SAFE HARBOUR

GLOBAL SUKUKS IN A TRANSITIONING WORLD

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Against high market volatility, US$-denominated global sukuks have delivered superior risk-adjusted returns. Performance has been underpinned by the structural transformation of the Gulf Cooperation Council (GCC) economies, which comprise the core countries of the sukuk issuer universe. Returns have been further bolstered by strong gains posted by sukuks issued by high beta sovereigns, namely Egypt, Turkey, and Pakistan. These countries benefit from financial flows from the GCC and from economic reforms.

Table 1: 5-year annualised fixed income performance (May 20, 2025) highlights the Middle East sukuk outperformance

	Annualised Return	Annualised Volatility	Return/Volatility Ratio
ME Sukuk (A3/BBB+)	2.5%	2.9%	0.86
EM Corporate (Baa2/BBB-)	1.9%	4.0%	0.49
Asia Credit (A3/A-)	0.6%	4.1%	0.15
MENA Conventional (A2/A-)	0.6%	5.9%	0.10
EM Sovereign (Ba1/BBB-)	0.1%	7.8%	0.01
Developed Market Sovereign	-3.0%	6.7%	-0.45

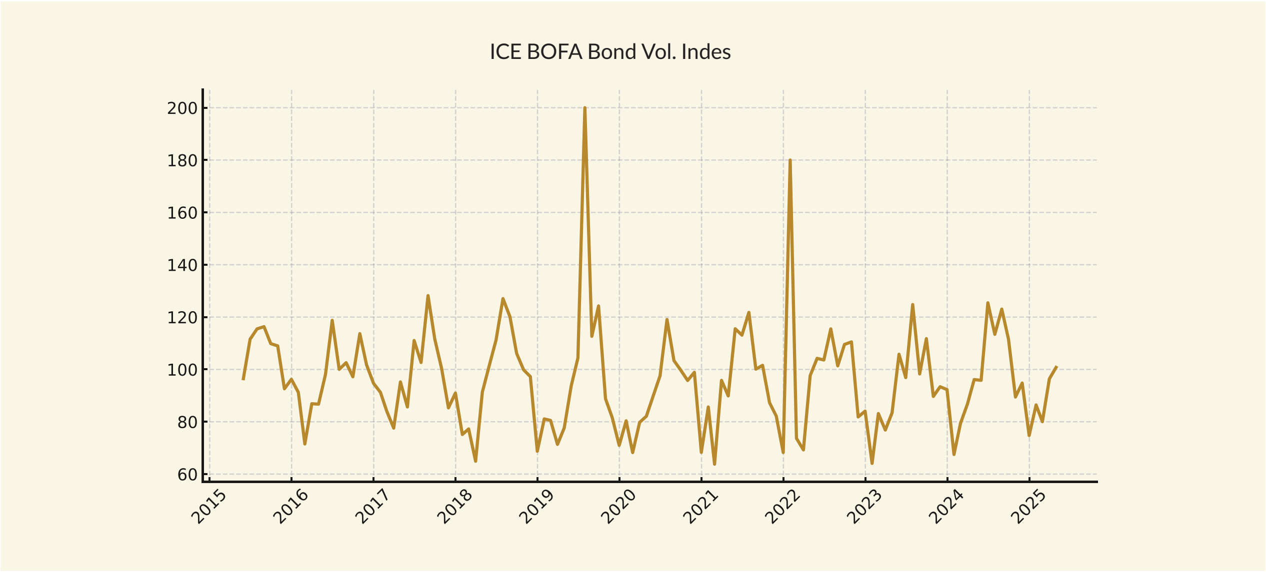
Sources: Bloomberg, JP Morgan

We expect financial market volatility will stay elevated for the foreseeable future. The increase in China's economic power is altering global financial and trade flows in unpredictable ways. Consequences of these changes will impact market stability. In this uncertain market environment, the global sukuk asset class offers fixed income investors a vehicle that provides a degree of insulation from volatility. At the same time, by investing in sukuks, investors can also capture the upside from the economic transformation taking place in the countries of the sukuk universe. Due to their strategic location, trade linkages and financial firepower, sukuk issuers are well positioned to take advantage of opportunities arising from the shifting of global geopolitical balance.

