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"**Success consists of going from failure to failure without loss of enthusiasm**"

*- Winston Churchill*

## FUND INFORMATION

**Pricing:**
Monthly NAV

**Fund Classes:**
Issued Shares
Class A Shares
Class L Shares

**Current NAVs (US$):**
Issued Shares 191.84
Class A Shares 180.81
Class L Shares 177.36

**Fund Custodian:**
Deutsche Bank

**Fund Lawyers:**
Walkers
King & Spalding

**Fund Auditors:**
KPMG

**Fund Administrator:**
Maples Fund Services

**Bloomberg Ticker:**
AJEEJMN KY Equity
AJEEMNA KY Equity
AJEEMNL KY Equity

**ISIN Code:**
KYG016361027
KYG016361100
KYG016361282

A Happy New Year to all and wishing you all the best from 2018. There is no doubt that investing in 2018 across geography and asset class has been frustrating for most. In the MENA region we managed to have the best market in the world being Qatar (+20.8%) and one of the worst performing markets being Dubai (-24.9%). Unfortunately for us we happened to be on the wrong side of the straddle, which was part and parcel of our substantial underperformance in 2018. The AMF returned -7.4% and -6.5% in the Class A and Class L shares respectively. This is against an S&P Pan Arab which was up 13.5%. This is the largest drag from an index since our inception and compounds a second year drag which puts us in unprecedented territories relative to our historical performance. A great deal of our economic model at Ajeej is predicated on relative outperformance; however, our allocation mechanism is largely primed to absolute value and benchmark agnosticism. The dilemma of this position is that we don't actively assess the risk of under-weighting the benchmark whether by industry or by geography. Our methodology of investing behind long term value, agnostic of the benchmark, inevitably has paid off in the past, but recently, and two years running, has not paid dividends. Our underlying philosophy will not change, however we have incorporated a dimension to assess the path to intrinsic value and to weigh this across our intrinsic value of the companies. This will help us in navigating the resistance to value and ultimately avoid value traps. We would not portend for this to overtake our methodology per se as the linearity of value is often difficult to determine; however, it creates a dynamic aspect to overlay, to what we do.

The successful announcement of MSCI's inclusion for Saudi Arabia was fulfilled in 2018. This under any other circumstance may have resulted in a much greater celebration; but the graduation came at a very difficult juncture for the private sector, which was mid-way through a multi-year recession, but ultimately lead to a respectable performance for the market closing the year up 8.3%. This performance, as we discuss later in the letter, was buoyed largely by the financial services sector and petrochemicals which happen to be largely insulated from domestic woes. The rising rate environment and stress tested credit enhancements over the year have enabled profitability through NIM expansion and limited asset quality effect. Whereas petrochemicals play into a global industry and have not had any material re-pricing on input factors over the past several years, unlike the rest of the Saudi private sector. We had strong exposure in Saudi banks representing over 2/3 of our Saudi exposure. Unfortunately, the detractors came from our consumer and insurance names that were most exposed to the woes of the real private sector economy. In essence, we are waiting for an equilibrium to be reached on the firm and the household in terms of spend and size. From the household perspective, the country has witnessed a shrinkage of over 8%, driven by the foreign expat departure; as for firms, there have been many sectors which have been downsizing, driven either by demand destruction, margin compression or regulatory overhaul. The prevailing thesis whereby substituting the jobs of expats for Saudis will create greater spend in the economy has not yet played out, neither in spending patterns nor in net job adds for Saudis in the private sector, which previously had below 15,000 Saudi jobs in

aggregate. Moreover, the exodus of the expats and dependents has led to an oversupply and excess capacity in many industries directly and indirectly related to the consumer space. This pervasive negativity effected businesses ranging from health care to discretionary consumer.

Our opportunity set on how we have ended the year looks attractive, and with Saudi Arabia at just over 40% of the portfolio, we don't envisage that coming down and in fact may grow structurally in the 1st half of the year. In essence the inclusion not only offers relevance to the market, but a fully dollarised MSCI exposure in very interesting industries. In time, we would expect the active flows to grow beyond their passive counterparts, and with an ARAMCO IPO which is now slotted for 2021, to shine an even brighter light onto the kingdom. While we have other GCC countries which are dollarised, the allure of Saudi will be the depth not only in stocks but in industries, and while the entry has been lacked the expected lustre due to macro, branding and private sector woes, our belief is that the MSCI inclusion is not a one-off watershed moment, but rather a longer and stickier growth story for participants to invest behind. As the non-oil GDP improves, the opportunities will abound, particularly with the changes that are happening in liberalising the population and ultimately the mind-set. While the MBS branding was largely negative during the final quarter of 2018 and has spilled over into 2019, this market will be extremely attractive over the next five years and we look forward to navigating our portfolio through this opportunity.

