

# MENA House views

Third Quarter 2019





## Welcome to Al Mal Capital Q3 2019 MENA HOUSEVIEWS.

**Middle East and North Africa equities posted decent returns in the first half of the year** although they lagged U.S and Emerging markets equities. In the first section of this quarterly publication, we look at **H1 & Q2 2019 in the rearview**.

As mentioned in our 2019 outlook published in early January, we believe there are still some secular and cyclical reasons to be positive on MENA equity going forward. In a dedicated section, we **share our main investment themes and stock convictions for the months to come**.

The last section of this quarterly MENA equity outlook includes our **macro and fundamental views** on the main regions.

**Our flagship Al Mal MENA equity fund is off to a very reasonable start this year with a year-to-date gain of 7.5 per cent as of the end of June.** The fund is up 30 per cent (net of fees) since January 2017, outperforming most of the main asset classes. This demonstrates that an unconstrained and disciplined strategy focusing on alpha opportunities can generate strong returns even in volatile market conditions.

**Another very positive development on our side is the launch of the UCITS Luxembourg fund co-branded with Azimut, one of the leading European asset managers. Al Mal Capital is the sub-adviser on this fund which replicates our highly successful Middle East equities strategy.**

While our forecasts and views are always subject to changes, our commitment to serve our clients is not.

We remain at your full disposal for any specific issues you would like to discuss, so please do not hesitate to contact us.

Middle East  
Equities



H1 2019 in the  
rearview

# H1 & Q2 2019 in the rearview

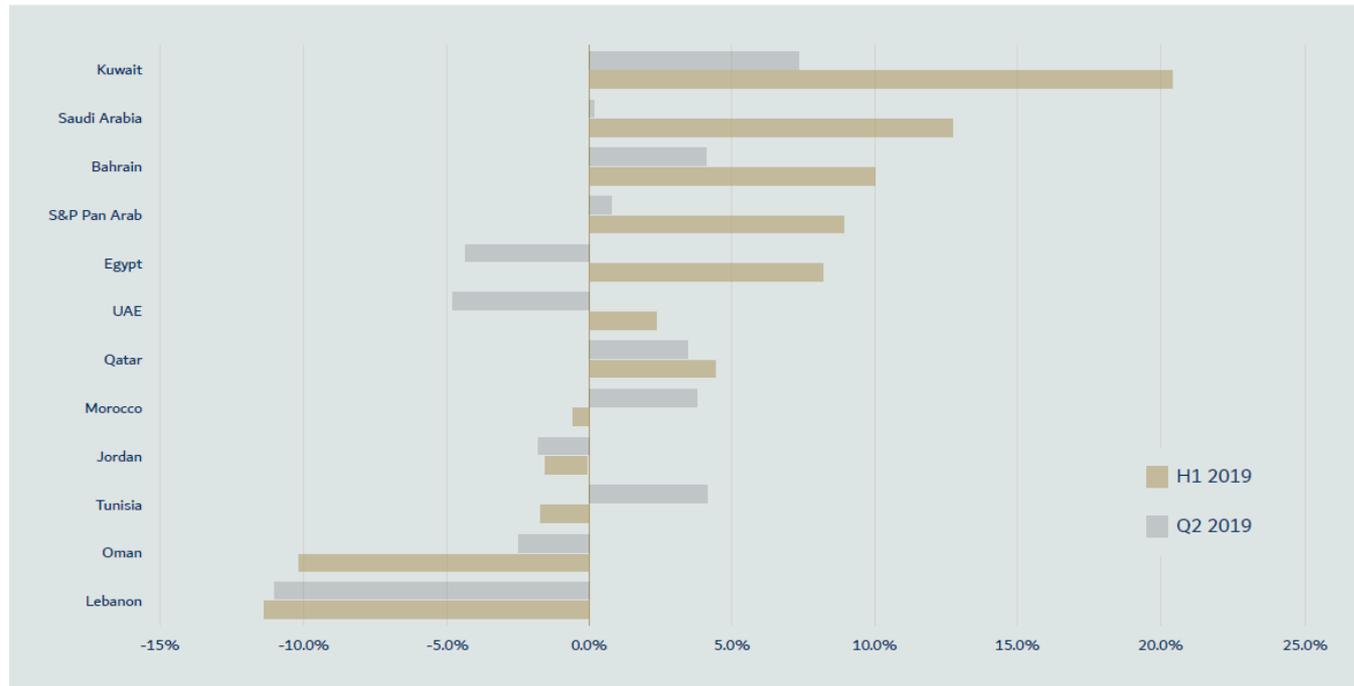
## S&P Pan Arab index is up +8.9 per cent in H1 with Kuwait and Saudi Arabia leading



Middle East equities posted decent returns in the **first half of this year (+8.9 per cent)** although they lagged U.S and Emerging Markets equities. As a reminder, the Middle East equities was the best performing region last year (+6.2 per cent for the S&P Pan Arab index in 2018), strongly outperforming World equities (-11 per cent) over that period. It is this not a surprise to see the S&P Pan Arab index lagging the world equity index in H1 as the oversold markets such as U.S or Emerging markets equities had a higher potential recovery as global equity markets bounced.

In terms of **country performance (see chart below)**, Kuwait was by far the best performer with a 20.4 per cent gain ahead of Saudi Arabia (12.7 per cent). Egypt performed in line with the broad S&P Pan Arab while UAE underperformed.

MENA equity markets performance in Q2 2019 and H1 2019



## H1 & Q2 2019 in the rearview

S&P Pan Arab index is up +0.8 per cent in Q2



When it comes to the quarterly performance, **the S&P Pan Arab index posted a gain of +0.8 per cent in Q2.**

At one point in the May selloff, the benchmark for MENA equity markets was down -4 per cent on a quarter to date basis but a rebound in June enabled the S&P Pan Arab Index to close the quarter in positive territory.

**Kuwait** was the best performer in MENA this quarter, adding 7 per cent which brings its year to date gain to 20 per cent. The much anticipated upgrade to 'Emerging Market' status was announced by MSCI, effective May 2020.

The smaller markets of **Tunisia, Bahrain** and **Morocco** came next with decent performances of around 4 per cent during the second quarter. Qatar managed to recover all of its first quarter losses and is now in positive territory for 2019.

**Saudi Arabia** – the biggest market in terms of index weight – closed exactly flat for the quarter. May saw the first phase of passive money flowing in from MSCI trackers.

The **UAE** once again underperformed the wider S&P Pan Arab Index - however there were marked difference between Abu Dhabi and Dubai.

**Egypt**, which did very well during the first quarter gave back some of the gains (-4 per cent), as inflation stayed due to electricity price hikes and fuel subsidy reforms. The worst performing market in MENA in the second quarter (and the first half) was **Lebanon**.

## H1 & Q2 2019 in the rearview

The Al Mal Mena equity fund is up +7.5 per cent since the start of the year



The fund performance in the **second quarter** was flat (-0.4 per cent). The slight underperformance is a result of the underweight in the two markets – Saudi Arabia & Kuwait - which have continued their run based on non-fundamental factors.

To our opinion, this beta rally is on its last leg. It is worth highlighting that the S&P Pan Arab index now stands at 800 points which is just 3% shy of the 4-year high, achieved at a point when oil prices were much higher.

At a PEG ratio of 1.6x, the focus should soon shift away from the 'index inclusion' theme to pure stock picking stories. On a **year to date basis**, the Al Mal Mena equity fund is **up 7.5 per cent** against 8.0 per cent for the benchmark (last NAV date in the first half is as of 26th of June).

It is important to note that throughout this period the active share of the Fund has been high (40-50%) despite being invested in the better liquidity names while maintaining a very reasonable ex-post tracking error (around 6%).

**While past returns are never a guarantee of future results, we continue to believe that our bottom-up, deep fundamental research and high conviction approach investing into a region full of alpha opportunities will produce attractive returns in the medium to long-run.**

