

Equity markets

# GCC: Regional equities underperformed in 1Q17 as Kuwait rallied

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**Regional markets had an unimpressive start to the year, underperforming international markets, though Kuwait bucked the trend with a strong rally.** The GCC MSCI total return index advanced a mere 0.6% on the quarter, dragged down by a weak showing for the Saudi market. Performance was mixed among other regional markets, with Kuwait putting in a stellar performance. Total GCC market capitalization stood at \$946 billion at the end of the quarter, having lost \$6 billion during 1Q17.

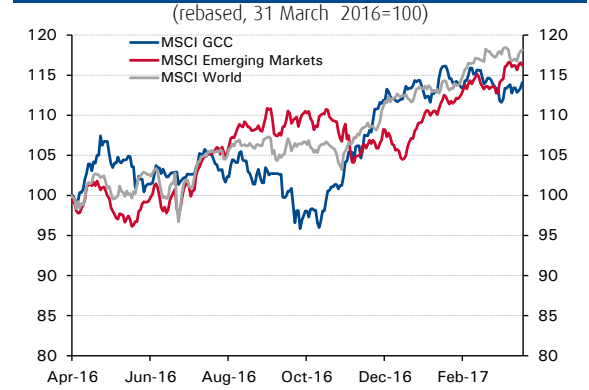
**Internationally, most equity markets continued their post US election rally, buoyed by an improving outlook.** US markets were making new highs and the S&P 500 and the DJIA were up 6.1% and 5.2%, respectively, in anticipation of upcoming business-friendly policies in the US. Markets were also buoyed by a more hawkish Fed, which raised rates in March, well before earlier expectations; it is now looking to hike rates two or three more times in 2017. Markets took that as further confirmation of a more positive outlook. European equities took their cue from US markets and advanced 7% in 1Q17 despite a less dovish ECB stance and boosted by positive data from the eurozone.

**Emerging markets (EM) rebounded following a poor showing in 4Q16 as flows to EMs picked up.** The MSCI EM index was up a strong 7.8% outperforming the MSCI World, which closed up 5.6%. Improved economic outlooks in most of these markets boosted equities. Meanwhile, fears of more protectionist US trade policies, which were behind most of the sell-off in 4Q16, appear to have abated for now. Emerging markets, along with other risky asset classes, also benefitted from the continued flow of positive data from advanced economies. According to the IIF, capital flows to EMs have recovered notably. Net portfolio EM inflows totaled \$31 billion in the first two months of the year compared to outflows of \$25 billion in 4Q16.

**Regional markets were mixed but underperformed overall, dragged down by Saudi Arabia.** Saudi equities gave back some of the strong gains seen in 4Q16, weighing on regional indices. MSCI GCC was up 0.6% in 1Q17. While a record international bond sale in 4Q16 triggered a rally and helped abate concerns over domestic liquidity, focus seems to have shifted back to the fundamentals. The low oil price environment continued to weigh on Saudi growth, with recent data pointing to further softness. Corporate earnings in 2016 continued to reflect weakness, with profits down 6% y/y. Earnings also appeared to surprise to the downside; profits of 69 companies were 16% lower than analyst estimates.

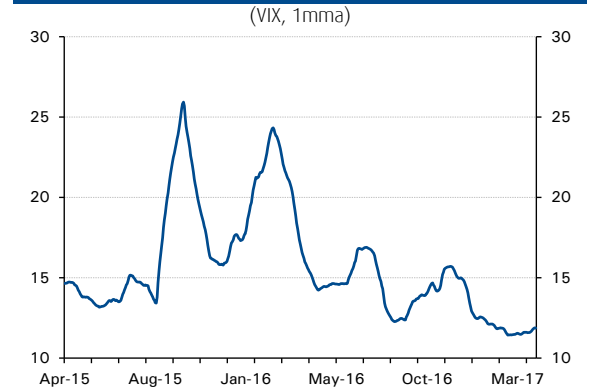
**Meanwhile, Kuwait equities saw a strong 1Q17, standing out as one of the best performing markets thus far this year.** The value-weighted index was up 8.7%, its best quarter in over six years. A hefty pick up in trading volumes was at least as noteworthy. Daily volumes reached levels not seen since the financial crisis and averaged more than double 4Q16. The immediate catalyst for the rally may have been the October 2016 acquisition of Americana by a UAE investor, which appeared to inject much needed optimism in the market. Equities may have also been helped by expected changes in the composition of some frontier market

