

Schroder ISF* Middle East Fund Update

Market Review

The MSCI World index delivered a negative return in May against a background of heightened concerns about eurozone sovereign debt (although markets recovered some ground towards the end of the period). Investor confidence was also impacted by a unilateral move from the German financial regulator to ban the naked short selling of various securities, while concerns about policy tightening in China contributed to a fall in commodity prices. Overall, Middle Eastern markets underperformed developed and broader emerging markets during the month.

Egypt posted the weakest returns in the region, with the underperformance of local index heavyweight Orascom Telecom having a negative impact. Turkey also underperformed, with general weakness in the banking sector weighing on the market, while local currency depreciation had a negative impact on US dollar returns. The GCC markets were also in negative territory, impacted by a fall in the oil price. The UAE and Saudi Arabia underperformed the regional index. Generally weak returns from banking and real estate stocks had a negative impact on the UAE market while the underperformance of local index heavyweight Saudi Basic Industries weighed on the Saudi market. Kuwait and Qatar outperformed with mobile telecoms stock ZAIN and Qatar National Bank (respectively the largest constituents of the local indices), both holding up relatively well.

Performance Comment

Stock selection and asset allocation both had a negative impact on fund performance in May. Stock selection in Turkey, Oman and Qatar had a negative impact, outweighing the positive impact of stock selection in Egypt. Our underweights in Kuwait and Morocco also impacted negatively (we are underweight these markets due to expensive valuations).

Outlook/strategy

The long-term case for investing in the region remains strong. Middle Eastern countries are at a relatively early stage in their development and have strong growth potential. While many of these countries continue to benefit from oil and gas riches, they are investing in new products and skills to diversify away from reliance on energy exports. The region has a young, fast-growing population which should also contribute to more rapid economic development.

Following the end of the month, we reduced our exposure to Qatar, although we remain overweight as domestic growth conditions are strong and we are finding good bottom-up opportunities in this market. We increased our overweights in the UAE (inexpensive valuations) and Oman (improving valuations). We remain overweight Turkey (attractive valuations) and Egypt (reasonable valuations, strong macro-economic outlook). Our largest underweights remain Kuwait and Morocco (due to relatively expensive valuations in these markets). We are also marginally underweight Saudi Arabia (valuations are on the high side although the domestic macro-economic backdrop is favourable).



Important Information: *Schroder International Selection Fund is referred to as Schroder ISF throughout this document.

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