

# COMPASS

YOUR INSIDE GUIDE TO WHAT'S GOING ON IN SICO

## CHIEF EXECUTIVE'S UPDATE

**“While we are cautiously optimistic for the rest of 2010, we are not yet out of the woods, and there is still more volatility on the way.”**



Welcome to the latest issue of *Compass*, in which we review developments at SICO during the first half of 2010, and take a look at prospects for the rest of the year.

### First quarter 2010 ended on a positive note

The New Year started on a subdued note. Plans by authorities in the US to impose stricter regulations on the banking sector, the EU bailout of Greece, and monetary tightening by China, were just some of the factors that caused international markets to decline in January 2010. Ongoing concerns about Dubai's debt, and weak 2009 corporate results, affected regional markets. Dubai, Abu Dhabi and Qatar continued to decline, while the other GCC markets rose only marginally.

By the end of the first quarter, however, the situation had improved. With a moderate revival in global economic growth, Brent oil rising to just over US\$ 80 a barrel, and announcement of the Dubai World restructuring proposal, international and regional markets returned to positive territory during March.

Against this backdrop, SICO posted a net profit of BD 1.28 million for Q1 2010 compared to a loss of BD 167 thousand for the corresponding period in 2009.

### Quarter two marked a dramatic reversal

The positive market momentum carried through into April and early May, with Brent oil reaching a 19-month peak of over US\$ 87. However, the middle of May marked the beginning of a major reversal. This was sparked by concerns about the scope of EU sovereign debt, a seeming

slowdown in the Chinese economy, the growing likelihood of sweeping financial sector reforms being enacted by the US Congress, and Brent oil dropping to a trough of US\$ 65. These, and other factors, led to international and regional markets posting their worst monthly performance for over a year. The second quarter ended with fears of a double-dip recession, concerns that austerity measures by the UK and Germany would impact economic output, and international and regional markets continuing their negative performance.

SICO's financial performance in Q2 2010 reflected this downturn, with the Firm posting positive results for the second quarter, albeit significantly reduced in scale to the first three months of the year. Net profit for the second quarter was BD252 thousand. Consequently, SICO announced a net profit of BD 1.53 million for the first half of 2010, an increase of 64% over the net profit of BD 935 thousand for the corresponding period in 2009. The Firm remains strongly capitalised and highly liquid, and we believe well positioned to take advantage of new business opportunities when the markets improve. As a matter of fact, we are undertaking

a number of initiatives that will unfold within the next six months. Concurrently, though, we maintain a 'fortress balance sheet'.

### Strong operational progress

From an operational point of view, SICO made excellent progress during the first half of the year. Business highlights include the launch of the SICO Money Market Fund, maintaining our number one position on the Bahrain Stock Exchange, and the signing of a depository agreement with the Bahrain Stock Exchange by our subsidiary – SICO Funds Services Company.

In view of excessive global market volatility, we continued to place the highest priority on strengthening SICO's risk management framework. We placed particular emphasis on enhancing our operational risk management – supported by the establishment of a new Internal Controls Unit as part of Financial Control – together with new initiatives aimed at instilling a risk management culture throughout the Firm.

### Future outlook

SICO has a cautiously optimistic outlook for the rest of the year. We expect that moderate global economic recovery – and the resulting stable demand for energy – providing healthy support for oil prices. Regional sovereign wealth funds should further build up their reserves, while GCC governments are likely to continue their steps towards overlooking their financial systems and to stimulating their economies.

Corporate earnings are expected to show healthy but choppy growth, since they are coming off a lower base in 2009, and we consider regional market valuations to be attractive compared with historical levels as well as with international markets. We continue to monitor the lending activity in the region since we view this as a key catalyst for economic growth. Encouragingly,

Net profit for first half year 2010

**BD 1.532**  
million

Versus BD 935 thousand in 2009

Assets under Management  
at end-June 2010

**US\$ 427**  
million

Versus US\$ 399 million at end-December 2009

## CHIEF EXECUTIVE'S UPDATE CONTINUED

the IMF is now forecasting the MENA region to grow by 4.5% this year and 4.9% in 2011. This is a faster rate than that predicted for the world average as well as for the average of developed nations.

"Despite the extreme volatility that highlighted the first half of 2010, SICO posted an impressive financial performance, with HY1 net profits increasing by 64% to BD 1.53 million."

However, there are a few 'flies in the ointment' that we believe could have a negative impact in the short-term. These include continued credit tightening, a slowing down of foreign portfolio investment to the region, and reversion to a more indigenous and retail-oriented investor base with reduced access to margin trading.