**Chart 1: Total return indices**



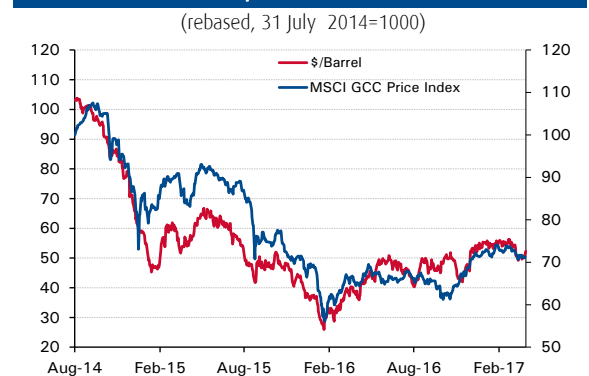
Source: Thomson Reuters Datastream

**Chart 2: Volatility Index**



Source: Thomson Reuters Datastream

**Chart 3: Oil prices and GCC markets**



Source: Thomson Reuters Datastream

indices which could boost Kuwait's weight in them.

**Kuwait's rally comes after years of lagging the region despite solid economic fundamentals.** Kuwait has enjoyed relative stability on the political arena, which paved the way for faster reform and project implementation. Thanks to its strong financial position, Kuwait has also experienced a milder fiscal adjustment than other GCC countries. As such, there has been no slowdown in nonoil growth in 2015-2016. This has been reflected in corporate profits, which fared better than GCC peers. Indeed, earnings announcements surprised on the upside by 5% in 1Q17.

**Other markets, for the most part, lacked any direction.** The boost GCC equities got from the OPEC deal to cut output late last year faded by 1Q17. Corporate earnings for 2016 were disappointing in most cases, especially for Qatar. Profits of 42 listed Qatari corporates were down 12% while a sample of 18 companies announced earnings 27% lower than analyst estimates. Even the second tranche upgrade by FTSE to EM status in mid-March failed to provide a sustainable lift. By contrast, Bahraini corporate earnings were positive, with a sample of 37 companies seeing growth of 14%. The Bahraini market was up 11%.

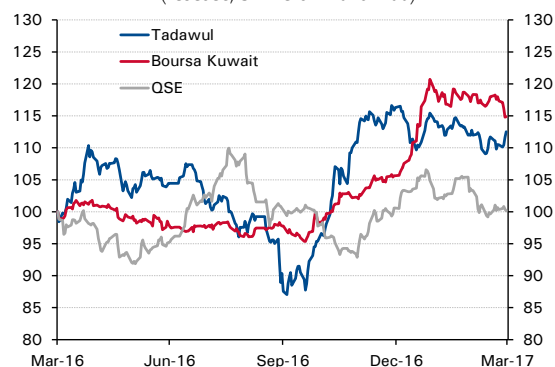
**With the exception of Saudi's Tadawul, market activity picked up.** The daily traded value averaged \$1.5 billion, slightly lower than in 4Q16. Kuwait saw a big jump in turnover. The daily traded value in Qatar was also up a strong 54% driven primarily by the FTSE upgrade. GCC markets also saw a reversal of the outflows that followed the US elections in line with EMs. According to EFG Hermes, net inflows to the region averaged \$223 million per month in the first two months of 2017 compared to a monthly average of \$167 million in the 4Q16. The Qatari market accounted for the bulk of this reversal on the FTSE upgrade. Kuwait also saw a pickup in net foreign inflows in January.

**Valuations for GCC markets are looking more expensive but remain underpriced compared to EMs.** Price-to-earnings per share (P/EPS) for most GCC markets were up compared to 4Q16. However, with global emerging markets at a P/EPS of 19.4, GCC markets remain relatively cheap.

**Regional markets, lacking a catalyst of their own, will continue to be driven by international markets and oil.** Progress in the US on passing tax reform and infrastructure spending will be closely watched, while monetary policy in advanced markets will continue to be a key focus for investors. In Europe, elections in France and Germany, and Brexit talks will continue to affect sentiment. In the GCC, markets will continue to follow fiscal adjustments and progress on structural reform closely.