SUKUKS IN THE GLOBAL MARKET LANDSCAPE

The 2020s have been marked by exceptional volatility in global financial markets. From 2020 to 2025, markets have contended with the economic fallout from the COVID-19 pandemic, a surge in inflation driven by Russia's invasion of Ukraine, and then, a new disruption stemming from abrupt shifts in US tariff policies. If implemented as proposed, these tariff changes would leave the United States with the highest

Charts 1 and 2: Market volatility has increased against the backdrop of increasing Chinese economic strength



Source: Bloomberg

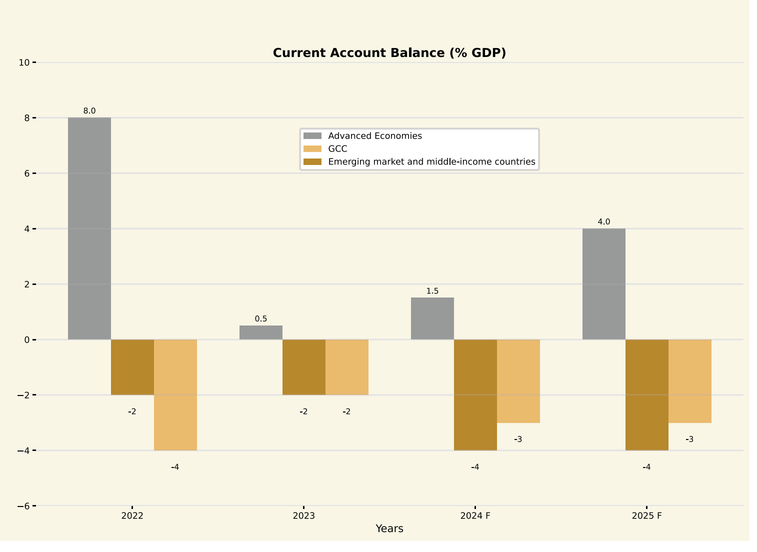
tariff rates among developed economies. The developments are unfolding against the backdrop of China's sustained economic ascent, which is reshaping the global trade and financial order established after World War II and accelerated by China's entry into the WTO (formerly GATT) in 2001.

Source: IMF

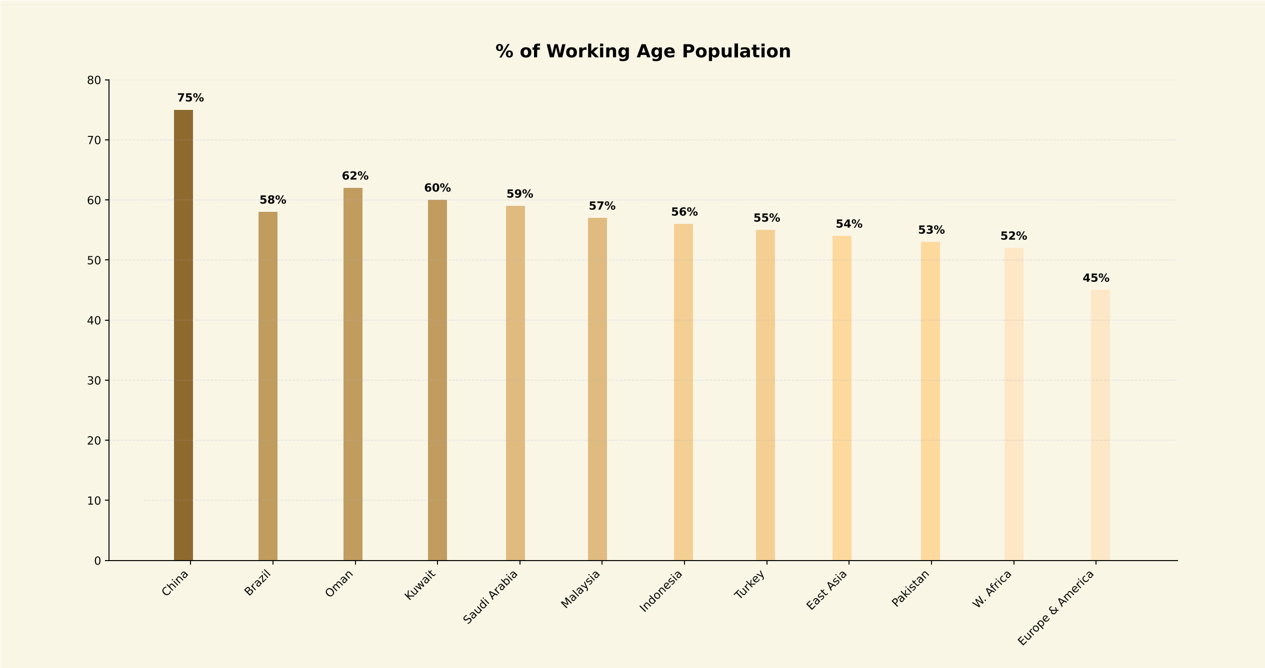
> Countries in the global sukuk universe—nations enjoying notable economic and demographic advantages—the GCC, stand out as attractive strategic partners

Although recent talks between the US and China have sparked optimism that a complete rupture in their trade relationship may be avoided, we believe that substantial damage has already been done. Both countries appear to be actively seeking to reduce mutual dependency and are likely to compete more aggressively for influence in strategically important, resource-rich developing nations with favourable demographics.