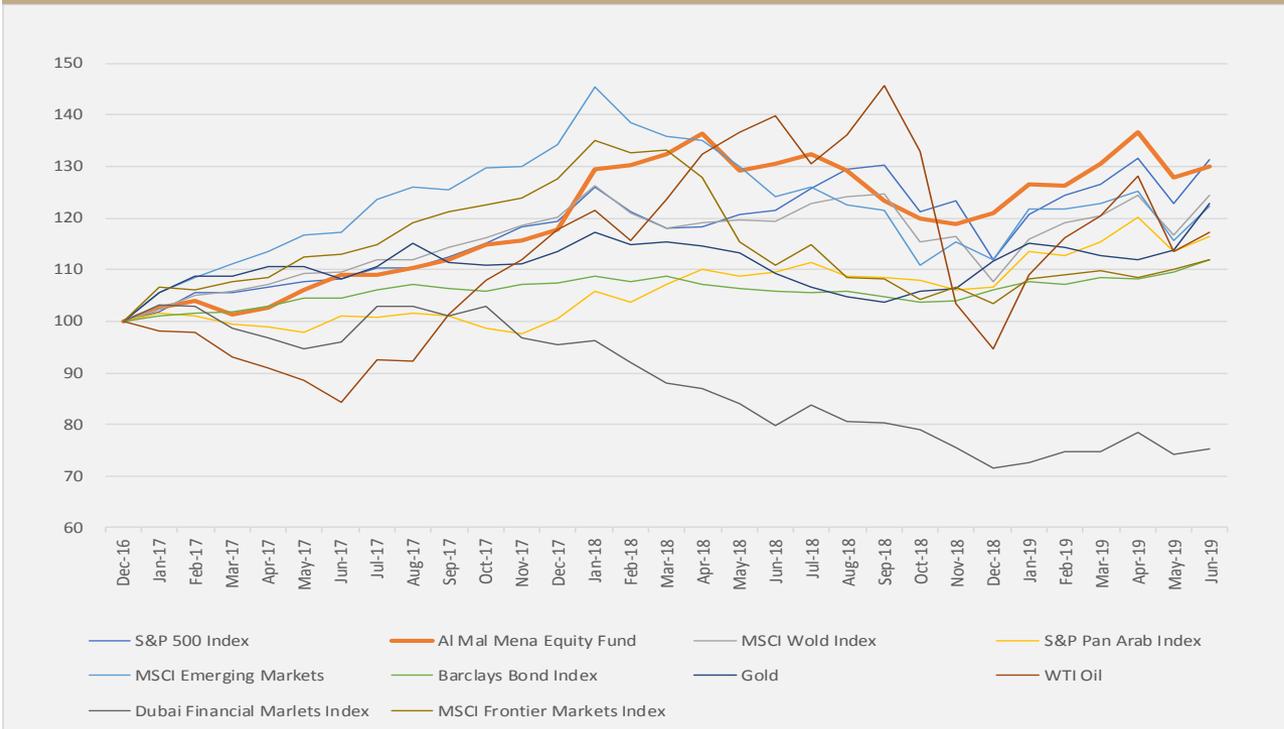
# Strategy performance since January 2017

Al Mal MENA equities Fund versus key market indices from January 2017 to the end of June 2019



## 10 QUARTERS IN THE REARVIEW

Al Mal MENA equity fund performance (net of fees) since implementation of the new strategy (1/1/2017 – 30/6/2019)



	S&P 500	Al Mal MENA Equity	MSCI World Index	S&P Pan Arab Index	MSCI Emerging Markets	Barclays Bond Index	Gold	WTI Oil	Dubai Financial Markets Index	MSCI Frontier Markets Index
Cumulative performance since January 2017	31.40%	30.0%	24.39%	16.55%	22.34%	12.02%	22.84%	17.12%	-24.70%	12.04%

# H1 & Q2 2019 in the rearview

## Macro Highlights: Signs of Divergence



With most markets in MENA having now reported their Q1 GDP results, a better picture is emerging on the trajectory of the regional economy as we start the second half of 2019. When looking back over H1, we can see clear signs of a divergence in local business cycles. Encouragingly, some of the largest regional economies – including Saudi Arabia, the UAE and Egypt – are all showing signs of an acceleration in consumption and investment. In contrast, the picture is less flattering for the rest of the non-GCC universe, as several of MENA's smaller economies, such as Morocco, Tunisia and Lebanon have all shown signs of a softening in activity.

### **A rebound in the GCC's two largest economies...**

Saudi Arabia's Q1 GDP growth came in at 1.6 per cent y/y, which was slower than the 3.5 per cent and 2.4 per cent rates of expansion that were posted in Q4 and Q3 2018. Growth in the oil sector slowed sharply to only 1.0% y/y in Q1 from 5.9 per cent in Q418, and with OPEC having recently announced an extension to its production-cut agreement through the end of 2019, the sector is likely to remain a headwind on the broader economy this year.

That said, it can certainly be argued that while the overall pace of growth has slowed, the quality of Saudi Arabia's economic recovery has actually improved. In particular, non-oil private sector growth came in at 2.3 per cent y/y in the first three months of 2019, representing the fastest pace of expansion since the fourth quarter of 2015. Looking at the data from an Expenditure perspective, it is also encouraging that government spending was not the main factor driving consumption and investment higher, but rather, it was household spending and business investment. When seen within the wider context of a host of high-frequency macro data (including trends in private sector credit, POS data, new mortgage lending, etc.), it becomes increasingly evident that a recovery is gradually taking hold within the Saudi consumer sector, and likely accelerated through Q2 and into the second half of the year.

A similar turnaround in the business cycle of the UAE has also become evident in recent months. Leaving aside the oil sector which, like Saudi Arabia, will be slight constraint on overall GDP growth, the Augmented Economic Coincident Indicator which is calculated and published by the central bank showed growth in the non-oil economy rising to 1.6 per cent y/y in Q1, compared to only 0.5 per cent in Q418 and Q318 respectively. This pace of expansion is below historical trend, but also indicative of an economy on the mend. Particularly encouraging from our point of view was the strong rebound in employment growth in the first three months of 2019, as there was a net +60k new jobs created in the UAE's private sector in this time period. Other data, including the UAE's Purchasing Managers' Index, have similarly pointed to an uptick in business activity, with the PMI having registered its second-highest reading on record in May (59.4), while the H1 average rose to 56.7 from 55.9 in H118 (see next page).

# H1 & Q2 2019 in the rearview

## Macro Highlights: Signs of Divergence



UAE non-oil augmented economic coincident indicator



Purchasing manager indices



### A more nuanced picture in the rest of the GCC...

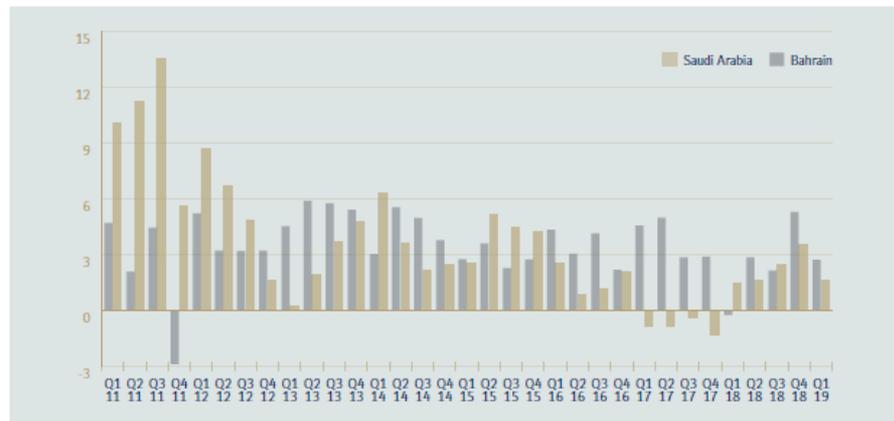
It is encouraging that the GCC's two largest economies are showing signs of recovery, however the macro picture in the rest of the region is slightly more nuanced. Domestic demand trends in Bahrain stand in contrast to those in Saudi and the UAE, as the country posted real GDP growth of 2.7 per cent y/y in Q1, however this was driven predominantly by the hydrocarbon sector which expanded 9.2 per cent y/y in real terms, compared to slower growth in the non-hydrocarbon sector of only 1.5 per cent. To the extent that fiscal policy is restrained as part of Bahrain's efforts at containing its budget deficit, slower government spending could continue to pose a downside risk to the non-oil economy in the near term.

# H1 & Q2 2019 in the rearview

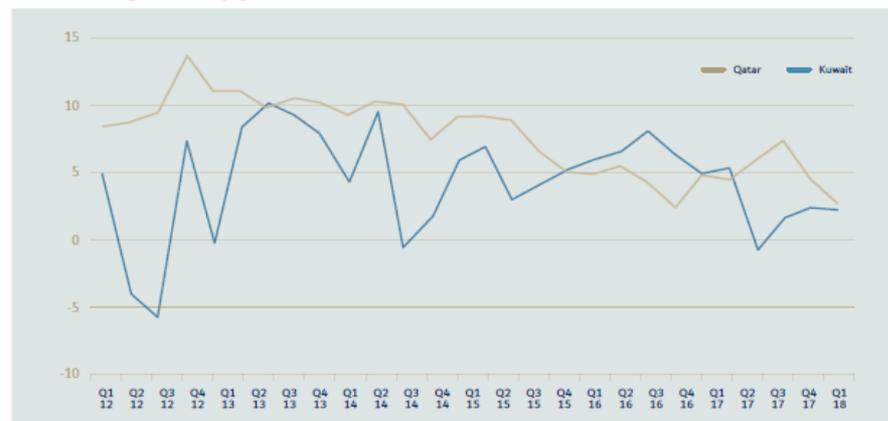
## Macro Highlights: Signs of Divergence



Real GDP growth, % y/y



Non-oil GDP growth, % y/y



As we highlight in our Country Spotlight this month, Kuwait's non-oil economy is also expanding at a roughly similar pace of 2 per cent, while Qatar's non-oil economy, having outperformed its regional peers throughout much of the downturn since 2016, is showing signs of slowdown, as the stimulus provided by the multi-year construction-led boom gradually fades away (at the time of publication Qatar's Q1 GDP data was set to be released).

Oman does not release quarterly national accounts data, however the majority of high-frequency data from this economy also tends to indicate a pace of non-oil growth in the low single-digits.

