

September 2011

Kuwait 15 Index Improving Alternatives

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On 16 December 2010, the Kuwait Stock Exchange announced plans to launch a new index, called "Kuwait 15", in addition to the current Price and Weighted Indices. With this, the Kuwait stock market will have three indexes. The constituents of the new "Kuwait 15" index would be calculated based on both market value and value traded and would include top 15 companies listed on the KSE from across the sectors and is expected to start in November 2011¹.

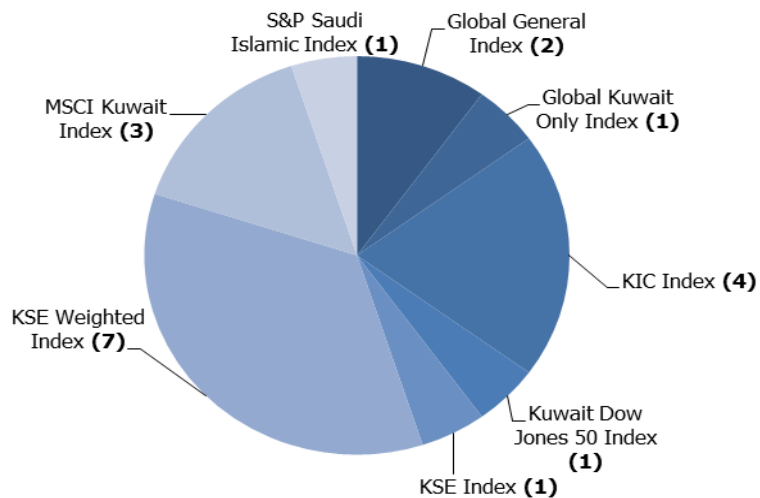
We believe that the new index would be a better indicator of the overall market for the following reasons:

1. Many companies in the current benchmark are not traded frequently thereby distorting the returns of the index.
2. The Top 15 index would represent market leaders and this will improve the quality of the index.
3. Moreover, as there are only fifteen stocks in the index, it will be easy for portfolio/fund managers to replicate the index, and hence, the tracking error² of the portfolios based on this index would be low.
4. As the constituents of the index would be reviewed every six months and based on our calculations we do not see a major churn in the index, consequently, passive tracking this index would not involve much trading cost.

However, we do have our reservation as to whether fifteen stocks is an appropriate number for the index and will it be able to reflect the true market scenario at all times.

While the launch of the Top 15 index will add to the existing group of indexes available (Appendix-1), we feel this index will play a greater role for future fund launches.

Figure 1: Benchmark Used by Kuwait Conventional Equity Funds



Source: Zawya & Markaz Research

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¹ Arab Stock Market Analysis

² Tracking error is a measure of how closely a portfolio follows the index to which it is benchmarked.

In June 2011³, Kuwait Stock Exchange picked the following 15 firms for its new Kuwait 15 Index, to be reviewed every six months.

We delineated Top 15 stocks based on market capitalization and value traded

Table 1: Kuwait Stock Exchange 15 Selected Firms

No.	Company	Ticker	Sector	Market Cap. (KWD Mn)	Turnover (KWD Mn) (YTD Jul-11)
1	National Bank of Kuwait	NBKK.KW	Bank	4,201.36	448.83
2	Mobile Telecommunication Co	ZAIN.KW	Telecom	4,055.04	454.29
3	Kuwait Finance House	KFIN.KW	Bank	2,369.84	377.07
4	Gulf Bank	GBKK.KW	Bank	1,192.91	139.63
5	Boubyan Bank	BOUBYAN	Bank	1,050.49	75.62
6	National Mobile Telecommunication (Wataniya)	BOUK.KW	Telecom	969.17	26.60
7	Ahli United Bank	AUBK.KW	Bank	952.05	32.10
8	Burgan Bank	BURG.KW	Bank	663.10	122.97
9	Mabaneer Co	MABK.KW	Real Estate Operations	445.15	57.14
10	Kuwait Project Co	KPRO.KW	Financial Services	401.56	47.38
11	Gulf Cable & Electricity Industries Co	CABL.KW	Electrical Equipment	315.36	16.92
12	Agility Public Warehousing Co	AGLT.KW	Air Freight & Courier Services	272.58	72.83
13	Boubyan Petrochemical Co	BPCC.KW	Investment Trusts	267.20	87.19
14	Kuwait International Bank	KIBK.KW	Bank	264.91	270.84
15	National Industries Group Holding	NIND.KW	Industrial Conglomerates	256.81	83.77