A major concern remains the impact on the region by the issues currently facing the major economic growth engines of the US, China and the Euro Zone. Particular economic issues facing the US and Europe have some way to go before being resolved, while the battle between Capitol Hill and Wall Street over financial sector reforms looks like ending in a new version of the Glass-Steagall Act. Any further tightening of interest rates could slow down the Chinese economy, with damaging implications for commodity exporting economies and East Asian emerging markets. And finally, the sovereign debt crisis facing the EU, which started with Greece, is now spreading to other countries, although this seems for the moment to have aborted.

The extreme volatility that highlighted the first half of 2010 is a reminder that the road to economic recovery is likely to be longer – and bumpier – than many originally expected. However, supported by strong macroeconomic fundamentals, the GCC has the strength and commitment to withstand the worst consequences of any further slowing of the world economy.

We are not yet out of the woods, and there is still more volatility on the way.

I would like to wish all stakeholders a pleasant summer break, and Ramadan Kareem.

**Anthony C. Mallis**  
Chief Executive Officer

## RISK MANAGEMENT

During the first half of 2010, SICO maintained its focus on risk management to ensure that the Firm remains strong, methodical and consistent in the face of the current challenging economic and financial environment.

In expectation of continued market turbulence, SICO took the following proactive steps:

- Continued to adopt a cautious and conservative investment strategy aimed at preserving the Firm's strong capital base and maintaining a safe, liquid and profitable portfolio.
- Strengthened and enhanced the focus of the Risk Management department by recruiting a Risk Analyst to join the team.
- Conducted regular portfolio reviews by senior management to ensure that investment decisions at the ground level remain responsive and aligned with market dynamics.
- Monitored fiduciary portfolios to ensure compliance with internal investment guidelines.
- Bolstered SICO's operational risk management framework by appointing Operational Risk Coordinators in each department. The Firm conducted workshops to ensure Coordinators'

understanding of their roles and responsibilities; raise their awareness of operational risks and controls; instill a compliance culture across the Firm; monitor and report operational incidents to facilitate prompt corrective actions; and maintain preventive control to mitigate such risks in the future.

- Actively contributed suitable comments on several consultative papers issued by the Central Bank of Bahrain and the Bahrain Stock Exchange, including the new Corporate Governance Code of the Kingdom of Bahrain. SICO places the utmost priority on adequately managing the Group's compliance risk and to maintaining cordial relationships with all regulators.
- Established a new Internal Control Unit as part of Financial Control to enhance the Firm's internal control framework.

## BAHRAIN ISSUES NEW CORPORATE GOVERNANCE CODE

Following a deliberative process of over one year, the Corporate Governance Code of the Kingdom of Bahrain has been issued by the Ministry of Industry and Commerce. The purpose of this new Code is to establish best practice corporate governance principles in the country, and to provide protection for investors and other company stakeholders through compliance with those principles. The Code becomes effective on 1 January 2011 and all companies to which it applies should be in full compliance by year-end 2011.

The Code is intended to apply to all operating joint stock companies that are incorporated under the Bahrain Commercial Companies Law. In its initial form, the Code will apply to public companies, but it should be used as a model by all other companies. It is expected that the Ministry will issue revisions to apply the Code to other types of companies. While the code follows best practice, it is nevertheless considered as the minimum standard to be applied. Companies may adopt higher standards of corporate governance, and industry regulators, in particular the Central Bank of Bahrain, may issue additional directives or guidance as appropriate.

## MARKET MAKING

Since pioneering the market making concept on the Bahrain Stock Exchange (BSE) in 1997, SICO has maintained its status as the sole official market maker on the BSE. The Firm has also consolidated its position as one of the GCC's premier market makers. Currently, 25% of SICO's market making activities is conducted outside Bahrain, across the GCC region.

SICO has built considerable expertise in advising, managing and placing fixed income issues – both sovereign and corporate – and is active not only in Bahrain but also across the region. The Firm's growing strength in this area stems from its in-house research capability, and its one-stop-shop service that provides end-to-end solutions for an increasing number of fixed income investors.

## ASSET MANAGEMENT

- New first-of-its-kind money market fund launched
- SICO retains leading position in latest Zawya Fund Rankings
- Increased interest in DPMAs
- Global distribution capability expanded
- Total assets under management increase to US\$ 427 million

The new **SICO Money Market Fund**, which was launched in May 2010, is the first locally-managed fund of its kind to be offered by a Bahraini fund manager. The fund aims to provide investors with higher returns compared to bank deposits while offering weekly liquidity. The fund will invest in 'investment grade' money market instruments, such as GCC government bills and notes, corporate paper, and domestic banks' term deposits, capitalising on movements in the short-term yield curve.

