Equity markets

GCC: Oil weighs on regional equities; KSA up as EM inclusion draws closer

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Regional equities retreated in 2Q17, continuing to underperform international markets, with the exception of Saudi Arabia. The MSCI GCC ex-Saudi Arabia price index declined 5.2% on the quarter, with most regional markets closing in negative territory amid notably lower volumes. Saudi's performance, however, was boosted late in the quarter, with its index up 7% in 2Q17, after MSCI put it on a watch list for possible inclusion in the emerging market index. Total GCC market capitalization stood at $971 billion at the end of the quarter, having added $17 billion during 2Q17, on the back of the Saudi rally.

Internationally, most equity markets continued to advance, making new highs despite losing some of their momentum. Nothing seemed to stop the rally in international equities that started last November with the election of President Trump. Equities have since shrugged off a handful of political, security and economic setbacks. The MSCI advanced market index was up 2% in 2Q17 and 13% since November's election. US equities continued to be buoyed by promises of more business-friendly policies albeit being less hopeful on the timing.

European equities continued to take the lead from US markets, little affected by events that could have weighed on sentiment. Brexit developments, terrorist attacks, bank and Greek debt issues had little lasting impact on stocks. Instead, investors chose to focus more on the positives, including a steady flow of solid economic data from core economies, the election of a pro-EU and pro-business president in France and a central bank committed to pursuing an accommodative monetary policy despite strengthening economic conditions. The Euro Stoxx 50 was down 1.7% on the quarter, but remains up 4.6% year-to-date.

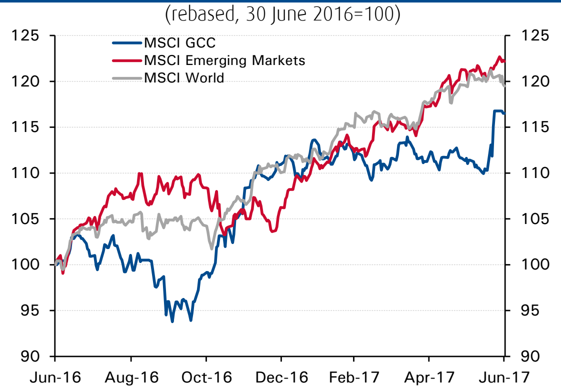
Emerging markets (EM) continued to outperform as foreign inflows picked up. The MSCI EM index was up 6% in 2Q17 as fears of more protectionist US trade policies took a backseat. Emerging markets, along with other risky asset classes, benefitted from the continued flow of positive data from advanced economies. Flows to these markets picked up supported by easy monetary policies by the major central banks and a gradual predictable path for Fed rate hikes. Indeed, the latest Fed hike in June was almost entirely priced in by markets. According to the IIF, net portfolio flows to emerging markets totaled $41 billion in the first two months of 2Q17, bringing the six-month moving average to $25 billion for the first time since November 2014.

GCC markets bucked the trend and continued to underperform with most ending the quarter in negative territory. Sentiment in the region remained closely linked to oil prices which fell below $50 per barrel despite the recent extension of production cuts by OPEC. Amid low oil prices, ongoing fiscal consolidation and some sovereign rating downgrades, business and consumer confidence has remained subdued. This, in turn, weighed on equity prices with the MSCI GCC ex-Saudi price index retreating 5.2% in 2Q17.

The exception were Saudi shares which rallied as MSCI announced the potential inclusion of the market in its emerging markets index

Chart 1: Total return indices

(rebased, 30 June 2016=100)



Source: Thomson Reuters Datastream

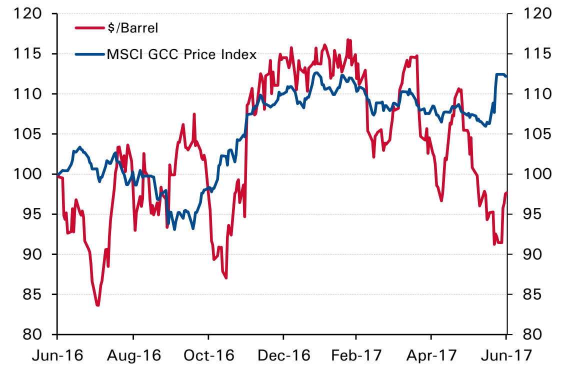
Chart 2: Volatility Index

(VIX, 1mma)

Source: Thomson Reuters Datastream

Chart 3: Oil prices and GCC markets

(rebased, 30 June 2016=100)



Source: Thomson Reuters Datastream

and the King elevated his son to crown prince. On 20 June, MSCI announced that it was placing the Saudi market on its EM watch list. The announcement came on the heels of a series of stock market reforms. Adding Saudi shares to its EM index could result in $9 billion, or 2% of market cap, in passive inflows. Inclusion in the index is expected in mid-2019, if not earlier. Saudi shares jumped 5% in the first trading session after the announcement, which coincided with the news that Mohammed Bin Salman was elevated to crown prince.

