategy is bottom-up fundamental through a deep research process. We favor an unconstrained and high conviction approach. The fund active share is around 70-80%.

Our investment strategy considers the real value drivers for each company regardless of the country or sector. We classify value drivers into 3 main buckets:

- Core: the real value driver is the management and their strong capital allocation capabilities;
- Value: the real value driver is the company's assets or services;
- Opportunistic: the real value driver is be the theme or the sector benefiting from a certain event.

We are cognitive of surrounding risks and mitigate the risk at 2 levels:

- Portfolio: the 3 buckets mentioned above include companies which are at a different stage of their business cycle. As such, the correlation between the 3 buckets is very low (0.62x over 3 years and 0.30x over 1 year) and thus creates diversification within the global portfolio;
- Company: the weight assigned to each company is determined in accordance with the level of confidence we have for each company (High, Medium or Low). This level of confidence depends on a proprietary risk factoring metric.

Reason #5: Strong absolute and relative performance since early 2017

As mentioned earlier, the 2017 performance was strong (+17.8% net of fees) in a flat market (-1.5% for the index). Not only was the performance strong against benchmark but it did well against peers as we ranked #2 out of our universe.

It is also worth highlighting that an alpha of 19% with 6% tracking error implies an information ratio of roughly 3.0x. Last but not least, the fund volatility was lower than the index despite the fund's concentration.

The fund has a great start in 2018 with a January performance of 9.9% (net of fees) versus 5.9% for the index.

Reason #6: A scalable strategy

On purpose, we selected an investment universe which allows us to pick highly differentiated companies. We define our universe as GCC, Levant and North Africa (mainly Egypt and to a lesser extent Morocco). This universe is rather heterogeneous and exposed to very different dynamics (think about impact of rising oil prices on a country such as Saudi Arabia versus Egypt);

Unlike some competitors, we are not investing into illiquid micro/small caps to generate such level of performance. We believe we can achieve exactly the same results with a USD 500-700m assets under management. Not only our strategy is scalable, but we have much higher capacity left than most of our direct competitors.

Reason #7: A highly liquid strategy

The current Bahrain registered fund offers weekly redemption frequency to investors. Once the UCITS structure will be ready, investors will be able to redeem on a daily basis.

The same daily frequency could be applied to a managed account as well.

At a time when many investors believe that the only way to generate double-digit returns is to allocate to illiquid strategies such as Private Equity or real estate, it is somewhat refreshing to see that very decent returns can be achieved with a strategy which allows investors to get their money back within a week.

Reason #8: Full transparency

As our investment strategy does not imply investing into small & micro caps and because it is based on a clear, repeatable investment process, we chose from day 1 to communicate with our existing and potential clients in a transparent way and on a frequent basis.

We thus publish portfolio details and comments on a weekly, monthly and quarterly basis. We also offer direct access to portfolio managers

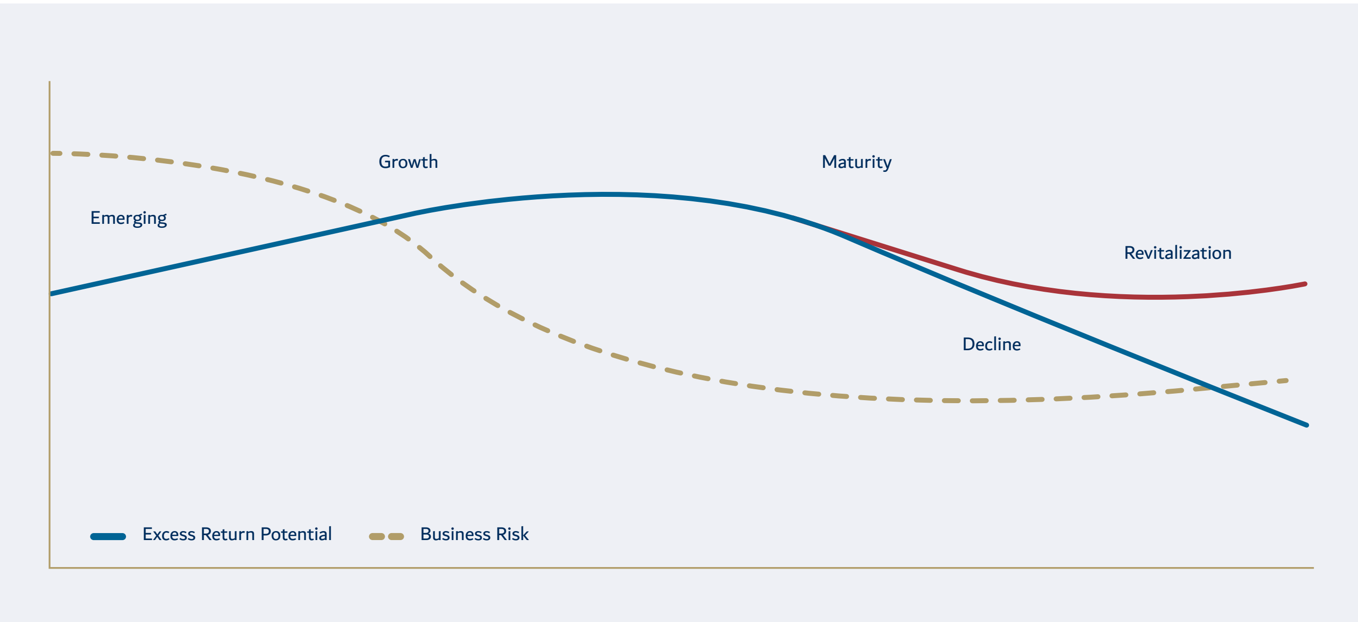
Reason #9: Investing into a fund and team which might be in the "sweet spot" of their lifecycle

