MACRO & MARKETS: GLOBAL & GCC

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Looking beyond this bull market

Highlights

- GCC macros remain in uncertain territory, with OPEC+ production cuts having an evident impact on economic growth.
- GCC equity markets remain volatile, with high oil prices providing support while higher for longer interest rates add downward pressure.
- Foreign inflows to GCC markets have witnessed an uptick in recent months, especially in the case of Qatar whose valuations are relatively attractive.
- Banks in the region enjoy a better ROE compared to their global counterparts, but their exposure to economies like Turkey, Egypt and Pakistan present downside risks.
- Global Markets continue to rally, with Japan outperforming others during H1 2024 owing to the depreciation of the Yen against the Dollar.
- With most markets at a life-time high, investors need to look deeper for alternative opportunities. Sector rotation and some Emerging Markets could be trends to watch out for.

Economic growth predictions are proving to be as volatile as stock markets! World Bank predicted GCC to clock a real GDP growth of 2.7% for the year 2024 in April 2024 only to revise them downwards to 2.2% in June due to uncertainty in oil output. Key OPEC producers like Saudi Arabia along with Russia has been enduring a production cut for a while now to keep oil prices from sliding below their comfort level ($80/bbl, I guess). But the impact of oil output cuts is now showing up in their GDP growth though the non-oil GDP growth continues to be solid.

GCC stock markets are now in a confused zone where sometimes they celebrate the strong oil price (now quoting near $86/bbl) while on other days they worry about higher for longer interest rates and their impact on earnings. S&P GCC composite index ended the month of June 2024 on a positive note, higher by nearly 3%. On a YTD basis, Kuwait continues to be the only market in the positive territory. A recent McKinsey study highlighting the superior RoE enjoyed by GCC banks (with a spread of at least 200 to 400 bps over global Banks) came as a shot in the arm for GCC stock markets. GCC markets are also enjoying some good foreign flows especially to Qatar where investors are now seeing value after its steep underperformance lately. However, they would also be watching carefully the exposure of GCC banks to economies like Turkey, Egypt and Pakistan especially in the banking sector. These economies have experienced sharp currency depreciation and hyperinflation and GCC banks that have exposure looking to contain the impact by expanding the asset pie with acquisitions within GCC. The story of Turkey is noteworthy given its inflation and currency trajectory exhibited in the table. While these economies offer large local markets to tap, they come with significant political and economic risks. We published a note some time ago on how GCC banks have spread their wings into these economies.

Turkey inflation and currency depreciation

Date	CPI (Y/Y)	LIRA/USD
31 December 2023	53.44	29.48
31 December 2022	71.98	18.69
31 December 2021	19.42	13.32

In times like these when markets exhibit high levels of volatility, it results in a large range among the best and worst performers. For example, while Kuwait with a YTD of 1.8% being the best market, Qatar at -8.0% being the worst and the range (best+worst) is at 9.8%. At a sector level, GCC Industrial sector was the best at 5.5% while Telecom was the worst at -9.4% producing a range of 14.8%. At a blue-chip stock level in the Real Estate sector, Aldar Properties (Abu Dhabi) was the best at 20.6%, while Dar Al Arkan (KSA) was the worst performer at -17.9%, producing a range of 38.5%. The idea here is not to present the best and the worst as they keep shifting but to stress the importance of the wide range. Such wide variations are a nightmarish situation for an active fund manager, and they matter a lot for the GCC markets as active management still holds sway over passive funds.

Global markets are still partying hard with June 2024 posting yet another increase of 1.9% for MSCI World. S&P 500 also rose by 3.5% in June 2024 to take the YTD to 14.5%. However, the standout performer among global markets continues to be Japan Topix that is now up by nearly 18.7% YTD. Japan is enjoying the stock market bonanza thanks to Yen depreciation of 14%. Topix is comprised mostly of companies with export focus and hence currency deprecation is benefitting the stock market. So far, Bank of Japan keeps threatening to intervene (24 hrs. a day if required according to the Governor!) but is allowing the currency to slide.

U.S. inflation data came in positively and was in line with market expectations, especially the PCE, the most trusted gauge by Fed. It looks like the Fed will finally blink with a 25-bps cut in September 2024. Though the dot plot says no more, markets are anticipating at least one or two more cuts in 2024 following the one in September. The Summary of Economic projections (SEP) by the Fed indicates one rate cut in 2024 and four rate cuts in 2025 (if we believe that each rate cut will be 25 bps). The Fed is projecting a 2024 end PCE of 2.6% and 2025 PCE of 2.3%. While the U.S. economy could tame the food and energy inflation post Covid, it still could not do so for service inflation. That is what the Fed would be watching to move with rate cuts.

The good news is that everyone is only talking about rate cuts and not otherwise. This shows that the current YTM is up for grabs from a yield perspective. The yield curve still is somewhat inverted showing higher yield for 3 months than 30 years. Hence, the suggestion is mostly to park the money in the money market and enjoy 5%+ yields than buy bonds and lock the YTM. However, the cash yield may quickly vanish once the Fed starts the rate cuts whereas locking the high yield in the Investment Grade on in High Yield can make sure to reap the income even when Fed progresses through the rate cuts. Hence, the current high cash rates are only optically appealing according to some investment banks. There are some analysts who are pointing to huge returns one can make as capital gains when yields fall, say, by 50 bps or 100 bps. While that is true for longer duration papers, history tells us that Fixed income mostly produces just that i.e., income.

