Ajeej Capital
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FUND INFORMATION

Pricing:
Monthly NAV

Fund Classes:
Issued Shares
Class A Shares

Current NAVs (USD):
I-Shares 97.21
A-Shares 95.46

Fund Lawyers:
Walkers

Fund Auditors:
KPMG

Fund Administrator:
Apex

Bloomberg Ticker:
AJEEJMN KY Equity

ISIN Code:
KYG016361027

Fee Structure:
Management 2%
Performance 20%
Hurdle Rate 8%
High Water Mark

Min Subscription:
Initial USD1m
Subsequent USD100k

January 2013

Dear All,

Happy New Year and best wishes for 2013 from the Ajeej team. As we reflect upon 2012, it certainly had its fair share of verve, particularly as we witnessed chapter 2 of the Arab revolutions. Our objective is not to reflect on the region politically, but rather allude to its implications for the investment environment. Beyond this landscape, which one cannot help but view through a mainly political lens, it is apparent in our minds that we also have a series of chronic issues globally which we have to come to terms with as it reflects the new reality which we live in.

The AMF returned **11.6%** compared to the S&P Pan Arab at **3.6%** for the year. We were positioned more defensively with a consistent cash balance for the year of over 20% along with a complete exclusion of the Egyptian Party despite its 50% return for the year. It is obvious that a recalibration of these two points would have boosted our returns significantly; however, we do not compromise on our process and instead do things akin to Mr. Sinatra's **"My Way"**, with a caveat that our foundation is dynamic and predicated on concept renewal in order to aspire to the ethos ***"do better tomorrow what we did yesterday"***. As we celebrate our 5 year anniversary and dwell upon the massive experience curve attained technically, qualitatively and physically (the move to the DIFC), we feel that we are just at the cusp of fulfilling our potential both as an organisation and in the performance cycle.

WHAT DO YOU MENA!?

Ok, so essentially how have the markets done relative to fundamentals and dynamics in 2012?

Saudi Arabia was up 6.0% for the year, with December gaining 4.1%. It was a roller coaster year giving back gains after q1 ended with the market up 22%. Setting aside what we discussed about the global conditions which have a relevant causal effect, Saudi has been hampered with some domestic issues which led to an underperformance for the year. With a rich domestic investor base, we saw resurgence in volumes mainly in q1 of 2012, with an average daily liquidity for the year of USD 2 billion (approximately 100% increase YoY). Despite being curtailed by regulators, due to a flood of speculators on small caps, the interplay in asset class from equities vs. real estate has become more balanced particularly with the sustainable yield (over 4%) of the market perking the interest of a broader based investor. The question then becomes, with ample supply of capital, attractive fundamentals, and a sustainable yield, why has the market not re-rated? It has nothing to do with non access of global investors; whilst their entry would be welcomed, it serves as a catalyst mainly to further institutionalisation and diversification of the investor base. From where we are sitting this could happen in 2013 or just as likely in 2016. The main driver is transition planning, and whilst this is an inevitable risk there are mitigating factors of having taken the hard decisions and signalled on succession to the new guard. The greater the visibility the less skittish the investor. This will play an increasingly important role for broad based market participation, and whilst the macro fears are quelled by expansionary budgets sustainable for some time, the stock market is less convinced. We are less worried and are assuming the transition will be successful, but with expected speed bumps, and hence continue to hold a substantial portion of the portfolio is largely non beta names. We have made the conscious decision to invest behind companies that have the footings to benefit from shifting towards upward trending optimal capital structures given low interest rates and shy away from companies that use interest rates as their raw materials. We have attempted to reflect this later in the newsletter as a juxtaposition between consumer companies and Saudi banks.

Qatar was down -4.8% for the year, with December losing -0.5%. Certainly a frustrating year for all those invested in the market as it was the worst performing market in the GCC after Bahrain. Moreover, it was one of the few countries in which volumes decreased relative to 2011. So what happened? Previously, the lack of depth in Qatar was trumped by macro visibility and exciting CAGRs in corporate earnings. These are no longer present to the same degree. The big spend continues, but the trickle down to the public market is neither as apparent nor visible enough to act as a catalyst for visible growth moving forward. The absolute dividend yield of the market is resilient, hovering above 4.5%, but the relative yield to other markets is diminishing and the sustainability less comforting. Sure, the trickle down mechanism is efficient given that the public sector and GREs employ about 90% of the local population, but that will only take our comfort levels so far. Diversification of money abroad to invest in depth and take on a new form of Qatari quasi colonisation with a cheque book rather than a gun can hopefully translate into flag planting of growth of Qatari companies. Then why are we still invested in Qatar? Well we are bottom up investors and we will invest behind Qatari companies that play to the strength of the factors mentioned earlier. Those companies that will piggy back on Qatar's regional aspirations offer interesting growth while providing good value in their domestic market. That is how we are and will position ourselves in Qatar as we stress test the growth scenario, and there are still a few interesting companies that continue to come out of the wood work.

