MENA EQUITIES: FOLLOW THE GROWTH AS VISION BECOMES A REALITY

Musa Haddad Head of Fund Management, and
Rameshwar Tiwary, ED, Equities Management

The GCC growth outlook

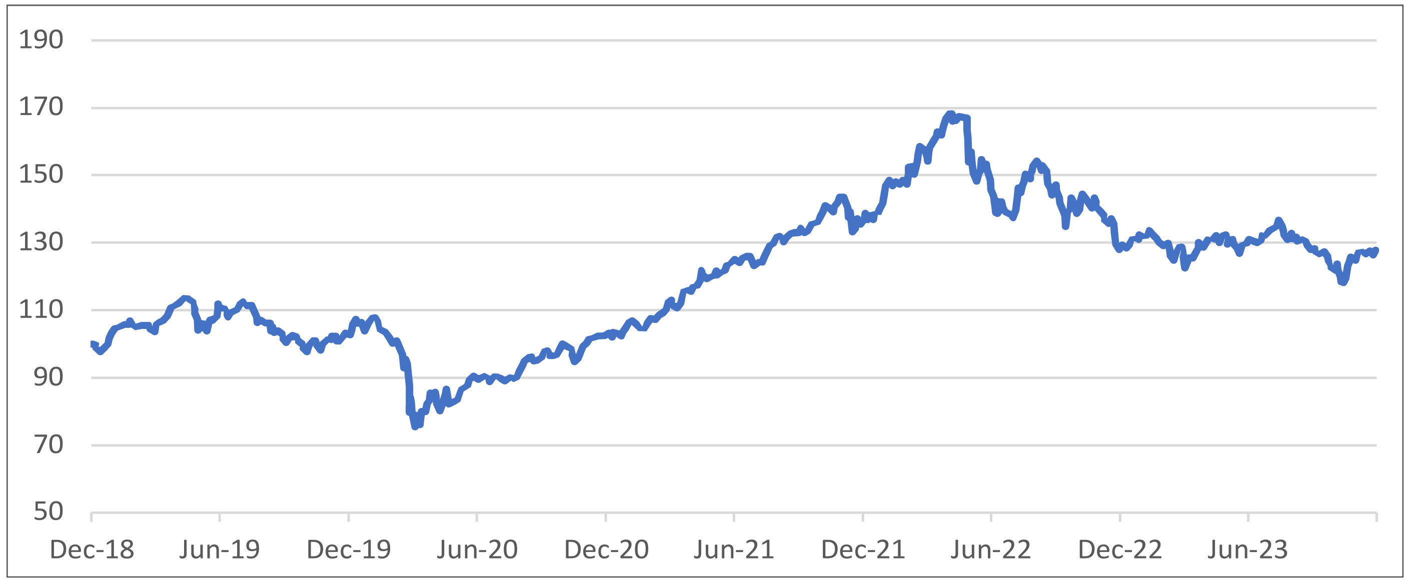
The growth outlook for the GCC remains upbeat, as strong growth in non-oil GDP of around 3.4% is expected in the medium term. With the aim to diversify the economy and reduce the dependence on hydrocarbons, the GCC countries continue to invest in the non-oil economy and implement various reforms. Saudi Arabia's non-oil GDP growth will remain above 5% in 2024 and 2025. Overall, the GCC's real GDP is expected to grow at 3.6% and 3.7% in 2024 and 2025 as per the latest forecast from the World Bank.

The Purchasing Managers' Index (PMI) for GCC countries is at a multi-year high, indicating that strong growth in the non-oil sector will continue. In November, the PMI data for Saudi Arabia and UAE stood at 57.5 and 57.0 respectively.

Social reforms remain key, such as the increased female participation in the Saudi labour market. The continued liberalisation of social norms including the implementation of new avenues for more people to become permanent residents in the region, particularly in the UAE and Saudi Arabia, with the easing of visa restrictions is supporting growth. Saudi plans to double its population by 2030 from the current 8 million. As a result of all these steps, the region is witnessing higher and sustainable growth.

For the UAE and especially Dubai, the fiscal position continues to show improvement, with public debt falling to 25% of the emirate's GDP after repaying AED 29 billion, just one and a half years after the establishment of the Public Debt Management Office to handle government financing and the sovereign debt portfolio. Debt was mainly reduced by paying off obligations arising from various financial instruments, including AED 3.3 billion in Islamic bonds, AED 5.2 billion in bank loans, and AED 20 billion as part of the financing provided by the government of Abu Dhabi and the Central Bank of the UAE. Dubai is expected to record a fiscal surplus of 4.6% for FY 2023.

