



Reasons to believe the worst is over

Clear signs indicate that the bottom of recession or peak of contraction has been reached. Investors are being advised to take advantage of the upturn and make tactical investments to take advantage of emerging pockets of growth. **Ritwika Chaudhuri** has her reasons to believe the worst is over.

There are reasons for hope all around the globe. Intra and inter government policy coordination and timely stimulus packages have started working, ensuring pockets of recovery. Economic indicators in select countries are improving and financial markets are showing signs of coming out of the woods, therefore influencing a turnaround in investor sentiment.

Though not exactly euphoric, many investment advisers are much more positive today. A consensus is building that a long-drawn era of depression has been averted.

"We see a reflationary trend around the corner. It looks like we have reached the bottom of the recession or the peak of contraction," says Lim Say Boon, chief investment strategist of group wealth management at Standard Chartered. "Equity market recovery, spreads in the money market and LIBOR [the London Interbank Offered Rate] are all indicating that the worst of the crisis is over."

Say Boon, however, expects the recovery from the recession to be U-shaped rather than V-shaped, with the US economy somewhat improving by the fourth quarter of 2009. Globally, one can expect a muted recovery, he says.

An investment strategy report from Barclays Wealth issued in May argues along the same lines. Among the signs that the global economy is getting ready to start growing again later this year, it lists stable US consumer spending even

before the fiscal stimulus money had hit paychecks, a sharp movement in Chinese business confidence (with the improvement in manufacturing sentiment) and inter-bank lending spreads approaching pre-crisis levels. (See Graph 1)

"We have seen some recovery in the market beginning in 2009. Definitely there has been a turnaround in sentiments. We are seeing flows of investments coming back, compared to the end of 2008. Global recovery is expected by the end of 2010 or early 2011," says Vivek Kudva, managing director for CEEMEA and India at Franklin Templeton Investments.

Reasons for hope

The Barclays Wealth report sees clear evidence that the current economic downturn will not deteriorate into a severe depression, although recession and disinflation may not be avoided. It's true that economic data haven't exactly been strong. But the downside surprises have started to be interspersed with an increasing number of upside surprises, says the report. This development is leading to an increase in the percentage of optimists among investment strategy analysts. Most feel that a modest global economic recovery will begin by the fourth quarter of 2009, led by the US, China and emerging Asia.

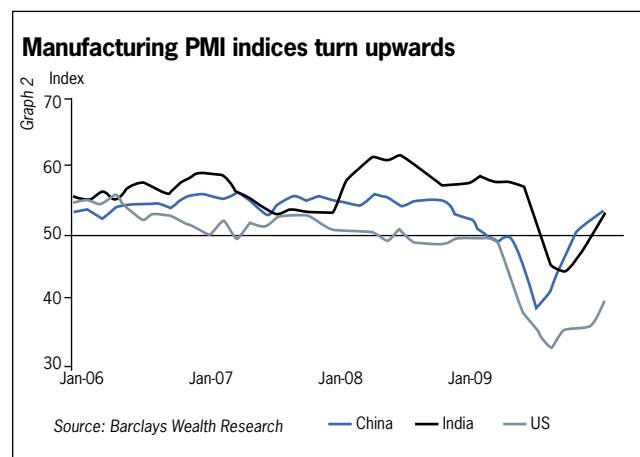
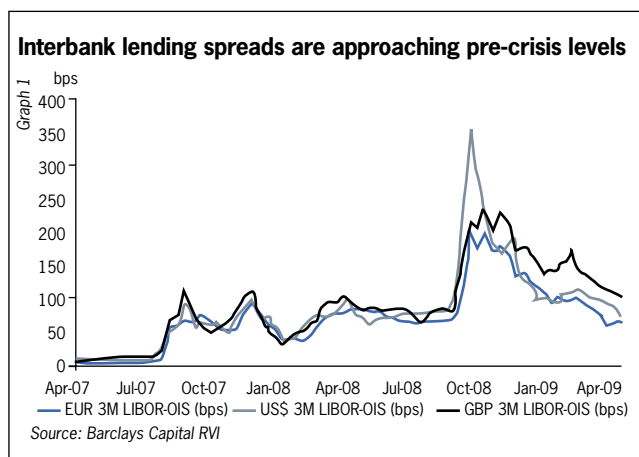
"This is mainly due to three reasons: policy coordination between and among governments are unprecedented with problems identified earlier, stimulus



