From West to East

Weekly Investment View
15th November, 2018

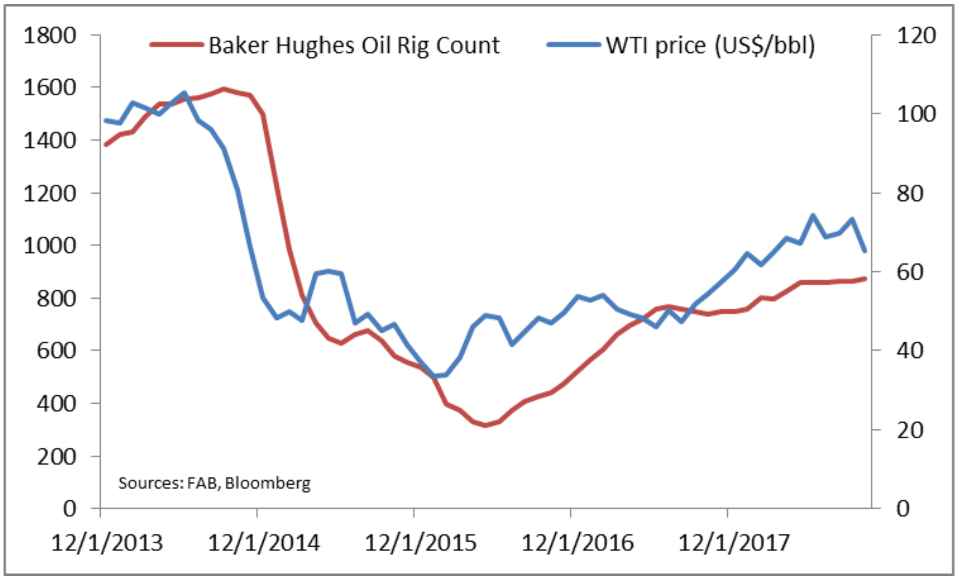
The best investments tend to appear during volatile times

It has been a rocky ride for investors lately, but it is at such times that some of the best opportunities arise. Perhaps two of the best examples of assets that could offer compelling long-term returns and which have been temporarily sold off were on offer this week.

Take oil prices, for instance, and all the various asset classes and securities that tend to track them. On Wednesday, Brent crude broke a six-day losing streak, after 23 down-days in the 33 trading days since the start of October. As a result, the commodity is down 22.8% since its recent peak on 3rd October, prompting a series of fear-inducing headlines about an oil bear market. However, at US$66.6/barrel, there is arguably now a higher probability of prices moving up in the next few months, rather than down. In fact, the long-term technical trendline for crude still indicates an up-trend channel, not a bear market.

There is fundamental reason to believe that too. While supply has outstripped demand for the past couple of months, according to data from the International Energy Agency (IEA), that could soon be reversed. The members of 'OPEC+' have agreed to reduce output in response to the short-term glut in inventories. Saudi Arabia alone intends to reduce output by 500,000 barrels/day next month, exactly the amount of over-supply currently in the market according to the IEA numbers. Assuming other OPEC members tag along, the excess production could soon be reduced.

Then there is US shale oil. US production breached 11 million barrels/day this year, an absolute record, making the country, together with Saudi Arabia and Russia, one of the world's biggest producers. In the past year alone, the US added 3 million barrels/day of production, more than enough to offset the reduced production from Venezuela and lower exports from Iran. Much of that was due to an increase in shale oil output driven by higher prices – which made it once again economic to pump oil from small fissures in rock. These producers, however, react to prices. As the chart above shows, within five months of a significant price move the number of rigs operating in the US changes too, as does output. So that part of the supply is likely to be reduced before the end of the first quarter.



Finally, geopolitical concerns are probably understated, too. Apart from the earlier decision by Saudi Arabia and the UAE to increase output, most of the additional oil that OPEC produced this year came from higher production in Nigeria and Libya, where local governments were able to quell rebels who had been making attacks in their respective oil-producing regions. Nigeria is likely to see tensions in the Niger Delta flare up ahead of its February general elections, hence some of that additional output could be cut off, too.

Once supply is taken out of the market and starts pushing prices up, only a few countries have spare capacity to quickly increase output - and even that ability is limited. According to the IEA, spare capacity is currently around 2 million barrels/day (or about 2% of global consumption). So there is only a thin buffer. Once spare capacity is utilized, companies drawdown inventories, and that is when oil prices can move upwards quite sharply.

"Oil might yet move lower, although the probability of it moving higher from here outweighs the likelihood of significant further losses."