S&P GCC Composite Large Mid Cap Index



Source: Bloomberg/FAB Asset Management

Global sports and event hub

The region is rapidly becoming a global events hub. Recently, COP28 UAE, Dubai Expo, and the Qatar FIFA World Cup were successfully organized. Along with this, Abu Dhabi, Bahrain, Qatar, and Jeddah are now becoming permanent slots for Formula 1 races. Saudi Arabia has successfully won bids to organise, the Asian Winter Games in 2029, Expo 2030, and the 2034 FIFA World Cup. We think, Saudi Arabia has positioned itself as the Mecca of the sports world, with various initiatives of investing and hosting some of the biggest and renowned sporting events globally. Saudi has garnered significant attention, it has been aggressively positioning itself as a country beyond hydrocarbon and religious centre, a vibrant young athletic, and a global cosmopolitan country with a rich heritage.

Apart from this, Saudi Arabia is very active in organising and promoting football league championship. The Saudi Pro League clubs have signed up some of the world's most renowned professional football players. These include, Cristiano Ronaldo, N'Golo Kanté, Roberto Firmino, Karim Benzema, Rúben Neves, Jota and we expect this trend to continue.

Saudi Arabia's investment in sports extends beyond football, with several investments being made by the Saudi's Public Investment Fund in golf - LIV, the PGA, and DP World Tour. Also, investment was made in e-sports, racing, wrestling, and Indian Premier League in cricket.

Sports investment strategy

The investment in the sports and outdoor e-commerce market is expected to boost the Saudi's economy, with cross-benefit derived from sports, tourism, manufacturing, and construction. Saudi Arabia's investment in the football league and other sports is partially driven by its ambition to double or even quadruple its current tourism revenues. Saudi is targeting to welcome 100 or even 150 million visitors annually by 2030. Saudi and other GCC countries are pursuing their economic diversification strategies by investing in sports.

Another strategic goal behind such investment is to create a sense of national pride around sports among the youth population, not only in Saudi Arabia but also across the GCC and broader MENA. It has an important bearing on strategic considerations such as social unity and health awareness, which will benefit other sectors specifically the discretionary side across the GCC.

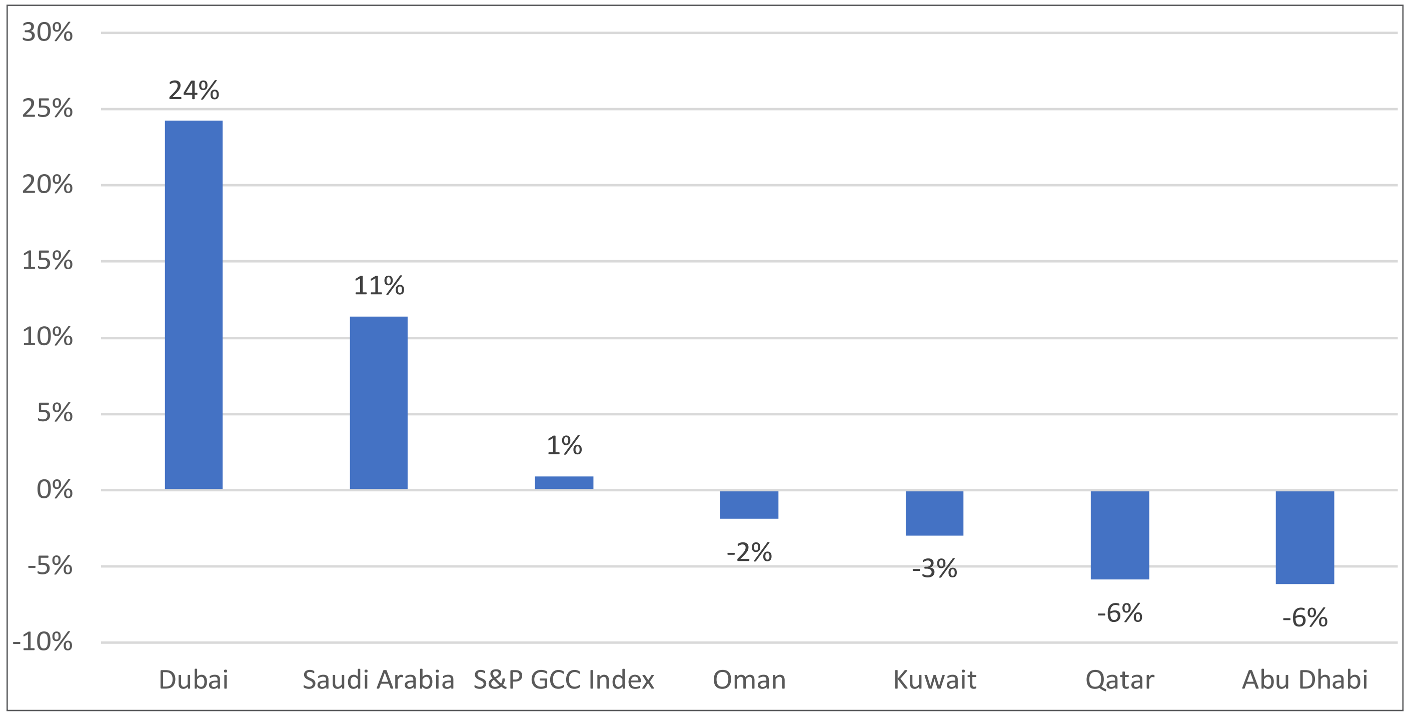
Saudi Arabia is committed to have sports as a significant contributor to its GDP. In a media interview the Crown Prince of Saudi Arabia, MBS, was quoted as - "If sport washing is going to increase my GDP by way of 1%, then I will continue doing sport washing, I'm aiming for another 1.5%, call it whatever you want, we're going to get that 1.5%".

