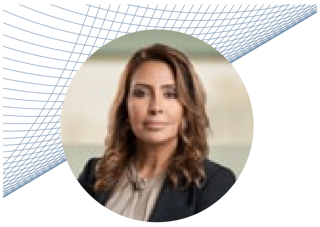
A Gradual Return to Confidence

As a leading GCC asset manager and investment bank, SICO has over 20 years of active experience in tracking the investment landscape across the region. While the GCC is still recovering from the collapse of oil prices in 2014-2015, there are now pockets of opportunity that if leveraged properly can lead to a gradual return in confidence for the region as a whole



"Inclusion in EM indices, stable oil prices, relative immunity from trade wars and high credit quality are all reasons to consider the GCC a better value than the rest of emerging markets"

Ms. Najla M. Al Shirawi, Chief Executive Officer of SICO

Over the past decade GCC markets and investment opportunities have attracted deserved attention. As economic weight continues to shift southwards and eastwards, emerging markets have become increasingly important trading partners and investment destinations. Investors facing headwinds and uncertainties in established markets have looked to EMs to bolster growth and diversify exposure, while at the same time others have watched, nervously waiting for signals that growth is collapsing.

The GCC contains some of the world's most compelling economies, with UAE, Qatar, and Saudi Arabia ranked 17, 25, and 30 out of 137 countries on the World Bank's global competitive index, and for decades the story has been growth underpinned by energy advantages and strong demographics. But GCC countries, in addition to being oil and gas exporters, are investment destinations with major infrastructure projects, booming tourism, and financial services sectors, and with governmental reforms, they are increasingly securing the region's role as an economic and trading hub. Last year all GCC economies showed positive growth, reversing a 0.4% contraction in real GDP for the region in 2017. The IMF expects this recovery to continue, and while 2019 earnings growth for GCC countries will reach mid to high single digits at best, specific markets will be more vibrant. Let's dig in.

Global oil consumption in 2019, largely from China, the U.S., and India, is expected to outpace supply by 29% allowing continued improvements in the current account balance of GCC countries. Saudi Arabia's deficit, which has been narrowing since 2016, is expected to reach 1.7% in 2019, offering headroom for a slightly more expansionary fiscal policy. Bahrain will also benefit from fiscal stimulus in the form of project spending and assistance from the GCC development fund. Airport modernization, the BAPCO refinery expansion, Alba's Line 6 expansion project, and other big-ticket projects will ensure private-sector growth and drive earnings. In the UAE real-estate sector, most of the negatives from a recent slowdown appear to have been priced in, and from a yield perspective, select names will be able to deliver real value. Overall, real GDP for GCC economies is forecasted to grow by 3% in 2019, with Kuwait's five-year development plan and public investment projects in Qatar (for the 2022 FIFA World Cup) and in UAE (for Expo 2020) acting as drivers.

In capital markets, international fund flows and their impact on the Saudi Stock Exchange (Tadawul) will be a key theme that will play in the largest GCC stock market. Tadawul's inclusion into the FTSE Russell Emerging Markets index began in March and will continue in five tranches over the coming year. Additionally, Tadawul debuted on the S&P Dow Jones EM index in March and the MSCI's index in late May. The resulting increased confidence in Saudi stocks, on top of passive investment by index-tracking funds, is certain to heighten demand. In fact, global and GCC-based investors bought Tadawul equities at record levels in January. Kuwait has also experienced similar sentiment on the back of a potential upgrade to EM status by MSCI later in the year.

In debt markets, J. P. Morgan has included Saudi Arabia, UAE, Bahrain, Kuwait and Qatar sovereign bonds in its Emerging Market Bond Index (EMBI). Over the last three years, GCC countries have issued a quarter of all new debt sold by emerging markets and they account for 14% of total outstanding EM debt stock. Investor demand in 2018 also drove increases in sovereign issuances, and as governments push expansionary budgets in 2019, more can be expected. The inclusion of GCC sovereign bonds in EMBI will add USD 150 billion to the index, widen the investor base, and lead to increased liquidity of GCC bonds and Sukuk. As a result, sovereign spreads relative to international benchmarks should decline, bringing lower financing costs that could generate stronger private investment and more broad-based economic growth.

In the last couple of years, GCC countries have experienced a surge in M&As with 7 between listed GCC companies in 2018, and for 2019, consolidation remains a key theme, especially in the banking sector. Arab banks are already some of the most efficient financial institutions in the world and they will continue to seek cost efficiencies and synergies in the face of pressures on profitability. A new round of mergers and acquisitions in the GCC's banking sector, particularly in UAE, may offer an important source of value addition.

Tailwinds from the inclusion in EM indices, stable oil prices, relative immunity from trade wars and high credit quality are all reasons to consider the GCC a better value than the rest of emerging markets, and while a rally is good in the near term, earnings will eventually need to pick up to avoid a correction in 2020. SICO will continue to watch these markets carefully, as we believe markets to not be just one way trending which makes a case for generating alpha through active investing stronger than a mere passive approach.