Similar dynamics apply to the US stock market, and to technology stocks in particular. Recent news related to suppliers of Apple iPhones have caused investors to revisit their growth expectations for the most valuable company in the world. That prompted a sell-off in technology stocks that compounded with the losses that started in October – driven by profit-taking and investors moving money out of names that performed very well, to fund bets on the recovery of some underperformers. The trend probably remains to the downside for some of the most-watched names, however.

This market sell-off has dragged down a number of prices of stocks of good companies which have very sound businesses and may be cheap at these levels - particularly for investors taking a longer-term view. That debate was undertaken very thoroughly in the latest FAB Asset Allocation Committee meeting on Thursday. While members acknowledged that the momentum overall for technology stocks might remain downwards for the time being, they also agreed to remain overweight in the sector. They did, however, reiterate their caveat of avoiding social media stocks, especially given the regulatory headwinds these companies face. Excluding those, and avoiding overvalued names, technology certainly remains a lynchpin of the AAC's core beliefs.

In the same way that computers, the internet and smartphones have revolutionized every industry in the world - and society itself - cloud and quantum computing, computer-based learning, crowd-sourcing, and the automation of homes and businesses are likely to reshape everything yet again in the next 20 years.

"Investors should see this market sell-off as an opportunity to buy stocks of companies they believe will shape the future."

While market dislocations are great opportunities to pile up on the assets that are likely to outperform in the future, sometimes investors need to step back. Particularly, when the reason for selling is something that is completely out of their control. European and UK assets are the example in this case.

Both had a rocky ride last week, but in that case the fundamental case for investment is harder to make given the uncertainty of the outcome. Underlining that, implied volatility for the British pound rose to the highest in 20 months and near the record logged in June 2016, when the UK voted to exit the European Union.

The move was a natural reaction to the newsflow coming out of London and Brussels. On Sunday, one of UK Prime Minister Theresa May's ministers resigned as she geared up to announce what could be a Brexit agreement that, she said, should be agreeable to both Brussels and to the UK. She announced the deal the next day saying that she had her cabinet's support. The market, however, seemed skeptical and continued to whipsaw the British pound. Part of the suspicion derived from the fact that after reaching the agreement, Theresa May still in reality needed to get final approval from her cabinet, then the British Parliament, and finally the European Parliament – all for a deal which many disagreed with.

The key contentious issue in the deal was the treatment of the border between Northern Ireland and Ireland. The EU has said that a hard Brexit would mean establishing a full border between the two, given that Ireland is a member of the EU and Northern Ireland is part of the UK. That would bring back the spectre of local conflict which had been mostly quelled in recent years. Theresa May's team had gone back and forth with the EU several times on the issue with either side disagreeing on some part of a potential deal. Finally, this week, she presented a solution that would involve Northern Ireland remaining part of the customs union, but therefore also following European rules for trade and some other areas.

The Democratic Unionist Party of Northern Ireland, which happens to be a key member of the coalition that put Theresa May in power, quickly opposed it. Then Brexit Secretary Dominic Raab resigned on Thursday and other ministers were expected to follow. That suggested that cabinet support for Theresa May's deal was much weaker than she inferred in her speeches earlier in the week. That - added to the lack of support for the deal from the DUP - further gave investors reason to think that the deal would not get through Parliament either, and could even prompt Theresa May's resignation. All this just four months before the deadline for the UK to exit the EU. As we go to print, a formal request has just been made for there to be a vote of confidence in Mrs. May's leadership.

"The probability of a hard Brexit is increasing and investors may want to exercise caution with regards to British and European assets for now."

Amid so many negative headlines, at least investors in the UAE, and in Dubai stocks in particular, received some good news last week. According to local newspapers, the central bank has removed a cap on real estate lending for local banks. Some details of the regulatory revision are still pending, but it seems banks will soon be able to lend more than 20% of their deposits to real estate.

That has the potential to supportreal estate prices in the country, which could help the Dubai market in particular. The Dubai Financial Market Real Estate Index is down 26.9% for the year-to-date, one of the worst performing sectors and the main culprit for the 17.6% drop in the local stock market index. Loosening lending constraints is one of the most effective ways of helping real estate prices recover.

"The removal of a real-estate lending cap could put a floor under home prices in Dubai."

While the effect may not be immediate, that bodes well for real estate (and banking) stocks, which are significant components of the Dubai index. Add to that the previously-mentioned potential for higher oil prices next year, hence investors may indeed be looking at a good opportunity to buy Dubai (and Abu Dhabi-based) stocks.

