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MACRO & MARKETS: GLOBAL & GCC

September 2024

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Disclaimer

Everything hinges on the Fed rate cuts

Highlights

- GCC markets (S&P GCC Composite) were flat for the month and the year, with the Real Estate sector standing out as an outperformer, driven by strong sales and rising property prices in UAE and Saudi Arabia.
- Saudi Arabia's equity market performance in the past five years has largely been driven by P/E expansion, as opposed to the UAE markets where earnings growth was the primary driver, making the latter more insulated to market downturns.
- Global markets continued their bull run in the hope that the FED's assessment of inflation is correct, and a soft landing will be achieved. Going by history, FED has been wrong before and just a small economic shock could topple the markets.
- Gold marches ahead with further gains, supported by its accumulation by emerging market Central Banks. Despite strong gains, the yellow metal's run up is nowhere close to what was witnessed in U.S. Tech stocks, indicating further headroom for gains.
- Taking exposure to passive ETFs could be sub optimal strategy compared to stock picking when it comes to emerging markets. Despite broad market indices indicating the outperformance of developed over emerging markets, there are several under tapped opportunities from a valuation perspective.

GCC markets meandered along in August with the S&P GCC composite index staying flat. The year-to-date performance is also flat. For the year, Dubai (6.5%) and Kuwait (5.3%) lead the table while Qatar (-5.8%) and Abu Dhabi (-3.1%) lag. While oil price hovers within a range of $75-$80/bbl, geopolitical tensions are keeping fund managers awake at night. The gradual easing of supply cuts by OPEC+ from October and the gloomy demand scenario due to China's economic weakness would be oil price negative, and the uncertain middle east geopolitical developments can be oil price positive. These opposing forces should keep oil price in a tight band at least for now.

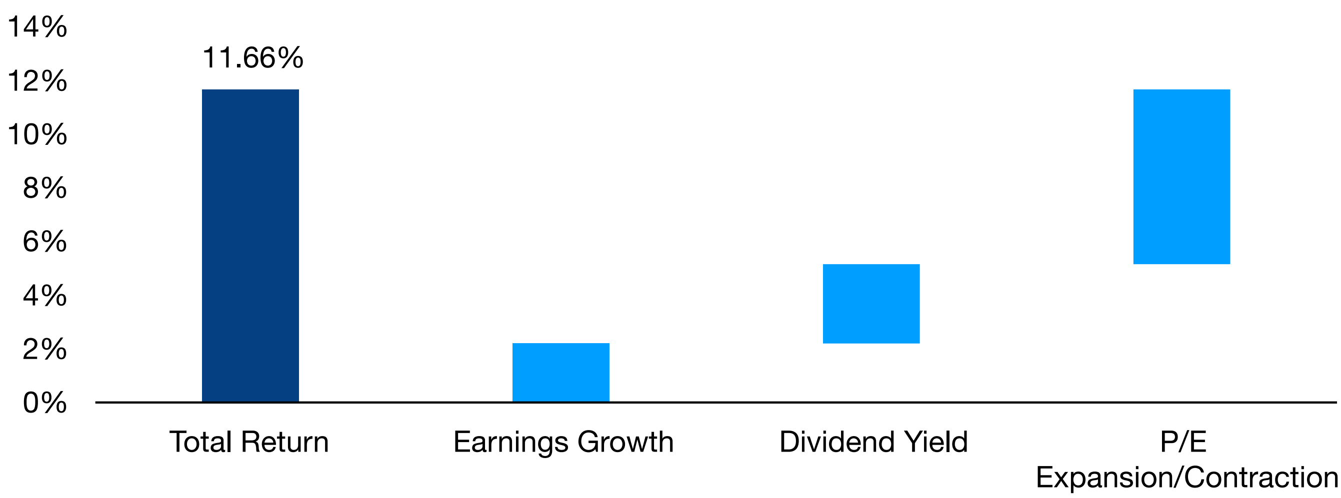
While the overall stock market is flat in the

GCC, real estate sector stands out as an exception with the Refinitiv GCC Real Estate index up by 14.5% for the year. Property prices and rentals in UAE and KSA have been strong in 2023 and 2024 across segments. Dubai housing prices were up by 20.7% in Q1 2024 y/y, Riyadh housing prices up by almost 8% and average Grade B rents for offices in Abu Dhabi were up by 9.7% in the same period. Kuwait's commercial real estate segment sales surged 16.9% y/y in Q1 2024. Emaar's (Dubai) profit increased by 70% YoY in 2023 and continued in an uptrend in H1 2024 with net profit before tax growing by 33% y/y. Aldar Properties' (Abu Dhabi) net profit grows 57% y/y in H1 2024 on significant backlog realization and strong investment portfolio performance. Many real estate stocks gained on strong corporate earnings in 2023 and H1 2024. The hospitality sector is also a key contributor, with a rise in tourism and business travel, contributing to a robust performance in hotel average daily rates.

