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MSCI upgrades usher in new era of GCC stock liquidity

By Tariq Qaqish of Al Mal Capital

After years of efforts to enter MSCI's index, the UAE and Qatar finally received their emerging market badge in June. The upgrade involved a serious look at how both countries revised their regulatory frameworks in order to meet best practice standards and foreign investors' requirements.

We believe this is an important achievement not only for the UAE and Qatar, but for the wider Gulf region. In the long run, this development will create positive effects such as renewed market confidence, eventually translating into a wave of liquidity for both exchanges, among other benefits.

Amidst a challenging global environment, increased level of capital market integration and globalization of economies, traditional developed market and asset allocation strategies are no longer sufficient to generate favorable risk reward opportunities. Emerging countries offer better growth opportunity while developed countries suffer serious economic breakdown.

Although the weight of the UAE and Qatar is still below 1% of the MSCI Emerging Market Index (which we believe does not reflect the real economic weight), the upgrade, nevertheless, remains beneficial in the long term.

We do look forward to a better participation by institutional foreign investors in adding depth to dominant retail markets. We believe there will be more emphasis on corporate governance pertaining to investors' protection and shareholders' rights.

Additionally, the importance of investor relation role within corporates will be elevated to meet the increasing number of capital providers, who are seriously looking into parking their money in this region.

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Further reform would be needed to urge blue-chip companies listed on UAE and Qatar exchanges to raise their foreign ownership limits and therefore free float; consequently this would translate to a better environment that protects minority investors. A large free float limits the scope for controlling shareholders to act in ways that might be against the interests of smaller equity holders.

We would also envision that the upgrade will eventually urge the two different exchanges in the UAE (ADX and DFM) to merge and become bigger players among regional stock markets.

Yet everything comes at a price. From now onwards, both UAE and Qatar markets will be benchmarked to other emerging markets' characteristics. Valuation matrixes, funds flow, and correlation are few factors investors should follow on. As an example, the recent announcement by the US Federal Reserve to reduce its stimulus has raised concerns that emerging markets will benefit the most from cheap foreign money that were routed into their economies.

The upgrade will bring long-term foreign investors and at the same time short-term sophisticated hedge fund managers. We advise retail investors to look beyond momentum trading and familiarize themselves with the new regulation especially in the UAE, where regulators allowed short selling used mainly by hedge fund managers.

We see the upgrade as an indication of confidence by the international community and a major milestone for both countries. We look forward for better market liquidity, better governance and wider investors mix.

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