The UAE, in aggregate, was one of the best performing markets for the year (Dubai 19.9%, Abu Dhabi 9.5%), with December recording only a modest gain (Dubai 0.9% and Abu Dhabi -1.6%). Volumes were also up over 20% for 2012. We have dedicated a section on Dubai real estate in particular and those of you who follow us regularly know our cautiously optimistic view of UAE banks. A beneficiary of the Arab spring? How sustainable is this? Well this works in two ways. The tourism market looks fantastic and sustainable particularly with the residual effect of the Arab spring. The foresight of the infrastructure spend has played out well as today the infrastructure of tourism covers A-D class tourists in a manner and depth that was not present in 2004-2006. As we describe later, we should be excited, but there are headwinds that are not to be ignored, including the debt restructuring, particularly the 2014/15 wall, and job creation away from services, where we are filling in capacity rather than creating more, but we take what we can get. As for the banks, there continues to be interesting value, less predictable growth, but nonetheless, a sense of consistency and prudence that create comfort on the asset restructuring process for many of the banks that we are looking at. These two themes continue to be important and germane to our core portfolio moving forward.

Kuwait is a market we have hardly dabbled in since the fund's launch, but the question looms as to whether it is time to start looking at this market; the market was up only 2.1% in 2012. The macro potential looks interesting where many influential participants feel that there is an inflection point on government spending and that the historical gridlock has subsided somewhat. The country has tremendous potential, but the internal trickle down has been clogged and government spend muted through the political due process. The victory of the Islamic bloc at the beginning of the year has raised hope of higher government spend across the board. This pendulum has certainly oscillated throughout the year, but sentiment on the ground remains positive. We will see how this plays out, as it could possibly recalibrate the growth paradigm of many companies which we follow in the market. We will not preclude Kuwait from being an important part of the portfolio in the coming years.

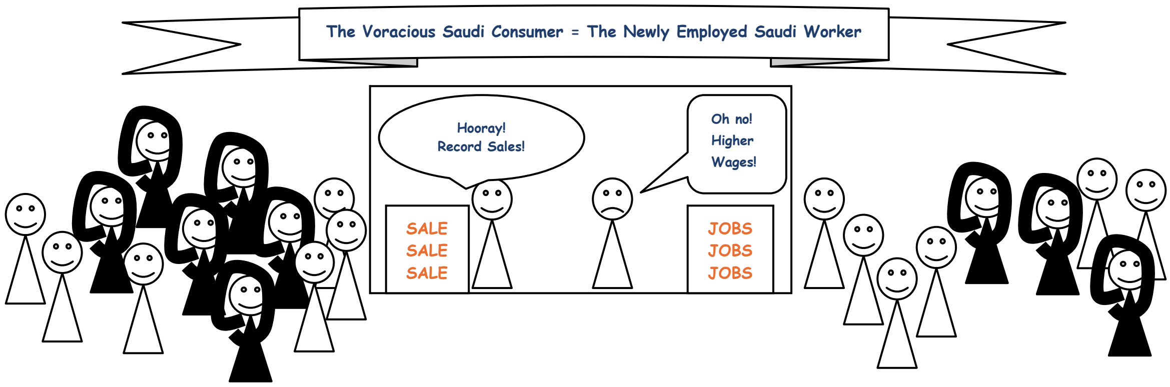
Egypt had a stunning year in term of market performance up 50.8% for the year supported by the December performance of 13.6%. We at Ajeej love the constituents of the market and the depth of the market, but we fail to see the value today given the dynamics and the challenges in the economic development arena. Setting aside the statistical volatility measure of Egypt being 5x that of other MENA markets, it is not the whip lash that has kept us out, but rather the inability to attribute fundamental variables to the companies in the market, particularly when compared to the respective peer group in the GCC. We simply don't understand it and rather than making excuses, which we continue to do on a regular basis, the omission is likely to persist until we are able to find equilibrium on long term fundamentals when measured against the value of the companies in other markets within our addressable universe. It has been an enigma that has given us some opportunity loss, but kept unexplainable volatility out of the fund.

In this next section we simply are clubbing the opportunity set of our bottom up companies into themes and reflecting upon our views from our Jan '12 newsletter and discuss the continuation of these themes moving forward.