While we were agile and had the foresight of missing the downfall of Egypt, exiting pre-revolution in 2010, we were much heavier handed with our entry and the over exposure to the market, this has cost us dearly in our portfolio on both an absolute as well as relative basis. The positive aspect is that all the fundamental markers of the portfolio have done very well and with the drawdowns making our holdings even more attractive, particularly as we look at the demand construction of the consumers coupled with the growing population; this particular function is growing very nicely. Moreover, the macro stabilisers manifested on the fiscal side and validated by the IMF have provided the necessary comfort factors to build reserves and ultimately manage the reduction of debt while slowly eradicating the current account deficit. The CBE's FX mechanism, which was largely in place to build confidence to foreign investors, is being wound down reflecting an increased confidence of investing in Egypt on its own merit. The biggest challenge will be to shift foreign instrument investment flow into non-oil FDI to support the fundamental market. In order for that to happen it will require cohesive action by ministries to attract investment and to spur a three pronged approach in the real economy predicated on import substitution, export orientation and servicing the young and rapid consumer demand. It will require a drop in rates to unlock the coming of the next age for Egypt. While we don't like tying ourselves to a value trap with one binary driven key, we feel it is imminent and the fundamentals continue to improve while we wait for this move. We are seeing the backdrop becoming increasingly favourable and have spent significant time with many ministries on understanding their efforts and aspirations and, as such, feel very comfortable with our exposure and portfolio in Egypt.

The UAE , particularly Dubai has been the greatest laggard, and despite providing a tremendous base combining superior infrastructure with improving regulation, the residual effect of politics has taken its toll and its branding strength as the "Switzerland of the Middle East" or even Asia for that matter. Important marginal buyers, from both Qatar and Saudi, no longer see this as an investment target, the former due to the blockade and the latter due to dynamic ring fencing. Undoubtedly, the economic woes of Saudi have also added further insult to injury, so while there is a deep distress opportunity it is harder to see an inflection point. There is the potential for certain decisions on the federal level that could ignite the demand in the market, but it remains to be seen how far these decisions will go. That being said, a recovery in Saudi and the steadfast nature of building a hub in entertainment, culture, logistics, aviation and trade, remain on track as seamless urbanisation goes unabated. Ultimately, it is easy for cynics to voice loudly in soft markets; however, the long term

strategy of thinking and executing 10 years ahead makes the ramp up in this macro backdrop painful. We continue to think certain pockets are more resilient and are not as suffocated in their value trap, but our exposure, despite having been draining, will be reduced in the first part of the year, given greener pastures of great value with less resistant paths to intrinsic value.

The aim of the balance of this letter is to show case our important themes, and we want to offer continued comfort regarding the fundamental picture of our portfolio, as well as depict that our enthusiasm towards the portfolio is positive on a 1 to 5 year basis, predicated on absolute performance. We thank you for your continued support, patience and belief in us.

## A Saudi Bank-Shot

Saudi benchmark interest rates and Saudi bank stocks both travelled a rising trajectory in 2018. With SAMA following the Fed's interest rate hikes, Saudi banks benefitted from their large non-interest-bearing deposit bases which helped NIMs to expand. Through the first 9 months of 2018, Saudi banks in aggregate achieved their highest rate of TTM profit growth since 2011-2012. The Saudi market's announced promotion to EM status by MSCI and FTSE also brought active demand for large cap stocks, including the bigger banks. The overlap of positive fundamentals and market demand factors led 11 of the 12 Saudi bank stocks to return more than 20% for 2018, with a few achieving total returns over 40%. (Another favourable factor for many banks was a YoY increase in dividend payments.)

So after such a strong performance in 2018, is there anything left for the Saudi banks story? We think yes. We cannot ignore the effective dates of the MSCI and FTSE promotions, which will bring further demand for Saudi stocks including banks (though the amount of selling that is waiting to greet those inflows is a matter of great debate and remains to be seen). But we think there still is more to the Saudi banks story than passive flows. For one, while expectations of Fed rate increases in 2019 have materially reduced recently, the lag effect of 2018's higher rates will continue to play through in 2019 for the Saudi banks (e.g. loans take time to reprice upward). We have seen some green shoots in lending volumes, with YoY loan growth returning to positive territory after being negative in 2017 and most of 2018. The growing mortgage market is a highlight, but broader lending demand should grow as government projects and privatisation efforts make their return. Higher rates on bigger loan books should translate to solid profit growth. The banks' December 2018 settlement of back zakat (Islamic wealth tax) payments removes a major uncertainty on both the level of the banks' capital and the profitability profile going forward, and gives the banks greater clarity on how they need to structure their balance sheets for future growth.