### SICO Equity Funds Update

During the first half of the year, the **SICO Arab Financial Fund (SAFF)** and the **SICO Selected Securities Fund (SSS Fund)** continued to perform strongly. SAFF was up 7.5% versus a 2.2% decline by the S&P GCC Financial Index; while the SSS Fund was up 1.2% compared with a 4.2% drop in the BSE All Share Index. However, both the **Khaleeji Equity Fund** and the **SICO Gulf Equity Fund** underperformed their respective benchmarks. This was mainly due to these Funds' underweight position in the Kuwait market, and their lack of exposure to Zain, which comprises a considerable portion of the benchmarks, and has appreciated by 26.3% since the beginning of the year.

## BROKERAGE

- SICO maintains leading position on BSE
- Platform expanded to include ETFs

SICO entered its 12th successive year as the **leading broker** on the Bahrain Stock Exchange (BSE) during the first half of 2010. Trading by the Firm during this period equated to 51% by volume, 45% by value, and 25% by the number of transactions completed on the BSE. The Firm also maintained its majority share of transactions generated by foreign investors, which account for over 50% of the BSE's turnover.

Supporting this business was the continued success of SICO's **Agency Brokerage Desk**, launched in 2009, which enables clients to trade listed investment opportunities available across the MENA, including access to the fixed income market. During the first six months of 2010, SICO expanded its regional network of counter brokers and signed a number of new major accounts. SICO has established a significant share of overall GCC market trades, despite being based in Bahrain, which places

### Latest Zawya Fund Ranking Results

SICO continued to lead the way in the Q1 2010 Zawya Fund Ranking results, which cover the three-year period from April 2007 to March 2010. The Khaleej Equity Fund and the SICO Gulf Equity Fund were ranked First and Second respectively in the GCC Equity Conventional Funds category. The Al Islami GCC Equity Fund, which the Firm manages for Dubai Islamic Bank, was ranked First in the GCC Equity Islamic Funds category. The ranking methodology for funds is based on four criteria: returns, volatility, compliance and fees. Zawya Funds Ranking is the first and only independent funds ranking system in the Middle East, addressing the rising demand for accurate information, unbiased research and analysis, as well as increased transparency in the regional funds industry.

Also during this period, there was increased interest in the Firm's **Discretionary Portfolio Managed Accounts** business, which continues to thrive; while SICO further expanded its **global marketing and distribution footprint**, with partnerships covering the key regions of USA, Europe and East Asia.

Despite the challenging market conditions, **total assets under management** increased to US\$ 427 million at the end of June 2010, compared with US\$ 399 million at the end of December 2009.

the Firm among the leading brokers in the region. Currently, 42% of SICO's brokerage activities outside Bahrain are in the Kingdom of Saudi Arabia, followed by 19% in Qatar, 18% in the UAE (DFM, DIFX and ADFM) and over 16% in Kuwait.

SICO has expanded its brokerage portfolio to include **Exchange Traded Funds (ETFs)** to meet the growing demand for this investment vehicle by institutional clients. An ETF is a security that tracks an index, commodity or a basket of assets similar to an index fund, but trades like a stock on an exchange. ETFs are attractive as an investment because of their low costs, tax-efficiency, and stock-like features. Since becoming available in the US in the early 1990s, ETFs have developed into an international market that has grown from US\$ 800 million in 1993 to an estimated US\$ 1 trillion in 2010.

## SICO MMF

The 1st money market fund launched by a Bahraini fund manager.

## CORPORATE SOCIAL RESPONSIBILITY

### Industry Conferences / Events

During first half of 2010, SICO either sponsored or participated in four financial industry conferences and events, including presentations made by CEO Anthony C. Mallis, Head of Asset Management Shakeel Sarwar, and Head of Research Jithesh Gopi.

- Institute of Chartered Accountants of India Bahrain Chapter Annual Regional Conference.
- CFA Bahrain Annual Forecast Dinner and Charter Award Ceremony.
- 6th Annual Middle East Insurance Forum.
- Inaugural CFA Institute Middle East Investment Conference.

### Charitable Initiatives

The Firm also supported a number of educational and charity fundraising initiatives.

American Mission Hospital: Annual Island Classic Charity Golf Tournament, Bahrain.

Madrasati Palestine Initiative: repairing and restoring damaged schools, and providing accommodation and education for refugee students.

AIIESEC: International platform for young people to develop their leadership potential.

Signed MoU to establish areas of cooperation to promote leadership skills of Bahraini students and provide a positive impact on the Kingdom's youth.

Sponsored Bahrain's Young Hands for Sustainable Futures Project to educate students, families and SMEs on environmental sustainability.