Source: Reuters and Markaz Research

In our attempt to examine historical performance of such an index, we went about delineating Top 15 stocks based on market capitalization and value traded (turnover) in order to construct the index. :

From the companies listed on the Kuwait stock exchange, the top 25 companies based on market capitalization were selected along with their respective value traded figures

Selection Criteria:

1. From the companies listed on the Kuwait stock exchange, the top 25 companies based on market capitalization were selected along with their respective value traded figures.
2. Each constituent's weight is calculated separately for market cap and value traded.
3. 75% weight is given to market cap and 25% to value traded to arrive at a final weighting.
4. Top 15 companies, based on weighting calculated in step 3, are selected to constitute the index.

³ Arab Times

The index is highly dominated by banking stocks

Table 2: KSE Top 15 Consolidated

KSE TOP 15 Consolidated Index Composition (Ticker)												
	2006		2007		2008		2009		2010		2011	
	1H	2H	1H	2H	1H	2H	1H	2H	1H	2H	1H	
1	NBKK	NBKK	ZAIN	ZAIN	ZAIN	ZAIN	ZAIN	ZAIN	ZAIN	ZAIN	ZAIN	NBKK
2	ZAIN	ZAIN	NBKK	NBKK	KFIN	NBKK	NBKK	NBKK	NBKK	NBKK	NBKK	ZAIN
3	KFIN	KFIN	KFIN	KFIN	NBKK	KFIN	KFIN	KFIN	KFIN	KFIN	KFIN	KFIN
4	AGLT	NIND	NIND	NIND	NIND	CBKK	AGLT	AGLT	GBKK	GBKK	GBKK	GBKK
5	NIND	AGLT	CBKK	AGLT	AGLT	GBKK	CBKK	CBKK	CBKK	CBKK	BURG	BOUK
6	CBKK	GBKK	GBKK	GBKK	CBKK	AGLT	BOUK	BOUK	BOUK	BOUK	BOUK	KIBK
7	KPRO	NMTC	AGLT	CBKK	KPRO	NMTC	NIND	GBKK	AUBK	CBKK	CBKK	CBKK
8	GBKK	CBKK	NMTC	BOUK	GBKK	NIND	GBKK	NMTC	AGLT	KIBK	BURG	BURG
9	NMTC	TIDK	KPRO	ABKK	GLOB	KPRO	NMTC	NIND	NMTC	AUBK	AUBK	AUBK
10	TIDK	KPRO	BURG	KPRO	SAFT	BURG	KPRO	KPRO	NIND	NMTC	NMTC	NMTC
11	GLOB	BURG	BOUK	NMTC	BURG	ABKK	AUBK	FOOD	ABKK	AGLT	BKME	BKME
12	BURG	GLOB	AUBK	BURG	NMTC	AUBK	BURG	AUBK	KPRO	ABKK	ABKK	ABKK
13	BOUK	NREK	TIDK	BPCC	ABKK	BOUK	ABKK	ABKK	FOOD	NINV	ALAF	ALAF
14	NINV	BOUK	NINV	ALQK	TIDK	NINV	FOOD	NINV	BURG	NIND	MABK	MABK
15	AUBK	AUBK	ABKK	GLOB	MABK	GLOB	KIBK	BKME	BKME	BKME	FOOD	FOOD

Dropped from Index in the next period
 Added to the Index in that period
 Added to the Index in that period & dropped in the next

Source: Reuters, Markaz Research

Note: Please see Appendix-2 for a full description of the ticker symbols

Zain and National Mobile Telecom Co are the two telecom companies that have formed part of the index from 2006 to 2011

Index Composition

The index is highly dominated by banking stocks, with seven banks forming part of the index in the first half of 2006 to ten banks in the first half of 2011. The weightage of the banks in the index has increased from 55% in 1H06 to 68% in 1H11, mainly due to increase in the number of banks. National Bank of Kuwait has been there in all the years under review, contributing the majority of the sector composition.