Beyond the aforementioned, it is important to highlight that Saudi banks are not immune to the growing trend of company consolidation in the region, and this is a major theme for 2019 and onward, with SABB/Alawwal moving toward an expected merger completion in H1 2019, and NCB/Riyad beginning merger talks that would result in the largest bank in Saudi and 3rd-largest in MENA if carried out. This comes as banks seek to benefit from economies of scale in addressing regulatory requirements and strategic needs, such as financing larger-scale projects and building out new digital banking capabilities. It also comes as more foreign banks are receiving licenses to operate in Saudi and could theoretically present a competitive challenge for some parts of the domestic banks' business. The consolidation should offer investment opportunities, both short term

and long term, as the process plays out. In the meantime, several banks have recently enhanced their investor relations functions, and this better transparency should support valuations in the long term.

## Why Not to be Nihilistic on the Nile

After its stock market witnessing a fall from grace last year, Egypt is set to bear the fruit of some of its massive macroeconomic structural and landscape developments, figuratively speaking. For much of the year, Egypt was arguably caught in the crossfire of the Emerging Market selloff which began in late April; despite unleashing two consecutive interest rate cuts two months prior, supposedly sending a strong bullish signal to investors. We saw foreigners, invested in the Egyptian treasuries, fleeing, drawing down on more than US$12.5b since March by the end of the year. That naturally put pressure on the country's supply of foreign currency resources, in a short amount of time. What was more pertinent to our portfolio was the subsequent spill over into the stock market as yields became more attractive to local investors. Previously, the treasury debt market used to be roughly evenly split between foreigners, the Egyptian public, and private banks, which resulted in a healthier price competition, where papers were priced according to international rate parity, driving them much lower than they otherwise would have been. With the exit of the foreign investors, the banks regained a monopoly over treasuries once again, driving up the yields, and with them, dragging down equity valuations.

With only a handful of EM stock markets closing the year in the black (with Qatar and Saudi leading the way), Egypt's performance distinctly average, but relative to our regional benchmark it was certainly a drag, despite the currency (generally the biggest concern about investment in Egypt) staying steady with the IMF's blessing. The currency devaluations that spread across the developing market space, pressured the relative indices on a dollar basis, knocking down a thinning Egyptian market another peg or two. With that said, if we take a step back and look at the bigger picture, where others see chaos and risk, we aim to see opportunity. For that reason, if you skip ahead to the factsheet at the end of this letter, you'll see that our allocation to Egypt now stands at nearly a third of the portfolio, up from just over 10% a year earlier. The bulk of which is real estate, which we discuss in more detail below.

Generally though, in order to demonstrate why our conviction to Egypt takes pole position to our portfolios relative to its size, we may need to backtrack on the timeline first.

The fallout from the Egyptian revolution initially left the country's economic position muddied, to say the least. Foreign reserves quickly dried up; the tourist sites and hotels were so desolate you could hear a pin drop in an field of Egyptian cotton; natural gas and oil reserves couldn't keep up with depreciated wasteful power plants coupled with a growing population which saw a massive spike in new births during the actual revolution (more people stayed at home); and previously inefficient public and monetary policies had their glaring weaknesses further exposed. All of these elements put a not so insignificant dent in what was already a vulnerable environment. The silver lining was very clear though, it was time for radical change. With options running out, Egypt hesitantly dusted off its IMF-signal and pointed it to the sky; after much reluctance to call for help, the severity of the situation overcame nation's ego.

As is tradition among strained developing nations who are seeking external financing, the conditions required

to be met were marked by fundamentalism and a detachment from protectionism and sovereignty; all of which were elements strongly called out for by local economists for years, if the country were to have any chance in catching up with its EM peer group. It's no secret that the initial turmoil was unpleasant; a backlog of bad decision making and socio-economic bureaucracy were to come tumbling down on the rulers and people under the new economic regiment, with the only motivation being a very faint light at the end of a very long tunnel, well that and avoiding a further and deeper plunge into economic ruin. Between a local currency that fell to less than half of its original value, and the gradual phasing out of energy subsidies, the inflationary effect was not exclusive to a sudden rise (doubling effectively) in local prices, but also assured continued pressure for the period of economic reform that we are currently witnessing.