Vivek Kudva

packages are beginning to work and economic indicators like PMI [Purchasing Managers Index] indices and GDP in selective pockets are showing signs of recovery," notes Khurram Jaffree, director of investment and products at Barclays Wealth. (See Figure 1 and Graph 2)

According to investment strategy analysts at Barclays, the fiscal stimulus pledged includes automatic stabilisers such as rising unemployment benefits, which all add up to a significant sum. Countries like Germany and Japan that were initially reluctant are now also in the game. In addition, the monetary measures being taken by the likes of the Bank of England, the Federal Reserve, the European Bank and the Bank of Japan are helping even more as they engage in quantitative easing through purchases of government and private papers. The European bank is also



considering steps of its own to follow in that direction.

A significant effort is being made to reduce system malfunctioning through US public private partnership investment programmes by offering private investors attractive loan terms for taking toxic assets off banks' balance sheets. Moreover, measures like extended IMF funding show willingness to take action on a global level to avoid large-scale defaults and debilitating crisis in the global economy.

The steep decline in the price of oil has also acted as a stimulus. It has been a boon for large oil importers like the US, Japan and the Euro area, boosting real incomes of households even before fiscal stimulus kicks in.

A number of economists and market watchers feel that Asia is likely to lead the global economic revival. Global economic crisis has been a catalyst for change in China's economic policy, which is shifting away from export orientation to domestic-demand-driven growth. This policy, backed by fiscal stimulus and

aggressive bank lending, is likely to have an impact not only on China, but also on its other trading partners.

Investment options

Barclays Wealth recommends that investors start increasing portfolio risk, albeit modestly. "We are propagating a gradual shift towards risk from a totally neutral attitude," says Jaffree.

The Barclays Wealth report does indicate that volatility in the market will continue to remain well above normal for many months to come. As such, both

Green shoots are for real

A majority of respondents to a recent survey conducted by **MONEYworks** said they felt that the green shoots of recovery were for real. Overall, there's far more optimism in the air today than there was a couple of months ago. A **MONEYworks** report.

Even as Wall Street continues to look for direction and even as world leaders still seem unsure about whether the worst is behind us, a vast majority of respondents to a **MONEYworks** survey said they believed that the green shoots of recovery were for real.

The survey of more than 200 respondents, including millionaires and young professionals just starting out in life, was conducted at a **MONEYworks** Young Professional Event held in Dubai in June. The total number of respondents who agreed or strongly agreed that the green shoots were for real was nearly double the number of those who disagreed or strongly disagreed. Forty-six per cent felt that the green shoots were for real, compared to 23 per cent who felt they were not.

The majority of respondents, however, felt that despite the green shoots being real, the world economy had yet to turn the corner. In fact, 40 per cent of respondents disagreed that the world economy had turned the corner, compared to the 29 per cent who felt the opposite.

The survey was conducted just days before an International Monetary Fund (IMF) statement proclaiming that the

world was beginning to pull out of the first recession since World War II.

"The worst is behind us and the recovery is coming," said Olivier Blanchard, the IMF's chief economist.

Blanchard added, however, that the recovery was fragile and that the improved forecast was mainly due to better performance in Asia, especially India and China.

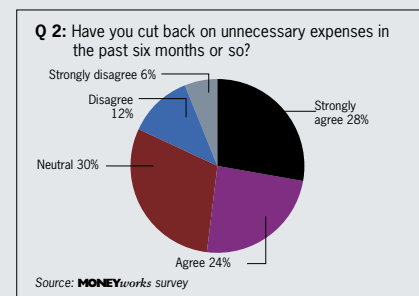
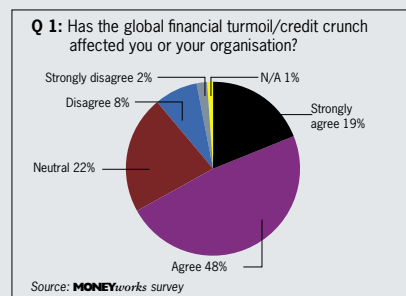
According to the IMF, most growth in the next two years will come from the developing world, while wealthy countries will stay in recession until mid-2010.