Theme	2012	Discussion Newsletter Jan 2012	2013	Discussion
Qatar Macro	"+"	**2012** – Thesis holds QNB a rock but trying to find more plays outside of banking. We feel slightly underexposed in the portfolio, but would expect to add to this theme.	"+"	**2012** – We got this one wrong; but the opportunity cost to cash was not substantial. **2013** – QNB is a staple and offers tremendous upside value, the realization catalyst less clear, but relative value compared to regional peers given growth makes the stock very interesting. Some potential interesting play to the strengths of Qatar lie outside the banking system and we continue to explore such opportunities.
UAE Banks	"N"	**2012** – Neutral will continue to play this exposure through the conviction in ADIB although not a ground breaking year. Any further weakness on stock	"+"	**2012** – The theme through ADIB did not work as per expectation, but did not have a material attribution to the fund's performance. **2013** – This theme should have a strong play in 2013, and we see opportunities in UAE banks beyond ADIB as well.
Saudi Banks	"N"	**2012** – Unfortunately the drivers are not clear even with balance sheet growth pressure on NIMs continues and with no clear interest rate rise to benefit from unique liability costing of banks not likely to play out big in the portfolio in 2012, despite 1 possible conviction position, which if due diligence highlights opportunity, we will size in.	"N"	**2012** –Not material and fulfilled expectation as discussed from a performance perspective. Fundamentally the balance sheet growth sustained and reached capacity, but YOA (yield on earning assets) decreased effecting NIMs. **2013** – Valuations look attractive, yields relative to market less attractive. Please refer to the in-depth section in this newsletter for more discussion on the sector. In essence difficult to ignore but interest rate trajectory keeps the re-rating lower and all other efforts more immaterial to results. We don't expect banks to have a major run.
Fertilisers	"+"	**2012** – We continue to be + on Maaden and neutral on balance of fertilisers. Maaden has many challenges but the development of its overall portfolio and growth in minerals at current levels makes it an important part of our portfolio.	"N"	**2012** –Our exposure to this sector played out well through Maaden, but only in the 1st quarter of the year. Balance was largely neutral. **2013**– We do not see a significant re-rating in this sector and remain neutral at current levels for all within the NPK chain.
Real Estate	"N,-"	**2012** – There is value in the market but the realization could take years and the dynamics unappealing. Given this the level of distress is overdone on some companies, so it is not beyond the realm of possibility of exposure on unique opportunities as they arise with proper catalysts of realisations associated with it.	"N"	**2012** –The price performance was all over the place based on which country. Our exposure to the sector was only through Emaar which played out fairly well to our attribution. Egyptian real estate had a major run up in general, AD real estate was also + given merger activity and consolidation of sector. **2013** – We are positive only on Dubai real estate whilst other markets at best reflect Neutral status. We were never keen on the participation of Saudi real estate through the public markets making the dynamics more questionable rather than the economics.
KSA Infrastructure	"N"	**2012** – Aramco is moving slowly and no real demand coming through in the next 9 months but thesis holds. One has to be patient with our Aramco counterparts.	"N"	**2012** – This played out as per our expectation and in fact from a fundamental perspective was "-" rather than "N" when pertaining to ARAMCO and construction. **2013** – The inevitable upside risk of ARAMCO playing out for specialised players increases with time whereas other infrastructure remains competitive keeping margins compressed. We don't expect this sector to play a major role in 2013.
Petchems	"N"	**2012** – We will continue to be underweight the sector and with likely more downside to oil couples with weakening demand across the pchem product matrix slow. Undeserved drawdowns on company specific stocks present a nice entry to add exposure to our intensive list of companies which we follow.	"N"	**2012** –This sector was "-" for 2012 and in fact a negative attribution to the portfolio. We were underweight the sector but still had some skin in the game. The operating rates declined putting pricing pressure coupled with the Brent – WTI gap which weighed heavily on KSA players. **2013** – We certainly don't ignore the sector in its entirety, there may be some selective exposures based on dislocations which we may look at, but given the chronic state and uncertainty of global GDP growth this is an obvious proxy and with the spread between WTI – Brent adding a compression / expansion on margins adds to the uncertainty of drivers in this sector. We are likely to have a similar weighting to this sector as in 2012.
Domestic Retail KSA	"N/+"	**2012** – Our exposure and play out in the sector will continue and it will continue to form an important constituent of the portfolio many discoveries we are looking for in this sector.	"+"	**2012** –Mobily was our single greatest attribution in 2012 up over 50%. Moreover this sector provided the highest participation in this portfolio. **2013** – Enough companies in this sector are attractive to weight a bullish stance. We have dedicated a section to consumer focused companies and we expect this sector to continue to play out well into 2013.

"Hi, I'm Awad, how can I help you today?"

...Is my Saudi employee my best customer or my biggest threat?