Egypt also struggled with huge natural gas supply gaps, which it attempted to fill, temporarily, by starting up regasification units and importing LNG to keep producers and household electricity running, in turn expanding their import bill. With still one more round of subsidy fuel cuts on the horizon (June 2019), the discovery of several large gas fields within the country's maritime borders almost has the appearance of a deus ex machina.

With an unnaturally stable exchange rate for the past 2 years (as we mentioned, this is with the blessing of the IMF), and a December headline inflation figure that surprised everyone on the downside (it's the second lowest in over 18 months) it's time for the CBE to grab the interest rate lever again. We hope that the decision will be easier this time, given the Fed's more recent revisions for 2019. Furthermore, with the discovery and leap in development of Zohr field late last year, the country has officially imported its last LNG tanker for a while, and despite its growing energy needs to fuel the ambitious economic forecast, the full development of current reserves, and the development of newly discovered ones is widely expected to turn the country into a net gas exporter once again, with the intention to restart its gasification units underway after almost a decade of idleness (well at least until the population equilibrium tips to the other side of the scale at least).

The other major risk factor that has been largely mitigated was oil price; initially, the government had budgeted for US$67/bbl for FY2018/19 back in June, which appeared unrealistically optimistic. What we didn't expect to see coming though was the lowering of demand as fuel prices climbed, leaving the effect on the fiscal subsidy bill largely unchanged in the early months of the fiscal year. This was then followed by a steep drop in oil prices, to the point where the government cancelled back its old partial oil hedge deal at the budget price. A most welcome surprise for the budget and inflationary figures.

Coming off a tangent, this brings us back to our initial question, why is it right for us to be overweight in Egypt today? The opportunity for growth is clear, but with mitigating risks that we constantly need to cognisant of. The CBE continues to maintain its grasp on the direction of the currency, or lack thereof, setting the price-point for where the EGP should be bought and sold. Although this can be advantageous when conditions are smooth, it can and will ultimately put pressure on reserves when vectors point south; the CBE would be the first to tell you that first-hand. Now, a currency devaluation is always an unwelcome risk on our returns, but from a macro point of view, it does not have to be motivated by distress. As such, we do not rule out the possibility of this taking place sometime this year, or perhaps the introduction of a truer float? With that said, the portfolio is positioned against inflation and currency risk, with the majority exposure in real estate (with MNHD and TMG being core), dollarised assets and income (EFG-Hermes, EKHO), revival of tourism (TMG), and beneficiaries from relaxed interest rate environments that will fuel corporate borrowing (CIB). When all is said and done, we look forward to seeing our contrarian blueprint play out, in line with our strong convictions for Egypt's equity market in 2019.

## Egypt Real Estate – A Natural Hedge on the Banks of the Nile

As promised, here is a brief, but deeper dive in our largest core benchmark-agnostic thematic.

Despite a year in which aggregate presales (value and units) grew significantly in Egypt, Egyptian developer stocks tumbled throughout the second half of 2018, mirroring a broader decline in the Egyptian market. While concerns on inflation, interest rates stifling capex investment, and over-selling units to investor clientele are valid and would be expected to reflect in the share prices of the larger developers, the extent of the decline is overdone.

It is overdone in particular given the maturation of the real estate market in Egypt and the developers themselves, many of whom are only now starting to add significant non-residential (and income generating) assets to their projects. In addition, the financial engineering (developing more creative payment plans, moving towards a co-development / phased payment method for land acquisitions) that developers increasingly need to deploy in Egypt we view as no bad thing, as it enforces both discipline (from a cash flow management perspective) and shares duration risk with land owners.

In our view, despite the very strong uptick in unit sales over the past 3 years within the gated community / planned city space in which the listed developers operate (moving from sales of around 10k units per annum up to 15k units per annum), demand in this segment (which in itself represents at most 10% of new annual housing demand in greater Cairo) is between 15k – 20k units per annum, based on private school enrolment rates (the children of those living in these communities) and graduation rates from top universities around Cairo (the target market). Moreover, within this small slice of the greater Cairo population (perhaps 2 million people at most of more than 20 million), we estimate that more than 300k live in older stock, and many of these are actively moving out of the city centre and into newer stock due to greater amenities, and the shift in many school campuses to the outer rings of Cairo.

In the longer term, the suburbanisation of the managerial class in Cairo supports the plans of developers to build significant commercial, retail, healthcare, and other service assets in their outlying developments. In the past decade, the outer rings of Cairo have seen a significant residential population inflow, whose demand for leisure, retail, and commercial space adjacent to their homes is only now starting to be met. The listed developers (and their unlisted counterparts) are well placed to realise strong returns from their remaining land banks as they develop them into these desired non-residential assets.