# H1 & Q2 2019 in the rearview

## Macro Highlights: Signs of Divergence



### Non-GCC is underperforming, with the exception of Egypt

Outside of our immediate vicinity, the picture for much of the non-GCC MENA region is less bullish. Economic growth in Tunisia, for example, slowed to only 1.1 per cent in Q1, representing the weakest pace since the first quarter of 2016. Looking ahead, while a weaker currency is helping the external sectors of the economy such as tourism, it is unclear if significant progress on reform momentum can be achieved in the second half of the year as parliamentary elections are set to take place. Similarly, in late June the governor of the central bank of Lebanon told an investment conference in Beirut that the economy would likely have zero percent growth in 2019, although he also pointed to the tourism sector as a potential bright spot.

**Morocco** stands somewhat apart in this regard, as while real GDP growth was only 0.4 per cent y/y in Q1, this was driven in large part by declines in the agricultural sector (which is still mostly dependent on unpredictable rainfall patterns) and lower public spending. When looking at some recent developments that are not currently captured by the official Morocco GDP statistics – such as the opening of the largest port in the Mediterranean, as well as ongoing investment by European automakers who are keen on using Morocco as a base for export-oriented manufacturing – then the picture for Morocco becomes more encouraging, particularly beyond the short term.

Real GDP growth, % y/y



# H1 & Q2 2019 in the rearview

## Macro Highlights: Signs of Divergence



There is a notable exception to this trend, however. As we highlighted in our Country Spotlight in our June Perspectives, the **Egyptian** economy's recovery has been stellar, with headline GDP growth running between 5.0-5.5 per cent currently. There is a lot to like in the Egyptian investment story at the moment, particularly as the combination of the EGP devaluation and ongoing policy reforms support an increase in exports and fixed investment (please see last month's Perspectives for a more detailed analysis).

### **What about MENA (PT)...**

Far outside of our immediate universe, the picture is more concerning. Indeed, the Turkish and Pakistani economies have been showing signs of a sharp macro slowdown as both grapple with emerging balance of payments crises. The recent signing of an IMF agreement should be the catalyst to start Pakistan's multi-year recovery, with the hope being that Fund-mandated policy reforms help stimulate foreign private sector capital inflows (i.e. reduce the reliance on foreign aid), while a weaker currency can help rebalance the current account.

Turkey's economic recovery prospects for the second half are more encouraging, as we suspect the sharpest slowdown in domestic spending (both at the consumer and business level) was seen in the first half. Real GDP growth in the first quarter declined -2.6 per cent y/y, following on from a contraction of -3 per cent in Q418, largely as a result of weaker confidence following the sharp sell-off in the lira in 2018. Notwithstanding ongoing political risks, with the currency recently stabilizing and inflation gradually normalizing, we suspect consumer and business sentiment will gradually improve through the end of this year, while the weaker TRY will continue to support an export-led recovery.



## Outlook for Q3 2019 and beyond



**Despite some negative headlines on the region, Middle East equities have been performing reasonably well since the start of 2017, as the S&P Pan Arab index posted a 16.5 per cent absolute performance over the period. Below, we first review the reasons why we stay positive on the region. We then share our main investment themes and ideas for Q3 and beyond.**

#### **SECULAR REASONS**

- The Oil crash has been a once in a life time opportunity for the region to “reinvent itself”. We are seeing major economic, societal and capital markets reforms being implemented and this should help MENA to move post-oil era into a more diversified economy with greater representation and activity in the capital markets (e.g. Saudi inclusion into MSCI EM & FTSE index, etc.);
- The geopolitical situation aside, MENA is full of attractive companies and ALPHA opportunities (80% of the volume is retail money, the market is under-covered by sell-side research, etc.);
- There is still very low foreign ownership (i.e. FDIs can only go upward);
- MENA is de-correlated from other EM markets (\$-peg, solid fundamentals, oil exporter);
- Based on the points above, we believe that MENA capital markets have entered into a virtuous circle: index inclusion of Saudi & Kuwait will attract passive and active foreign flows – these foreign investors will require more transparency and improved governance – flows will also improve liquidity – valuations will adjust upward over time – all of the points mentioned earlier will boost performance, attracting more foreign flows, etc.

#### **CYCLICAL REASONS**

- Asset allocators and global emerging markets fund managers will continue to favor the region (in particular GCCs) given limited currency (\$-peg);
- Unlike many other EM countries, GCC countries are benefit from rising oil prices;
- The region has limited exposure to trade war (vs. Asia for instance);
- Valuations remain decent (except some large caps in Saudi, Kuwait or Qatar);
- The strong fundamentals of the region (foreign reserves, low debt, fiscal stability, dollar-peg) also attract flows versus weak EM countries (Turkey, Argentina, etc.)

# Middle East Equities

## Growth at reasonable price



If we look at the overall simple average, the region is trading at 14.7x estimated 2019 earnings and those earnings are expected to grow at double digits. On a relative basis, MENA equity valuations remain attractive.

Within the MENA region, relative valuations in part explains why we continue to overweight markets such as Egypt as it is trading at a very low PE/G\*.

### Valuations

Region	P/E (T12m)	P/E (2019)	P/B	Div Yield %	PE/G
Saudi Arabia	20.3x	16.8x	2.0x	3.4	1.61
UAE	13.6x	10.9x	1.3x	4.6	0.97
Qatar	15.0x	14.5x	1.7x	4.0	1.69
Kuwait	17.9x	16.5x	1.2x	5.8	0.94
Egypt	14.8x	9.4x	1.7x	3.1	0.73
Oman	7.2x	7.2x	0.8x	7.3	0.64
S&P Pan Arab Index	16.4x	14.7x	1.6x	3.9	1.05

(\*) PE/G is a ratio which divides a P/E multiple by expected growth. The higher the PE/G, the more you are paying for expected growth, i.e we would tend to favor lower PE/G over higher PE/G.



### 1. Egypt – The Best Growth Profile

To our opinion, Egypt remains the most attractive country within the region. The market was the darling of MENA equity investors between January 2017 and April 2018 as the EGX30 recorded a gain of 65% in dollar terms over this period. But between April and December 2018, the pressure on emerging markets (currencies and equities) and stronger oil prices took a toll on Egypt equities as the EGX30 entered a bear market, falling 30% (in dollar terms) from its peak on April 26th till year-end, hence giving up all its last year gains and underperforming the broader S&P Pan Arab index.

**Despite the 2018 pullback, we remained positive on Egypt. On a top-down basis, we believe that Egypt looks set to maintain its position as the fastest growing economy in the entire Middle East and North Africa in 2019 and 2020, as a significant amount of pent-up demand following several years of below-trend growth is finally released, and drives consumption and investment higher. Headline GDP growth is currently running at roughly 5.5% y/y, and the government is targeting to raise this already robust pace of expansion to over 6.0% in the upcoming fiscal year (beginning in July). Even the IMF, which is traditionally more conservative in its forecasts, is projecting growth of 5.9% in FY2019/20.**

The economic rebalancing that has taken place has been pronounced, and has significantly reduced threats to underlying macro and market stability. The current account deficit, for example, narrowed to -2.7% of GDP in the last fiscal year, compared to a shortfall of -6.7% only one year earlier. Even as capital controls were removed as part of the country's IMF agreement, FX reserves steadily rose to record highs, and currently sit at roughly USD44bn, which represents a healthy seven months of import coverage.

As the economic rebound appears to have been driven primarily by the export sector and public investment (the latter is most likely related to several of Egypt's 'mega projects'), a key challenge moving forward into H2 2019 and beyond will be in facilitating stronger private sector activity. In this light, the slow and steady monetary policy easing expected from the central bank will prove critical, as the combination of lower borrowing costs, a more stable political backdrop, and a stronger growth outlook eventually filters through into higher levels of business investment.

**The stability of the EGP should help underpin a more bullish Investment Thesis on the North African economy. Recent weeks have seen the currency appreciate to multi-year highs, even as other emerging market currencies came under downside pressure.**



#### 2. Saudi Arabia – Mainly about Flows

The inclusion of Saudi Arabia in the main EM indices (MSCI & FTSE) is a major event for the region.

First, in terms of capital flows. Indeed, \$60bn flows are expected through the 7 phased MSCI / FTSE inclusion in FY'19 / Q1 '20 (\$20bn passive and \$40bn active). We do believe that the KSA inclusion is still underplayed by the market as we have only seen \$1 billion of inflows in 2018.

We would also highlight that the EM indices inclusion is not just a Saudi story – e.g. the Kuwait phase 2 inclusion in the FTSE index took place in Q4 and the MSCI upgrade is expected to take place in June '19.

Going forward, we expect MENA markets to have a weight of 5% in the MSCI and FTSE EM benchmarks by 2020 (up from 2%).

The planned IPO of Aramco by 2021 should add 2%. With a total of 7%, the weight should not be far from the weight of Latin America for instance. With such a weight in the main EM index, global asset allocators will not be in a position to avoid the region anymore – this is a major event which should trigger the virtuous cycle mentioned earlier in this document.

While KSA continues to be an index inclusion story for 2019, we have seen some green shoots in corporate earnings. We are selective in our picks and are positioned on themes such as industry consolidation and healthcare. Insurance is another area where we see growth both in medical and motor segments.

As explained above, the 7 phased MSCI and FTSE inclusion are expected to bring passive flows which are likely to benefit large caps mainly. We would be very cautious if the market as a whole becomes very expensive following the initial phases.