A Time of Plenty: To be a Saudi consumer company in 2011 and 2012 was to open one's doors to a Saudi public clamouring for everything on the shelves. From high tops to laptops, the King's March 2011 announcement of extra salary payments, subsequent salary increases for Saudis in both the public and private sector, and the launch of the Hafiz unemployment program (which distributes cash benefits to unemployed Saudi men and women) resulted in two years of plenty for Saudi retailers.

The First Wave of Retail Prosperity...: Although we certainly didn't predict the surge in government transfer payments and salary increases that occurred in 2011 and 2012, the buoyant outlook for Saudi consumers was one of the drivers behind our investment in Alhokair from 2010-2012, a company that controls ~50% of the mid-market (mall stores) fashion retail market in Saudi Arabia. Alhokair was a prime beneficiary of the initial surge in consumer spending that occurred in 2011, and the company's results reflected (and continue to reflect) same store sales growth combined with expansion (~10% per annum) and acquisition of a competitor during 2012, which we expect has added around 20% to the company's top line. So far, the company's 2012/13 revenues are up +37% 9M 2012/13 following on +24% 2011/12 due to their prime positioning as a purveyor (primarily via Zara) of fast fashion. During 2012, we exited our investment in Alhokair as we feel that much of this 'first wave' of retail demand has been priced into the stock, and there is more downside risk on costs than upside risk remaining, though we continue to follow the company closely.

...Because of New Faces in the Crowd: Although not a precise measure of consumer spending, monthly 'point-of-sales' data published by SAMA (the Saudi Central Bank) is an indicator of credit and debit card transaction volumes with retailers in the Kingdom, the monthly value of which has surged from an average of SAR 6b/month in 2010 to SAR 8b/month in 2011 to SAR 10b/month in 2012, an aggregate increase of 67% in just two years. Interestingly, average value per transaction has remained relatively constant SAR 475 in 2010 vs. SAR 514 in 2012, a 4% CAGR in line with inflation. Taken together with robust same store sales growth reported across a wide range of retailers of ~10-15% for 2011 (with similar expectations for 2012), it's clear that Saudis are shopping more frequently, and that new shoppers (whether the newly employed or newly receiving benefits) are joining the burgeoning Saudi consumer culture.

The Second Wave of Prosperity Reaches Saudi Corporates...: As 2012 began, Saudi businesses, particularly in the services and tourism sectors, began to reflect greater confidence that the consumers thronging the malls were buying more than just shoes and toys, and were in fact spending as never before on travel, tourism, and services (education, healthcare), helped along again by continued emphasis in the 9th 5 year plan on improving Saudi human capital. The HSBC Saudi Arabia monthly PMI has remained above 55 (expansion is indicated by readings above 50) for the past 2 years, in certain months recording higher readings than any other market globally, according to HSBC. Key beneficiaries of demand for services by these expanding businesses such as Budget Saudi (car rental, long term vehicle leasing, and now commercial trucking) and Al Tayyar Travel (corporate travel, expatriate annual leave flights, and religious travel) became cornerstones of our portfolio in 2012, as these mispriced corporate service providers' growth has reflected buoyant corporate and government demand. Moreover, we expect government, corporate, and tourism services demand (and by extension demand for these service companies' services) to remain very strong through 2013.

...And then the Saudi Consumer Becomes the Saudi Employee: 2012 began with final implementation of the 'Nitaqat' system of points whereby companies with insufficient numbers of Saudi workers are prevented from renewing the visas of their expatriate workforce, and all companies are assigned a category stoplight-style as 'Red,' 'Yellow,' or 'Green.' In addition to this exciting new terminology, 2012 ended with a raft of decrees and pronouncements on further Saudization (Saudi participation in the private sector workforce), including a new minimum monthly wage for Saudis (SAR 3,000), and an annual fee (SAR 2,400 or USD 640) per foreign worker when a company's workforce is more than 50% expatriate. At average expatriate wages of SAR 1,550/month (reflecting mainly unskilled labour in the construction industry), this fee represents a 13% increase in employee wage expense.

Faced with rising employee costs (whether from increasing Saudization, increased expatriate workers needed to 'help' Saudi workers, or increased fees on expatriate workers), the Saudi consumer retail and consumer services companies face a number of potential challenges to their margins in 2013. Demand looks set to remain strong, and thus the question is whether or not shareholders will begin to lose out to Saudi workers as margins compress reflecting higher wages...

We feel that companies with relatively low employee cost / sales (due to the nature of their industry) and those with the ability to utilize technology to achieve greater productivity with existing employees have the greatest short term margin protection. Companies like Budget Saudi and Altayyar (both of which have shown strong productivity gains in their workforces in the last several years) are well positioned on these metrics.