The last decade of Cairo real estate development has focused on building almost 100k new units in the suburbs of Cairo (with ~100k further units under active development today, and another 100k more units buildable in already announced projects). The next decade will see continued development of residential space to address demand from Cairo's white collar workers and their families. As these workers' jobs migrate outward, developers will generate excess economic returns from developing and leasing or selling the commercial, retail, service, and leisure space demanded.

**The Saudi Consumer Roller Coaster…Strap-in & Hold-on…It'll be Worth It…Ultimately**

For more than a year now, Saudi consumer corporates have been on a roller coaster ride, which has largely pointed downwards, with management and shareholder teams doing their best to stomach that sinking feeling, as profits and stocks dive into a territory unseen. Nonetheless, in 2019 hopes of slowing down the drop, and ultimately finding that critical point where the direction for the sector changes, are keeping the survivors from bailing and are encouraging them to hold on to their tightening belts (how's that for mixing metaphors?) knowing that whoever doesn't fall off will truly enjoy the ride uphill.

Following 2 years of contraction, private consumption (which we estimate via combined cash + POS transactions) was up ~6% for Jan-Nov 18; however, we were perplexed to see the positive jump not reflected in LFLs of clothing and grocery retailers (-3% to -15%) or revenue trends of food producers (~-6%). In fact, across the board the consumer sector negated the 6% jump: FMCG volumes declined -5%, electronic sales were down in double digits, imports were down -20% YoY, electricity consumption declined, and shops shut down – all of these pointing in the opposite direction. Although we know the reported numbers are partially propped up by a 5% VAT that came into place in 2018 and possibly inflated by cash withdrawals by expats leaving the country as part of their final exits, there still seems to be growth in areas not apparent in the listed space. Our meetings with management teams across the listed and unlisted space indicated that the unlisted sector and new entrants are in fact in a better state of health, and that people are now spending on unconventional activities driven by acceptance of a more open society instead of the status quo avenues reflected in the public space. For example, several new ladies' gyms have opened up with strong demand; a number of cinema screens have been erected where users still need to book in advance, several concerts, parties and shows have been held in a stark break from tradition, even a Formula-E event was ironically hosted in the capital city of the world's largest oil exporter. All these were first time experiences for most of the Saudi population, and not to be scoffed at. UAE based EMKE Group owned Lulu and Majid Al Futtaim owned Carrefour are positive about the sector in Saudi over the coming period and are investing significantly in preparation for the upswing. The younger generation is elated, and we are witnessing this first hand, to see their young perceived progressive leader bringing about positive change to their everyday life, the flip side of which is that the corporates are struggling to manage the impact of the not so linear changes.

During early 2018, the Saudi Labour Ministry (the ride operator if you will) announced plans to restrict employment of expats in 12 retail sub-sectors including clothing & footwear, electronics, hardware, car spare parts, carpets, pastry, watches and others over three phases during September 2018 – January 2019. The problem for large listed corporates is manifold; firstly, the wage differential between a Saudi and an expat is anywhere between SAR 2-4k a month; secondly, the turnover among nationals is very high as everyone is looking to meet Saudisation targets; finally, the Saudi nationals are not used to long work hours and are likely to shy away from physical labour (again we are generalising, albeit fairly). Hence, in 2018 the cost base increased while the service quality declined, which led to weak sales and lower margins. This was exacerbated by declining basket sizes and decreased impulse purchases. Companies which have been largely unaffected, are today beginning to tighten their belts, becoming more efficient and finding innovative ways to prepare themselves for further potential bumps along the way. Some have started to outsource visas to manage their Nitaqat targets, some have launched self-checkout counters, while others have shifted particular medial tasks (like restocking, etc.) to graveyard shifts in order to lessen the chance of expat employees being seen during working hours. Companies have trimmed the fat off their work forces, reduced wastes, changed fuel mix and

rethought routes to cut costs…all positive adjustments for long term sustainability.

The VAT led documentation process has been a potent spoiler for the expat-run unorganised sector, and is forcing them to shut businesses - nearly 3000 'baqalas' have closed shop in 2018 alone. The light at the end of the tunnel is industry consolidation and a greater share of the remaining pie for each surviving player. Electronics retailers were the best performers driven by closure of independent mobile phone shops and the more recent Saudisation/closure of electronics shops.

