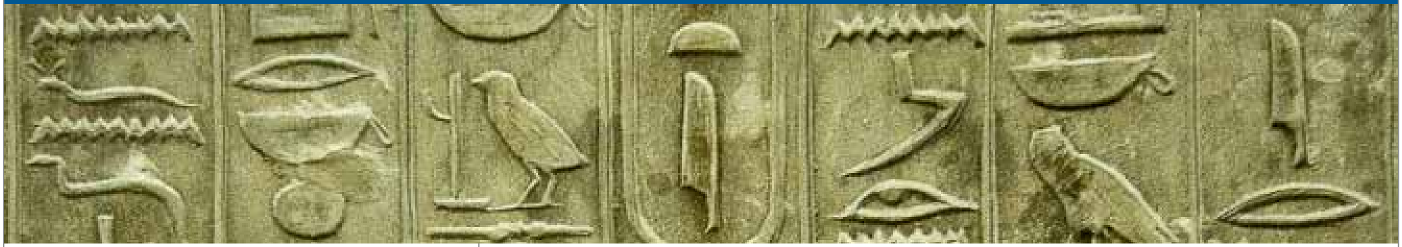

Egypt: Standing in the Middle of Nowhere and Everywhere

By Douglas Clark Johnson

My email correspondence to Cairo from New York was returned as undeliverable. Somehow I doubted that everyone I knew in Cairo had suddenly changed jobs. As the international media soon reported, the government had simply flipped the switch on the internet.

That's not the sort of thing that typically builds investor confidence. But we'll likely recommend Egyptian equities once the current uncertainty diminishes. However skittish the political backdrop, Egypt should be a mainstay of a well structured emerging-market allocation. We see little prospect of regressive economic-policy implementation down the road. Our view might be different if current protests shift to an Islamist-led revolt, but so far that does not seem to be happening. We're seeing grassroots discontent expressed by young Egyptians. More than half the population is under 35 years of age.

We'll likely recommend Egyptian equities once the current uncertainty diminishes. However skittish the political backdrop, Egypt should be a mainstay of a well structured emerging-market allocation.

Egypt: Less Tourism-Dependent Than Stereotype

Tourism Contribution to Total GDP

Country	Tourism as Percent of GDP	Global Rank
Lebanon	37.6%	11
Tunisia	16.1	33
Greece	15.5	37
Morocco	14.1	42
Egypt	13.0	50
Turkey	9.7	75
Saudi Arabia	9.5	78
Italy	9.4	79
Israel	6.4	134
Sudan	5.9	142

Note: Value of tourism defined broadly to include government expenditures and capital investment.
Source: World Travel & Tourism Council, 2010.

Our **Research Notes** series aims to provide timely commentary on investment topics of interest to our clients and friends. As a specialized investment firm bridging Islamic and conventional markets, Codexa Capital's analytical work explores aspects of asset management relevant to global audiences with interests in niche and evolving stories.

Before the recent sell-off, Egyptian stock-market movement provided few clues about investor sentiment. A better indicator of confidence in the underlying economy may be provided by remittance flows from Egyptian workers based in other countries. A lot of money has been making its way back home in recent years, supporting consumption and investment.

For readers seeking political context, Tarek Osman's just-published book *Egypt on the Brink: From Nasser to Mubarak* (Yale University Press) could not be more timely. In his chapter on the "Young Egyptians," he writes that the country resembles the agonized character at the beginning of Naguib Mahfouz's novel Autumn Quail, "standing in the middle of nowhere and everywhere."

We doubt the country will end up so fractured that it's unable to recover economically. While some rules will likely change, our read is that liberalization and deregulation will continue apace once a new cabinet is formed. The economic reshuffle set to take place will probably be constructive, acting as a catalyst for stock-market gains. Our friends at the Egyptian Center for Economic Studies (see www.eces.org.eg) have lots to say about underlying economic issues, although their website may still be stifled by the internet shutdown.

Before the recent sell-off, Egyptian stock-market movement provided few clues about investor sentiment. The broad index was essentially locked in a trading range since recovering from the Western financial crisis. A better indicator of confidence in the underlying economy may be provided by remittance flows from Egyptian workers based in other countries, although this data is not as timely as most economic indicators.

A lot of money has been making its way back home in recent years, supporting consumption and investment. Between the first quarter of 2010 and the first quarter of 2008 (before the Lehman shock), worker remittances into Egypt increased by some 39%, according to the most recent data provided by the World Bank. Egyptians themselves seemingly have enough faith in their economy to send increasing sums to their homeland. We can assume this process will continue apace under a more accommodating macro-economic backdrop, both domestically and globally.

The casual observer may assume that tourism has a major impact on the economy, but Egypt is diverse and complex. The World Travel & Tourism Council ranks Egypt only 50th worldwide, in terms of total tourism impact on the economy (including government spending and capital investment). Neither should one entirely discount this industry, of course. Fairly recent history suggests the tourists will return for their intake of ancient Egypt, despite being shut out of the Egyptian Museum this month. After the November 1997 massacre at Deir el-Bahari near Luxor, an immediate setback in tourist arrivals was followed by a steady climb.

A weaker Egyptian pound is inevitable, given the coming sharp run-off in tourism and the attendant hole in the balance-of-payments. Investors should expect volatility in asset prices, but currency movement may have a different implication for equity investors than for those in fixed-interest markets.

A softer currency will support earnings in some sectors, because of the revenue growth certain companies can generate in export markets. Any moderate currency-induced inflation may further aid profit margins through better pricing, unless interest-rate policy has to tighten dramatically. The annals of emerging market investing are chock-full of price relationships in which a loss on the currency has been easily recovered by an outsized gain in stock prices.

Aside for a near-term rebound, global investors will not likely see any material gains in Egyptian stocks for another six-to-nine months. But savvy neighbors, including those in Saudi Arabia and elsewhere in the GCC, will probably engage opportunities over the very near-term, given their appreciation for the Egyptian market's evolved status among regional bourses.

We should witness signs of recovering asset prices during the fourth quarter, in conjunction with improved foreign-exchange earnings (tied to the opening of the tourist season). And of course it may take that long for a newly formed cabinet to sort out its economic priorities. This provides a comfortable time period in which to reallocate portfolio positions, prospectively ratcheting down any overblown Asian exposure.

Note on Codexa Capital

Codexa Capital bridges Islamic and conventional markets. Our expertise crosses project finance, product structuring, and capital introduction activity. Our issuer audiences are global; our investor audiences spread primarily across the Muslim world.

This note's principal author, Douglas Clark Johnson, is CEO and Chief Investment Strategist of Codexa Capital. He can be reached at douglas.johnson@codexacapital.com.

Disclosures

Codexa Capital LLC

80 Broad Street, 5th Floor
New York, NY 10004

+1 212.330.9155
contact@codexacapital.com
www.codexacapital.com