Further, those companies training and equipping new Saudi workers like Alkhaleej Training have an important role to play within the Saudi economy over the next several years, particularly as demand by Saudi parents for a more modern and comprehensive education (like that provided by the affordable private schools Alkhaleej is building) continues to grow.

Finally, those companies actively reaching out to the lower-middle income segment of Saudis (many of whom live in small cities and towns far from Riyadh and Jeddah) are the companies that should outperform going forward. Companies like Extra and Herfy who've extended their sales footprint into 'virgin' retail territory beyond the cities are poised to capture this new demand.

And companies like Saudi Ceramics, Shaker, and Alabdullatif which are focused on providing affordable durable goods like tile, sanitary ware, white goods, and carpets and who already post a Saudi-wide sales presence are well-positioned to capture demand from first-time Saudi homeowners.

Taken together, these companies are the least likely to feel a major impact from rising wage costs and the most likely to be able to provide services to the 'new' Saudi consumer: a young graduate perhaps with young children, recently employed either in the public sector or the private sector in a second tier Saudi city on a moderate salary, ready to fit out and furnish a first home, take a vacation to Dubai, rent a car, or go out for a meal. These young people (and perhaps even the expatriates whom they will soon hire as maids and drivers) are the future of Saudi consumer demand.

Saudi Banks: Can We Bank on Saudi?

The Saudi banks team under captain Al Rajhi Bank looks poised to begin 2013 in pole position. The banks are well-capitalized relative to global peers, their asset quality metrics remain generally benign, and they operate efficiently as demonstrated by their low cost/income ratios. SAMA, the Saudi central bank, retains its reputation as a strict and effective bank regulator – no funny business on this race track! Meanwhile, the Saudi economy remains robust, driven by ongoing high oil prices; and demographics (roughly 40% of the Saudi population is under the age of 20) should be favourable for banking sector growth in coming years (high octane fuel for the banks' tanks, if you will). Further, even following a strong start to the year in terms of their stock price performances, Saudi banks are trading at valuation multiples near the low end of their range during post-global-crisis years.

Despite that positive general background, we currently believe that investing in Saudi banks should be undertaken on a selective bottom-up basis only. There are certain headwinds facing the sector that must be considered when forecasting the potential growth the individual banks could achieve. Even though Saudi banks are well placed in the race for growth, some banks are 'better-maintained' than others, and more likely to outperform.

First, the environment of low interest rates remains a drag on the sector's profitability, and certain banks are better-placed to deal with this environment than others. Interest rates on loans continue to be relatively low, with low base rates and pricing competition among banks keeping rates down for all. Total loan growth is in the mid-teens for the Saudi banks (see, we told you demographics and broader government spending would prove helpful), helping to support interest income, but the low asset yields prevent interest income from increasing in a more significant manner. Asset yields could potentially increase if credit becomes scarcer due to tighter sources of funding for the banks (see discussion below), but in our base case we do not anticipate a strong near-term upward move in asset yields. In simpler terms, there might be jet fuel in the tank, but the central bankers have effectively installed speed limiters for all banks.

In the low interest rate environment, controlling funding costs is a key to maintaining net interest margin, and we anticipate that funding costs will see upward pressure in the Saudi banking system in coming quarters. Since December 2008, banks have benefitted from an ever-rising share of demand deposits (mainly non-interest-bearing) in their deposit bases; demand deposits were 41% of total Saudi system deposits in December 2008 and then grew steadily in share until peaking at just over 60% in August 2012, as customers were hesitant to lock in time deposits at low prevailing rates (and since the same customers were hotfooting it to the shopping malls to spend those deposits month after month, spurring record consumer sales monthly since March 2011). We believe that the % allocation to demand deposits has peaked; management at more than one bank have recently indicated that raising new non-interest-bearing deposits in the market has become challenging. Thus, average cost of deposits could see an upward move in coming quarters, as the banks compete for fewer new deposits and begin to pay interest on a higher % of deposits. Moreover, some Saudi banks may seek to raise longer-term debt financing to increase Tier 2 capital ratios, to diversify sources of funding, and to better match assets and liabilities; in most cases, such financing would come at a higher cost than the current average cost of funds. Banks with greater ability to control funding costs have a better chance of maintaining or increasing their net interest income in this challenging low interest rate environment.

The young age of the Saudi population should in theory offer a boost to the Saudi banks' growth opportunities, as more Saudis enter working age in coming years. However, a high youth unemployment rate (it's tough to employ all those theology and Arabic language graduates in retail and services, let alone in industrial occupations) coupled with the still-small percentage of women in the workforce, means that the potentially bankable population is smaller than raw numbers would suggest. Opportunities for women continue slowly to become available, and the Saudi government is seeking to combat unemployment through Saudization initiatives and educational programs to improve the skills and knowledge base of Saudi workers. However, such efforts will take time, and in the short term they could put mild pressure on the banking system as some corporate customers see their profitability and cash flows reduced due to higher costs of employing Saudi nationals instead of (or in addition to) cheaper foreign workers. The banks could see some deterioration in their asset quality indicators if there is prolonged cost pressure on their corporate clients, particularly in the construction/contracting sector where the portion of foreign workers is high and company margins are already strained by years of fierce post-crisis competition and shrinking margins.