The IMF has also forecast that advanced economies would shrink 3.8 per cent this year and grow only 0.6 per cent next year, while developing countries would grow 1.5 per cent in 2009 and 4.7 per cent in 2010.

It is expected that growth in India and China will have its positive impact

on the economies of the GCC, but the recent commitment and seriousness shown by regional governments towards infrastructure spending is also going to help in a big way. There are large projects lined up in Saudi Arabia, which should boost the Kingdom's housing and home finance industry in the very near future. There are also plans afoot to build a massive airport free zone housing various industries in the Kingdom, which is bound to bring international and local investments into Saudi Arabia.

In the UAE itself, all planned infrastructure spending continues. Dubai's metro project is on track, while the federal government is setting up the Union Railways Company with an investment of AED1 billion. France announced that it plans to set up its first military base in the GCC in Abu Dhabi,



macroeconomic and financial markets are likely to stabilise only gradually.

Although stability in the financial markets will be slow to come, bankers and financial advisers unanimously believe that valuations of different asset classes are attractive at present and suggest that it is time to consider investment, rather than sitting on cash.

As has happened in the past, markets have rebounded before economies have bottomed out. During the Great Depression and during the 1980s, when the S&P 500 PE ratio was at its lowest,

the market spiked as investors found some great valuations to invest in. The S&P 500 six-month index is now lower than any other period, so bouncing back healthily is a fair possibility. The same is also true for the six-month return on the MSCI Asia Pacific ex-Japan.

Say Boon, however, predicts a correction coming soon. He says that markets have moved too fast after the lows of March 2009 (35 per cent globally and 50 per cent for emerging markets).

“There will be another disappointment as markets undergo another correction,

which might not see the March low, but will definitely see muted growth. That means another chance to buy, and stocks will be worth a lot more in two to three years,” Say Boon points out.

Given that the fear of uncertainty still continues, the absolute risk-free situations for many investors today are cash or short-term government bonds. The Barclays Wealth report recommends increasing risk from this absolutely secured defensive position. It reads: “We believe that with the risk of prolonged downturn still as high as 20 per cent,

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while the emirate’s various projects worth hundreds of billions of dollars have not been taken off the shelf. The government is committed to developing these projects. Sources also say that the UAE’s northern emirates are planning projects worth tens of billions of dollars. Tenders are likely to come out soon.

Although the oil price doesn’t look great, at US\$60 a barrel, it is up almost 90 per cent from the lows seen at the beginning of the year. And that has helped to bring some confidence back to investors in the region.

Leading business owners and institutions, including local and international exchanges that **MONEYworks** talked to last month, have all spoken with the same voice. They are starting to find that the fall in prices and sentiments have either been arrested or have slowed down considerably. They also said that they’re seeing some signs of positive movement in terms of deal closures. Most felt that business activity was likely to pick up by the last quarter of this year. The majority of respondents to **MONEYworks’** survey were of the same view.

The effect of the crisis

Understandably, a significant majority of respondents to the **MONEYworks** survey said they had been affected by the financial crisis. Nearly 70 per cent of the respondents said they had been impacted negatively by it. While 50 per cent of those affected by the crisis had seen deterioration in their employment or related areas, 25 per cent had seen their salaries reduced.

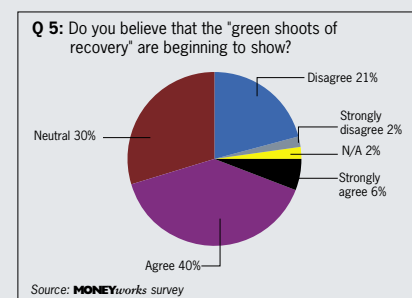
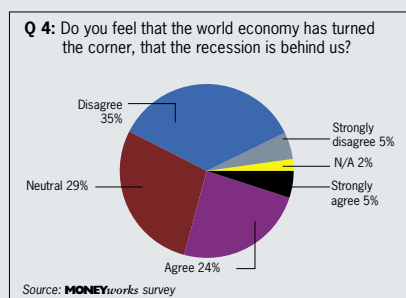
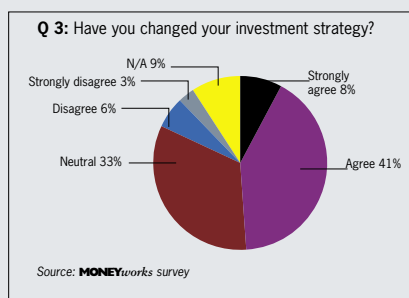
While 30 per cent of these respondents remained neutral on a question about cutting back on unnecessary expenses in the past six months, over 50 per cent said they had cut back on their spending on non-essentials. Only 20 per cent said they had not cut back on unnecessary expenses.