Charts 3 and 4: The sukuk issuer universe comprises countries with attractive financial profiles and demographics



Source: IMF



Source: UN

In this context, countries in the global sukuk universe, notably the GCC, stand out as attractive strategic partners. These nations enjoy notable economic and demographic advantages, making them increasingly important in the geopolitical landscape evolving. Sukuk-issuing countries represent 10 per cent of the global population and control roughly a third of the world's oil reserves. Together, they account for approximately 18 per cent of emerging market (EM) GDP, while GCC countries boast significantly higher per capita GDP than the broader EM average. Additionally, many core sukuk issuers maintain some of the highest current account surpluses globally. As geopolitical competition intensifies, investment opportunities in these countries will likely gain prominence.

SUKUK UNIVERSE: SUSTAINED MOMENTUM

Currently, about 70 per cent of US$-denominated global sukuks are issued by oil-producing GCC countries, which rank among the wealthiest in the world and benefit from ongoing structural reforms. On the other end of the spectrum, the sovereign sukuk universe also includes high population growth developing countries such as Egypt, Pakistan, and Turkey. What binds these diverse economies is the financial flow from asset-rich GCC nations—primarily in the form of remittances and strategic investments—into dollar-scarce economies. These flows play a critical role in providing external liquidity.

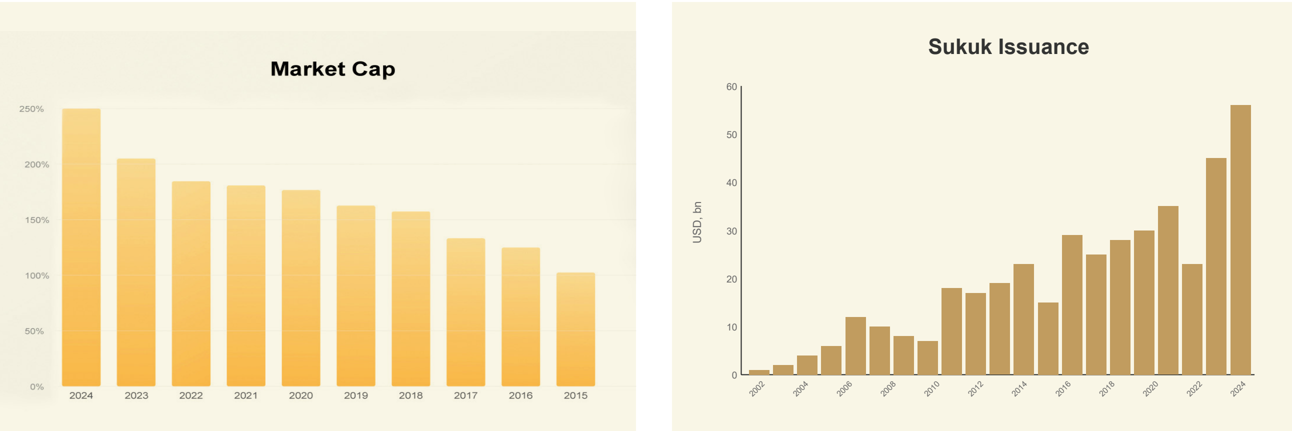
Looking ahead, we anticipate a notable increase in cross-border capital movement, particularly following the UAE's large-scale investments in Egypt. With geopolitical alliances being in flux, the GCC countries are likely to cement their existing relationships through direct investments that serve both economic and strategic objectives.

We believe the US$ sukuk asset class is well-positioned to sustain its historical momentum. Key factors supporting this outlook include strong investor demand, rising confidence, and growing financing needs among issuers in core markets. The sukuk market is expected to play a central role in financing Saudi Arabia's economic transformation, which is a core pillar of the country's Vision 2030 reforms aimed at reducing dependence on hydrocarbons.

To achieve this, the Saudi government is ramping up infrastructure spending across non-oil sectors such as tourism, healthcare, leisure, and entertainment. Given that Saudi Arabia represents nearly 50 per cent of GCC GDP—and that its current infrastructure lags behind some of its GCC peers—we expect a substantial increase in Saudi sukuk issuance. This issuance is intended to elevate the country's infrastructure to regional standards.

By 2027, we project that Saudi entities will account for over 50 per cent of the outstanding sukuk market, up from approximately 33 per cent

Charts 5 and 6: Strong growth of the asset class highlights attractive fundamental dynamics



Sources: Bloomberg

> GCC countries remain largely unaffected by the new import tariffs imposed by the US government

at the end of 2024. This will significantly expand the overall size of the sukuk market. Global investors, as recent demand trends suggest, are likely to continue supporting Saudi borrowing, attracted by (a) relatively attractive valuations compared to credit ratings, and (b) improving credit fundamentals among Saudi issuers.

