Equity markets

Oil prices and global volatility weigh on GCC equities in 2015

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It was a tough year for regional stocks (and world stocks) with most markets ending 2015 well into negative territory. GCC equities underperformed most international peers with the MSCI GCC total return index retreating 15% during the year, its weakest performance since 2008. The correction followed three years of solid performance. While regional markets fared worse than their international counterparts, equities in general were thrashed in 2015. Total GCC market capitalization stood at $904 billion at year end, after shedding $200 billion during 2015.

Internationally, most equity markets lost ground in 2015 and the MSCI world index closed the year "flat". While losses in these markets were relatively limited, volatility increased in 2015. Indeed, daily losses often exceeded 5% in some major markets. Uncertainty surrounding the timing of a Fed rate hike was a primary reason behind the increased volatility. When the Fed finally made its first move since 2008 and raised rates in mid-December, stock markets seemed to have already priced in the hike, and its effect on equity prices was more or less muted.

Worries of weakening Chinese economic fundamentals and some unexpected measures by Chinese authorities also fueled uncertainty during 2015. Chinese equities experienced a strong correction towards the middle of the year and ripples of the correction touched markets globally. Stock markets in China, which had seen a strong rally towards the end of 2014, peaked in May 2015; the Shanghai Shenzhen CSI 300 index was up 107% from October 2014. The correction was triggered by economic data signaling some softening in the Chinese economy. Chinese equities managed to retrieve some of their gains, closing the year up 6%, but have since had a very rough opening for 2016 (below).

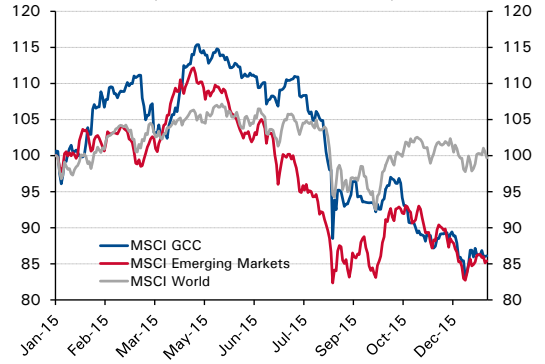
For a change, the euro area was in better shape, with European stocks among the best performers in 2015. That was despite some renewed concerns surrounding the Greek debt crisis and the risk of a Greek exit from the euro. Overall, European equities outperformed other markets, supported by the ECB's quantitative easing and a depreciating euro. The Euro Stoxx 50 index was up 4% on the year (in local currency).

For the region, lower oil prices remained the main driver of markets. Oil prices and GCC equities have moved largely in tandem since oil prices started retreating in the second half of 2014. The relationship has been far from symmetrical, with correlations increasing notably whenever oil prices took a dive. With the exception of the large petrochemical sector in the Saudi stock market, GCC equities have little direct exposure to oil prices, though or course oil dependence pervades the GCC economies.

Furthermore, low oil prices do raise concerns about fiscal sustainability and growth in regional economies. While GCC governments have expressed their commitment to support growth in the non-oil sector by sticking to their current development spending plans and maintaining large deficits in the medium term, a prolonged period of low oil prices could force governments to reduce capital spending and benefits, and could put pressure on liquidity. The issuance by the Saudi government of $28 billion in bonds in 2015 to finance the fiscal deficit

Chart 1: Total return indices

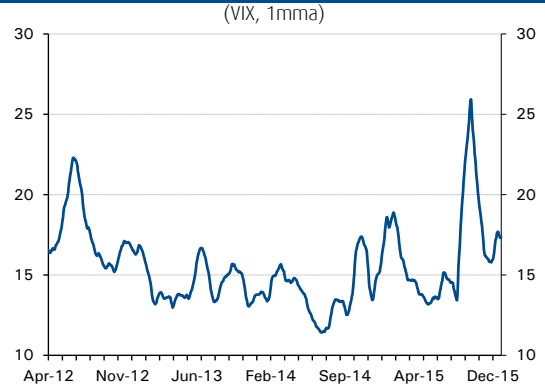
(rebased, 31 Dec 2014=1000)