### 3. UAE - Attractive valuations

The UAE markets, especially Dubai underperformed in 2018 – and this was especially the case for Dubai (see January 2019 Perspectives). The markets have somewhat recovered in the first half of the year, however valuations on a bottom up basis remain attractive.

### 4. Banks - Rising interest rates (with a pause)

We still like banks, as Fed rate hikes have been benefiting the net interest margins (NIMs) of GCC banks especially in Saudi, UAE and Kuwait. As the Fed monetary tightening is pausing earlier than anticipated, the net interest margin expansion story is likely to stall as well. However, it might then be the time to revisit the case of leveraged companies.

### 5. Geopolitics

Another investment theme where we would like to be positioned is the companies that benefit from geopolitical developments (and avoid those that get impacted). For instance:

- ❖ End of war in Yemen/ Syria: watch for cement companies in nearby locations;
- ❖ (Hypothetical) Qatar dispute resolution: resumption of trade and tourism with the rest of Gulf;
- ❖ Sanctions on Iran: we avoid companies that have exposure to the country;
- ❖ US – China trade war: Logistics & transportation companies such as DP world could benefit from any positive surprise on that front.

### 6. High and Stable Dividend Yields

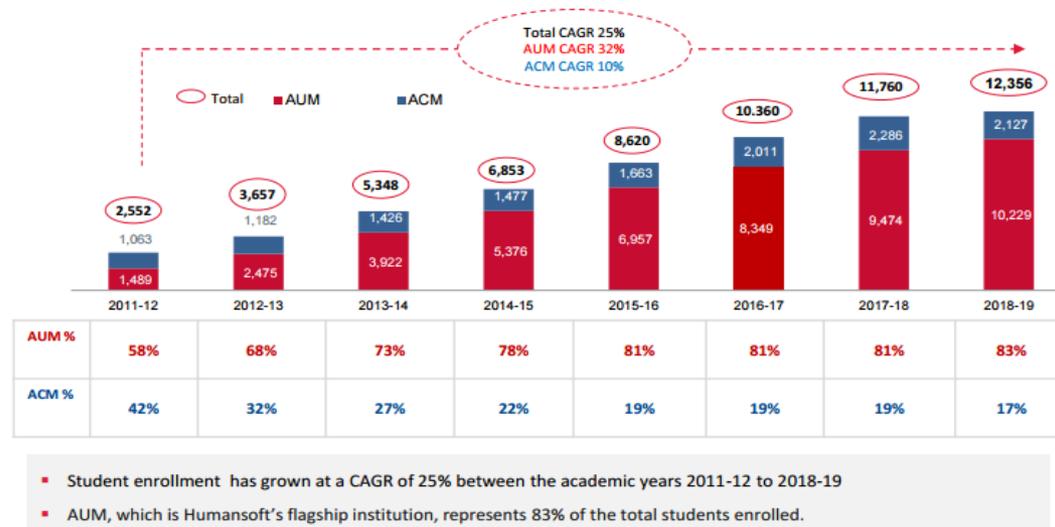
We find many companies with stable business models – telecoms, utilities (including district cooling) and real estate, where majority of income is generated by rentals and is largely recurring in nature. As investors take in account renewed expectations of lower interest rates, we believe such stocks where the dividend yield is 5-7% would attract flows.

# Case Study

## Humansoft Holding - Kuwait



Human Soft Holding Company is a Kuwait-based company engaged, along with its subsidiaries, in establishing and managing private universities and colleges, providing computer education, language training, executive courses, and electronic commerce and media. Humansoft has acquisition of interests in related business in Kuwait and abroad. The Company comprises of four business segments: Training and Career Development Programs, English Training, Learning Solutions and Higher Education.



- Higher Education:** Apart from AUM & ACM, Tawteen focuses on career development and job placement of GCC nationals in the private sector. Having conducted several projects in the UAE and Kuwait, where it has been able to train and place more than 2,500 newly graduated locals in the private sector, Tawteen now focuses on career Development and Placement of students at AUM and ACM by working closely with external organizations and employers.
- Training and career development programs:** Primarily, New Horizons Computer learning centres that operate out of key locations in the Middle East viz. in Kuwait, Dubai, Qatar and Abu Dhabi. These centres provide training courses building up from beginner level to the acquisition of advanced certificates in the latest Microsoft, CISCO and Citrix technologies. Professional courses are also on offer such as Six Sigma, Project Management and Information Security.

### Strong cash generation capabilities with limited capex requirements

The company has a strong cash generation capabilities with very high visibility of cash flow (at-least 1 year of visibility at the start of the session and for all practical purpose for 3 years as the average course duration at AUM is around 4 years and once the student enrol in the course the dropout rates are very low) with minimal capex requirement, management has guided for KWD 15mn for next three years as they are construction an auditorium and some other building and post that the campus will be fully functional with only maintenance capex requirement in the range of 2-3mn KWD every year

They have a strong ROE profile of 55% and with current net cash position of KWD 20mn they can significantly increase the leverage given their cash flow visibility and cheaper cost of debt, this will further improve the ROE of the company

# Case Study

## United Electronics Company (eXtra) – Saudi Arabia



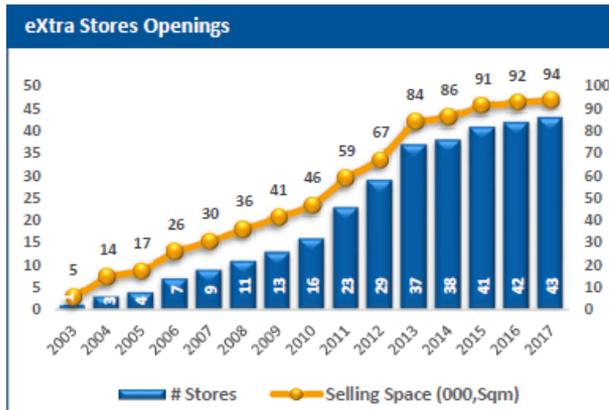
Extra is a leading electronics retailer in Saudi Arabia with a 14% market share. The company has 40 stores in KSA across 24 cities & 3 in other GCC countries. United Electronics began an aggressive expansion strategy in 2010 to become a leading big-box retailer in Saudi Arabia, capitalizing on rising discretionary spending and an ongoing shift towards organized retailers.

### Value drivers

Regulations requiring 100% Saudization for electronics retailers by November 2018 should drive strong market consolidation. Such developments push smaller, unorganized players out of the market, as these stores are mostly run by expats. We have already seen how the above played out in case of mobile retailers – market share of organized players increased from 26% to 47%. The new decree issued in early 2018 encompasses large electric appliances, audio-visual equipment and small appliances, which together has a current size of around SR 10bn. This is a big opportunity for the company & we estimate it can add at least SR 0.5bn to the topline with higher margins.

Consumer Finance - The company offers a unique consumer finance program & though the portfolio size is relatively small, its contributions to income is substantial because of high margins. Current book of around SR 280m is expected to grow to SR 500m by 2019. Bad debt ratio is at 2% (target is to <5%). In our view, This along with differentiating 'after sales services' initiatives are a big advantage against other big box retailers.

Extra also has a strategic alliance with the regions second biggest e-commerce player 'Noon', as exclusive partner for a consumer electronics and home appliance items.





10 strong reasons to  
consider Al Mal Mena  
Equity Fund as an  
investment vehicle of choice

# Why Al Mal Capital?

## 10 STRONG REASONS TO CONSIDER THE AL MAL MENA EQUITY FUND AS AN INVESTMENT VEHICLE OF CHOICE (1/4)



### Reason #1: Al Mal commitment

While the MENA equities team has been revamped in early 2017, the involvement of Al Mal Capital in regional equities fund management is more than 10 years old. Indeed, Al Mal UAE equity fund was created in April 2006 whereas Al Mal MENA equity fund was launched in June 2008. At a time when many regional financial firms are leaving the segment and most international asset managers continue to shun the space, Al Mal Capital is investing and expanding into Middle East equities. This is the best proof of Al Mal Capital level of commitment and conviction on our regional markets. Al Mal Capital has been of the very few long-standing MENA equity specialist and has a strong objective to be seen among the worldwide leaders in this space.

### Reason #2: The strong backing of Dubai Investments

In 2015, Dubai Investments increased its ownership to obtain a majority shareholding in Al Mal Capital. Our main shareholder has been a strong supporter of Al Mal asset management team and is backing our MENA equities ambition, for instance by seeding our newly created funds.

### Reason #3: the launch of the fund under a UCITS format

One of the missions of Al Mal Asset Management team is to promote MENA equities as a destination of capital for international investors. As such, we need to provide them with a fund structure which is investable. Al Mal MENA Equity Fund is currently registered in Bahrain. While this fund domicile provides the manager with many advantages (including direct access to Saudi market), it is not investable for most international investors, would they be institutional or retail.

Al Mal Capital and Azimut Group, one of the largest European asset managers, have signed a partnership agreement to jointly launch a Middle Eastern equity UCITS fund. The strong regulation of UCITS and the resulting high level of investor protection have made them popular with supervisory authorities and investors all over the world. The UCITS brand and, particularly, Luxembourg UCITS have a large market share in a number of non-EU countries, e.g Asia, Latin American and MENA countries.