Valuation multiples of Saudi banks are attractive relative to their own history, but much of the reduction in multiples can be explained qualitatively. A portion of the multiple de-rating is attributable to the banks' lower structural profitability in a low interest rate environment (again, jet fuel in the tank but a fancy 'Bernanke Driving Speed Limiter' device in action). Moreover, the numerous IPOs in Saudi during the last few years have offered Saudi investors access to additional sectors and opportunities, reducing the centrality of banks in Saudi equity exposure. Finally, while low interest rates reduce the potential earnings streams for the banks, they also offer attractive investment opportunities to non-financial companies, who can borrow funds to invest in their businesses at historically low rates. Thus, some of those non-financial companies currently have growth profiles superior to those of the banks. Another important dynamic in the mind of the average Saudi investor is that many of the Saudi banks offer less attractive dividends than those available in other sectors, which is a switch from the banks being relatively high dividend payers vs. the market historically. To put it simply, the consumer companies benefiting from historically low interest rates on loans for expansion and record levels of consumption are able to generate high levels of free cash and pay high dividends relative to the banks.

Stock Selection:

While the sector faces certain headwinds as outlined above, valuations for the banks do remain attractive, and so we consider the sector on a bottom-up basis. We look for certain characteristics when determining which of the Saudi banks have the most favourable financial outlook for 2013, and then combine that with valuation and further assessment of market dynamics in identifying bank investments.

We prefer banks that have capital ratios well above the minimum central bank requirements. Higher capital ratios give further room for growing loans and other assets, and they also allow for maintenance of dividend payouts. Elevated capital ratios are like precisely-inflated tires; they allow the race car to grip the road and handle turns and changes efficiently at high speed. We believe that a few banks may become growth- and dividend-constrained in the next 12-18 months due to relatively lower capital ratios. Those banks would need either to raise capital or to slow their pace of growth (i.e. hitting their brakes through the turns). While those less-well-capitalized banks have ratios that remain well above the regulatory minimum, we believe that in practice the central bank will strive to maintain a buffer above that minimum, where the size of the buffer may vary for individual banks depending on SAMA's assessment of the characteristics of each bank.

We also assess the overall balance sheet structure for each bank to forecast which banks should be able to grow interest-earning assets while also protecting their margins. All else equal, we prefer banks with higher % balances in cash and other short-term liquid assets. First, with those balances already in place, the bank is better-positioned to meet liquidity requirements under Basel 3 guidelines. Second, to the extent that the bank is carrying excess liquidity, it has greater room to opportunistically reallocate that liquidity into higher-earning assets; a bank in the opposite position would have to move into lower-earning assets to meet liquidity requirements. We look for banks with lower ratios of loans to deposits. Some of the Saudi banks are nearing what we understand to be rough SAMA regulatory guidelines on loans/deposits, so in order to grow loans they will also have to grow their funding base, which could come at a relatively higher cost at a time when demand deposit growth is slowing (as discussed above). In contrast, a bank with a lower loans/deposits ratio not only has more room to grow loans, but also can reduce deposits in order to protect its net interest margin.

Beyond agility (capital ratios), capacity (cash and liquid assets position), and ability (unlikely to run into SAMA limits), we look for banks that have opportunities to improve their earnings profile, either through significant balance sheet growth, improved efficiency (e.g. better NIM or better operating cost efficiency), or lower volatility in provision charges. If a bank seems to have relatively fewer opportunities for balance sheet growth, and at the same time seems to have neared peak efficiency in terms of operating costs and provision charges, then we would need to be quite comfortable that the bank can maintain such efficiencies, since the possibility for a negative earnings surprise should be higher than the possibility for a positive one in such a case.

In summary, for 2013 it's a question of identifying which Saudi banks are able to handle upcoming twists and turns (challenging interest rate environment, competition for deposits and funding, and growth coming from 'new' customers [services companies] rather than 'old friends' [contractors]) with agility while being powerful enough to rule the straightaway once the curves are mastered. Within the framework discussed above, we currently like Bank Al Bilad (above average growth prospects, diversifying remittances business, liquid balance sheet, advantages on funding costs) and Riyad Bank (strong capital base, highest dividend yield among the Saudi banks – and attractive among Saudi companies in general, exposure to both corporate and retail banking, improvement in operating efficiency, and potential to revert to sector mean loan growth in the coming 2-3 years). We also like the potential for profitable asset reallocation at Samba and the potential for asset quality normalization at Saudi Investment Bank, two banks that also have strong capital bases.