GCC IN THE INTERNATIONAL ARENA: A SOURCE FOR STABILITY

The strategic importance of the GCC region in the global context was underscored by President Trump choosing it for his first international trip in May 2025. The visit focused on strengthening commercial, defence, and trade relationships, exemplified by the US-Saudi investment summit. It also highlighted the region's growing role in international diplomacy.

One immediate outcome of the renewed US-GCC engagement was a reduction in regional geopolitical risks. Before the visit, through Omani mediation, the US reached a ceasefire agreement with the Yemeni Houthis, who agreed to stop targeting US vessels in the Red Sea. This agreement also reduced the likelihood of renewed Houthi attacks on the GCC, particularly Saudi Arabia. Before this deal, there was a risk that the US might pressure GCC countries to retaliate, potentially provoking further missile strikes by the Houthis, as seen in the past. The ceasefire has significantly lowered this risk, at least in the near term.

Similarly, the region stands to gain from Syria's reintegration into the Arab League. With the country devastated by years of civil war, Syria will require enormous reconstruction efforts, estimated in the hundreds of billions of dollars. This presents opportunities for both regional and international companies to participate in the rebuilding process.

GCC AS A TRADE FULCRUM IN AN ENVIRONMENT OF RISING PROTECTIONISM

The results of the April 2025 US–Saudi investment summit highlight the region's growing economic influence, building on recent diplomatic gains. During the visit, the Trump administration signed multiple agreements with Saudi Arabia, Qatar, and the UAE. These deals are expected to stimulate the respective economies by expanding trade and investment in a mutually beneficial way.

The GCC stands to benefit particularly from US investment in sectors such as technology, where the US is a global leader. Other priority sectors include energy, healthcare and AI, where the goal for the GCC is to become a regional hub.

GCC economies are also relatively well-positioned to capitalise on the disruption caused by recent shifts in US trade policy. Unlike many Asian economies, GCC countries have been largely unaffected by the new import tariffs imposed by the US government. Their competitive position may have improved. Energy, which accounts for over 50 per cent of GCC exports, remains exempt from tariffs, while non-energy exports face only a 10 per cent baseline tariff.

This limited exposure creates an opportunity for the GCC to attract production relocation from higher-tariff regions, assuming these trade differentials persist. Sectors such as petrochemicals and fertilisers are likely to see gains, driven by the region's low feedstock costs.

With world-class infrastructure, low-cost labour, and strong logistics networks, the GCC is well-positioned to absorb such shifts in global production. Regional governments have long pursued industrialisation to reduce their reliance on energy exports, and the current US trade environment further supports this strategy. The recent rise in non-oil growth underscores its effectiveness.

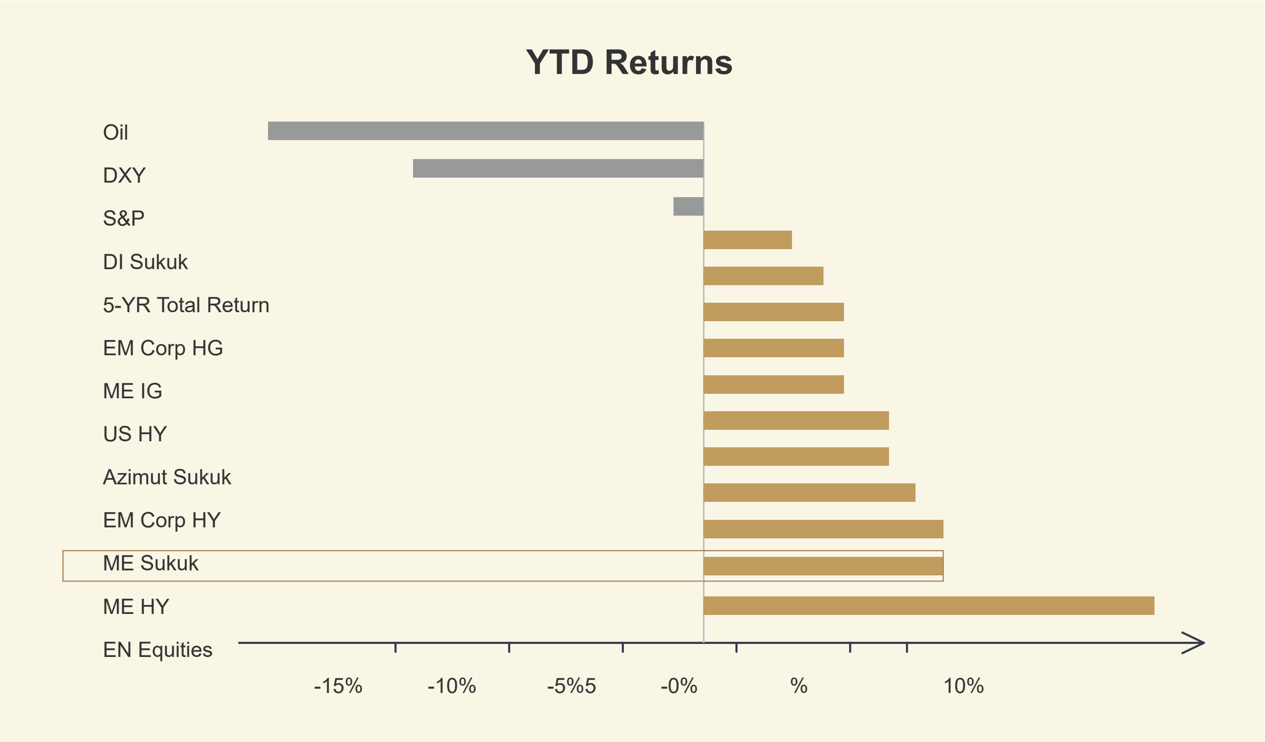
The primary risk to the region remains a potential global economic slowdown, which could suppress oil prices. Prices may also come under pressure due to OPEC+'s plan to phase out 2.2 million barrels per day of voluntary crude production cuts over the next 18 months. However, falling prices could also impede Trump's goal of increasing US oil output by 3 million barrels per day. Additional tariffs on Venezuelan oil, renewed sanctions on Iran, and heightened Middle East tensions are likely to place a floor under oil prices.