The progressive expat levy structure has forced many expats off the ride with nearly 877k (-13%) insured expat employees and 426k (-18%) expat dependents exiting Saudi by the end of 2018, according to the Council of Cooperative Health Insurance. An interesting side note, conventionally, expats from the sub-continent and poorer Arab countries transport a disproportionate amount of electronics and phones to their home countries to save on taxes whenever heading back. This may have been a reason for divergent performance of listed electronic retailers this year, but we will not know for sure before 2Q19 results when the expat exodus slows down following the last round of Saudisation.

On the other hand, the idea that expat employees will be replaced by locals 1:1 didn't really materialise, as merely 139k new Saudis joined the private sector insurance pool (a proxy for job creation). Assuming an average salary of SAR 10k a month, the overall increase in income would be SAR 16.8b, and adding the SAR 27b in payments to Citizen's Accounts - the resultant increase in income is SAR 43.8b a year. On the flip side, the Government collected SAR 46b in VAT, SAR 12b in Excise tax and SAR 15b in higher electricity tariff – that makes a total of SAR 72b. If we apply the 80/20 rule on Saudis/expats, the additional expense has been SAR 58b – which is much higher than income. Moreover, Saudis who were meant to benefit from Government initiatives of Saudisation are losing out on other sources of income such as rents from leasing shops/residential units to expats, or share in profit from expat-run small businesses sponsored by a citizen (we spoke about Saudi true third pillar of industry, rent seeking, in last year's newsletter). We estimate that nearly 10% of total spending was backed by other income sources, and instead of increasing, disposable income has declined. Additionally, the new trend of working for a living away from the rentier mentality will take some time to filter into the society, but will surely be achieved given time.

From what we think, 2019 will be the year when things bottom out as the population decline eases, workforce participation of women picks up, income levels normalise, citizens live increasingly livelier and more open social lives, consumer sentiment picks up, all of which in turn should allow for price increases, home ownership improvement and consolidation benefits become apparent. We along with large organised retail/QSR players remain optimistic for the long term and are investing heavily into brick and mortar stores as well as ecommerce platforms in preparation for the steady climb afoot…let's hope this particular section of the roller coaster's track is disproportionately long.

## Is it time to go to the Operating Room?

It might be bad luck to pick the wrong time to ramp-up new capacity at Saudi's healthcare service providers, but the series of negative dynamics that impacted the sector was too much to bear. Expats and their de-

pendents, who are the key users of outpatient capacity, continued to leave the country in 2018. Certain indicators show that nearly 900k expats and approximately half of that number of their dependents left the country in 2018. That was on the back of increasing expat costs through fees to the government, which also impacted the hospitals themselves with staff costs increasing and in some cases affecting operations from reductions of blue-collar labour.

Moreover, according to the hospitals, Saudis themselves rationed more of their healthcare spending in 2018, with declines in cash patients (typically Saudis seeking outpatient care in the private sector) dropping significantly for more operators. This left the hospital operators with limited options, including accepting more government patients: while these patients fill beds, payment is often slow and the care required is simple rather than complex, resulting in lower tariffs.

In addition, those expat employees that remained largely moved into lower tiers of insurance coverage (gold to silver, silver to bronze): a cost saving measure pursued by their employers, but one that further pressured hospitals and insurers and particularly hurt those hospitals that catered to top tier patients. From a demand perspective, the only silver lining we see in 2019 is the enforcement of medical insurance for Saudis in the private sector, which is set to begin from this month with newly linked insurance, pension, and visa systems. This enforcement should eventually cover a gap of an estimated 2mln Saudis (18% of the insured base) currently working (or a dependent of a worker) in the private sector without private insurance. These Saudis of course are not new users to the medical services sector, but the hope is that enforcement will redirect some of this demand away from public hospitals and towards the more efficient private sector.

These factors pressured the valuation of the hospital operators throughout the year, and they largely gave back the cumulative alpha generated in recent years compared to the Tadawul index. Their valuation gap vs EM hospitals also widened on a trailing basis over the year; however the more anaemic growth we now expect for these operators over the next 2 years means that the bottom may not yet have been reached for many and thus we continue to stay away from most of the sector in 2019.

As the saying goes, only deep water reveals the diver, and 2018 provided a clear demonstration of the strengths and weaknesses of the Saudi hospital management teams. As we move into 2019, if these management teams continue to demonstrate their skill, we would look to re-enter the sector, but we no longer expect that ‘a rising tide will lift all boats’. Having built their ‘boats’ – a near doubling of bed capacity in the listed sector over the past 5 years and a further doubling to come in the next 3, we continue to search for the best sailors in the KSA healthcare sector.