In my last note, I dwelled on how to deal with lifetime market highs. A related question is how to look beyond the current bull markets in most of the developed markets. This question is important as we all know that what goes up should come down one day and hence this party cannot last forever. When markets finally awake from this AI induced market boom, it is important to look beyond this bull market to preserve the wealth already made. Some emerging markets offer opportunities like India, but they would come with typical emerging market risks. If one can perform a deeper dive, some great opportunities can be found. Deep sector rotation within and outside the U.S. can also be a sound strategy. On the fixed income side, as already mentioned, locking in yields can be appealing. The inclusion of India in the JPM EM Bond Index is a great thing to watch as this is anticipated to trigger a flow of $20 billion in the next few years.

Finally, I just figured out that there is a new short opportunity i.e., of Finfluencers. This research says that 56% of Finfluencers are “antiskilled” meaning that following their financial advice on social media can result in -2.3% monthly returns. The research says that there could be economic benefits to taking investment positions against the recommendations of “antiskilled” Finfluencers.

Equity & Commodities	Close	Returns	
		YTD-24	2023
Global Equities			
Global (MSCI World)	3,512	10.8%	21.8%
USA (S&P 500)	5,460	14.5%	24.2%
Japan (TOPIX)	2,810	18.7%	25.1%
GCC Equities			
GCC (S&P GCC Composite)	142	-6.4%	6.2%
Saudi Arabia (TASI)	11,680	-2.4%	14.2%
Abu Dhabi (FTSE ADX General Index)	9,061	-5.4%	-6.2%
Dubai (DFM General Index)	9,968	-8.0%	21.7%
Kuwait (Boursa Kuwait All Share PR)	6,937	1.8%	-3.1%
Commodities			
Oil (Brent Crude in USD/bbl.)	86.4	12.2%	-10.3%
Gold (in USD/oz.)	2,326	12.8%	13.1%

Fixed Income	Yields	
	May-24	2023-end
U.S. Treasury 10Y Sov.	4.37%	3.87%
Saudi Arabia 10Y Sov.	5.05%	4.39%
Abu Dhabi 10Y Sov.	4.88%	4.32%
Kuwait 10Y Sov.	5.11%	4.34%

Source: Refinitiv, YTD and Yields as of June 30, 2024

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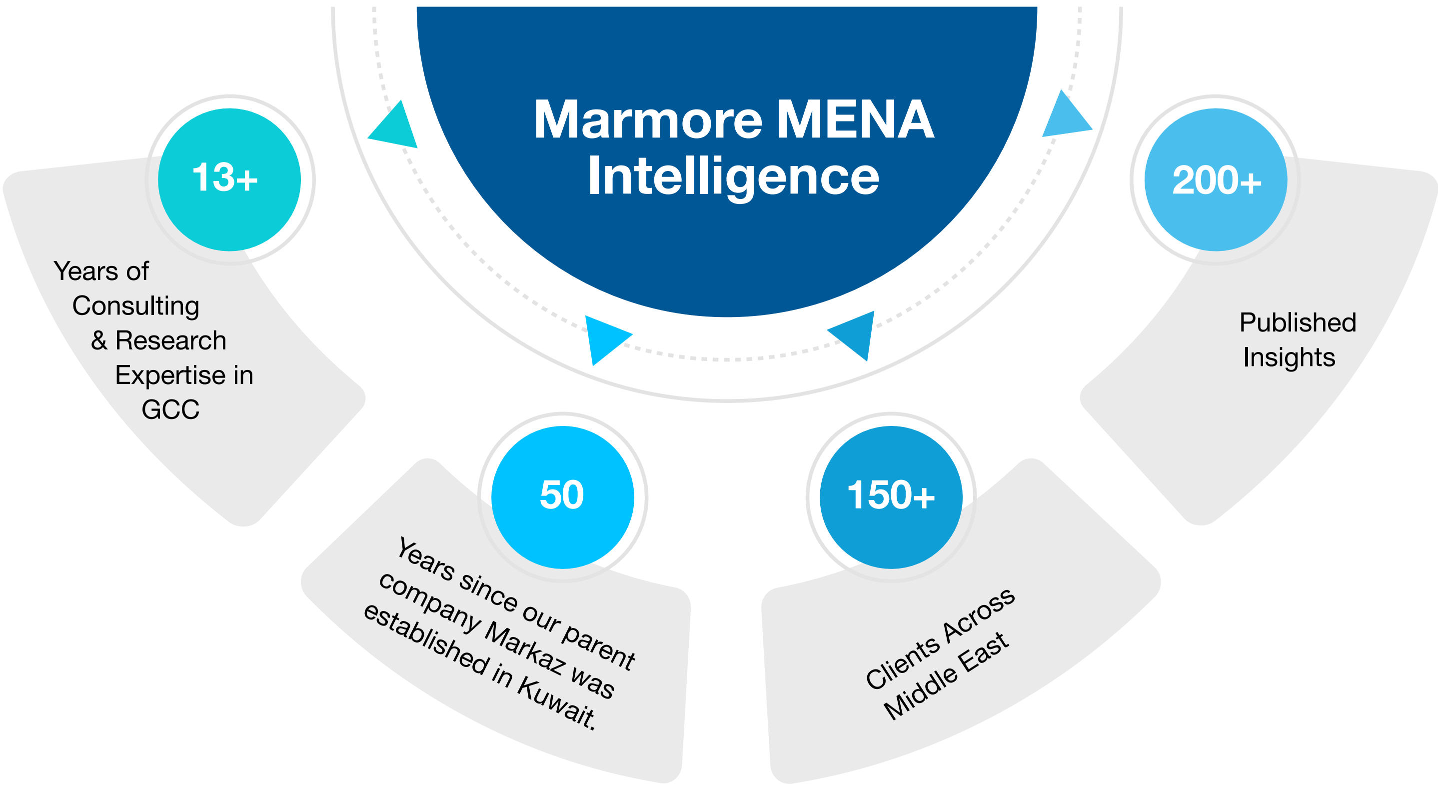

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