SUKUK PERFORMANCE TRENDS

The global sukuk asset class has outperformed in 2025, defying rising economic and geopolitical uncertainty, fluctuating oil prices, and elevated issuance, particularly from Saudi Arabia. Issuer credit profiles remain resilient, supported by robust sovereign balance sheets, strong external positions, and meaningful progress in economic diversification initiatives.

In Saudi Arabia, rising foreign investment and increased labour force participation have strengthened non-oil sector growth, helping offset contractions in oil-driven activity across much of the GCC. As noted earlier, we expect GCC economies to remain relatively insulated from the negative effects of global trade tensions. Economic momentum is likely to persist as major investment projects continue to come online. Improved fundamentals have translated into higher sovereign and quasi-sovereign credit ratings across the region, with

Chart 7: Middle East sukuks outperform in a volatile market environment

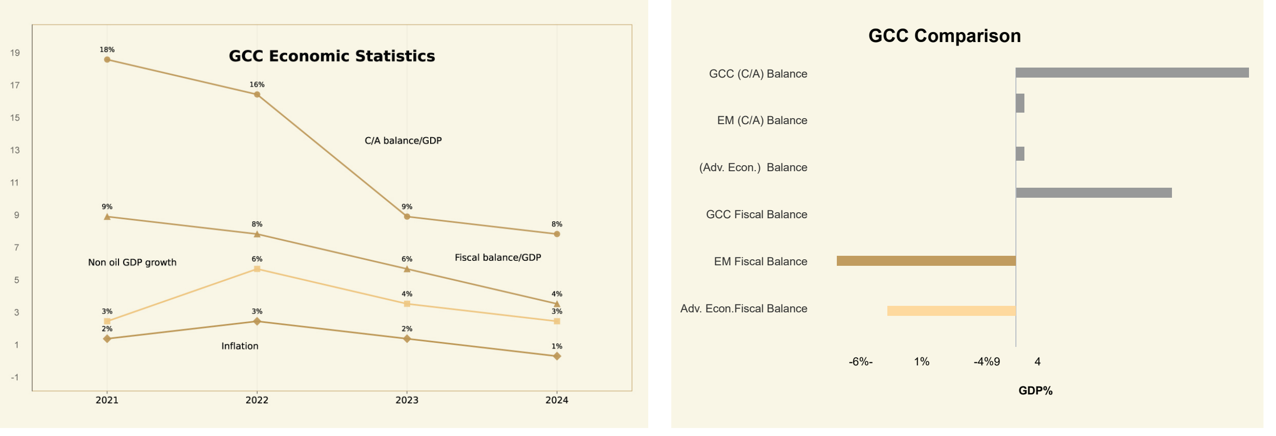


Source: Bloomberg, 20 May 2025

Bahrain being a notable exception. Oman is on the verge of attaining investment-grade status from all three major credit rating agencies. Meanwhile, Saudi Arabia maintains a positive ratings trajectory, despite widening fiscal deficits and increased debt issuance.

