
From: Richard Kahn <[REDACTED]>
Sent: Wednesday, March 14, 2018 4:52 PM
To: jeffrey E.
Subject: Fwd: Other ways to trade Saudi

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Begin forwarded message:

From: "/b>"Ens, Amanda" <[REDACTED]>
Subject: "/b>Other ways to trade Saudi
Date: March 14, 2018 at 12:48:07 PM EDT
To: "/b>"rkahn" <[REDACTED]>
Reply-To: "/b>"Ens, Amanda" <[REDACTED]>

Saudi trade continues to gain momentum as we head into March 28 FTSE decision, followed by MSCI in June. Our base case is for a positive outcome for both EM index reviews.

- Tadawul +5% past 3 sessions printing new 3 year highs, Foreign inflows YTD at \$1.35bn
- Recent headline on Aramco: Saudi Aramco likely to be delayed to 2019. Delay not all together surprising given complexity of the transaction, delays in choosing the trading venues, as well as to better align the IPO with potential MSCI / FTSE index inflow timelines
- Crown Prince MBS will appear on '60 minutes' on March 18th, one day before he lands in the US for a 10 day tour, meeting Trump on the 20th.
- Reform agenda picking up speed: Women Driving; Entertainment/Movie Theaters; Welfare Programs; Market access reforms; Int'l debt issues

Saudi Fundamentals are strong (see Jean-Michel Saliba's report from Jan. 29th below):

- Growth has bottomed out
- OPEC is succeeding at rebalancing the oil market. Fiscal adjustment now sufficient to safeguard stability at cUS\$60/bbl.
- Equity strategy: remain positive, outlook gains momentum - We retain our positive view on the Saudi market as we see strong earnings momentum as well as increasing appetite for Saudi equities amongst global investors:

Best way to access the trade: M1SAP (MSCI Saudi Provisional Index)

- 32-name SCI-owned index, that will rebalance into the full MSCI EM index upon inclusion
- Trades 90m/ day based on bottleneck liquidity
- Tradable on swap at 1mL+90bps, std comm applies; also accessible on fully funded Luxembourg-listed warrant (MERRILL1DT LX)

10 single stock names to own in Saudi.

- Al Rajhi: BAML Top pick for 2018 >> Largest bank in Saudi >> Reflation trade beneficiary >> We see the bank continuing to deliver strong earnings momentum on the back of: (1) Stand out NIM expansion given a unique cost of funding position and further policy rate hikes (2) a continued normalization in asset quality driving CoR lower; (3) Higher loan growth than peers as it benefits from consumer loan growth (particularly housing) whilst taking share in the corporate market and (4) Al Rajhi is set to be a key beneficiary from the potential forthcoming Saudi index inclusions.
- NCB: We see NCB as a key beneficiary from the economic diversification program the Government has introduced. Its large balance sheet and resulting ability to finance mega projects should allow it to capture market share in the coming years. Further support will come from saving the PIF as a major shareholder. We also see a sublime margin outlook given NCB's ability to benefit from rising interest rates and bond yields.
- SABIC: Expect strong earnings momentum in FY18E driven by robust product prices as well as solid plant operations. View company's intent to expand internationally as a catalyst for unlocking balance sheet value. The company is expected to be the largest constituent of Saudi MSCI EM Index (~16%). Shares trade at a 2018E EV/EBITDA of 7.4x, ~20% discount vs global peers.
- Yansab: Given robust MEG pricing outlook (40% of profits, prices up 18% YTD) providing a healthy tailwind to earnings this year, we expect an attractive dividend yield of 6% (top quartile globally) in FY18E/19E well supported by FCF yields of 9% and a net cash position.
- STC: One of the main beneficiaries of index inflows into Saudi. STC has finally improved management representation to investors with the departure of the previous IR, and new team in place. Significant government receivables recovery to drive stock price for next two quarters, while Careem stake can provide some positive headline risk on valuations.
- Jarir: We like Jarir for its potential to increase its market penetration having increased its store count by 13% since August 2017 while maintaining its premium ROE of 53% and attractive dividend.
- Al Tayyar : Stock will see a slew of positive catalysts over the next two quarters, particularly a second tranche of substantial gov receivable recoveries in 1. 130mn SAR loss from associates in 2017 is a one off and should make comps easier this year. Q1 earnings should see the first earnings growth after a very difficult 2 years. Makkah real estate REIT will also provide an uplift.
- Al Hokair: has massively underperformed in Saudi index and consumer sector and should see substantial improvement in business in 2018 as LFL turns the corner and the company businesses a beneficiary from social reforms in the country. Debt restructuring concerns likely behind us at this point, relief there could be the main catalyst for the name.
- Malath / Alrajhi Takaful: 2 of the top motor insurers in Saudi secular growth trend in motor insurance sector over the next two years as the regulator clamps down on more than 50% uninsured drivers while women driving to present multiyear volume growth story.