Meanwhile, corporate earnings announcements did not provide much support to equity prices in 2Q17 across the GCC. The growth in 1Q17 profits of 630 listed GCC companies was strong at 18% y/y. Profit announcements were also better than expected with a sample of companies announcing earnings that were on average 3% higher than expectations. But markets seemed unfazed by either the strong results or reduced valuations that now look quite attractive.

Qatar underperformed regionally with the ongoing political rift with its neighbors hitting equities hard. Qatar's general index declined 15% in 2Q17 having dropped more than 7% the day Saudi Arabia, the UAE, Bahrain and Egypt announced that they would sever ties with the emirate. The political crisis hurt confidence in Qatar, raising economic and financial concerns, and triggering downgrades to the state's rating. The performance of Qatari equities was weak for months even before the crisis. The second tranche upgrade by FTSE to EM status in mid-March failed to provide much uplift. Also, an MSCI index rebalancing in May saw a net outflow of foreign funds from Qatar for the first time in 16 months.

Activity in regional markets weakened notably with all markets seeing declines in turnover. The daily traded value averaged $1 billion down 30% compared to the previous quarter. Kuwait saw the sharpest drop in activity following an exceptionally strong first quarter. Regional activity declined further as the summer season and Ramadan approached.

Foreign flows to the region also saw a sharp drop. According to EFG Hermes, inflows to the region averaged $126 million in the first two months of 2Q17, down 70% compared to its 1Q17 average. Indeed, part of this big drop was due to Qatar's FTSE upgrade which saw a sharp rise in flows to the market in March. Meanwhile, flows to GCC markets and market liquidity more generally have been impacted by the rise in regional debt issuances, as banks and sovereigns tapped debt markets.

Regional equities will continue to be driven to a large extent by developments in oil markets and progress on fiscal adjustment and structural reform. Regional politics will also be monitored closely and will have an impact, probably on some markets more than others. Internationally, progress on tax reform and infrastructure spending initiatives in the US will be closely watched, while monetary policy in advanced markets will continue to be a key focus for investors.

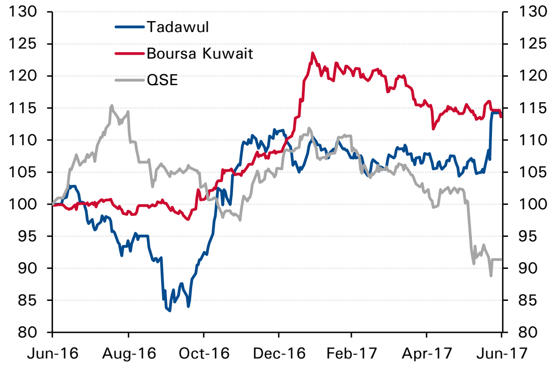
Table 1: GCC markets indicators for 2Q17

	Market capitalization (USD billion)	Average daily turnover (USD million)	Growth in 2016 profits (% y/y)	Price/ earnings per share
Bahrain (Bourse)	21	2	14	9.3
Kuwait (Boursa)	91	55	1	15.5
Oman (MSM)	21	8	0	10.9
Qatar (QSE)	133	76	-12	12.7
Saudi (Tadawul)	468	764	-6	16.4
Abu Dhabi (ADX) & Dubai (DFM)	236	146	-2	18.7
GCC	971	1046	-5	-

Source: Thomson Reuters Datastream, Thomson Reuters Eikon

Chart 4: GCC markets

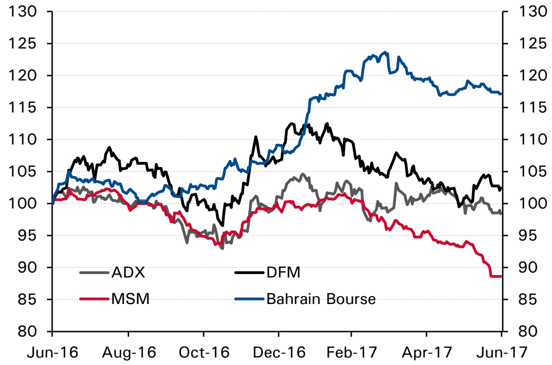
(rebased, 30 June 2016=100)



Source: Thomson Reuters Datastream

Chart 5: GCC markets

(rebased, 30 June 2016=100)



Source: Thomson Reuters Datastream

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