**This newly established Fund was launched at the end of June 2019 and is co-branded by Al Mal Capital and Azimut. With more than USD 60 billion in Assets under management, Azimut is one of the largest and fastest growing asset managers in Europe. And thanks to Azimut UCITS umbrella platform and their global distribution footprint, Al Mal highly successful MENA equity strategy is now be accessible to institutional and private investors around the world.**

### Reason #4: A unique investment approach and process

As already mentioned above, we believe that our investment approach and process is pretty unique. Our investment strategy is bottom-up fundamental through a deep research process. We favor an unconstrained and high conviction approach. The fund active share hovers between 40 and 60% over time.

# Why Al Mal Capital?

## 10 STRONG REASONS TO CONSIDER THE AL MAL MENA EQUITY FUND AS AN INVESTMENT VEHICLE OF CHOICE (2/4)



### **Reason #5: Strong absolute and relative performance since early 2017**

As mentioned earlier, the Fund is up +30 per cent since early 2017 performance against +15.3 per cent for the S&P Pan Arab index. Not only was the performance strong against benchmark but it did well against peers.

It is also worth highlighting that an alpha of 15% with 6% tracking error implies an information ratio of 2.5x. Last but not least, the fund volatility was lower than the index despite the fund's concentration.

### **Reason #6: A scalable strategy**

On purpose, we selected an investment universe which allows us to pick highly differentiated companies. We define our universe as GCC, Levant and North Africa (mainly Egypt and to a lesser extent Morocco). This universe is rather heterogeneous and exposed to very different dynamics (think about impact of rising oil prices on a country such as Saudi Arabia versus Egypt);

Unlike some competitors, we are not investing into illiquid micro/small caps to generate such level of performance. We believe we can achieve exactly the same results with a USD 500-700m assets under management. Not only our strategy is scalable, but we have much higher capacity left than most of our direct competitors.

### **Reason #7: A highly liquid strategy**

The current Bahrain registered fund offers weekly redemption frequency to investors. The same weekly frequency will be offered through the UICTS Luxembourg format and could be applied to a managed account as well.

At a time when many investors believe that the only way to generate double-digit returns is to allocate to illiquid strategies such as Private Equity or real estate, it is somewhat refreshing to see that very decent returns can be achieved with a strategy which allows investors to get their money back within a week.

### **Reason #8: Full transparency**

As our investment strategy does not imply investing into small/micro caps and because it is based on a clear, repeatable investment process, we chose from day 1 to communicate with our existing and potential clients in a transparent way and on a frequent basis.

We thus publish portfolio details and comments on a weekly, monthly and quarterly basis. We also offer direct access to portfolio managers.

# Why Al Mal Capital?

## 10 STRONG REASONS TO CONSIDER THE AL MAL MENA EQUITY FUND AS AN INVESTMENT VEHICLE OF CHOICE (3/4)



### Reason #9: Investing into a fund and a team which might be in the “sweet spot” of their lifecycle

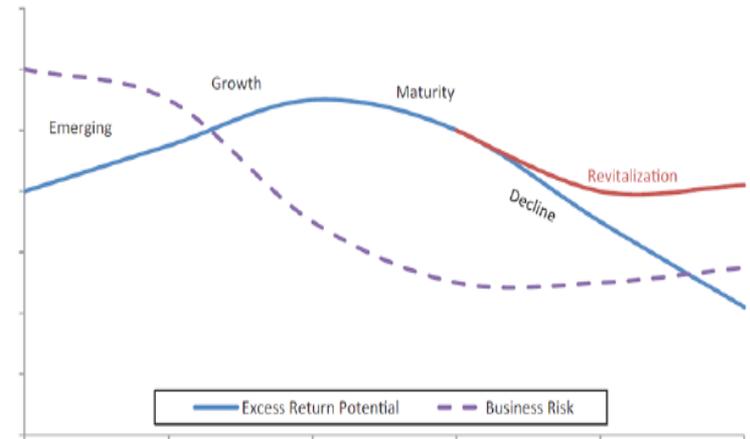
In December 2017 edition of Perspectives (Special Focus: “The Fund Lifecycle Theory”), we mentioned that many investors are under the wrong impression that the right timing to invest in a fund is when it has a long track record and large assets under management (AUM). In this article, we highlighted that “bigger” and “older” are not always better.

Indeed, many institutional investors and family offices may significantly narrow down the number of fund managers, looking for at least five years’ track record and over US\$300-500 million in managed funds. As we highlighted in this article, several academic and industry research has suggested that large size and old age can have a negative impact on fund performance and performance persistence.

The “Fund life cycle theory” suggests there is an optimum time to allocate to an asset manager. As shown on the chart below, the growth and early maturity stages of a fund represent the “sweet spot” for investing. It is the time window where the fund manager is most likely to generate solid, consistent excess returns and has developed a sustainable business and stable operational infrastructure.

Al Mal MENA Asset management team is highly qualified, passionate and dedicated. While past results is not a guarantee of future results, the performance achieved since the start of 2017 is a strong encouragement for the foreseeable future.

*Chart: Excess return potential and business risk depending on the life cycle stage*



# Why Al Mal Capital?

## 10 STRONG REASONS TO CONSIDER THE AL MAL MENA EQUITY FUND AS AN INVESTMENT VEHICLE OF CHOICE (4/4)



### Reason #10: the upside potential of MENA equities

As mentioned earlier, we are upbeat about the near-future prospects of our regional markets. While many investors have been skeptical about the potential added value of MENA equities to a global portfolio, 2018 proved to asset allocators that Middle East markets can de-correlate from both developed and emerging markets while generating attractive returns. To our opinion, international investors will continue to learn about the attractiveness of MENA and progressively allocate to our regional markets. As highlighted below, the MENA region blends most of the characteristics of developed, emerging and frontier markets – this is a very unique feature.

### MENA, a region like no other



# Why Al Mal Capital?

## Investment conclusion



### INVESTMENT CONCLUSION

The way we see our role as Al Mal Middle East equities team is the following: whatever the direction and performance of the market, we want to invest into what we define as the very best opportunities within our investment universe. We believe that by doing so, we should at least double our client's capital over 7 years. It should be achieved by going long the market and generating around 5% of alpha vs. the index per annum.

While we cannot guarantee a repeat of the strong performance we achieved since early 2017, we are confident that our high conviction approach will enable us to generate above benchmark returns going forward. And with the Middle East market outlook improving, it is thus not too late for investors to allocate to Al Mal MENA equity fund.





## Country Views



## Opportunities

- ❖ The **largest population in the GCC** (32mn) with an average age of 25 still represents a significant consumption power.
- ❖ The **National Transformation plan** should strengthen the fiscal and economic outlook over the longer term.
- ❖ **Strong Oil and Net Foreign Assets reserves** (reached \$456 billion) should support transition over the medium term.
- ❖ **MSCI and FTSE inclusion** over the medium term.
- ❖ **Large debt capacity** (20% of GDP as of 2018 and expected to reach 50% of GDP by 2021) to support budget deficit.
- ❖ **Third largest oil reserves** globally after the United States and Russia.
- ❖ **Social Reforms** such as women driving & entertainment will open up new avenue.

## Challenges

- ❖ High **dependency on oil** (30% of GDP & 81% of government revenues).
- ❖ Scarcity of **skilled local labor**.
- ❖ **Margin compression** as a result of Saudisation and subsidy reforms and expat exodus leading to lower demand
- ❖ **Geopolitical tensions** with Iran Yemen and Syria.
- ❖ **New taxes and fees** in form of VAT and expat dependent levy, higher gas and electricity prices to adversely impact consumer purchasing power

## Key Macro Indicators

Indicator	2014	2015	2016	2017	2018
Real GDP Growth (%)	3.7	4.1	1.7	(0.7)	2.2
CPI (Average)	2.2	1.3	2.0	(0.9)	2.5
Population (Millions)	30.8	31.0	31.7	32.6	33.2
Gross Debt (% GDP)	1.6	5.8	13.1	17.2	19.1
Current Account (% GDP)	9.8	(8.7)	(3.7)	1.4	8.3



## Our Take

We argue that the Kingdom as we knew it over the past 30 years would not exist in 10 years. The kingdom is **moving from a passive approach to a proactive approach** at all levels from politics to social to economics. The goal is for the kingdom's major cities to be at the same level as other major international cities and for that to happen Saudi Arabia is a place investors do not want to miss. There will be more catalysts with major IPOs and reforms along the road.

**The market was among the best performing index globally in 2018 up 8.3% (Tadawul index) and performed well in H1 2019 (+12.7%).** Most of the strength is coming ahead of obtaining emerging market status by MSCI and FTSE, with the later officially upgrading Saudi as EM secondary market (inclusion by mid 2019). Despite geopolitical tension late last year country saw foreign inflows of USD 1.6bn in 2018 and was successfully able to place USD7.5bn bond in January 2019 showing strong investor confidence in the nation. Currently foreign ownership in Tadawul stands at 4.1% we expect this to go up significantly post MSCI inclusion. While KSA continues to be an index inclusion story for 2019, we have seen some green shoots in corporate earnings. We are selective in our picks and are positioned on themes such as industry consolidation and healthcare. Insurance is another area where we see growth both in medical and motor segments.