Cole Mackay, CFA, Director

Emerging Europe, Middle East & Africa Equity Sales Bank of America Merrill Lynch

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SALES VIEW ONLY

Global Research

GEMs Paper #31

Saudi Arabia: growth bull, fiscal bear

29 January 2018

Key takeaways

- Growth recovers as high oil prices allow looser fiscal, contain near-term deterioration. Mega-projects offer upside potential
- The oil price at which reforms now bring imbalances to low mid-single digit levels moves to US\$60/bbl, from US\$50/bbl before.
- Earnings momentum, index events make us positive Saudi stocks. Prefer banks, petchems. Top picks: Rajhi, Samba, Yansab, Sabic

FULL REPORT

Macro: sweet spot for now

Economic activity has bottomed out as high oil prices are allowing implementation of looser fiscal policy and containing near-term fiscal deterioration. The government intends to support activity through a) a more gradual pace of fiscal reforms; b) introduction of Household/Cost of Living Allowances and Private Sector support programs; c) introduction of structural reforms; and, d) the launch of mega-projects. The latter provides most upside potential to our average growth projections of 2.2-2.5%yoy.

Fiscal reforms now need US\$60/bbl to safeguard stability

The oil price threshold at which the macroeconomic adjustment brings imbalances to low mid-single digit levels moves to cUS\$60/bbl, from our previous assessment of US\$50/bbl. The revised Fiscal Balance program exposes the budget to volatility in oil prices. Still, there are four ways in which authorities can improve on fiscal dynamics: 1) front-loaded energy pricing reform; 2) privatizations; 3) proceeds from anti-corruption crackdown; and, 4) phasing out of the Royal Order next year.

Equity strategy: remain positive, outlook gains momentum

We retain our positive view on the Saudi market as we see strong earnings momentum as well as increasing appetite for Saudi equities amongst global investors. Our views are based on: (1) attractive valuation, with the Saudi market now trading at a mere 3% premium to GEMs versus a historic premium of more than 30%; (2) improving macro fundamentals; (3) the prospect for accelerating earnings, FCF and dividend growth on the back of reform programs, an expansionary budget and a more pedestrian pace of austerity implementation; and, (4) the potential twin index inclusion events in 2018.

Preferences and petchems

Within the Saudi market, our preference lies with companies offering strong earnings and FCF momentum, attractive valuations and dividend yields. In this regard, our sector preference is tilted towards the banks and petchems, who we see as key beneficiaries from the 2018 budget and revised fiscal balance program. We highlight Al Rajhi & Samba as our top picks amongst the banks, Yansab & SABIC amongst the petchems. Elsewhere, given the inflationary pressures on operating costs (e.g. expat levies, rising utility costs), we are more selective; focusing on names that are least affected by the regulations and that have attractive company specific growth stories.

Commodities: As good as it gets for OPEC

OPEC is succeeding at rebalancing the oil market. Our supply/demand balances reflect a faster-than-expected market tightening due to improving cyclical conditions, cold winter, and OPEC compliance. A gradual OPEC+ deal exit would keep spot and forward prices in a range with the market in backwardation, and preserve OPEC's long-run market share.

