PORTFOLIO STRATEGY

EMERGING MARKET EQUITIES

Rise of the Gulf equity markets

GULF

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The Gulf region is changing dramatically and provides growing opportunities for emerging market investors

KEY POINTS

- **Gulf countries are undergoing a social and economic transformation**
- **Most economies in the region are diversifying away from oil**
- **Demographics are a driving force, thanks to the young population**
- **Corporate governance is improving across the board**

The rise of the Gulf economies, and Saudi Arabia in particular, is the most important investment story of the past decade, according to Asha Mehta, founder and CEO of Global Delta Capital and author of 'Power of Capital'. But for the region, economics cannot be divorced from politics.

Private sector investment opportunities need to be considered against the backdrop of geopolitical tensions, which add a layer of complexity to nations whose leaderships have invariably been selected by birth and not via voting booths.

Saudi Arabia, says Mehta, is embarking on one of the emerging market's most substantive and most rapid transformations under its controversial leader, Crown Prince and Prime Minister Mohammed bin Salman.

Among the other GCC markets which Mehta sees as promising opportunities are the UAE, given its head-start in diversifying its economic base and its solidified position as a financial capital, and Kuwait, owing to the nascent foreign participation in the market and its inefficient but broad listed equities market.

Qatar also stands out, says Sergey Dergachev, emerging market specialist at Union Investment, because of its role in liquefied natural gas (LNG) production, which is fuelling a construction boom.

Anderson Whamond, chairman of the Gulf Investment Fund, adds that with substantial macroeconomic resilience and growth prospects, Qatar still trades at a discount to its GCC peers, despite witnessing a significant increase in foreign direct investments (FDI), having recorded more than $3bn (€2.8bn) of inflows since January 2022.

Qatar, along with the UAE, has to tread a delicate political tightrope maintaining relations with the West and with Russia and China. "There has been, for example, a great deal of relocation of many companies' employees from Moscow to Dubai and you are seeing a lot of fresh money pouring into real estate markets in places like Dubai," says Dergachev. He argues that Qatar and UAE have been among the biggest beneficiaries of the increased geopolitical tensions, given their positioning as gateways between East and West.

Oil and gas reserves have been the key source of wealth for the region. Amandeep Shihn, a director of manager research at WTW, says: "I don't believe that Saudi Arabia or other GCC countries are different from any other emerging market country whose economy has been dominated by commodities, such as Colombia, Peru or Brazil." Most of the GCC countries are benefitting tremendously from the increase in energy prices following the Russian invasion of Ukraine, but they are also making determined efforts to diversify away from the dominance of hydrocarbons in their economies.

Indeed, Mehta argues that despite the 2022 boom in revenues caused by the rise in oil prices following the Russian invasion of Ukraine, the year-on-year outperformance of the Gulf markets has shown that oil prices are "yesterday's news for this region". Rather, she argues, the driver of growth has been the liberalisation of these markets, as this historically closed region has opened up to foreign investors.

The IPO of Saudi Aramco, says Mehta, was a literal indication that Saudi Arabia was selling its "crown jewel" – oil – to facilitate the diversification of the economy, away from oil and towards innovative areas such as fintech, artificial intelligence and health technologies. The government also recently announced the 'Shareek' programme, a partnership with private sector companies to accelerate the kingdom's economic diversification strategy. Saudi Arabia and other Gulf countries have allocated significant capital to alternative, cleaner-energy investments, including the UAE's Masdar renewable-energy complex based in Abu Dhabi.

Young people and industries

A key driving force for growth for the Gulf region has been demographics. There is no bigger economy with a faster working-population growth than Saudi Arabia, points out Mehta. But all the Gulf countries are characterised by having very young populations. That, combined with the historical reliance on expats to manage the oil industry means that "a key vision for many of the countries is to diversify away from oil, to reduce the unemployment amongst nationals and to reduce the dependency on expats", explains Khurram Mirza, CIO of Dubai-based Kroma Capital Partners.