## Key Market Metrics (2019)

Metric	P/E	P/B	DY	RoE	ND/EBITDA
<b>Current</b>	16.7x	2.0x	3.4%	12.8%	0.6x
<b>10 Years Average</b>	17.2x	1.9x	3.4%	11.3%	0.6x
<b>10 Years High</b>	23.6x	2.8x	4.2%	13.8%	1.1x
<b>10 Years Low</b>	13.2x	1.3x	2.6%	9.1%	0.1x

\* Source: Bloomberg, REIDIN and AMC A.M. Estimates



# United Arab Emirates: A tale of two Markets



## Opportunities

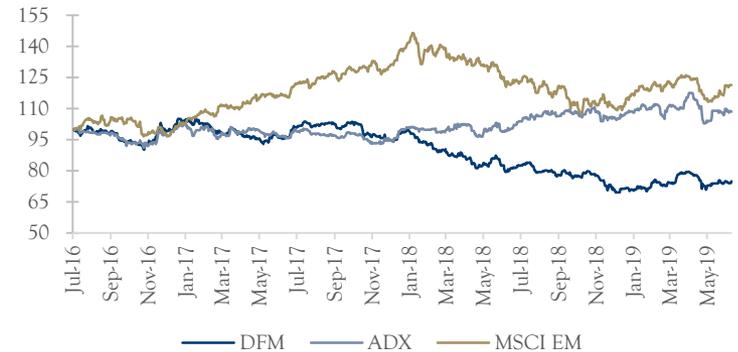
- ❖ **Subsidy reforms and decreased spending** has allowed the UAE to significantly improve investment outlook in the country.
- ❖ **EXPO 2020**, along with continued development of attractions, will result in sustainable growth in tourism (est. 20 mn visitors by 2020, CAGR 2015-20: 7.1%). Total projects award is expected to reach USD 9bn in 2019
- ❖ **Tourism** was 8.3% of 2017 GDP, with expected growth rate of 5.4% / year over the next 10 years, in line with the Dubai Plan 2021, and Abu Dhabi Vision 2030.
- ❖ **Disciplined and swift fiscal adjustments**, prior to the slump in oil prices, resulting in decreased dependence on oil revenue. Aim is to reduce oil contribution to GDP to 20% by 2021, from ~30% currently.
- ❖ **The largest financial buffers** at USD1.26 trillion in SWFs.

## Challenges

- ❖ Even though it is the most diversified economy, **oil still accounts for 30% of GDP**.
- ❖ **Further fiscal reforms** in the UAE, i.e. subsidy reforms, Emiratization, have the potential to cause a slowdown in economic growth.
- ❖ Continued **fiscal diligence in Abu Dhabi**.
- ❖ **Geo-political tensions in the region**, along with the UAE's strategic alliance with Saudi Arabia may challenge tourism, trade and international finance in the UAE.
- ❖ Many small developers that emerge during the mini boom 2012-14 may default or create an oversupply in the real estate market

## Key Macro Indicators

Indicator	2014	2015	2016	2017	2018
Real GDP Growth (%)	4.4	5.1	3.0	0.8	1.7
CPI (Average)	2.3	4.1	1.6	2.0	3.1
Population (Millions)	9.3	9.6	9.9	10.1	10.4
Gross Debt (% GDP)	15.5	18.7	20.2	19.7	18.7
Current Account (% GDP)	13.5	4.9	3.7	6.9	6.6



## Our Take

Many things are keeping investors' sentiment muted in the UAE, although we believe that technical factors are playing a big role here. Indeed, regional investors prefer to position ahead FTSE/MSCI inclusion in Saudi rather than to inject fresh money into the region. The UAE is taking most of the burden given it has the **highest foreign ownership percentage** (~10% vs. 4.1% in KSA). Signs of weakness in Dubai and Abu Dhabi's real estate sectors are not helping with lots of supply coming to the market in next few year while on demand side we haven't seen any excitement on the streets. Dubai tourism remain resilient with Dubai airport passenger numbers were flat in November vs last year despite stronger dollar.

Valuation in DFM index remain inexpensive with P/E (2019) of 6.7x and dividend yield of 5.5% making it quite attractive for long term investors. Some **technical factors** like passive flows due to higher index weight will continue to support First Abu Dhabi Bank, and we believe raising foreign ownership in a high quality name like Emirates ENBD will help to close the valuation gap with the sector average. We are thus positive on ENBD Bank based on relative valuation.

## Key Market Metrics (2019)

Metric	P/E	P/B	DY	RoE	ND/EBITDA
<b>Current</b>	10.8x	1.3x	4.7%	11.7%	0.7x
<b>10 Years Average</b>	19.9x	1.2x	3.6%	7.1%	1.4x
<b>10 Years High</b>	130.4x	2.0x	7.3%	11.6%	6.9x
<b>10 Years Low</b>	8.3x	0.7x	1.8%	-1.5%	-1.0x

\* Source: Bloomberg, REIDIN and AMC A.M. Estimates



# Kuwait: Mainly an index inclusion story but some “alpha” as well



## Opportunities

- ❖ **Economic reforms** should support the country over the long-term
- ❖ Kuwait has **large financial buffers** (USD 592 billion in its SWF) and to date has not borrowed from local banks, maintaining the sector's liquidity at healthy levels.
- ❖ Meaningful progress has been made on key infrastructure progress
- ❖ Given low capital spending, **budget deficit is expected to be manageable** at low single digits.
- ❖ **FTSE EM upgrade** and **MSCI potential inclusion** in the future.
- ❖ **Sixth largest oil reserves globally**. Additionally, the lowest oil breakeven prices in the GCC at USD50 per barrel.

## Challenges

- ❖ Still a state managed economy with the **highest dependency on oil** (94% of government revenue and 70% of GDP) among GCC countries, which led to a slowdown in project awarded in 2016 (-45%), second only to Saudi Arabia (-63%).
- ❖ High percentage of employees in Kuwait (>90%) work for the **public sector**, further straining fiscal spending and slowing state obligations.
- ❖ High level on unemployment among Kuwait's (12%)
- ❖ **High concentration of real estate and consumer loans** (60% of loans) in the banking sector.

## Key Macro Indicators

Indicator	2014	2015	2016	2017	2018
Real GDP Growth (%)	0.5	0.6	2.9	(3.5)	1.7
CPI (Average)	3.1	3.7	3.5	1.5	0.7
Population (Millions)	4.0	4.2	4.3	4.5	4.6
Gross Debt (% GDP)	3.4	4.7	10.0	20.7	14.8
Current Account (% GDP)	33.4	3.5	(4.6)	5.9	12.7



## Our Take

Kuwait was the best performing country within MENA in H1 (+20.4%) on the back of FTSE/MSCI inclusions. However, the government still needs to expand spending to trigger more growth. Nevertheless, we still find some of the best value in the region there.

We still believe that **2015-19 Kuwait Development Plan** will support growth over the medium term, and we actually started to see a pick-up in projects' awards. Moreover, it has much more capacity to gradually introduce reforms and alleviate the pressure on consumers. The government spending push should help the banking sector this year in improving loan growth, and given the headwinds and higher provisions taken last year, we expect this year to comparatively better. In addition, **higher interest rate** should be supportive for margins

In addition to high quality banks one key area we like in Kuwait is the government focus on **Education**.

## Key Market Metrics (2019)

Metric	P/E	P/B	DY	RoE	ND/EBITDA
<b>Current</b>	16.6x	1.2x	5.8%	13.1%	-
<b>10 Years Average</b>	16.7x	1.6x	4.4%	10.1%	2.3x
<b>10 Years High</b>	24.1x	2.1x	8.1%	19.6%	3.2x
<b>10 Years Low</b>	12.1x	1.0x	2.4%	-2.0%	1.4x

\* Source: Bloomberg, REIDIN and AMC A.M. Estimates



## Opportunities

- ❖ Committed to **investing in infrastructure**, particularly with the 2022 World Cup deadline.
- ❖ **Fiscal rationalization (5%) continued in 2017** with the central government holding the 2018 current expenditure at the same level. Public sector companies are increasingly cost conscious.
- ❖ **CAPEX growing at a healthy pace** – almost half of the spending will be directed towards completion of projects in healthcare, education, transportation and others toward hosting the 2022 World Cup.
- ❖ Qatar possesses the **second strongest position in the GCC following UAE with a net credit position of 115% of GDP**. This is one of the reasons it has not been downgraded by any of the rating agencies.
- ❖ Qatar also has **strong financial buffers** of around USD320 billion in its SWFs and has one of the world highest GDP per capita. Also the third highest gas reserves globally.

## Challenges

- ❖ **Private credit is slow**, despite the infrastructure push. Given banks' credit-to-deposit ratio is already very high at 115%, credit will eventually have to slow as deposits are now contracting
- ❖ **Diversification efforts** have had limited impact, and we have some concerns that Qatar is building excess capacities ahead of the 2022 World Cup, especially in hospitality and residential real estate
- ❖ Among the **highest debt levels in GCC** and increased difficulties in funding the banking sector.

## Key Macro Indicators

Indicator	2014	2015	2016	2017	2018
Real GDP Growth (%)	4.0	3.7	2.1	1.6	2.2
CPI (Average)	3.4	1.8	2.7	0.4	0.2
Population (Millions)	2.2	2.4	2.6	2.7	2.7
Gross Debt (% GDP)	24.9	35.5	46.7	49.8	48.4
Current Account (% GDP)	24.0	8.5	(5.5)	3.8	9.3



## Our Take

Qatar was one of the best performing market globally in 2018 up 21% despite the rift with neighboring countries lead by Saudi and UAE. The country has been able to weather the shock from the blockade better than expected. Data suggests the economy is resilient as non-oil GDP grew 4.2% last year. However, the country is becoming **much more dependent on governmental support**.