The majority of respondents also said they had made changes to their investment strategies during the economic downturn. A significant number said they had become more sensitive towards finding a good balance between debt and equity exposure in their portfolios. There were also those who had started diversifying beyond real estate

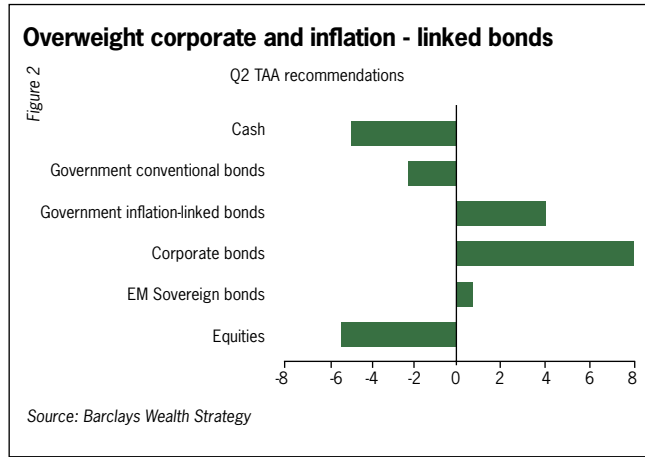
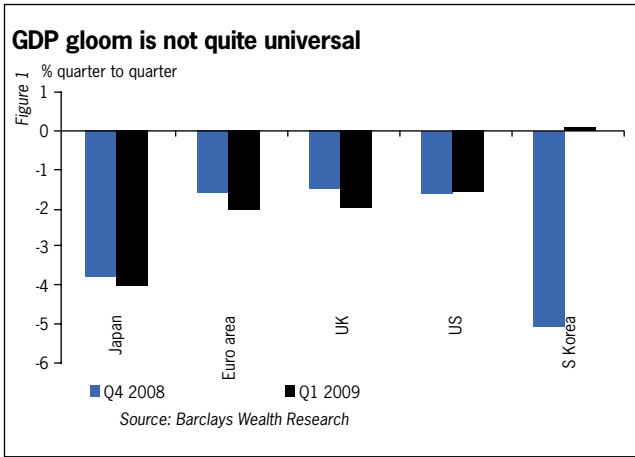
investments, many heading for high-interest savings accounts. In this period, it is clear that fixed-income securities have found many more takers and that capital-guaranteed funds look far more attractive.

Nearly 50 per cent of those surveyed said they had changed their investment approaches, having been hit by the economic downturn. Most had decided they’d had enough of equity and property. The result has been obvious, as both regional and international asset management companies focused on equities have lost a lot of ground in the region in the past year.

But as equity markets undergo correction after having seen significant gains recently, analysts feel there will be opportunities to buy equities during dips in the months ahead. Most are also confident that things will start looking up by the winter and should certainly pick up by the first quarter of next year. The emerging markets and the Middle Eastern markets will be in the thick of things, according to analysts. Most of them agree that the global recovery will start from the east.



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longer-term government bonds, either fixed rate or inflation-indexed, are an important component of a defensive portfolio.” (See Figure 2)

Overall, Barclays recommends underweight equity and cash and overweight fixed-income instruments with a strong preference for investment-grade corporate bonds and, to a lesser extent, inflation-protected government bonds.

For equities, the bank recommends increasing exposure to cyclical sectors in developed economies and avoiding expensive defensive stocks simply because the cyclical equities with current attractive valuations and earnings should benefit particularly from economic recovery. The report says: “For us, this means being long materials, industrials, IT, consumer discretionary stocks, short utilities and consumer staples.” (See Figure 3)

But Jaffree cautions: “While investing, we need to follow some tactical ideas.