## CUSTODY & FUND ADMINISTRATION

### SFS signs new depository agreement with BSE

The first six months of 2010 proved to be an eventful time for SICO Funds Services Company (SFS). During this period, SFS received approval from the Central Bank of Bahrain to change its licence from 'service provider for custody and fund administration' to 'investment business'; signed a Depository Participant Agreement with the Bahrain Stock Exchange; introduced a new Security Agency service; and secured a number of new mandates.



The signing of a **Depository Participant Agreement** in May 2010 with the Bahrain Stock Exchange (BSE) will enable SFS to provide custody of BSE-listed securities to local, regional and international investors. Significantly, SFS is the first and only indigenous firm to be appointed as a custodian on the BSE, which further enhances its recognition and reputation.

Under this agreement, SFS will also be able to act as a **Security Agent**, providing custody and agency of securities involved in a transaction between two parties.

Despite challenging market conditions and increased competition, SFS was successful in

securing a number of **new mandates** during the first half of the year, and continued to contribute to SICO's bottom line.

The company also announced the appointment of **Ms. Khulood Rashid Al Qattan** to the Board of SFS as an independent non-executive director. Khulood's career spans 22 years in banking, mainly in the investment field. Her experience embraces US and European equities trading, capital and money market instruments in local, regional and international markets, and portfolio management. Her previous positions include Head of Investments at BBK, Head of Wealth Management at Addax Bank, and Regional Director - Investment Placement at Evolve Capital. Khulood holds a Bachelor's degree in Accountancy from Ayn Shams University in Cairo, Egypt; and she is a member of the Arab Businesswomen's Council and the Bahrain Businesswomen's Society.

## CORPORATE FINANCE

With a successful track record approaching 15 years, SICO is a leading provider of corporate finance solutions in the Kingdom of Bahrain and the MENA region. The Firm is one of a select group of MENA-based investment banks that cover the entire spectrum of corporate finance-related products and services for blue-chip clients in key regional sectors.

Adverse market conditions during the first half of 2010 resulted in a number of awarded or potential corporate finance mandates being put on hold. However, SICO managed to secure new financial advisory mandates, including one in the Sharia-compliant financial sector. The Firm also acted as Financial Adviser to the independent shareholders in the fully-subscribed US\$ 1.11 billion priority rights issue by the Arab Banking Corporation in March 2010.

## SICO TEAM NEWS

### A warm welcome to the following new staff:

- Absar Ahmed Mirza:  
Head of Internal Control - Financial Control
- Shereen Abdulmajeed Ismaeel Hasan:  
Institutional Sales Manager - Brokerage
- Hamad Ali Mohd. Saleh Alheddi:  
Risk Analyst - Risk Management
- Roaya Abdulla Hasan Salman: Portfolio Administrator - Asset Management

### Congratulations on their CFA exam results to:

- Ali Marshad - Level 3
- Ambereen Jiwani - Level 2

- Fadi Mahmoud - Level 2
- Samer Taleb - Level 1

Congratulations are also due to Shaika Kamal who graduated from DePaul University in the US with a Master's degree in Finance

### Best wishes to the following newlyweds:

- Hassan Haidar - Asset Management
- Aysha Al Balushi - Customer Relations
- Khalil Shamsi - Financial control
- Ankit Gupta- Research



### And blessings on the birth of her daughter to:

- Najla Ebrahim - HR & Administration

## RESEARCH

SICO continued to expand its in-depth research coverage of the GCC region during the first six months of 2010, with the addition of 11 new companies.

### New Company Initiation Reports

Air Arabia  
Al Othaim Markets  
Al Rajhi  
Arab National Bank  
Bank Sohar  
Doha Bank  
Riyad Bank  
SABB  
Samba  
Saudi Fransi  
Yanbu National Petrochemicals

### Regular Reports

- 70 Company and Sector Updates
- 12 Petrochemical Round Ups
- 4 Oil Market Updates
- 6 GCC Economics-The Numbers reports
- 1 GCC Strategic Outlook report
- Daily GCC Market Watch reports
- Weekly Bahrain Market Watch reports

### Readership Survey

SICO conducted its latest research readership survey in February 2010. Key findings include:

- 51% of recipients find the monthly GCC Economic-The Numbers and the fortnightly Petrochemicals Round Up to be "very useful".
- 82% of recipients are interested in a Fixed Income report.
- 75% of recipients consider Saudi Arabia to be the most important MENA region market.

### Comments from recipients include the following:

"Excellent and outstanding activity."

"Thank you very much for the valuable information in your reports."

"I find the reports very useful and timely. Keep up the good work."

"I think SICO's service is one of a kind, and is gratefully appreciated in a region where quality information is difficult to obtain."

"SICO's reports excel when compared with regional players . . . and have dramatically improved during the past four years."