



Equities yielded highest returns across Lebanese asset classes

Investing USD 1.00 in the Beirut Exchange would have resulted in USD 3.74 a decade later after accounting for dividend reinvestment

High coupons in a declining interest rate environment caused Eurobonds issued by the Lebanese government to surge

Holding USD 1.00 in Lebanese Pounds would have yielded a respectable return of 8.16% annually, with risk minimized by the Central Bank's ability to defend the currency peg

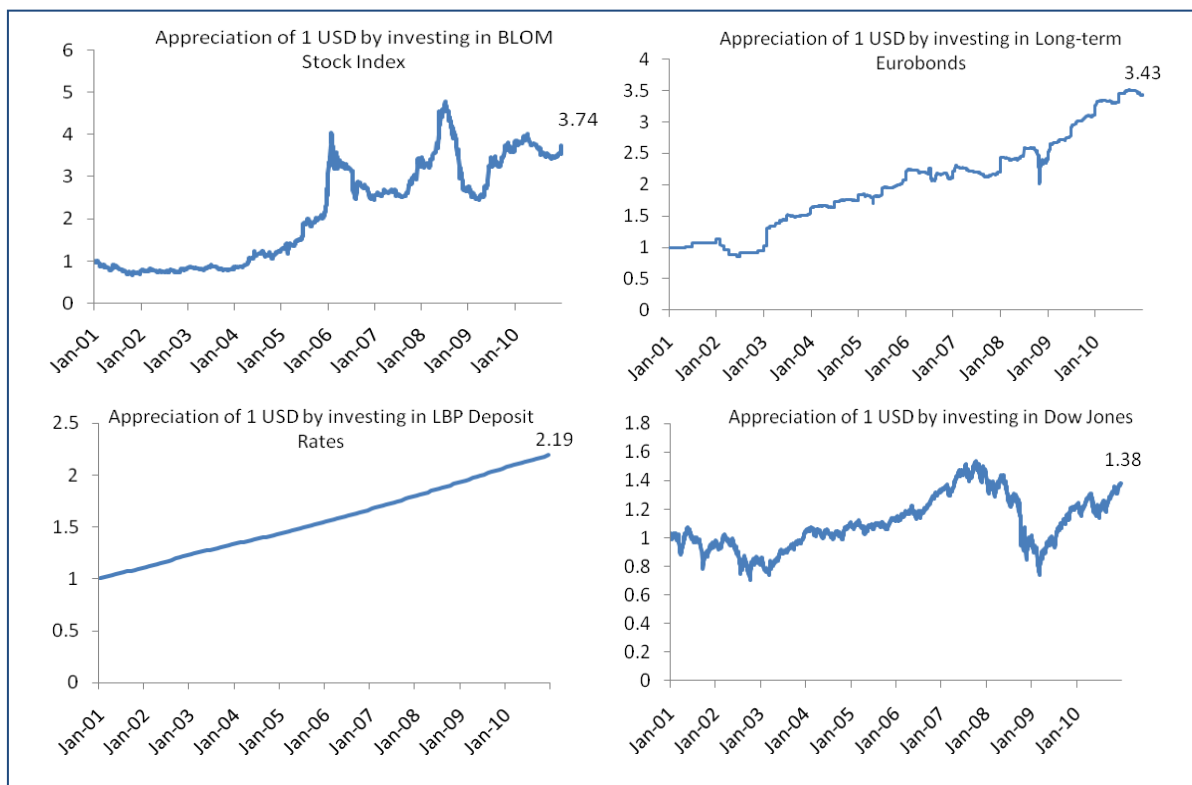
April 06, 2011

Contact Information

Senior Equity Analyst: Issa Frangieh
Issa.frangieh@blominvestbank.com

Head of Research: Marwan Mikhael
marwan.mikhael@blominvestbank.com

Research Department
Tel: +961 1 747 802
research@blominvestbank.com



Source: Bloomberg, Reuters, Banque Du Liban

Asset allocation may well be the most important decision an investor has to make. Should one allocate more to equities or to bonds? Is the risk premium in smaller countries sufficient for one to endure the additional risk? Of course, such questions are subjective and depend on one's investment objectives, his/her appetite for risk, and stage of the business cycle in the market that one wishes to participate in.

In this study, we take a look at the performance of four key asset classes that Lebanese investors are normally exposed to, by simulating a USD 1.00 investment in each. Namely, the four asset classes are: Lebanese-listed stocks represented through the BLOM Stock Index (BSI), Eurobonds issued by the Lebanese government, deposits in Lebanese Pounds, and large cap U.S. equities represented through the Dow Jones Index. Performance is tracked over the last decade with USD 1.00 invested in January 2001 and liquidated in December 2010.

