# Market Commentary - Eyes on Saudi Arabia

## Key Points

- Our long-term view on Saudi Arabia remains intact driven by economic and social reforms that dictate a larger private sector participation, job creation for nationals, focus on growing religious tourism, addressing housing issues, PIF's investment plan, privatization of government assets and improving the sovereign capital structure.
- We view this short-term volatility as an opportunity to gain exposure to stocks with attractive valuations and sound long-term fundamentals.
- As expected, Saudi Arabia is experiencing some pain as the economy goes through what we view to be a short-lived adjustment phase. However, execution remains a key challenge not only for Saudi Arabia but the region as a whole.
- A diluted version of sanctions on purchasing Iranian oil have come into effect with a waiver

for 8 countries. However, increased supply from both OPEC and US producers has weighed on oil price in recent weeks causing it to drop by c.16%.
- We expect oil price to range between US$ 60-80 per barrel which should enable GCC governments to push ahead with reform initiatives. However, we believe oil price will remain volatile with an upside risk from a positive trade deal between the US and China.
- Oil infrastructure spending is picking up again in the GCC after a period of minimal capex with a combined investment program of US$ 700 billion declared over the next two decades. Such spending typically leads to a higher economic activity and a sizeable trickledown effect.

## Market View

The Saudi Equity market has experienced a sell-off and heightened volatility in recent weeks due to geopolitical headline risk. Since early October, international investors were net sellers of Saudi equities with a total outflow of approximately US$1.6bn, which was offset by approximately US$2.1 of inflows from domestic investors and Government-Related Entities (GREs). However, we believe that this short-term volatility creates an opportunity for long-term investors, considering that fundamentals have not changed and valuations are looking increasingly attractive.

The recent events have overshadowed positive news coming out of the Future Investment Initiative Summit, held in Riyad, where Saudi Arabia signed 25 deals and memoranda of understanding worth US$ 50bn in the oil, gas, industries and infrastructure sectors, with Saudi Aramco claiming more than two-thirds of the total size. In addition, the Saudi government had announced projects worth US$ 10 bn as part of the national day celebrations in October 2018. Such announcements have been completely neglected by the market and we expect that investors will catch up with this news going forward.

The announced upgrade of Saudi Arabia’s equity market to Emerging Market (EM) status by both FTSE and MSCI was also eclipsed by the headlines which kept returns muted. Since MSCI’s announcement (20th June 2018) confirming Saudi Arabia’s upgrade, Saudi equities have declined by -3.5% to date. However, between June 2013, when the same upgrade was announced for Dubai and Qatar, and June 2014, when the upgrade was implemented, their equity markets rallied by approximately 70% in Dubai and 40% in Qatar.  Moreover; the median outperformance of the 21 markets promoted to MSCI EM status since 1994 was 15% during the 12 months prior to implementation and 22% during the 6 months prior to their inclusion (effective trade data). Saudi Arabia is also among the least owned market by foreign investors at 1.6% prior to an index upgrade event, this compares with Dubai and Qatar at 15% and 10% respectively. As a result, we believe that there is a significant upside opportunity in this market over the next 12 – 24 months.

The diluted version of sanctions on purchasing Iranian oil coupled with increased supply from both OPEC and US producers has weighed on oil price in recent weeks causing it to drop by c.16%. However, a positive trade deal between the US and China would remove a major overhang and is likely to spark a rally in oil price. We expect oil price to trade in the range of US$ 60-80 over the coming period, which should allow GCC governments to push ahead with reform initiatives and development plans.

As part of their fiscal reforms Saudi Arabia has identified a need to move to a more efficient capital structure and as such, has tapped into the international debt markets by raising US$17.5bn over the last 18 months and by monetizing government assets and investments. We believe, that as a result they will enjoy a moderate level of leverage that should not only meet their liquidity requirements but also find a balance between the need for fiscal consolidation and economic growth.

### Market Outlook

We believe the long-term view of Saudi Arabia continues to look positive with the social and economic reforms, as part of ‘Vision 2030’, are expected to gain momentum as the country lays the groundwork needed for improving private sector activity. This includes expediting processes for license and permits, arbitration and commercial conflict, bankruptcy and labour laws.

To help reduce the unemployment rate of nationals the government has restricted certain retail jobs for nationals only and has introduced a levy on employing expats. This will have an enormous trickle-down effect over the medium term, generating higher disposable income and creating a higher demand for services.

The consumer sector is going through a painful adjustment period with the higher cost of doing business and weakening demand due to the expat exodus, but we believe that the long-term impact of this reform will be positive for the country.

As far as our positioning in Saudi Arabia is concerned, we believe that the current market volatility presents an opportunity to increase portfolio concentration and trade around core positions.