## UAE Investment Thesis: Value Trap or Opportunity

After a brutal year in the UAE markets, excepting FAB in Abu Dhabi and a few others, many investors (and residents!) are wondering “where to from here?” for the UAE market and the UAE economy. 2018 began with the introduction of VAT, rises in indexed fuel prices on strong oil, and both economic and currency weakness in key source countries for Dubai’s lifeblood: tourism and trade. Geopolitics weighed on sentiment but the heaviest ball and chain in the early months was a gold one. VAT implementation included taxation of some inter-

mediate gold and jewellery products which, combined with the weak Indian rupee had a disastrous effect on the Dubai gold and precious metals wholesale trade (one of the emirate's oldest and still most important trade avenues).

As the year ground on, both the Dubai and Abu Dhabi governments rolled out a series of initiatives (100% foreign ownership allowed onshore in a larger number of fields, a pickup in current and capital spending plans (particularly in Abu Dhabi), and a few much needed reforms to the visa and residency system (allowing extended residencies for students, particularly graduate students, developing longer term visas for skilled professionals particularly in medicine). Unfortunately, as 2018 drew to a close, many of these initiatives remain ink on paper more than facts on the ground. To their credit, the governments of both emirates moved quickly where they could: freezing school fees for 3 years in Dubai, and freezing a number of other fees and removing others principally related to setting up businesses and business licensing. While these measures (in addition to a change in residence visa structure removing the ~US$ 600 deposit per employee that firms previously had to maintain upon hiring staff, and shifting to a significantly lower cost structure) were supportive, the crux of the UAE's domestic demand problem: not enough upper income residents - remains unsolved.

While population data does not provide the granularity to assess population in and outflow by income bracket, channel checks with banks, telcos, schools, and retailers paint a picture of a relatively significant population outflow among white collar workers in the country over the past 3 years – driven first by job losses in oil & gas and banking in Abu Dhabi and followed by declines in the retail, services, and entertainment sectors in Dubai. The overall UAE population has continued to grow, driven by an influx of unskilled and semi-skilled labour to build the roads and metro that form part of Dubai's ambitious Expo 2020 plan, and to build the houses sold to both end users and investors from 2013-2017. However, 2018 revealed that while you can grow population to staff restaurants, theme parks, schools, and retail stores, without customers there is surprisingly little operating cash flow to be had.

As we move into 2019, we expect to see some positive effect from the 2018 initiatives in fee reductions as well as from the improvement in relative cost of living and cost of doing business in Dubai with rents off 30% from their peak. However, enticing new white collar workers into the UAE remains a puzzle that we are unsure how the country will solve (ahem, we alluded to some federal decision making at the start of this letter), without further moves towards long term visas and ultimately permanent residency. Recent improvements in EM currencies and a drop in oil price should be supportive of tourist demand and stabilise the operating cash flows of some of the UAE's service businesses, but in the long term, they need to attract a population of residents whose length of stay significantly exceeds the 3 day average of tourists, and realistically exceeds the 3 year length of a typical work visa.

Until a clear path to upper income population growth appears in the UAE, it is difficult to forecast the turning point for local markets and local companies. In conclusion – today the UAE markets sit in a value trap, but it is one where the key to unlocking the trap lies almost fully in the hands of the country itself. Having 'built it', they need to open the gates and let people 'come in & *stay*'.

## Ajeej MENA Fund Monthly Returns 2018

| Monthly Returns | J | F | M | A | M | J | J | A | S | O | N | D |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Issued Shares | 4.7% | -0.8% | 2.4% | 3.6% | -5.4% | 2.0% | -1.3% | -2.7% | -2.4% | -5.6% | -0.8% | -0.8% |
| Class A Shares | 4.7% | -0.8% | 2.4% | 3.6% | -5.4% | 2.0% | -1.3% | -2.7% | -2.4% | -5.6% | -0.8% | -0.8% |
| Class L Shares** | 5.6% | -1.1% | 3.0% | 4.5% | -6.7% | 2.5% | -1.6% | -2.7% | -2.3% | -5.6% | -0.8% | -0.7% |
| S&P Pan Arab | 5.7% | -2.0% | 5.3% | 3.9% | -0.4% | 1.1% | 2.7% | -2.1% | 0.2% | -0.4% | -1.7% | 0.8% |