Contents

Macro: growth dull, fiscal bear

2018 budget = expansions don't come cheap

A US\$20bn price tag for growth

Government stimulus in the pipeline

Revised Fiscal Balance program - more growth, more risk

Macro stable

Equity strategy: opportunity abounds as momentum picks up

KSA trading on line with GEMs despite improving outlook

Banks & petchems preferred; selective elsewhere

National champions strategy remains attractive

2018 - the fear of potential twin index inclusions

Banks: budget supports positive outlook

Saudi banks key beneficiary of loosened fiscal policy

2018 shaping up to be a strong year for the Saudi banks

Consumer: factors align for a more positive outlook

Easing austerity, higher growth boost disposable income

Expat levies: uniform fees, differentiated impact

Petchems: government support to continue for an extended duration

Delay in feedstock prices and electricity tariff hikes

Types of support for the sector from the government

Healthcare: no surprises

Telecom: towards the end of the tunnel?

Utilities: a balancing fund to manage the transition

Commodities: as good as it gets for OPEC

Disclosures

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This report is intended for Coleman Mackay

From: Ens, Amanda
Sent: Wednesday, March 14, 2018 2:46 PM
To: Ens, Amanda <[REDACTED]>
Subject: MEGA Trade --> Long =audi...

Global Equities
MEGA – Europe

Opening New MEGA Trade:

Long Saudi Equities (Buy M1SAP on Swap / Liquidity \$100mm a =ay)

- Potentially the EM Flow Story of 2018... if FTSE =ddition is announced on March 28th we expect an inflow of \$5bn =n a basket which trades 100mm USD a day (50X ADV)... this is even =efore MSCI announcement in June where inflows could be substantially =igher
- The Most Powerful Macro Trades are when Macro =undamentals + Flow Meet... This is Saudi in 2018

Key Points:

1. Saudi has significantly underperformed Oil by 14% last = months. With the recent introduction of the citizens account =rogramme, subsidy cuts, pushing out the budget balance to 2023, and the =ews of increased handouts, Saudi should re correlate with oil and move =igher from here.
2. Saudi equities remain under-owned globally à foreign ownership of Saudi equities is at 1.3% vs Russia 70%, Turkey 55%, =outh Africa 50%, Brazil 45%, UAE 20%, Qatar 10%
3. Good liquidity vs other EMs but volume trading at lows =relative to history à Tadawul ADV close to all-time lows at \$1bn (10yr range =s \$1-8bn)
4. Major index events in 2018/19 with FTSE announcement =n 28th March next =atalystà FTSE announcement could =igger inflows of up to \$5bn . =ombined with the MSCI announcement later this year, potential active =nd passive inflows can total \$15-\$40bn. So the =otential of at least \$20bn inflows on a basket which trades 100mm USD a =ay (200 Days Volume) ?
5. In comparison, during the MSCI UAE and Qatar =nclusions, UAE was trading 10% below historic avg @14x PE and rerated to 22x =nto MSCI EM inclusion with Dubai up +110% (vs +47% prev year). Qatar was =rading inline with historic avg @11x PE and rerated to 18x =SCI EM inclusion with Qatar up +60% (vs +9% prev year)
6. Saudi risk indicators at 2015 =re-crisis levels à Saudi 5yr =DS is trading at 76 vs 40-210 3yr range; SAR 2yr fwd suggests market is less =orried about depeg fears and forward points can be used as a macro hedge
7. Valuations & dividend yields remain =ttractive à Market trades at a 10% =iscount (13.5x) to its historic PE (Saudi PE range is 10-26x). Avg dividend yield is 3.6% with =5 stocks yield more than 4%.

Our Middle East Team ready for Calls - Hamdy Hamoudi in London next week =9th-23rd March. Talal marketing in US 23rd-27th =pril. Marwan in Trading

MAR disclosure

Saudi has underperformed both Oil and EM in the last 6 months

Saudi equities remain under-owned globally

Risk indicators are back to 2015 pre-crisis levels. Saudi 5yr CDS down from 210 to 76 (note 40 was all time low)

Valuations remain attractive – Saudi trading at 10% below historic PE; Saudi ERR now at 1.22 vs 0.4 in 2016

MEGA Open trades

Theme/Trade
Trade expression
Entry Date
Expiry
Entry Level
Current Level
Hit Ratio

We think Fed rates expectations for 2019 remain on the low side with just marginally more than 1 hike priced.