After the strong 2018 performance, Qatar lagged the S&P Pan Arab index in H1 2019 (+4.5% versus +8.9%). Valuations remain demanding with Qatar index trading at a P/E (2019) of 14.5x which is higher than their 10 year average and almost double than Dubai index making it unattractive for active managers.

## Key Market Metrics (2019)

Metric	P/E	P/B	DY	RoE	ND/EBITDA
Current	14.5x	1.7x	4.0%	13.5%	-
10 Years Average	13.3x	1.7x	4.4%	13.3%	2.7x
10 Years High	19.1x	2.4x	6.1%	17.8%	3.8x
10 Years Low	9.0x	1.1x	3.4%	8.6%	1.6x

\* Source: Bloomberg, REIDIN and AMC A.M. Estimates



## Opportunities

- ❖ **Capital inflows** are helping to a large extent to level the current account deficit. Foreign reserves stable at US 18.4 billion.
- ❖ Banking system is **highly capitalized** and still profitable. Better liquidity position versus other GCC countries has lead to a negligible rise in interbank rates.
- ❖ Decline in oil has emphasized the **need for diversification** and increasing the role of the private sector.
- ❖ **Cheapest** market in GCC
- ❖ **More debt capacity** although it has been accelerating rapidly from 5% of GDP in 2014 to 18.5% in 2016, and 29% as of 2017
- ❖ **Large population** with a high share of nationals. More Omanis replacing expats will lead to higher consumer expenditure & retail banking

## Challenges

- ❖ **High dependence on oil** (used to account for 85% of government revenues) and lower reserves compared to other GCC countries has forced the government to cut spending aggressively. SWF holding at only USD24 billion.
- ❖ Government spending used to account for 55% of GDP, so **growth is expected to remain muted**. Non-Oil GDP to slow to 3.8%.
- ❖ Despite robust spending cuts, it still has the **highest** fiscal deficit in the GCC at low double digits.
- ❖ **Liquidity to tighten further** as deposits fall and government borrowing crowds-out the private sector.

## Key Macro Indicators

Indicator	2014	2015	2016	2017	2018
Real GDP Growth (%)	1.4	4.7	5.0	(0.9)	2.1
CPI (Average)	1.0	0.1	1.1	1.6	0.9
Population (Millions)	3.7	3.8	4.0	4.1	4.3
Gross Debt (% GDP)	4.9	15.5	32.5	46.9	50.9
Current Account (% GDP)	5.2	(15.9)	(18.7)	(15.2)	(5.9)



## Our Take

With oil price down 25% from the peak in October 2018 the worries for the country has emerged again despite efforts by government to cut spending aggressively. At USD 18.1 billion FX reserves and 50% Debt-to-GDP, options are limited and after recent downgrade by Fitch to BB+ and US FED interest rate increase their 10 year bond is trading at yield of around 6% making it more difficult for the country to borrow.

Almost all sectors got affected after increasing taxes, telecom royalties and energy subsidies. Even though huge steps has been taken, we believe reforms should not stop yet as the fiscal breakeven oil price is still higher than current market price and they are expected to continue posting fiscal deficit.

## Key Market Metrics (2019)

Metric	P/E	P/B	DY	RoE	ND/EBITDA
<b>Current</b>	7.2x	0.8x	7.3%	9.5%	0.5x
<b>10 Years Average</b>	11.6x	1.4x	4.7%	12.1%	-0.1x
<b>10 Years High</b>	18.6x	2.1x	7.5%	15.5%	1.4x
<b>10 Years Low</b>	7.2x	0.8x	3.6%	7.9%	-1.2x

\* Source: Bloomberg, REIDIN and AMC A.M. Estimates



# Egypt: Time to look ahead and shrug off old perceptions



## Opportunities

- ❖ Egypt's potential **population size and political significance** on the back of regional tensions can't be ignored. It is an indispensable ally for the GCC in balancing Turkish and Iranian regional influences.
- ❖ Authorities are **setting the house in order** – spending cuts, structural reform initiation, tax and subsidy reforms.
- ❖ **Privatization of state-owned companies**, starting with petroleum and banking sectors, should support both the market and the government.
- ❖ **Discovery of gas** will turn the country into a net exporter by 2020.
- ❖ Turning into an Outsourcing hub in **Services and Manufacturing** on account of low cost manpower.
- ❖ A revival in **tourism**. In 2018, tourism revenues up 45% (YoY) in 1Q 2019

## Challenges

- ❖ **Extremely high youth unemployment** at over 40%, rampant inflation touching 30% post devaluation.
- ❖ **External debt** is still high at 35% as compared to 41% in Q2 2017.
- ❖ **Ripple effect after the devaluation will take some time to settle**. High inflation and an adjustment period for spending habits might take longer than anticipated.
- ❖ Challenging security situation with ISIS in the Sinai desert.
- ❖ **High interest rates** deterring a rise in CAPEX.

## Key Macro Indicators

Indicator	2014	2015	2016	2017	2018
Real GDP Growth (%)	2.9	4.4	4.3	4.2	5.3
CPI (Average)	10.1	11.0	10.2	23.5	20.9
Population (Millions)	86.7	89.0	90.2	94.8	97.0
Gross Debt (% GDP)	85.1	88.5	96.8	103.2	92.6
Current Account (% GDP)	(0.9)	(3.7)	(6.0)	(6.1)	(2.4)



## Our Take

While certain domestic issues can partly justify the 2018 plunge of the Egyptian stock market, we believe that most of the weakness can be explained by the broad sell-off which took place within emerging equity and currency markets. This indiscriminate selloff has created some very attractive alpha opportunities, which led us to increase our overweight stance on Egypt at that time. However, selection remains key.

On a top-down basis, we believe that Egypt looks set to maintain its position as the fastest growing economy in the entire Middle East and North Africa in 2019 and 2020, as a significant amount of pent-up demand following several years of below-trend growth is finally released, and drives consumption and investment higher. Headline GDP growth is currently running at roughly 5.5% y/y, and the government is targeting to raise this already robust pace of expansion to over 6.0% in the upcoming fiscal year (beginning in July). Even the IMF, which is traditionally more conservative in its forecasts, is projecting growth of 5.9% in FY2019/20.

The stability of the EGP should help underpin a more bullish Investment Thesis on the North African economy. Recent weeks have seen the currency appreciate to multi-year highs, even as other emerging market currencies came under downside pressure.

## Key Market Metrics (2019)

Metric	P/E	P/B	DY	RoE	ND/EBITDA
<b>Current</b>	9.4x	1.7x	3.1%	31.3%	0.7x
<b>10 Years Average</b>	10.5x	1.5x	3.4%	6.1%	0.2x
<b>10 Years High</b>	17.0x	2.7x	6.6%	15.8%	4.4x
<b>10 Years Low</b>	5.6x	0.9x	1.3%	-41.0%	-1.4x

\* Source: Bloomberg, REIDIN and AMC A.M. Estimates



## Special Focus

# Kuwait MSCI Inclusion Puts Spotlight on Non-Oil Economy

## Special Focus: Kuwait MSCI Inclusion Puts Spotlight on Non-Oil Economy



In late June index compiler MSCI announced that it would be upgrading Kuwaiti equities to 'Emerging Market Status', a decision which is likely to result in billions of dollars of new inflows into the local stock market. Given the positive role that the 'Index Inclusion Story' has played in Saudi Arabia's investment profile over the past year, MSCI's decision to move forward with including Kuwait into the index is one of the rare events in this region that can truly be considered as 'game changing'. With foreign investor interest in the Kuwaiti equity market only set to grow in the years ahead, it will be increasingly necessary to capture an accurate picture of local macro and sector-specific trends, particularly given the relative scarcity of high-frequency data that is available on this market compared to the rest of the MENA and GCC region.

When formulating a view on the wider Kuwaiti economy, taking into account the hydrocarbon sector is clearly a necessary starting point. Whether measured as a percentage of GDP (47%) or share of export receipts (90%) and fiscal revenues (90%), there is little denying the overwhelming role of the oil sector. Through the first half of 2019, oil output was effectively flat in year-on-year terms, having averaged 2.7mn b/d. With OPEC + Russia having agreed at the end of June to extend, but not deepen, their production cut agreement through 2019, it appears that the oil sector will only be a slight drag on the economy this year. Assuming crude output in H2 remains at current levels, which is already slightly below Kuwait's quota as part of last year's agreement, then overall production in 2019 will decline by an estimated -1.0 per cent. This is a headwind on the economy, but not one which would result in a fundamental reassessment of the country's investment profile.