**Chart 4: GCC markets**

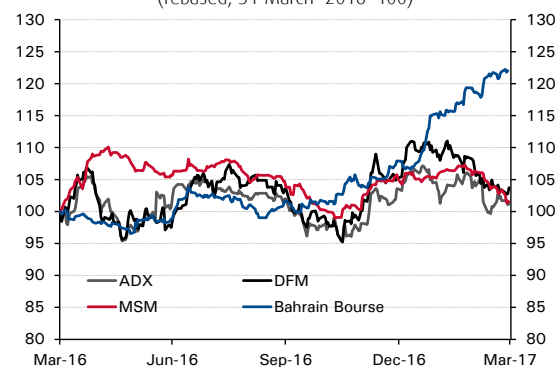
(rebased, 31 March 2016=100)



Source: Thomson Reuters Datastream

**Chart 5: GCC markets**

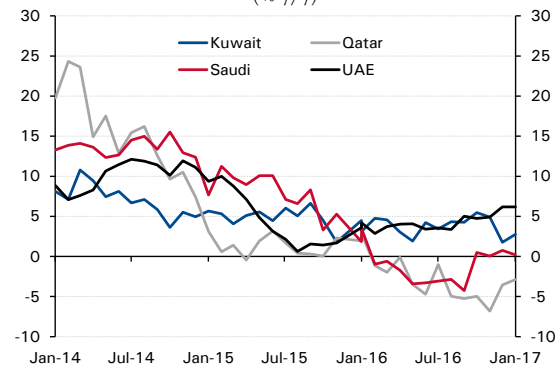
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Source: Thomson Reuters Datastream

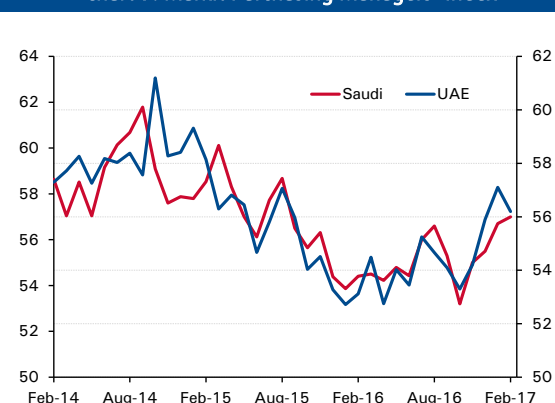
**Chart 6: Deposits at local banks**

(% y/y)



Source: Central banks

**Chart 7: Markit Purchasing Managers' Index**



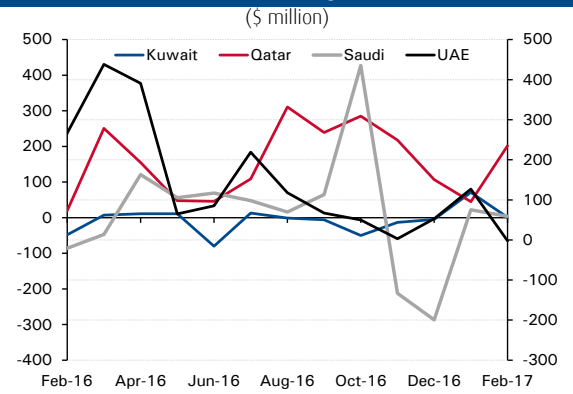
Source: Markit

**Table 1: GCC markets indicators**

	Market capitalization (USD billion)	Average daily turnover (USD million)	Growth in 2016 profits (% y/y)	Price/earnings per share
Bahrain (Bourse)	21	3	14	9.9
Kuwait (Boursa)	93	140	1	16.1
Oman (MSM)	22	11	0	10.5
Qatar (QSE)	152	100	-12	14.7
Saudi (Tadawul)	431	957	-6	17.4
Abu Dhabi (ADX) & Dubai (DFM)	227	276	-2	15.0
GCC	946	1487	-5	-

Source: Thomson Reuters Datastream, Thomson Reuters Eikon

Chart 8: Net foreign inflows



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