Country positioning

Our country preference stands for UAE and Saudi. In UAE, Dubai is more of a higher earnings growth and valuation play. Abu Dhabi offers a potential for further diversification, with a strong upcoming annual dividend payout, the current valuation looks reasonable, supported by a strong recovery in the corporate's earnings.

Saudi market remains a clear beneficiary of various government reforms driving economic growth on a sustainable basis. Government's focus on more value-added hydrocarbon products, clean energy, policies supporting the promotion of non-oil sector and reforms driving the growth for the other sectors remains positive. The execution of mega projects has gained traction, driving corporate credit growth in the banking system, we expect further progress thus driving various economic activities. We remain very selective in Kuwait, Qatar, and Oman, and further allocation will be subject to earnings and valuations.

GCC Market Total Return in 2023



Source: Bloomberg/FAB Asset Management, as of 13 December 2023

Sector positioning

At the sectoral level, our focus remains on financial sector but highly selective, especially on banks that are benefitting from higher interest rate environment driving the net interest margin expansion, along with gradual improvement in the credit growth and have strong asset quality. In Saudi Arabia we prefer banks

that have large corporate banking franchises as they are expected to benefit from further progress on these mega projects.

We are positive on Saudi insurance and healthcare sectors. We think these sectors will continue to enjoy very attractive earnings growth driven by ongoing reforms and expected benefits from potential increase in tourism and privatization of medical insurance.

Our view on the newly emerging sector such as the technology service sector in the region remains quite optimistic. Higher earnings growth in the sector is driven by government initiatives in digitalization.

We have maintained our underweight positioning on petrochemical sector as product pricing remains weak driven by excess supply and lower demand partially impacted by slower than expected pickup in demand from China. We have taken some selective positioning in the names where we think further decline in spreads is now limited.

Exposure to other sectors will be more stock specific focus, looking to hold companies enjoying higher pricing power or gaining market share through e-commerce or consolidation in the respective sectors. We will continue to participate in upcoming IPOs on a selective basis wherever we find high-quality businesses offered at a reasonable price.

Expected returns and outlook for 2024

We continue to believe that 2024 is going to be a year of stock pickers. The specific names within the healthcare, insurance, financials, and technology sectors offering strong earnings, particularly in Saudi

Arabia / UAE, will remain our focus area. In UAE/ Dubai, we remain constructive in our approach, with economic growth strongly supported by tourism, hospitality, transportation, and construction (6% of GDP) activities.

We expect the growth momentum in the GCC should continue to improve on the back of robust economic growth in the non-oil sector. Growth will be primarily driven by the domestic multi-year investment cycle, particularly in Saudi Arabia, supported by various reforms being implemented in GCC countries.

The SGCCPUX Index is currently trading on a prospective Price to Earnings (PE) ratio of 14.14x and, forecasted earnings growth of 8.52% for 2024. For GCC markets, the long-term average PE multiple is 15.82x. Thus, in 2024, we can expect a double-digit total return of around 10% to 12% range, including dividends.

Despite all this, we believe market volatility will continue due to global factors and geopolitics. However, we believe that GCC equities in general will be able to navigate given the decline in global inflation, and the Fed's rate cuts. Investors should take advantage of the volatility as an opportunity to invest in the GCC market for a more sustainable return ahead.