Portfolios are to be decided based on risk appetite and time horizon, and we need to balance between fixed income and equity. Also, we need to decide how to implement risk-adjusted return.”

The market has already assumed extremely high levels of default, although in reality, default might be lower, Jaffree adds.

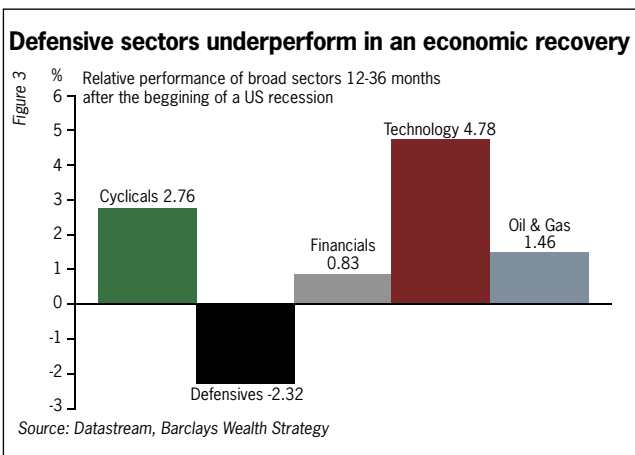
Say Boon also says that investment-grade bonds and emerging sovereigns are likely to perform better in the coming few years and probably merit a good buy now.

“We are aggressively chasing gold now as a portfolio hedge and cyclical currencies. Since the US dollar is a counter-cyclical currency and does well when the market is down, we would recommend currencies of emerging markets and commodity currencies, which are likely to be winners in the wake of the weakening dollar,” he notes.

Geographically, South and East Asia (ex Japan) led by China could lead the global economy into potential recovery, says the Barclays Wealth report. A Standard Chartered report also suggests that while the China factor will play a strong role in the overall global recovery through its trade and investment relations with the other neighbouring Asian countries and through its outward foreign direct investment to different regions globally, Asia (ex Japan) will be critically instrumental in driving global recovery because of less vulnerability and more policy ammunition. (See Figure 4)

Case for GCC investments

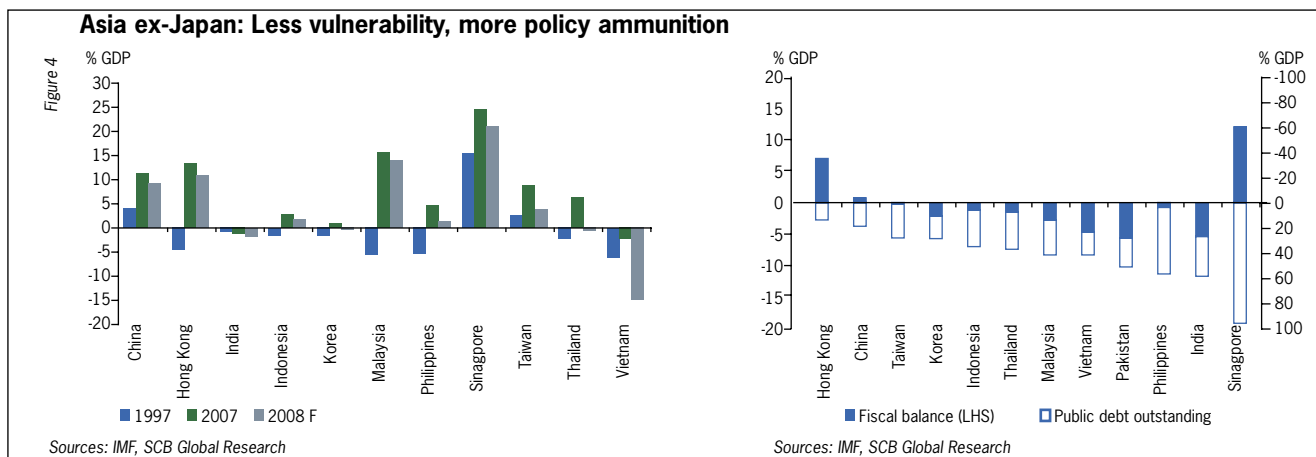
A Bank of America Securities-Merrill Lynch research report calls the GCC region a compelling trading buy for investors looking for laggards. Gulf equity markets have huge laggards. GCC markets were up by only 1.2 per cent