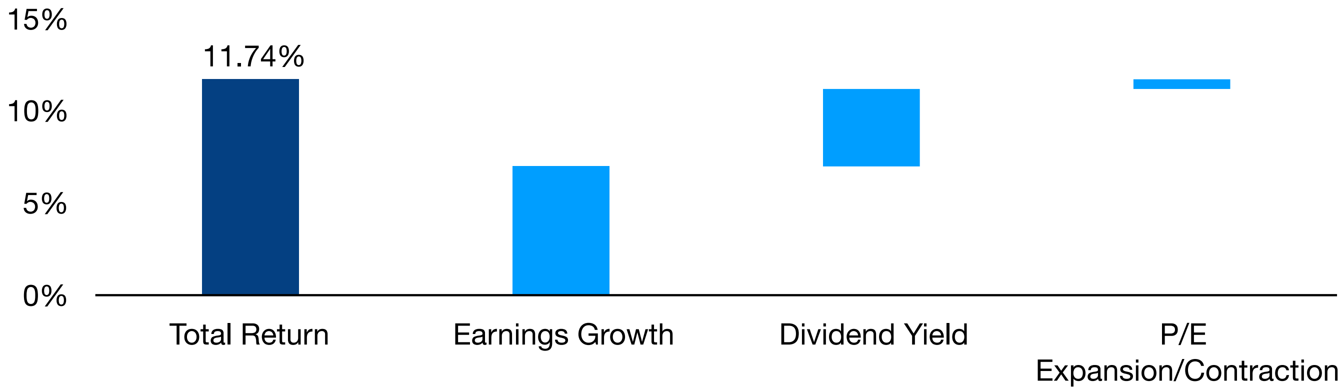
The P/E differential between UAE and Saudi Arabia

It is interesting to note that TASI's (Saudi Arabia) P/E ratio at 21x is far higher than ADX's (Abu Dhabi) 13x and DFMGI's (Dubai) 8x. Saudi Arabian market performance has been significantly helped by P/E expansion during the last five years as opposed to earnings growth or dividend yield while that of UAE has been mainly earnings growth and dividends with no contribution from p/e expansion. (see graphs)

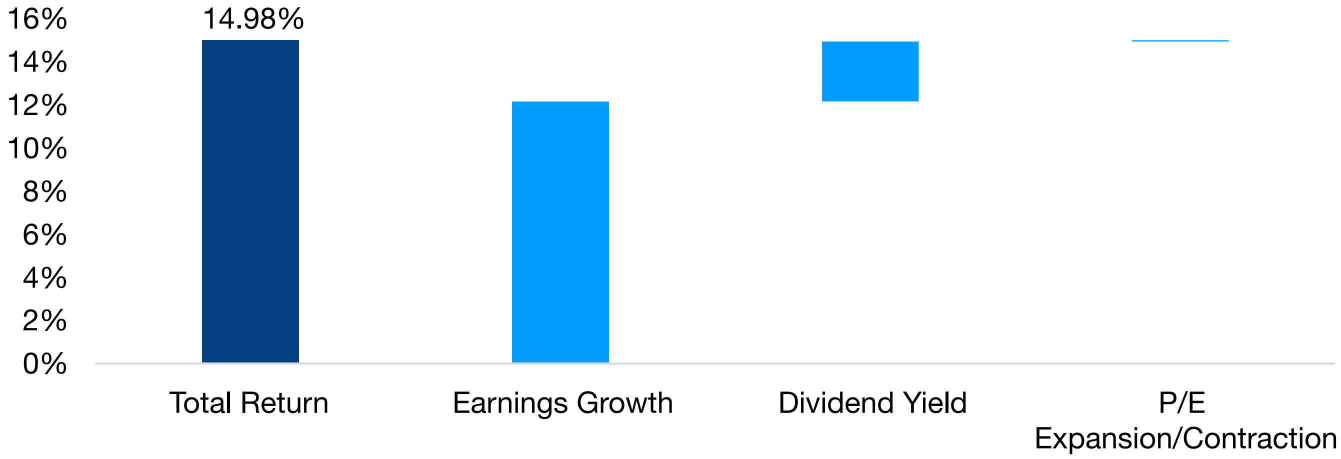
KSA Tadawul Index - Returns Decomposition (5Y Annualized)



Dubai DFMG Index- Returns Decomposition (5Y Annualized)



Abu Dhabi Index - Returns Decomposition (5Y Annualized)



What can explain this? Probably the fact that Saudi Arabia enjoys a higher weight in the MSCI EM index compared to UAE. Dubai looks to be a sweet spot going forward given the real estate strength explained earlier as well as the potential for P/E expansion. Real estate stocks constitute about 18.7% of the market capitalisation in Dubai. Looked at another way, in case of market downturn, UAE is more insulated than Saudi Arabia.

Global Markets continue to party

In anticipation of the first rate cut, global markets continue their bull market march with the S&P 500 and MSCI World clocking a gain of 2.5% in August 2024. With this S&P 500 is now up 18.4% for the year, followed by the MSCI World at 15.5%. The market support comes primarily from the Magnificent 7 stocks (barring Tesla). Though M-7 stocks have somewhat cooled down from their peaks (Google down 17% from its all time high), they continue to be main and only engine behind market frenzy with the artificial intelligence story still playing strong. The entire market narrative now hinges on possible Fed rate cuts though opinion diverges on the speed and scale of rate cuts.

