One Track Mindedness

Devaluation beneficiaries continue to be the focus of market players

Stocks that have risen YTD are mostly devaluation beneficiaries, whose sources of FX outweigh their FX costs; or whose revenues and costs are FX based, due to foreign operations/export orientation/import parity pricing. Failure to determine the point of stability for the exchange rate will create support for share price performance of that group.

Market Losing Steam; Seize Rebounds to Partially Offload

The waiting game; YTD gains and reform execution risks are having their toll on market movement with low chances of spikes

The market continues to swing between cheering devaluation and profit taking, within the 7,900 - 8,500 range. We continue to emphasise that several factors will continue to cap market performance beyond the upper boundary of that range:

1) The heavy-weight index constituents are edging closer to their fundamental FVs and their 52 week highs.

2) Execution risk for economic reforms is heavily in play. The recent shortage of some commodities and government confiscation of private sector inventories, in addition to government discussions of profit margin control are sending negative signals to investors.

The government has to stabilise the foreign currency market, implement subsidy cuts and budget savings at the same time as focusing on rationalising imports, incentivising investments and exports, whilst also keeping inflation in check, or creating a solid social safety net for low income groups. At this point, the task is very challenging with zero tolerance for cold feet. The market is highly volatile to macroeconomic developments but with lower appetite for risk taking.

3) Potential civil unrest (with calls for protests on November 11) to reject the ills of reforms will create selling pressure in the market.

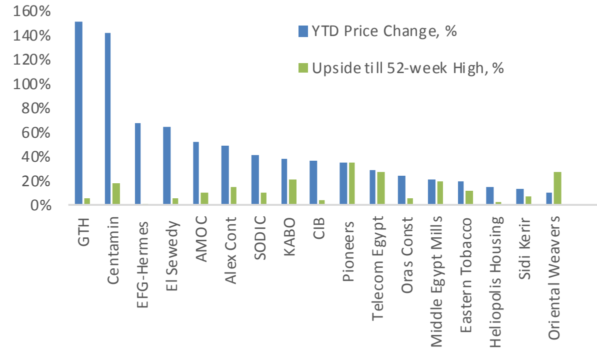
4) Devaluation was originally penciled for first half of November, but concerns about civil unrest obviously pushed the schedule, with latest Prime Minister comments pointing to sometime before year-end, noting that the IMF board approval will be anytime within two months from now.

5) Interest rates should go up by at least 200bps, concurrently with devaluation, in a bet to attract foreign portfolio investments into the fixed income market and higher interest rates will put pressure equities.

6) Fresh capital injections into the equity market await an absence of capital controls and the stabilizing of the foreign exchange rate, in addition to public acceptance of the ills of reform.

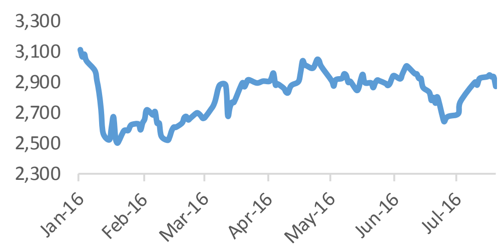
In conclusion, we advise investors to seize any rebound to partially offload positions.

Devaluation plays are top performers YTD



Source: Bloomberg, Pharos Research

EGX 30 has not moved much in USD terms



Source: Reuters, Pharos Research

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Thinking Outside the Box

Names we continue to like despite the rally and names that have not rallied, but which we want to flag

Despite the rally, we continue to like:

•COMI: The beneficiary of deficit monetisation and the proxy for positive macroeconomic developments

•HRHO: Commercial bank sale proceeds are USD based. New ventures (microfinance, leasing and consumer finance) have high growth potential.

•SWDY: An infrastructure play, with high exposure to the under-penetrated power sector in Middle East & Africa, in addition to being a devaluation beneficiary.

•ORWE: An FX neutral industrial player, poised to benefit from export incentivising programmes.

