GCC Equity Trends: Economic Reforms Support Growth and IPO Activity

by Mahmood Abdulla

In 2018, GCC equity markets had their best performance in five years, rising by 12% compared to losses in indices in emerging and global markets. This growth took place during a year of volatility in the global oil market, with Brent moving between a low of $55 per barrel and a high of $86. This came on a regional backdrop of continued fiscal reforms, with GCC state budgets taking on initiatives to increase non-oil revenue. The positive trend in GCC equity markets continued in 2019, with most indices showing persistence during the first few months of the year.

Oil prices experienced a steady upward trajectory throughout most of 2018, up until October where they dropped by almost 40%, before rebounding to around $70/barrel (Brent) by Q2 2019. Nonetheless, GCC governments continued their fiscal consolidation initiatives, including diversifying sources of revenue away from oil via new taxes. Such steps, varying across countries, were reflected in growth levels of different GCC stock indices.

Equity indices helped by new global flows

Overall, the MSCI GCC index grew by 12% during 2018, outperforming global and emerging market stocks which declined by 11% and 17% respectively. Saudi Arabia's Tadawul remains the largest of the Gulf's equity markets with market capitalization of $495 billion by the end of 2018 and witnessing $232 billion worth of trading during the year. The first few months of 2019 saw Muscat's stock exchange continue the losses it experienced last year while Dubai slightly picked up its performance in February 2019, slightly bouncing back from its declining trend of 2018. The remaining GCC markets experienced

Source: Thomson Reuters

an uptick in March, with Kuwait showing the strongest growth in that month.

The positive trend in the GCC during 2019 so far, which echoed and outperformed global markets, was driven by strong inflows of foreign funds, strengthening oil prices and expansionary state budgets across the Gulf, the latter two of which helped support regional growth and earnings. Saudi Arabia's inclusion in the MSCI Emerging Market (EM) Index, finalized in June 2019, will bring in an initial batch of passive investors who track this index. These investors will automatically allocate a percentage of their overall EM equity investment to Saudi Arabia's equity market. Moreover, the inclusion will garner more global attention to Saudi stocks and may eventually attract active investors. Based on past experiences, the inclusion into an index, also brings some speculative flows ahead of formal inclusion.

In addition, Kuwait is currently being considered for reclassification from Frontier Market to Emerging Market status by MSCI's annual market review for 2019, with an announcement expected in May 2020. This decision is anticipated to bring in an inflow of foreign funds to the Kuwaiti market. For the rest of the GCC markets, these upcoming few years will allow them to observe the opportunities and challenges that Saudi Arabia and Kuwait experience as their classification changes.

New instruments may boost liquidity

In addition to index inclusions, initiatives to develop GCC stock markets will start yielding results during 2019 and beyond. In January 2019, Nasdaq Dubai launched futures trading on the MSCI UAE equity index, a move that could pave the way for sophisticated hedging products that attract a new wave of investors. During the same month, Nasdaq Dubai also launched single stock futures trading on 12 Saudi companies, and in February it launched futures trading on FTSE Russell's Saudi Arabia index which comprises 46 Saudi companies. These steps expand the range of the region's capital markets product offerings, allowing investors to make use of leverage to magnify the outcome of their trades. They also allow some investors to hedge their risks, though implementation remains a question.