Recent increases in US Treasury yields have made sukuk credit spreads appear rich, reflecting the region's constructive macroeconomic outlook. Even so, select opportunities persist, particularly within the corporate credit space. Saudi sovereign and quasi-sovereign sukuks continue to offer relative value compared to similarly rated issuers in the Asia-Pacific region. That said, this is tempered by the ongoing risk of large-scale issuance from the Saudi government and quasi-government entities.

Charts 8 and 9: Key economic statistics and comparison highlight the fundamental strength of the GCC



Source: IMF

> **Dubai real estate sukuks will continue their post-COVID gains trend though price increases are likely to remain moderate in 2025 compared to the previous two years**

INVESTMENT ALLOCATION - SECTOR OPPORTUNITIES

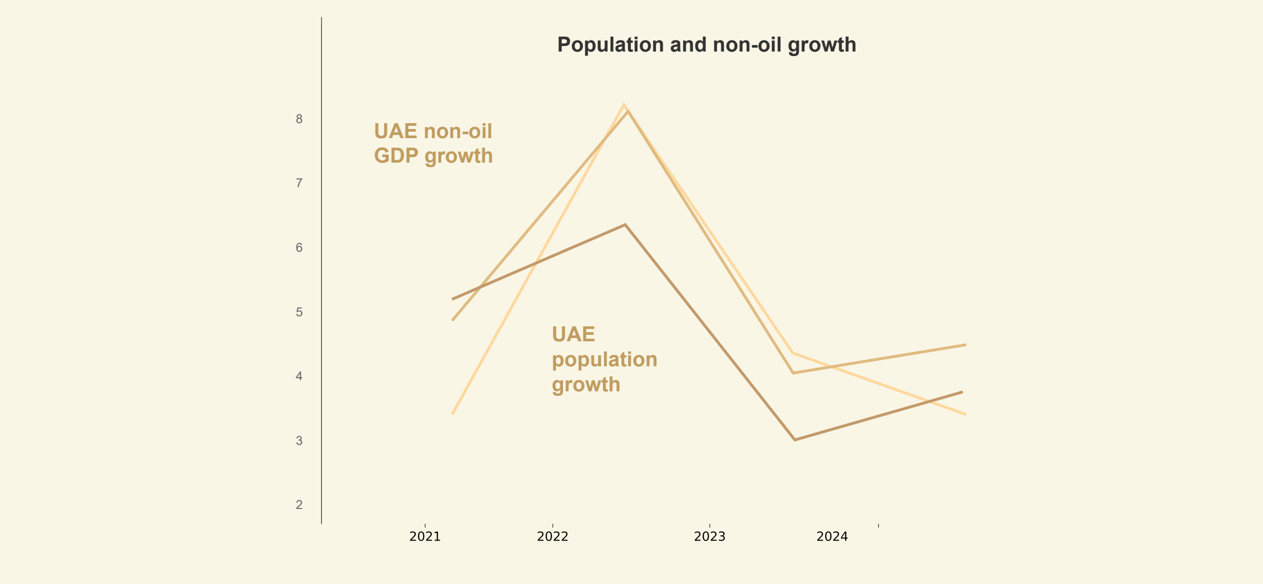
As a core allocation, we favour GCC bank bonds—both senior and subordinated. The region's ongoing economic diversification efforts create favourable conditions for banks, and we expect a supportive operating environment to persist, driven largely by structural rather than cyclical growth. GCC banks remain highly capitalised by global standards, significantly exceeding regulatory requirements. This strong capitalisation underpins growth, while robust profitability and high earnings retention enhance banks' capacity to absorb the effects of rising credit expansion. Additionally, substantial loan loss reserves further bolster their loss-absorption capabilities.