•GTH: Foreign based operations; positive developments on towers sale are key catalysts

Other picks that have not realised much potential, yet:

•MNHD: The market fails to fully discount Sarai land plot. Sales momentum gained pace over the last three quarters.

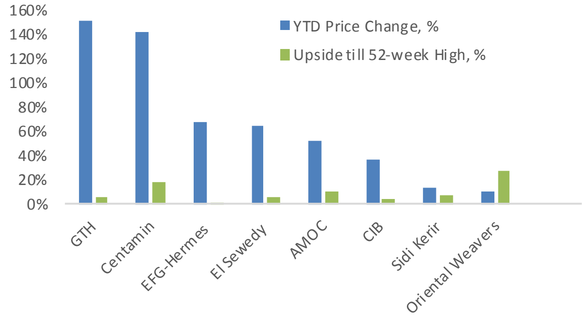
•TMGH: Continues to be undervalued; fails to realise potential on lack of share price catalysts.

•PHDC: Diversified project portfolio with solid brand equity.

•EKHO: An oversold stock penalised by its trading currency. The two jewels on its crown (Sprea and NatEnergy) offer significant upside from the current market price.

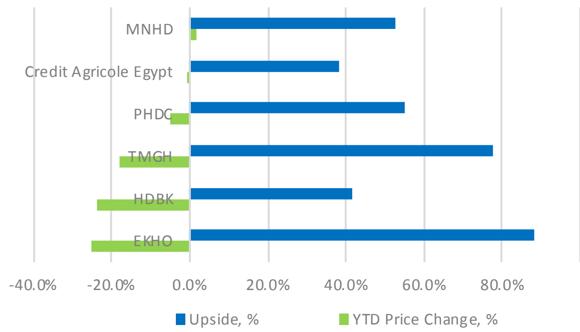
•HDBK and CIEB: Looking at both banks' ROAE, which is well above 23%, the banks should be trading at P/B2016e north of 2.0x from a current 0.7x and 1.7x for HDBK and CIEB, respectively.

Despite the rally, we still believe in those



Source: Bloomberg, Pharos Research

Picks we want to flag



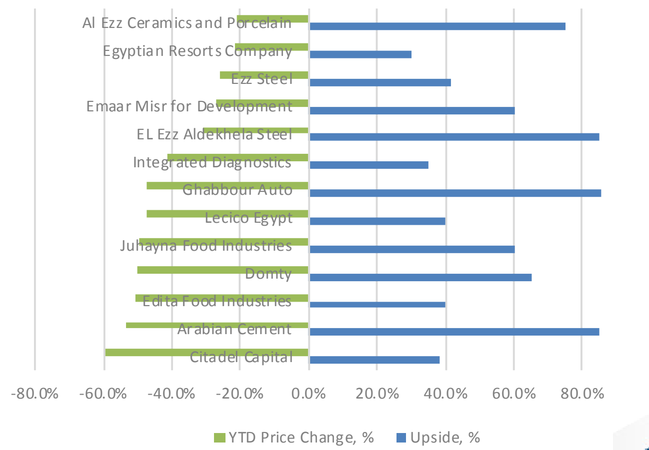
Source: Bloomberg, Pharos Research

Beyond Tunnel Vision is the Theme for 2017

"Post-devaluation hype", the laggards of 2016 will be the stars of 2017; Keep a close eye on oversold stocks

The stories that were negatively exposed to devaluation/cost pressure top the worst performers' list YTD. Their cycle should reverse when the "devaluation mania" ends and the currency challenges are behind us. Keep a close eye for the appropriate entry point, because recovery will be delayed. These names include: JUFO, Domty, Edita, AUTO, CCAP, IDHC. Some other names face challenges beyond currency weakness, but would provide decent potential return on a "tactical ST trade" basis: ARCC, ERC, ESRS, EZDK, ECAP and LCSW.

Laggards that will move "post devaluation hype"



Source: Bloomberg, Pharos Research

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