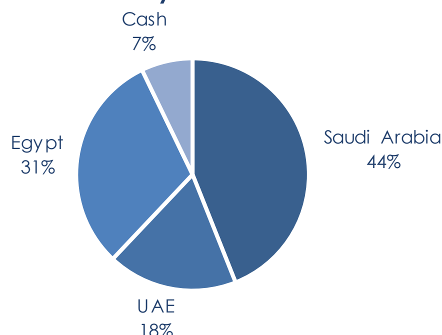
## Ajeej MENA Fund Historical Performance

| | Issued Shares | Class A Shares* | Class L Shares** | S&P Pan Arab | MSCI FEM | MSCI EM | MSCI World |
|---|---|---|---|---|---|---|---|
| 2007 | 25.7% | -- | -- | 24.5% | 7.9% | 3.4% | -2.7% |
| 2008 | -47.4% | -- | -- | -50.7% | -57.0% | -54.5% | -42.1% |
| 2009 | 16.1% | -- | -- | 18.4% | 20.8% | 74.5% | 27.0% |
| 2010 | 6.6% | 6.4% | -- | 17.4% | 24.4% | 16.4% | 9.6% |
| 2011 | 6.3% | 6.0% | -- | -10.5% | -20.5% | -20.4% | -7.6% |
| 2012 | 11.6% | 10.4% | -- | 6.9% | 16.9% | 15.1% | 13.2% |
| 2013 | 57.4% | 51.1% | -- | 26.6% | 1.2% | -5.0% | 24.1% |
| 2014 | 27.4% | 27.4% | 15.6% | 2.0% | 3.9% | -4.6% | 2.9% |
| 2015 | -1.6% | -1.6% | -4.3% | -14.6% | -20.4% | -17.0% | -2.7% |
| 2016 | 9.1% | 9.1% | 9.9% | 9.0% | 2.3% | 8.6% | 5.3% |
| 2017 | -1.1% | -1.1% | -0.1% | 4.6% | 23.6% | 34.3% | 20.1% |
| 2018 | -7.4% | -7.4% | -6.5% | 13.5% | -16.8% | -16.6% | -10.4% |

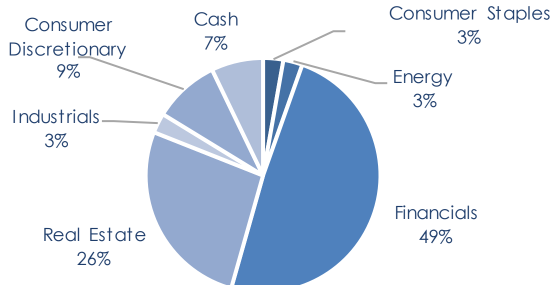
| | Issued Shares | Class A Shares* | Class L Shares** | S&P Pan Arab | MSCI FEM | MSCI EM | MSCI World |
|---|---|---|---|---|---|---|---|
| 1 year | -7.4% | -7.4% | -6.5% | 13.5% | -16.8% | -16.6% | -10.4% |
| 3 years | -0.1% | -0.1% | 2.7% | 29.3% | 5.2% | 21.6% | 13.3% |
| 5 years | 25.3% | 25.3% | -- | 12.6% | -13.0% | -3.7% | 13.4% |
| Inception AMF | 91.8% | -- | -- | 16.4% | -42.9% | -19.9% | 15.3% |
| CAGR | 6.0% | -- | -- | 1.4% | -4.9% | -1.9% | 1.3% |

* Class A Shares were launched as of the start of July, 2009.
** Class L Shares were launched as of the start of February, 2014. Starting NAV for Class L Shares was set to the closing NAV of Class A Shares as of the end of January, 2014.

### Country Attributions




### Sector Attributions




## Ajeej MENA Fund Terms

| | ISSUED SHARES & CLASS A SHARES | CLASS L SHARES |
|---|---|---|
| Minimum Investment | US$ 1mln (Issued Shares are closed) | US$ 40mln |
| Annual Management Fee | 2% of NAV | 1% of NAV |
| Performance Fee | 20% of profits with a hurdle rate of 8% gross return, and a High Water Mark | 25% of alpha over the benchmark: S&P Pan Arab Large & Mid-Cap NTR |
| Lockup Period | 1 year (soft lockup – 5% penalty if broken) | |
| Liquidity | Monthly (with 30 days notice) | |
| Currency | US$ | |
| Investment Manager | Ajeej Capital (DIFC) Limited | |

## Top 5 holdings in the Ajeej MENA Fund

| | |
|---|---|
| AL RAJHI BANK | 11.7% |
| MEDINET NASR HOUSING | 7.6% |
| T M G HOLDING | 6.6% |
| CO FOR COOPERATIVE INSURANCE | 5.9% |
| SAMBA FINANCIAL GROUP | 5.7% |

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