Buy Dec18 Eurodollar Futures (EDZ8) vs Sell Dec19 Eurodollar Futures (EDZ9)

07/02/2018

-

97.63/97.31

97.455/97.125

✓

We do not think the BoE will hike as much as the Fed next year when markets are pricing marginally more from the BoE.

Buy Dec19 Short Sterling futures (L Z9) vs Sell Dec18 Short Sterling Futures (L Z8)

07/02/2018

-

98.76/99.09

98.67/98.98

✓

The risk for equities is a further rise in yields led by higher real rates. Last time 10y real rates were here S&P was closer to 2720.

Long SPX Mar18 640/2600 put spread

28/02/2018
16/03/2018
10
0.00
X

We see asymmetry in =URGBP. We expect EUR to react positively if Italy/Germany is neutral/ =ositive this weekend and ECB pricing to become firmer. On GBP leg, UK =olitical risk remain underpriced with odds of early election in 2018 =ncreasing
Long EURGBP 3m =.91/0.94 call spread
02/03/2018
-
0.62%
0.45%
X

MEGA Closed =rades (Hit=Ratio Closed Trades = 77%)

Theme/Trade
Trade =xpression
Entry Date
Close Date
Entry Level
Close Level
Hit Ratio

Equities set up for hawkish BoE hike. =ignificant unwinds of FTSE longs into meeting. Dovish hike delivered =eans Long FTSE remains a catch up trade.
Long FTSE Feb18 =550/7700 call spread for 42 offer (7476 ref) (rolled from Dec, 7460 =ef)
02/11/2017
11/01/2018
42
100
✓

Dovish ECB priced in. With a 9x30bn =apering priced, risks skewed to higher core rates and/or tighter =preads both of which benefit SX7E
Long SX7E Feb18 =40 calls (rolled from Jan, 134 fut ref)
24/10/2017
25/01/2018
0.9
3.3
✓

We think Fed rates =xpectations for 2019 remain on the low side with just marginally more =han 1 hike priced.
Buy Mar18 Eurodollar Futures (EDH8) vs Sell Dec19 Eurodollar =utures (EDZ9)
11/01/2018
07/02/2018
98.18/ 97.535
98.12/97.31

✓

Positioning short/underweight. Positive news flow for Italy and Spain causing a squeeze in peripheral bonds and equities
Long equal weighted basket of Telefonica; Iberdrola; Enel; Unicredit & Santander

26/10/2017

15/02/2018

97.8

92.9

✗

Rates market continues to re-price ECB. 1y1y Eonia is almost back at recent highs pointing to more upside for SX7E.

Long SX7E Mar18 145 calls (40d, 142 ref)

25/01/2018

22/02/2018

2.85

0.2

✗

Russia is one of the worst performing markets in 2017. Under-positioning and fundamentals setting better

Long equal weighted basket of Russian Oil names: Gazprom, Lukoil, Rosneft

07/11/2017

22/02/2018

98.95

113.04

✓

We think we are entering a period of increasing volatility into the Italian Elections (4th March) and reduce our Long Equity exposure

Long SX5E Mar18 350 puts (35d vs 3406 ref)

22/02/2018

02/03/2018

39

58.40

✓

We see Political risk underpriced in Europe into 4 March (Italian elections and German SPD member vote)

Short FTSEMIB Index via Mar18 futures (STH8 Index)

22/02/2018

02/03/2018

22505

22005

✓

FTSE is the worst performing major market ytd. Moreover, we see asymmetry in GBP with UK political risk underpriced and BoE hikes overpriced. We do not agree that the BoE can hike more than the Fed next year.

Long UKX Mar18 375 calls

07/02/2018

02/03/2018

55

1.50

✗

The risk for equities is a further rise in yields led by higher real rates. Last time 10y real rates were here =P was closer to 2720.

Long SPX Mar18 =750/2700 put spread

28/02/2018

02/03/2018

15

30.40

✓

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