In December's edition of Perspectives (Special Focus: "The Fund Lifecycle Theory"), we mentioned that many investors are under the wrong impression that the right timing to invest in a fund is when it has a long track record and large assets under management (AUM). In this article, we highlighted that "bigger" and "older" are not always better.

Indeed, many institutional investors and family offices may significantly narrow down the number of fund managers, looking for at least five years' track record and over US$300-500 million in managed funds. As we highlighted in this article, several academic and industry research has suggested that large size and old age can have a negative impact on fund performance and performance persistence.

The "Fund life cycle theory" suggests there is an optimum time to allocate to an asset manager. As shown on the chart below, the growth and early maturity stages of a fund represents the "sweet spot" for investing. It is the time window where the fund manager is most likely to generate solid, consistent excess returns and has developed a sustainable business and stable operational infrastructure.

Excess return potential and business risk depending on the life cycle stage



As mentioned earlier, Al Mal Asset Management team has been strengthened in early 2017. While the new team cannot show a track-record of more than 5 years and over $300 million in assets, we have now reached the stage once the fund has achieved some success, when those making the decisions have gained some confidence but they aren't yet so well known that the fund is too big or impossible to get into.

Al Mal Asset management team is highly qualified, with four CFAs cumulating 50 year of experience. It is also a passionate and dedicated team. While past results is not a guarantee of future results, the performance achieved since the start of 2017 is a strong encouragement for the foreseeable future.

Reason #10: the upside potential of MENA equities

While last year was a challenging year for Middle East equities, we are upbeat about the near-future prospects of our regional markets. As such, while last year was purely about alpha, 2018 could be a year of **Alpha** & **Beta**. Indeed, we do see at least 4 main reasons for global asset allocators to look at MENA equities in a positive way.

- First, with oil stabilizing around USD 55-65, the region has entered into a "sweet spot": the oil price is still not high enough to slow down structural reforms but the recent oil recovery allows the GCC governments to relax their austerity programs. For instance, Saudi Arabia is heading for increased government spending which should stimulate both capital expenditures and consumption;
- Second, valuations in MENA are very attractive. With a forward P/E multiple of 12x, the region trades at a discount to the MSCI Emerging markets and most indices in the world despite distributing higher dividend yields and generating higher return on equity than in most markets. It is also intriguing to see that the market is cheaper than in early 2017 despite a 20% recovery of oil prices;
- Furthermore, 2018 is a decisive year when it comes to mega IPOs such as Saudi Aramco but also the potential inclusion of Saudi and Kuwait in the major emerging markets indices such as MSCI and FTSE. In case of positive developments on this front, we can expect a major pick-up of foreign flows into MENA equities;
- Last but not least, our regional markets remain full of alpha opportunities. For instance, the structural reforms which are being implemented are creating major disruptions in various sectors such as Insurance in Saudi or in the education sector within the GCCs – astute managers are well positioned to take advantage of this new paradigm.

Conclusion:

The way we see our role as Al Mal Middle East equities team is the following: whatever the direction and performance of the market, we want to invest into what we define as the very best opportunities within our investment universe. We believe that by doing so, we should at least double our client's capital over 7 years. It should be achieved by going long the market and generating 5-10% of alpha vs. the index per annum.

While we cannot guarantee a repeat of the very strong year we had in 2017, we are confident that our high conviction approach will enable us to generate above benchmark returns going forward. And with the Middle East market outlook improving, it is thus not too late for investors to allocate to Al Mal MENA Equity fund.

Final words

As highlighted in this publication, picking the right markets or asset classes to invest in is not a guarantee of achieving the best performance. Since we revamped our investment strategy and team on MENA equities, we have been able to produce attractive returns for investors despite challenging macro & geopolitical conditions on our regional markets. By selecting the best investment opportunities within MENA, we have been outperforming what is seen by many as one of the best market to allocate into, i.e. US equities. We invite our readers to have a close look at our MENA equities sections and why we believe Al MAL flagship fund should still be considered as an interesting addition to a diversified portfolio.

We remain at your full disposal for any specific issues you would like to discuss, so please don't hesitate to contact us.

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