Dubai Real Estate: Port in a Storm

There can be little doubt that Dubai has been the key beneficiary of the turmoil in the Middle East as we mark the two year anniversary of the 'Arab Spring'. With thousands of families and individuals seeking to relocate to a safe haven that isn't too far away from home, Dubai was and is the obvious if not the only real choice as a port in this regional storm.

This influx of human and monetary capital has revitalised the entire UAE economy but especially the economy of Dubai following a very difficult 2009 and 2010 for the brash city-state. This has had the effect of returning the emirate to a more established and mature version of its pre-crisis self. Indicators of this renaissance abound, first among them that Dubai was heralded as the world's best performing real estate market in 2012 with premium properties in various parts of the city rallying in the secondary market by as much as 30%. According to a recent Deutsche Bank report aggregating data from various brokers across town, average freehold property prices in 2012 jumped by 24% YoY. The catalyst to this jump becomes clearer when one considers that up to 80% of all transaction value came in the form of cash according to the Dubai Land Department.

From a qualitative and anecdotal perspective property demand is clearly on the rise; the amount of Egyptian and Syrian Arabic that one hears spoken in TECOM, Dubai Marina and Downtown Dubai has dramatically increased, despite the stringent restrictions placed by the UAE on visas for citizens from these beleaguered Arab states. And although the team in our Dubai office is a microscopic sample of the Dubai populace, the number of acquaintances, friends, family friends, old classmates and colleagues with whom we are personally familiar and who have moved to Dubai over the past 24 months from either Syria or Egypt is not insignificant. The primary market has also seen a resurgence in recent months, with new phases for Emaar projects selling out in a matter of hours (units in one particular project sold out faster than the Justin Bieber concert tickets made available the same day!).

As with most supply/demand relationships, an increase in one side of the equation does not go unresolved for long. The skeleton-like structures of unfinished buildings that were abandoned 2009 are once again are teaming with armies of construction workers in their blue overalls and hardhats. Even Emaar has been expediting the roll out of projects that have been on the back burner for some time.

And thus the current question is, "where are we heading from here?" Most tend to think that the trajectory is ever upwards, and we do not necessarily disagree. That being said we are slightly more cautious in our optimism than most, especially on the front of actual residential unit prices. One has to be cognisant of the myriad of opposing forces, some natural and some synthesised, which are at play in the market today. First, while real demand is certainly on the rise and as a result once dormant projects have found a new lease of life, investors eager for a return to the boom days of 2006-2008 are battling a new foe: the Emirati authorities. Having presided over the past 4 years of legal imbroglios, public relations snafus, and numerous (and ongoing) debt restructuring exercises, these authorities are decidedly NOT eager to see a return to May 2008.

A recent example is the UAE central bank's 'New Year's Resolution', which is a directive issued on December 31st, 2012, mandating that all mortgages to foreign investors be limited to 50% LTV; the banks' retort to this is that they would like this to be stretched to 60% LTV, and with such tepid negotiations it seems that this will be one directive that holds. The initial reaction from brokers and real estate investors was a panicked one, with many claiming that the market overnight turned from a seller's to a buyer's market. This may be partly true, but when one considers that 80% of all transaction value in Dubai in 2012 was cash based and not mortgaged, it seems unlikely that the new controls will have a huge impact.

The other cloud of the Dubai real estate horizon (appearing in September 2012 to dampen post-Ramadan buying) comprised of new rules for expatriate employees of Abu Dhabi GRE's to the effect that housing allowances for 2013 would be contingent upon residency in Abu Dhabi. Since the crises in 2008, many Dubai based professionals sought career refuge in Abu Dhabi. However, despite offering promising job opportunities Abu Dhabi has suffered from a critical shortage of housing for years, due to the moratorium on building imposed in Abu Dhabi in the late 1990s, and only lifted in 2005/6. More critical perhaps is the shortage of adequate schooling for the children of expat professionals. Therefore, many of those who did end up shifting there professional life next door to Abu Dhabi kept their personal life and residential addresses firmly in Dubai (the commute is a little over an hour if one travels beyond the speed limit within the 20km/hr allotted margin).