Investment tips from industry experts

- *Increase portfolio risk, but modestly.
- *Start shifting to the tactical offensive.
- *Underweight cash and significantly overweight fixed income.
- *Asia is likely to lead the global economic revival.
- *The credit market will outperform as risk appetite increases.
- *Volatility is likely to ease back gradually.
- *Find opportunity in cyclical currencies and undervalued cyclical equities.
- *Diversify out of US dollars due to their counter-cyclical nature.
- *Rebound in commodities on the recovery of emerging market growth.
- *Overweight Asia (ex Japan) or specific high-beta countries.
- *Buy the dips instead of chasing rallies.
- *Use gold as a long-term hedge against US dollar weakness and financial turmoil.

Source: Standard Chartered/Barclays Wealth



as of June 7 (year to date) compared to emerging markets (up by 33 per cent), hence attracting significant inflows.

Disadvantages in one region often turn out to be advantages at some point in time, as is the case for Dubai and Saudi Arabia. The report reads: "We believe that while Dubai is the best case for trade, the best investment case in this region remains with Saudi Arabia. It is hard to find much that has underperformed US banks in the past three years. But Dubai has, thanks to its real estate and oil bust. It's now cheap and unloved, and the combo of oil more than US\$60 per barrel and improving credit spreads are powerful drivers."

According to the report, Dubai is the cheapest market in all emerging markets. For example, on a price-to-book basis, it trades at a 56 per cent discount to the MSCI EM Index. Relative to Russia, the cheapest MSCI EM country, the UAE

trades at a 20 per cent discount on a price-to-book basis. And certainly, the UAE has the cheapest financial sector across the asset class.

Asian and Latin American bank stocks are also trading 20 per cent above their 200-day moving averages. In contrast, financials in Dubai are trading 20 per cent below their 200-day moving average.

The catalyst to boost the Dubai financial sector will be further compression in CDS spreads, which have narrowed 700 to 500 basis points in recent months. (See Tables 1 and 2)

Saudi Arabia is an attractive investment proposition anyway. It is the second largest oil producer in the world and accounts for half of the GCC's US\$1 trillion GDP, with the non-oil sector contributing 70 per cent of the growth since 2003. The Kingdom also has the second largest banking industry in the region.

The MSCI GCC (ex Saudi) Index trades at a 13 per cent discount to the MSCI EM Index on a twelve-month trailing basis and trades at a discount of 26 per cent on a price-to-book basis, which shows that Gulf markets are obviously cheaper than emerging markets. And the GCC has lots of opportunities, especially Dubai, Qatar and Saudi Arabia.

Kudva observes: "The current price of oil might slow down the GCC economy as a whole, but it will not affect the growth, as the Gulf economy is well positioned for growth. With lots of infrastructural activities and zero taxation, it continues to attract expatriates."

Table 1: Price to book

	Total	Financials
GCC ex Saudi	1.4	1.3
UAE	0.8	0.7
EM	1.8	1.8
Russia	1	1.1
Brazil	2.1	2.5

Source: Thomson data stream P as of May 27, 2009 and B as of April 30, 2009.

Table 2: CDS spreads (bps)

	15.9.08	10.3.09	27.5.09
Dubai	267	700	494
Bahrain	149	592	402
Oman		473	395
Qatar	115	328	179
Saudi Arabia*	33	285	148
EM	124	336	168
Russia	209	729	311

Source: Market and Bloomberg. *weighted average of MSCI EM countries CDS spread.

He adds: "This is especially true for Dubai, which is well diversified from oil, although real estate could act as a drag for sometime. I also see lots of opportunities in Saudi Arabia and Qatar, though each has its own challenges."

Like many of his peers, Kudva surmises that traditional markets like the US and Europe have saturated, whereas emerging markets and Baltic economies have lots of potential. Certainly, there are more opportunities for investors near home right now than in traditional markets. But in the longer term, traditional markets continue to offer interesting assets at a discount that was unthinkable a few years ago. As always, a balanced approach will pay more dividends than one that suffers from concentration.



Khurram Jaffree