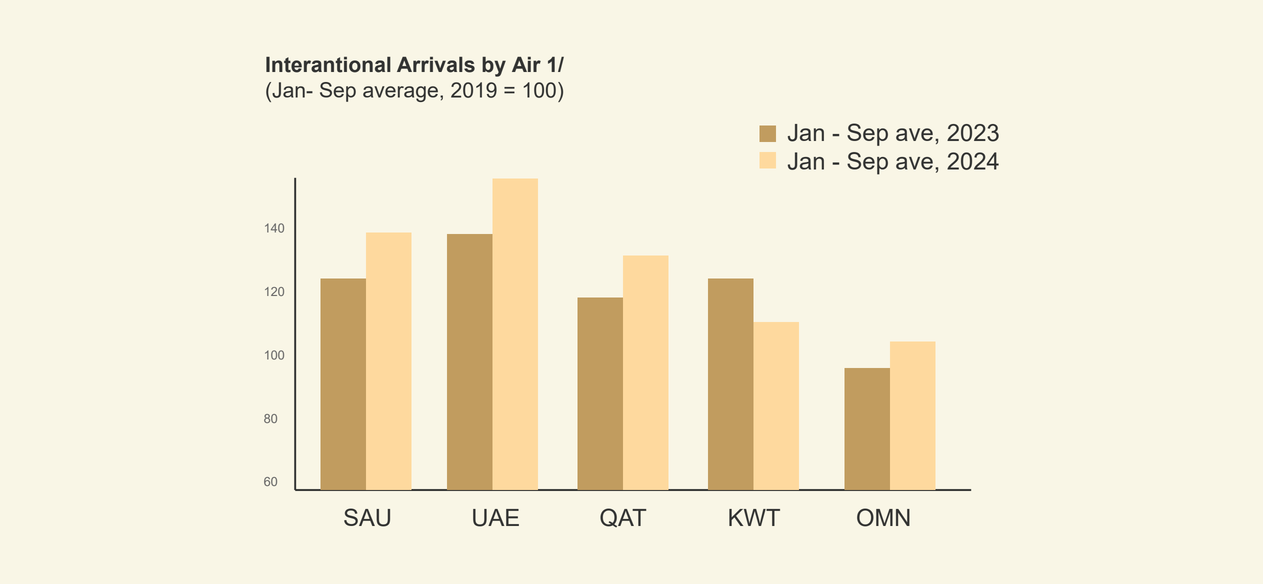
Funding conditions are likely to tighten as strong credit demand continues to outpace deposit growth. We anticipate continued robust lending growth, particularly in Saudi Arabia, driven by corporate borrowing linked to Vision 2030 initiatives. Mortgage lending is also expected to rise, supported by government programmes and demographic expansion. Across the GCC, the consistent outpacing of deposit growth by lending is prompting banks to explore alternative funding sources. We expect increased issuance in international capital markets to support expansion efforts. The banks' solid access to global funding and ample liquidity buffers strengthen their credit profiles, while sovereign backing remains a critical stabilising factor.

For high-yield exposure, we prefer Dubai real estate sukuks. Dubai's property market has seen substantial post-COVID gains, a trend that has continued into 2025. Although we expect growth to persist for the rest of 2025, price increases are likely to moderate compared to the previous two years. A large pipeline of pre-sold units is set to be delivered over the next 12- 18 months should support price stabilisation. This moderation gives developers room to navigate rising construction costs and possible delays due to resource competition. Given stringent lending standards, we do not expect slower price appreciation to adversely impact the credit quality of real estate issuers or the broader UAE financial sector.

Long-term demand for residential property in Dubai remains strong, supported by the city's strategic location, open economy, favourable immigration policies for skilled professionals, zero income tax, and strong trade ties with major global economies. Dubai's world-class infrastructure and a consistent track record of executing ambitious growth plans continue to attract both individuals and businesses.

Charts 10 and 11: Dubai property sector supported by non-oil growth and rising population





Source: IMF

INVESTMENT ALLOCATION: HIGH BETA SOVEREIGNS: OPPORTUNITIES AND CHALLENGES

High yield (HY) sovereign sukuk issuers outside the GCC—namely Egypt, Pakistan, and Turkey—have delivered strong gains over the past two years. This performance has been supported by improved risk sentiment, declining inflation and consequent Federal Reserve pivot, expanding the cross-border capital flows from the GCC, a greater willingness by governments to implement macroeconomic tightening to reduce external imbalances, and IMF financial support.

We expect these dynamics to persist in the near term, although the upside potential for HY sovereign debt is now more balanced compared to the post-"Liberation Day" selloff period. Financial support from GCC countries is likely to continue, driven by both financial and strategic motivations. Geopolitical considerations—especially proximity to regional flashpoints—have significantly influenced the flow of funds from GCC states and other actors to countries such as Turkey, Egypt, and Pakistan.

The need to expand influence and contain instability stemming from the Russia-Ukraine and Israel-Gaza conflicts has pushed geopolitical stakeholders to assist, either to avert humanitarian crises or to influence policymaking. One clear example is the IMF's continued support for Pakistan, despite the slow pace of structural reforms. A notable instance of strategic investment is the UAE's US$35 billion deal in Egypt's Ras El-Hikma project.