Investing in the BSI, whose major constituents are Solidere and Lebanese banks would have been the wisest decision of the four. Buying USD 1.00 of the index would have resulted in USD 3.74 a decade later. This of course accounts for reinvesting all dividends back into the index at the prevailing price, assuming a dividend yield of 4%. The overall upward trend in the market began in 2004 as real estate prices were increasing and the economy overall was notably growing. One can easily identify the first market pop near 2005 year-end, attributed to the withdrawal of Syrian troops from Lebanese territories. The market grew phenomenally for a few months but then experienced a brief correction which was followed by a more adverse decline due to the July 2006 war. Nine months into 2007, a new market rally took birth and was boosted by the Doha Accord that took place in May 2008, thus reaching an all-time high of 2,120. This was driven by the exceptional economic performance in Lebanon where growth in all sectors was being recorded.

However, the BSI's bull rally came to an end following the global financial crisis where investors started to liquidate their positions on the Beirut Stock Exchange to cover for losses from holdings on the international markets. As for the last rally in 2009, it was due to the capital inflows that flooded the Lebanese market once investors realized the country was shielded from the financial crisis. This was reflected through a large surplus of USD 8 billion in the Balance-of-Payment during the year. However, in this instance, investment was weighed towards real estate hence it is not fully captured in the BSI's performance.

An investment in Eurobonds, which are bonds issued by the Lebanese government in U.S. Dollar, would have been the second best in performance. Buying USD 1.00 of Eurobonds would have resulted in USD 3.43 a decade later, an average annual return of 14%. This spectacular performance is attributed to several key factors with the most important being the declining interest rate environment, especially following the global financial crisis. Between October and December 2008, U.S. Fed interest rates were slashed to 0 – 0.25% with the European Central Bank and others around the world decreasing their interest rates to historic lows in an attempt to revive their economies. Local interest rates followed the international scene, however with some delay. This led to a surge in demand for Eurobonds in early 2009 after the sell-off that took place in the third quarter of 2008.

The Eurobond maturing in 2016, which we're considering in this study, reached a price of USD 127 in December 2010 compared to USD 99.5 in January 2001 with a coupon close to 11%. The high coupon issued early on in the decade is explained by the elevated public debt-to-GDP ratio of 170%, with government revenues barely enough to service its debt. In order to attract investors, Eurobonds were being issued at extremely high yields to compensate for the risk associated with the country's debt. However, ample funds were secured from the Paris II conference in 2002,

allowing the issuance of long term bonds with lower yields. This caused prices of previously issued Eurobonds to start their upward trend in the beginning of 2003. Note that a large share of return in Eurobonds is attributed to coupon payments which are paid semi-annually. In this study, we reinvested all coupons back in Eurobonds in order to account for reinvestment risk associated with bonds.

As for depositing funds in Lebanese Pounds, the safest bet of the four, a USD 1.00 deposit would have accumulated to USD 2.19 a decade later. While interest rates have considerably declined from a high of 10.52% in January 2001 to a low of 5.68% in December 2010, the holding would still have yielded a respectable return of 8.16% annually. The innate risk in this case would have been the exposure to the Lebanese Pound. However the currency has been pegged to the USD since 1993 with the Central Bank demonstrating its ability to defend the peg through the past two decades, even during political, security, and economic shocks. It has done so by setting the right regulations and accumulating abundant foreign reserves in excess of USD 30 Billion by end of 2010.

Finally, an investment of USD 1.00 in the Dow Jones Index would have yielded USD 1.38, a rather disappointing return considering the general risk involved with equities. The past decade is labeled as the "Lost Decade" in the U.S. as very little growth was registered, which is reflected in the index. The Dow Jones experienced a long but mild rise, starting in 2003 and interrupted by the housing bubble in 2008. The sub-prime market mess gave birth to a financial crisis that wiped all gains accumulated during the past five years, and even registered a new low for the 10-year period. However, the recovery has been strong since the beginning of 2009 with the Dow Jones only 16% lower than its all-time high recorded in 2007. Note that the Total Return Index was used in our study, which assumed all dividends issued by the participants are reinvested in the Index at the prevailing rate.

For your Queries:

BLOMINVEST BANK s.a.l.

Research Department

Verdun, Rashid Karameh Str.

POBOX 11-1540 Riad El Soloh

Beirut 1107 2080 Lebanon

Tel: +961 1 747 802

research@blominvestbank.com

Marwan Mikhael, Head of Research

marwan.mikhael@blominvestbank.com

+961 1 747 802 Ext: 1421

Issa Frangieh, Senior Equity Analyst

issa.frangieh@blominvestbank.com

+961 1 747 802 Ext: 1419

Disclaimer

This report is published for information purposes only. The information herein has been compiled from, or based upon sources we believe to be reliable, but we do not guarantee or accept responsibility for its completeness or accuracy. This document should not be construed as a solicitation to take part in any investment, or as constituting any representation or warranty on our part. The consequences of any action taken on the basis of information contained herein are solely the responsibility of the recipient.