Kuwait oil production, mm b/d



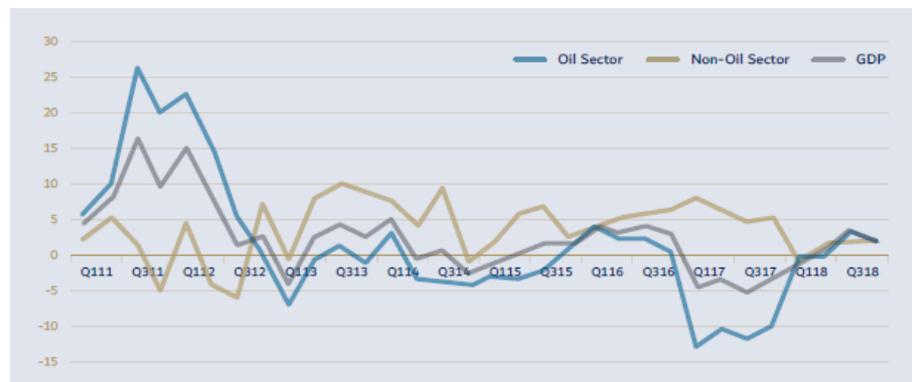


## Non-Oil Growth Matches Regional Trend...

Within the non-oil economy, growth momentum has slowed over the past year, although the pace of expansion is broadly similar to what we have witnessed across the rest of the GCC. Indeed, non-oil GDP expanded 1.2 per cent y/y in 2018 (and 2 per cent y/y in Q4), compared to an estimated 2 per cent and 1.3 per cent in Saudi Arabia, and the UAE. That said, if we lengthen our time horizon back to when the decline in global oil prices began in 2015, it is clear that Kuwait's economy was a relative outperformer, having notched non-oil growth of 5.3 per cent and 6 per cent in 2016 and 2017 respectively.

The largest contributor to non-oil growth in recent quarters has been found within the 'Other Services' sector of the economy, which accounts for 11% of GDP, and expanded by an impressive 14.4 per cent y/y and 10.3 per cent in Q4 and Q3 of 2018. Growth of over 10 per cent was also posted within the 'Hotel & Restaurant' sector last year, although the industry only accounts for roughly 1 per cent of the economy at this stage. The second half of 2018 also saw an encouraging rebound in the Construction sector, which grew 6.2 per cent y/y in real terms in Q4, and points to a potential acceleration in fixed investment.

Kuwait real GDP growth, % y/y



Kuwait claims on private sector, % y/y



## Special Focus: Kuwait MSCI Inclusion Puts Spotlight on Non-Oil Economy



More up-to-date figures are somewhat encouraging. Private sector loan growth is currently running around 5 per cent y/y, which is the fastest level in two years. Unlike other central banks throughout the GCC, policymakers in Kuwait did not follow the U.S. Federal Reserve in 2018 and refrained from tightening monetary policy (a higher base rate of 3 per cent mitigated risks associated with potential capital outflows), and that appears to be paying dividends now through stronger loan growth.

In addition, through the first four months of 2019, remittance outflows to Pakistan and the Philippines rose by a combined 10 per cent y/y to a three-year high of USD531mn, indicating a potential strengthening in the nonoil economy given the large share of expatriate labor.

Key Policy Rates, %



Remittances to Pakistan and Philippines, USDmn, Jan-Apr



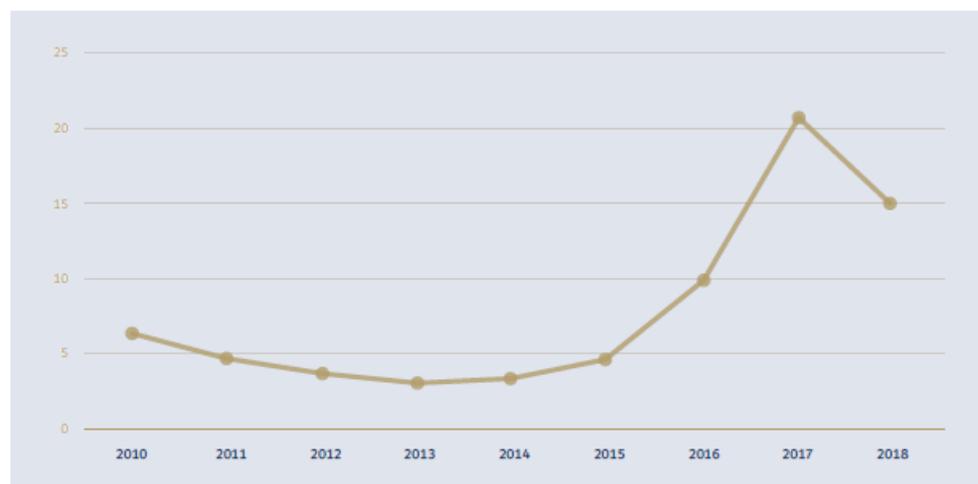


### Diversifying Revenue Streams is a Challenge...

Despite recent volatility in oil markets, global energy prices remained stable in the first half, having averaged USD66/bbl, compared to USD71/bbl in the first half of 2018. The lack of diversification in export and fiscal revenue streams undoubtedly leaves the economy more exposed to swings in global oil prices.

Theoretically however, even in a worst-case scenario of lower for-longer oil prices, Kuwait would have little difficulty in raising financing given still low levels of government debt (estimated at 15 per cent of GDP), as well as an extremely robust sovereign credit profile (see discussion below). The challenge, in our view, will not be found in foreign investor appetite for financing any potential fiscal or external shortfalls, but rather, in the potential for a lack of domestic reform momentum. Indeed, Kuwait's parliament has yet to pass a new debt law which is necessary for issuing new sovereign paper, which has forced authorities to cover short-term financing shortfalls by drawing down on funds accumulated within their General Reserve Fund (which is managed by the KIA).

General Government Gross Debt, % of GDP





### **Sovereign Wealth Assets are a Strength and a Weakness...**

Difficulties in passing a new debt law, which in the broader context of possible economic reforms can be considered relatively straightforward, is important as it might also signal the potential for slower progress in other reform areas. Indeed, unlike the UAE, Saudi Arabia or Bahrain, Kuwait has not yet implemented a VAT, while recent plans put forward by the eldest son of the Emir to construct an economic free zone (known as 'Silk City') that would have administrative, legal and judicial independence similar to Dubai's DIFC, appears to be facing stiff opposition from parliament. With one of the highest levels of GDP per capita in the world and large pools of national savings, the main economic challenge for Kuwait is perhaps a lack of urgency.

Despite the challenges associated with implementing a wide ranging diversification agenda, the FX earnings that have accrued over the years from hydrocarbon exports have been so large as to mitigate the very risks that are often associated with commodity-based economies. Since global oil prices began to fall in 2015, sovereign credit ratings throughout the GCC have dropped in tandem, and this has included numerous downgrades for Bahrain and Oman (both of which are now classified as 'non-investment grade'), but also Saudi Arabia (e.g. S&P has downgraded KSA's rating by three notches).

In contrast, Kuwait – despite being amongst the most dependent on hydrocarbons to generate FX earnings – has not had its sovereign credit rating downgraded once throughout this period and retains one of the highest ratings in the region alongside Abu Dhabi at AA/Aa2.



## Investment Team

# Asset Management Team



## **Charles Monchau, CFA**

Managing Director, Investment Management

Charles-Henry joined Al Mal as Managing Director - Head of Investment Management. Charles was previously SEO / Head of Asset Management at SHUAA Capital and brings more than 20 years of experience in international multi-asset investing. Before moving to the UAE, Charles was heading the Asset Allocation Team for the Europe & Middle East at Deutsche Bank (2014-2016). Based in Geneva, he was in charge of a team of 25 portfolio managers running around USD 10bn in discretionary mandates. Prior to Deutsche Bank, Charles was Regional CIO for EFG Private Bank (2010-2013) and held various senior portfolio management and buy-side research roles at Rothschild Bank AG in Zurich (2009-2010), Lombard Odier in Paris and Geneva (2001-2009) and BNP Paribas in Geneva and Nassau (1995-2001). He was also an adjunct professor in Finance at the International University of Geneva. Charles has an Executive MBA from Instituto di Empresa (Madrid & Shanghai) and a MSc in Finance (University of Geneva). He is also a CFA, CMT, CAIA and CIIA Charterholder.

## **Vrajesh Bhandari, CFA**

Senior Portfolio Manager | Analyst, MENA Equity

Coming with 13 years of experience in MENA Vrajesh will be leading our research efforts across the MENA markets. Vrajesh joined from A/T Capital in DIFC, where he was responsible for researching MENA equities & help manage the investment funds & portfolios. He has a wide-ranging experience in asset management & investment research focusing on Middle Eastern & Frontier markets. He has previously worked for GHOBASH Group, a family office in Dubai as a Sr. Investment Analyst where he managed a team overseeing the prop book invested in various asset classes. Prior to that, he worked on the sell side in the Equity Strategy team at HSBC (India) covering global markets. He started his career at Evalueserve, India as a Research Associate. Vrajesh has an MBA & a MSc in Finance from ICFAI Business School, India. He holds the CFA charter since 2007

## **Tamara Tannir, CFA**

Senior Portfolio Manager | Analyst, MENA Equity

Tamara joined Al Mal Capital in 2019 as a Senior Portfolio Manager. Tamara was previously portfolio manager (2014-2019) at The National Investor (TNI) in Abu Dhabi. She worked previously as a MENA equity analyst at Arqaam (2013-2014). She has previously worked at Deloitte and Ernst & Young as intern. Tamara has a Bachelor of Business Administration at American University of Beirut (AU) and holds the CFA charter since 2017.

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