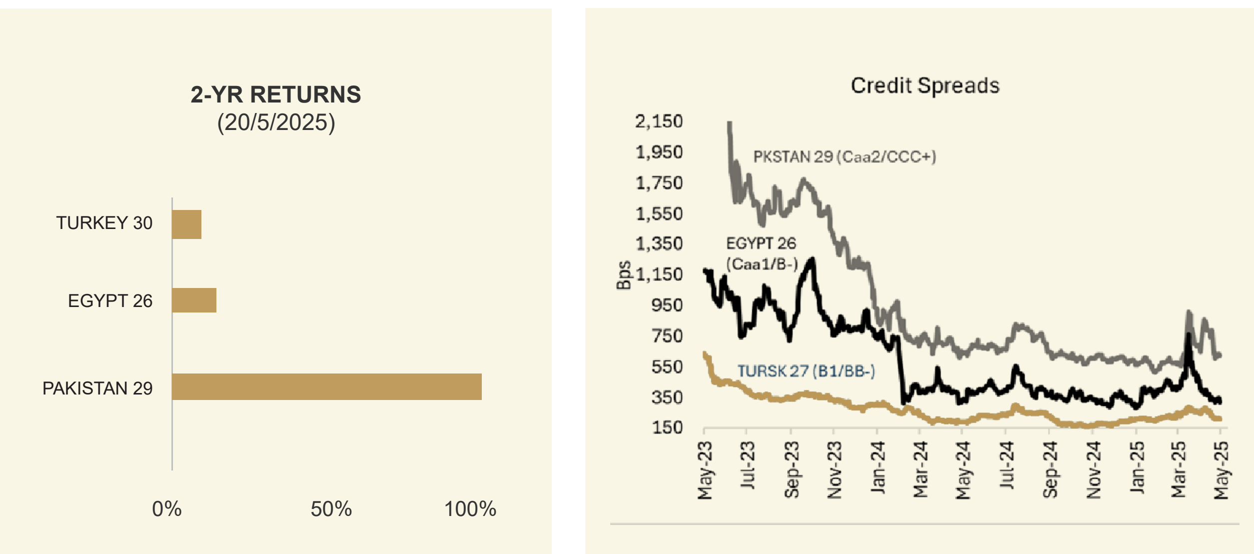
Despite the improved outlook for HY sovereigns, we believe volatility will remain high and suggest adding exposure selectively during periods of weakness. In Egypt's case, persistent concerns remain about the government's ability to establish sustainable macroeconomic stability. Egypt has historically struggled to deliver consistent economic growth, which hinges on enhancing domestic productivity, strengthening governance structures, and promoting competitive domestic markets. Progress on these fronts is expected to be slow.

Turkey's external position has markedly improved over the past year, although the country continues to run a current account deficit and remains exposed to political uncertainty. That said, a potential de-escalation in the Russia-Ukraine conflict may benefit Turkey geopolitically. However, Turkey faces significant refinancing needs, and high levels of corporate and sovereign issuance could cap further upside in Turkish external debt. Nonetheless, the foreign exchange buffers built over the past year provide a degree of resilience, and refinancing risks appear manageable barring severe global market volatility.

Pakistan's bonds experienced volatility in May 2025 after tensions with India escalated into the most intense military confrontation between the two nations in 25 years. Four days into the conflict, the US government brokered a ceasefire and announced bilateral discussions. These are likely to cover Pakistan's alleged links to Kashmiri militants, the broader status of Kashmir, and possibly a renegotiation of the Indus Waters Treaty.

Despite the conflict, we believe the impact on Pakistan's credit profile will be limited. Recent financial data shows a sharp increase in remittances,

Charts 12 and 13: High beta sovereigns have generated outside gains based on the improvement in their credit profile



Source: Bloomberg

which has significantly supported the current account. While export performance may be hampered by weak external demand and the effects of tariffs, a lower oil import bill, due to falling crude prices, should help cushion the decline in US dollar inflows. The suspension of trade with India is expected to have minimal impact on Pakistan's external account, given the limited volume of bilateral trade.

CHALLENGES AND PROSPECTS

The major challenge facing sukuk issuers in the coming years will be managing the evolving relationship between the US and China. One interpretation of President Trump's tariffs is that they were designed to undermine China's position in international trade and weaken its ties with global trading partners. Despite enjoying goodwill from the Trump administration, the Gulf GCC countries will not be exempt from scrutiny regarding their relations with China.

By increasing oil production amid declining demand, GCC governments complied with President Trump's early demands for higher oil output from OPEC. This move earned them political capital and some breathing room in navigating their growing relationship with China.

> As economic rivalry between the US and China intensifies, the GCC will face mounting pressure from Washington to pick a side

However, as economic rivalry between the US and China intensifies, the GCC will face mounting pressure from Washington to pick a side. While the GCC has committed to deepening ties with China, this objective must be pursued with caution. A failure to maintain a careful balance may erode the region's strong position in global trade.

Unlike most other nations, and as underscored by recent strategic agreements, the GCC has the capacity to direct large-scale investments, making it difficult for either the US or China to act against their interests. While many countries may struggle to avoid being drawn into the conflict, the GCC's economic leverage positions it more favourably to navigate this challenge.