FED is now convinced that inflation is under control and falling and has firmly signalled that it will initiate the first cut by Sept 18th. To FED's utter surprise, the steep rate increases one year back to contain inflation did not result in a recession nor it resulted in increased unemployment, a dream scenario according to many economists. If this soft landing really tuns out to be true, FED can pat its own back for engineering something that economic history never witnessed before. But what if Fed is wrong? Did they not err the first time around when they called a rapidly accelerating inflation as transitory? Now, when they think that inflation is well under control (at 3% it is still far away from the 2% target), and the reducing interest rates reignites inflation, then controlling it would mean a longer and tougher battle. Markets are walking on a tight rope and any small economic jolt (like the famous Bank of Japan increasing rates by 25 bps) can cause huge shocks to the system. The current FED action will be more consequential than BoJ given the reserve currency status of the U.S. Dollar.

Gold is truly gold

Gold has breached $2,500/oz and is now up 21% for the year. Asset allocators still look at gold more as inflation hedge for portfolio insurance purposes and hence allocation to gold (if at all) never exceeds say a modest 5%. There is an interesting churn that is happening in global financial markets that can explain gold's stupendous performance despite a strong dollar. Post U.S. seizing Russia's central bank assets worth $300 billion as a reaction to Rusia-Ukraine war, other emerging market central banks (note China) are building their gold war chest instead of treasury war chest. The dollar recycling that was at play before (commodity or export surplus invested in U.S. Treasuries pushing down the yield resulting in lower dollar helping global growth) no longer holds true Instead, gold accumulation is at play. There are other technical indicators too. For e.g., the Gold to Nasdaq ratio has now gone down from 1 in 2011 to 0.13 in 2024. While we know that gold has run up, we also know that Nasdaq has run up even more resulting in this low number. From the peak of tech bubble in 2000, this gold to Nasdaq ratio has increased 13x! If you think that this is market peak, then expect another repeat. Another metric would be short-term yields. Historically, when 2-year yields rise, gold falls and vice-versa. We know that 2-year yields have peaked and is well on its way to come down. Another indication that gold's march cannot be stopped.

Emerging markets can indefinitely emerge!

	USD Price Index			
	MSCI India	**MSCI China**	**S&P 500**	**MSCI EAFE**
Annualized Return	6.5%	-1.7%	8.6%	2.7%
Number of intra-year 40% corrections	5	6	1	1
Average of intra-year maximum drawdown	-24.8%	-29.0%	-14.9%	-16.2%
10-year volatility (daily)	18.4%	23.1%	17.5%	14.6%
30-year volatility (daily)	24.7%	28.6%	18.5%	17.5%

It is not easy to dismiss the performance of S&P 500 in the short, medium and long-term. A look at the 30-year performance of U.S. market compared to say China is startling. While U.S. produced an annualized return of 8.6%, China was negative 1.7% in U.S. Dollar terms. Such negative performance also came on the back of higher risk, whether measured using the standard deviation or drawdown. This opens the issue of investing in emerging markets using an ETF which can be sub optimal compared to stock picking.

It is interesting to note that for every major U.S. or developed market listed major, there is an equivalent emerging market stock that is now available at half or one-third of p/e. A case in point is Amazon, which has ap/e of 51x is 3 times more expensive than Ali baba at 17x. It is not that this differential has always prevailed. There are times in history when Alibaba's P/E was more than Amazon. A similar picture emerges with KT Corp (8 P/E) vs. Verizon (15 P/E) or CGN power (14) vs Constellation Energy (30).

Equity & Commodities	Close	Returns		
		Aug 2024	YTD-Aug 2024	2023
Global Equities				
Global (MSCI World)	3,661	2.5%	15.5%	21.8%
USA (S&P 500)	5,648	2.3%	18.4%	24.2%
Japan (TOPIX)	2,713	-2.9%	14.6%	25.1%
GCC Equities				
GCC (S&P GCC Composite)	148	0.3%	0.0%	6.2%
Saudi Arabia (TASI)	12,145	0.3%	1.5%	14.2%
Abu Dhabi (FTSE ADX General Index)	9,285	-0.6%	-3.1%	-6.2%
Dubai (DFM General Index)	4,325	1.3%	6.5%	21.7%
Kuwait (Boursa Kuwait All Share PR)	7,181	-0.8%	5.3%	-3.1%
Qatar (QE Index)	10,203	0.5%	-5.8%	1.4%
Commodities				
Oil (Brent Crude in USD/bbl.)	78.8	-2.4%	2.3%	-10.3%
Gold (in USD/oz.)	2,503	2.2%	21.4%	13.1%

Fixed Income	Yields	
	Aug 2024	2023-end
U.S. Treasury 10Y Sov.	3.92%	3.88%
Saudi Arabia 10Y Sov.	4.42%	4.39%
Abu Dhabi 10Y Sov.	4.16%	4.32%
Kuwait 10Y Sov.	4.49%	4.34%

Source: Refinitiv, YTD and Yields as of Aug 31, 2024

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