The challenge, according to Global Delta Capital's Mehta, is that "the nationals have benefited from very generous benefits, particularly social subsidies, as well security of jobs in the governments sector – over 50% are employed by government-related entities on average across the GCC".

As a result, the GCC countries need to encourage the creation of more private-sector jobs to reduce unemployment and there is a requirement for huge investment in education and training to reduce the reliance on expats. Mehta adds: "There is a fascinating ESG theme here: as Saudi liberalises not only its economy but also its social norms, the vast majority of new jobs are taken by Saudi women, and more women than men are enrolling into tertiary education."

Indeed, as Mirza says, "the young population are ready and willing to tackle the challenge".

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Khurram Mirza

One key sector that stands out is tourism where, according to Mirza, there is the potential for many "quick wins". Saudi Arabia has taken this to heart, with very ambitious plans to develop a tourism sector beyond what had been historically purely linked to religion, and concentrated on Mecca and Medina. Mirza says: "There are lots of other spots which are coming up. Most of them are man made, or natural historical sites, which just weren't marketed before."

That makes a dramatic change. "In 2011, I, like all women in Saudi Arabia, wasn't allowed to walk on the streets without a male escort or else, the religious police, dressed in long white tunics, could descend upon me," says Mehta.

Even as recently as six years ago, the biggest challenge in visiting Saudi Arabia was obtaining a visa, according to Union Investment's Dergachev. Business visas were given but required several invitation letters. However, visas for tourists, except for the Hajj and Umrah – the Islamic pilgrimages – were not possible. Saudi Arabia has now opened the door for international tourists and tourist electronic visas can be obtained within two to three days, underpinning the development of the tourism industry.

For investors, a traditional sector like banking can also be attractive. "The banks are rock solid," says Dergachev. But new opportunities also exist elsewhere, even in the tech sector, points out Mirza: "There have been some notable exits in the tech sector such as the car-hire firm Careem, that was bought by Uber".

However, liquidity can be an issue at times, particularly in the smaller markets. Mirza argues that the region has too many exchanges, which fragments liquidity. But Mehta is more positive and sees ample breadth and liquidity: "Over the last decade, many of these countries have been upgraded from frontier status as their liquidity dwarfed the frontier economies," she says. Saudi Arabia dominates the region, and the liquidity of the Saudi stock market represents more than twice the liquidity of all the frontier economies combined.

Improving governance

Corporate governance in the region is also improving, "A decade ago, when I visited corporates in Riyadh, I was an unwelcome guest, not only as a woman, but also as I carried along a long list of probing questions," says Mehta. That has now changed with corporates, especially larger ones, becoming more willing to meet investors and engage in constructive dialogue.

Moreover, adds Whamond, women's empowerment is now a strategic goal of Saudi Arabia's Vision 2030, the country's economic and social reform blueprint, that aims to increase their participation in the labour market.

"During the period between 2017 and 2022, the share of women in the labour market increased from 21.2% to 34.7% and the labour rate of their economic participation jumped from 17% to 37%," says Whamond.

Nevertheless, there are still gaps relative to international norms.

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Asha Mehta

Smaller firms, for example, often provide no contact details at all. As Mehta points out, the GCC region's corporates stem largely from privately-owned family businesses, and hence board independence and board experience remain a relative weakness.

Mehta believes that improving global ESG reporting standards will accelerate improvements throughout the region, thanks to the evolving international governance frameworks, which have the potential to drive improvements across the Gulf – both in terms of ESG reporting as well as the adoption of best practices.

That can only add to the attractions of a region that, argues Whamond, is underappreciated and underinvested in by global shareholders. The weighting of GCC in global indices is likely to increase as IPOs join the market and governments carry out stake sales. For investors, the story is not just about oil, "but about infrastructure spending, expansion of the non-oil and gas sector, privatisation, and economic, social, and capital market reforms", says Whamond.