For inquiries related to this article, please contact:

Alain.Marckus@bankfab.com or Christofer.Langner@bankfab.com

From West to East

Weekly Investment View
15th November, 2018

Disclaimer:

This report has been prepared and issued by Products & Services - Elite & Private Banking ("P&S-EPB") of First Abu Dhabi Bank PJSC ("FAB") outlining particular services provided by P&S-EPB and does not constitute or form part of any offer or invitation to sell, or any solicitation of any offer to purchase or subscribe for, any shares in FAB or otherwise or a recommendation for a particular person to enter into any transaction or to adopt any strategy nor shall it or any part of it form the basis of or be relied on in connection with any contract therefore. This report is incomplete without reference to, and should be viewed solely in conjunction with the associated oral briefing provided by P&S-EPB. The report is proprietary to P&S-EPB and may not be disclosed to any third party or used for any other purpose without the prior written consent of P&S-EPB. The information in this report reflects prevailing conditions and our views as of this date, which are accordingly subject to change. In preparing this report, we have relied upon and assumed, without independent verification, the accuracy and completeness of all the information available from public sources or which was otherwise reviewed by us. In addition, our analysis are not and do not purport to be appraisals of the assets, stock or business of the recipient. Even when this presentation contains a kind of appraisal, it should be considered preliminary, suitable only for the purpose described herein and not be disclosed or otherwise used without the prior written consent of P&S-EPB. FAB clients may already hold positions in the assets subject to this report and may accordingly benefit from the buying or selling of such assets as referred to in this report. This document does not purport to set out any advice, recommendation or representation on the suitability of any investment, transaction or product (as referred to in this document or otherwise), for potential purchasers. Potential purchasers should determine for themselves the relevance of the information contained in this document and the decision to purchase any investment contained herein should be based on such investigation and analysis as they themselves deem necessary. Before entering into any transaction potential purchasers should ensure that they fully understand the potential risks and rewards of that transaction (including, without limitation, all financial, legal, regulatory, tax and accounting consequences of entering into the transaction and an understanding as to how the transaction will perform under changing conditions) and that they independently determine that the transaction is appropriate for them given their objectives, experience, financial and operational resources and other relevant circumstances. Potential purchasers should consider consulting with such advisers and experts as they deem necessary to assist them in making these determinations and should not rely on FAB for such purposes. FAB is acting solely in the capacity of a potential arm's-length contractual counterparty and not as a financial adviser or fiduciary in any transaction unless we have otherwise expressly agreed so to act in writing. FAB does not provide any accounting, tax, regulatory or legal advice. FAB is licensed by the Central Bank of the UAE.

London: *FAB London Branch is Authorized by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from FAB London branch on request. Registered in England & Wales: Company No: FC009142: VAT No: GB245 3301 91.*

Paris: *FAB Paris Branch is licensed by the French Prudential Control Authority as a credit institution. FAB Paris is registered in France under the company number: RCS Paris B 314 939 547.*

Switzerland: *This publication is for your information only and is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product. Certain services and products are subject to legal restrictions and cannot be offered worldwide on an unrestricted basis and/or may not be eligible for sale to all investors. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness. All information and opinions as well as any prices indicated are currently as of the date of this report, and are subject to change without notice. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. At any time the First Abu Dhabi Bank PJSC and/or FAB Private Bank (Suisse) SA may have a long or short position, or deal as principal or agent, in relevant securities or provide advisory or other services to the issuer of relevant securities or to a company connected with an issuer. Some investments may not be readily realizable since the market in the securities is illiquid and therefore valuing the investment and identifying the risk to which you are exposed may be difficult to quantify. Futures and options trading is considered risky. Past performance of an investment is no guarantee for its future performance. Some investments may be subject to sudden and large falls in value and on realization you may receive back less than you invested or may be required to pay more. Changes in foreign exchange rates may have an adverse effect on the price, value or income of an investment. First Abu Dhabi Bank PJSC expressly prohibits the distribution and transfer of this document to third parties for any reason. First Abu Dhabi Bank PJSC and/or FAB Private Bank (Suisse) SA will not be liable for any claims or lawsuits from any third parties arising from the use or distribution of this document. This report is for distribution only under such circumstances as may be permitted by applicable law. The "Directives on the Independence of Financial Research", issued by the Board of Directors of the Swiss Bankers Association (SBA) do not apply.*

Singapore: *First Abu Dhabi Bank P.J.S.C., Singapore Branch is regulated by the Monetary Authority of Singapore and holds a Wholesale Bank license.*