Source: Thomson Reuters Datastream

Chart 2: Volatility Index

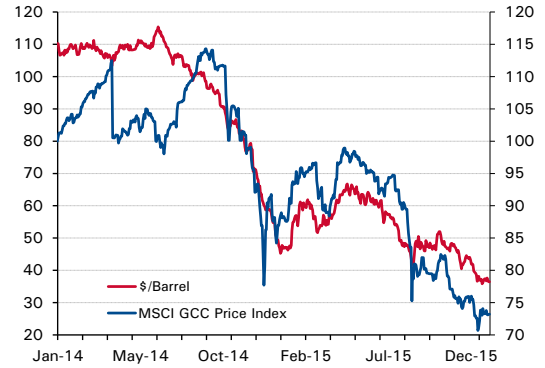
(VIX, 1mma)



Source: Thomson Reuters Datastream

Chart 3: Oil prices and GCC markets

(rebased, 31 Dec 2013=1000)



Source: Thomson Reuters Datastream

served as a reminder of these concerns.

The region's geopolitics continued to affect sentiment. Terrorist attacks in Saudi Arabia and Kuwait, and instability in neighboring countries elevated security concerns. While the impact on markets was not always obvious following any particular event, general investor sentiment seemed to be hampered by the heightened security risks (and the new year started with a Saudi-Iranian diplomatic row).

Markets in the region continued to be pressured by a number of domestic and market specific factors. In the UAE, worries about an imminent correction in property markets continued to make headlines. In Qatar, the possible threats to the 2022 World Cup remained a concern, albeit a remote risk. In Kuwait, with stock market liquidity remaining below historic averages and equities trading well below book value, several companies listed on the Kuwait Stock Exchange requested to delist, though the companies in question were all relatively small and had little impact on market capitalization.

The GCC saw some positive events take places, but these were largely overshadowed by market volatility. In June 2015, Saudi Arabia opened up the market to direct foreign equity ownership, though only to qualified investors. This and other developments, such as the inclusion of KSA stocks in popular international indices and changes to trading and ownership restrictions, should continue to impact the Saudi market. Qatar also benefited from increased foreign investor interest with the upgrading in late 3Q15 of the equity market to "Emerging Market" status by FTSE. In Kuwait, the CMA issued the final amendments to its bylaws late in the year, a step generally seen as positive for the market.

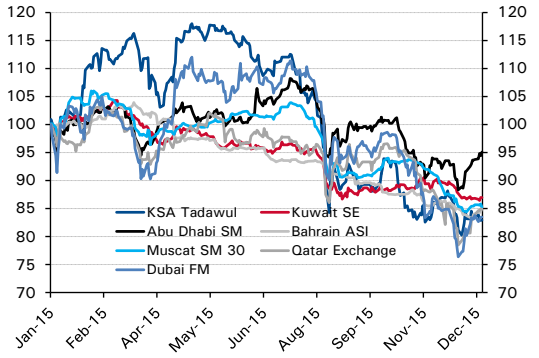
All GCC markets ended the year in the red. Saudi Arabia and Dubai were the worst performers, down 17% each. Despite a stellar performance earlier in the year, on the back of the decision to open up the market to foreign investors, Saudi equities were weighed down by further decline in oil prices. Dubai, with a larger foreign investor base, is typically more exposed to international factors (including oil prices). Qatar, Oman and Bahrain were each down 15% in 2015. Kuwait's value-weighted index was down 13% on the year and Abu Dhabi outperformed the region with a smaller decline of 5%.

Market liquidity shrank in 2015 and should stay under some further pressure in the coming months. With banks now turning to fixed income markets to issue Basel III compliant perpetual and other bonds, and sovereigns also turning to capital markets to help finance their deficits, some liquidity is bound to be directed away from equities. Also, with regional rates now starting to rise following the first Fed hike late December, fixed-income assets are getting more attractive.

Regional markets are likely to continue to be moved by a number of regional and global factors in the coming months. Economic data from the major economies will have important implications for oil prices and the global outlook. Geopolitics will also remain a key driver particularly in light of the recent developments between Saudi and Iran. Chinese equities were already down 7% ytd in the first two trading sessions of 2016 and seem to be setting the mood for world equities, down too on the back of some weak economic data releases. More fundamentally for the GCC markets will be looking at governments' fiscal and reform plans for the coming years in order to gauge the implications for non-oil growth in GCC economies.

Chart 4: GCC Markets

(rebased, 31 Dec 2014=1000)



Source: Thomson Reuters Datastream

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