In order to address this (and not on behalf of commuters but on behalf of property owners in Abu Dhabi unable to find tenants), last September the Abu Dhabi government announced that professionals working in the emirate will not receive their housing allowances unless they can provide proof of residence in Abu Dhabi. The implementation of this new directive was supposed to take place at the start of 2013, but has now been postponed to a "later date". Initially there was concern that the new ruling would put downward pressure on Dubai residential units (specifically rental prices in developments in the south such as JLT, Discovery Gardens and Dubai Marina), but there has been little to no effect to date. In reality, the enforcement of such a ruling would be extremely challenging given the persistent lack of adequate schooling in Abu Dhabi for which many expats would understandably and reasonably be given exemptions to live in Dubai. Moreover, many households are dual income, and if one spouse works in Abu Dhabi, it us not unlikely that the other works in Dubai; again resulting in an exemption.

Other controls in place come in the form of rental controls. An aggressive jump in rental prices in the summer of 2012 prompted the Dubai Land Department to issue a directive that limits any rent increases to existing tenancy contracts to 5% per annum. With land lords in Dubai unable to raise rents more than 5% any given year, a ceiling is put on how far property prices can climb if a certain minimum level of yield is demanded (of course this assumes a rational market, which is probably a stretch, given Dubai's history of exuberant real estate prices, and the examples of Singapore and Hong Kong). Again however, this control can be circumvented by "persuading" a tenant to leave the property and leasing it to someone new. Yields themselves have been in steady decline for the past year, dropping approximately 1% in 12 months to slightly below 7%, which is less than 0.5% away from trough yields witnessed in 2009.

So is it resurgence? Is it a return to Dubai of yesteryear where investors were flipping an apartment twice a day? Or is the market maturing in earnest and turning to a healthy growth path? All are plausible and possible outcomes in this port in a storm. Despite the damper that recently announced mortgage limits may place on price appreciation, we view them as prudent moves by a 'harbourmaster' committed to maintaining order in an ever busier port.

Portfolio Review:

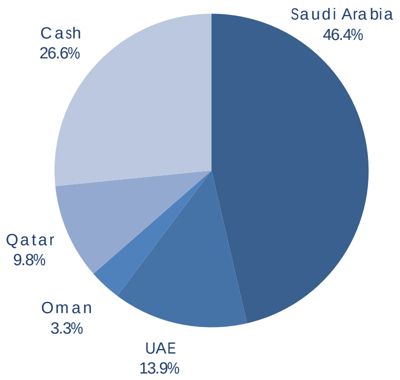
This section is available to investors only

Ajeej MENA Fund Historical Performance

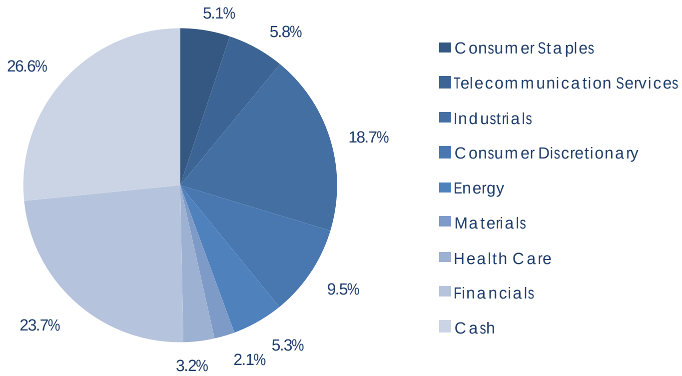
Annual Returns	2007	2008	2009	2010	2011	2012	Since Inception
AMF %	25.7%	-47.4%	16.1%	6.6%	6.3%	11.6%	-2.8%
S&P Pan Arab %	23.5%	-51.6%	13.6%	11.4%	-12.7%	3.6%	-31.7%

2012 Monthly	J	F	M	A	M	J	J	A	S	O	N	D
AMF NAV	89.6	94.3	99.2	98.6	93.2	92.0	95.9	97.3	95.6	97.8	95.1	97.2
AMF %	2.8%	5.3%	5.2%	-0.7%	-5.5%	-1.2%	4.2%	1.4%	-1.8%	2.4%	-2.8%	2.3%
S&P Pan Arab	655.1	703.4	730.7	707.7	663.6	647.1	652.0	672.2	666.6	662.4	647.0	662.4
S&P Pan Arab %	2.5%	7.4%	3.9%	-3.2%	-6.2%	-2.5%	0.8%	3.1%	-0.8%	-0.6%	-2.3%	2.4%

Country Allocations



Sector Allocations



Top 5 holdings in the Ajeej MENA Fund

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Ajeej MENA Fund	December-2012
Return, MTD	2.25%
Return, YTD	11.59%
Return Since Inception	-2.79%
Annualised 30d Volatility (on NAV)	6.82%
Sharpe Ratio Absolute	1.17
Alpha Benchmarked on S&P Pan Arab Composite YTD	7.95%
Value at Risk (VaR) - 95% (for the monthly holding period)	3.41%