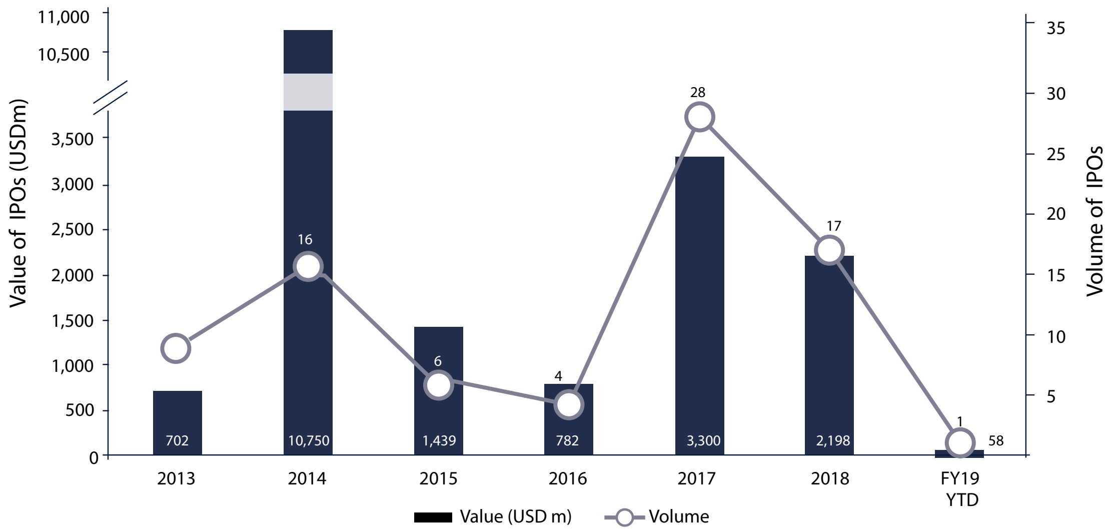
> Performance in GCC equity markets during the rest of 2019 and beyond is expected to be driven internally by the size of fund inflows as a result of the inclusion in global indices and externally by geo-political tension

A key element to observe during the rest of 2019 is the volume of trading activity. Despite the positive performance of GCC stocks during 2018, trading activity declined for the fourth consecutive year. More initiatives to introduce sophisticated trading products could encourage higher levels of activity in the future, especially if they are married with more investor education and strong macro policies.

On a larger scale, macro-level challenges in the horizon that could impact equity markets include rising political tensions in the Middle East region as well as the current trade war between the US and China. While these two developments could slow down global fund flows, it is expected that internal factors will continue to be a more impactful driver behind the performance of GCC equity markets. The performance of listed companies as well as initiatives to introduce more sophisticated trading products are examples of these drivers.

Watch for more IPOs

On the IPO front, a key driver of interest and flows, the GCC followed the global trend of muted activity during Q1 2019. During that period, there was only one IPO in the GCC while globally, the number of IPOs was half that of Q1 2018. This could be due to increased international uncertainties including the US-China trade war, Brexit and geopolitical tension between the US and Iran. Despite this general theme, some blockbuster offerings took place in the US, such as Airbnb, Lyft, Pinterest, Uber and WeWork.



Source: PwC

2018 saw some slowing down in IPO activity in the GCC, with the number of offerings dipping to 17 down from 28 in the year before with the value of IPOs decreasing by a third to reach $2.2 billion. Nonetheless, both the volume and value of IPOs in 2018 was stronger when compared to 2016 or 2015. Moreover, what could be the largest IPO in history is set to take place by 2021 if Aramco lists 5% of its shares to raise up to $100 billion according to the company's valuation. Depending on the stock exchange chosen for this listing, it could bring a large share of investment and attention to Saudi Arabia and the GCC or at least unlock new funds for investment elsewhere by the Saudi government. The positive sentiment surrounding this IPO continues to grow, especially after Aramco's financials showed record income of $111 billion, more than the combined profits of Apple, Google and ExxonMobil.

A noteworthy trend in 2018 in the GCC was the offerings of large real estate investment trusts (REITs). Particularly, Saudi Arabia played a significant role, with two large REIT IPOs, Sedco Capital REIT and Bonyan REIT, raising a total of $347 million. This partly reflects the recent reforms including the mortgage law and other areas of financial development.

Looking forward, continuing privatization efforts could help boost IPO activity this year. In addition, historical data shows that the number of public offerings tends to pick up in the second half of the year. IPOs that are expected to take place in 2019 include Abu Dhabi National Oil Company (ADNOC). Another catalyst of growth in equity markets could come from family businesses as they test public offerings which are considered by some to support succession planning and processes.

Performance in GCC equity markets during the rest of 2019 and beyond is expected to be driven internally by the size of fund inflows as a result of the inclusion in global indices and externally by geo-political tension as well as the direction of oil prices. With these drivers, and with most indices coming off of a decent 2018, a continuation of growth in GCC markets should continue to outperform global equity markets.

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