Table 3: Composition of Kuwait Top 15 Index

	2006		2007		2008		2009		2010		2011
	1H	2H	1H	2H	1H	2H	1H	2H	1H	2H	1H
Banks	55%	53%	49%	53%	51%	62%	57%	57%	62%	64%	68%
# of companies	7	7	8	7	6	8	9	8	9	10	10
Telecoms	21%	22%	34%	27%	25%	25%	29%	29%	30%	31%	25%
# of companies	2	2	2	2	2	2	2	2	2	2	2
Financial Institutions	13%	10%	8%	7%	12%	7%	3%	5%	2%	2%	1%
# of companies	4	3	3	3	4	3	1	2	1	1	1
Others	12%	14%	9%	12%	12%	7%	11%	9%	6%	4%	5%
# of companies	2	3	2	3	3	2	3	3	3	2	2

Source: Reuters and Markaz Research

Zain and National Mobile Telecom Co are the two telecom companies that have formed part of the index from 2006 to 2011. Zain, as the incumbent, has been the dominant partner contributing the majority of the sector weight.

The weight of financial services sector in the index has diminishing over the years, from 13% in 1H06 to 1% in 1H11. The participation of other sector in the index has been on a steady decline over the years.

Performance

It is interesting to note that the Top 15 index consistently outperformed the price index and the weighted index

Following the construction of the indices, we employed two methods to analyze its returns; 1) an equal weighted or Price index methodology, and 2) a market cap weighted methodology. We then compared the returns with those of the standard benchmarks. It is interesting to note that the Top 15 index consistently outperformed the price index and the weighted index barring a small diversion in the period July 2007 to June 2008. This lends the case for the Top 15 index from a portfolio management point of view.

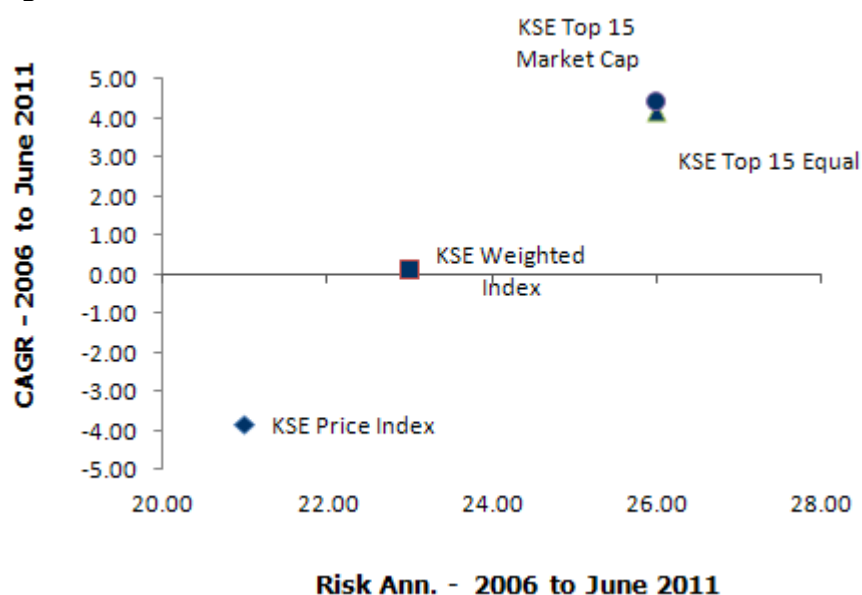
Table 4: Comparison of Returns (%)

KSE Top 15 Index versus Kuwait benchmarks											
Index	1H06	2H06	1H07	2H07	1H08	2H08	1H09	2H09	1H10	2H10	1H11
KSE Top 15 Equal	-10.9	13.4	41.2	0.3	13.0	-42.1	12.4	-13.7	1.5	46.0	-4.7
KSE Price Index	-12.6	0.7	20.5	3.5	23.1	-49.6	3.8	-13.3	-6.6	6.3	-10.7
Alpha	1.7	12.8	20.7	-3.2	-10.1	7.5	8.5	-0.4	8.1	39.7	6.0
KSE Top 15 Market Cap	-6.4	14.1	53.4	-3.1	2.4	-40.8	20.5	-14.9	8.2	38.7	-11.1
KSE Weighted Index	-9.8	4.8	35.4	-0.7	7.9	-47.3	10.4	-14.1	3.0	21.8	-10.4
Alpha	3.4	9.2	18.0	-2.4	-5.5	6.5	10.1	-0.8	5.2	16.9	-0.7

Source: Markaz Research, Reuters

Figure 2: Annualized Risk and Return

On a CAGR basis between January 2006 and June 2011, both the KSE top 15 equal and KSE top 15 market cap indices have outperformed the KSE price and KSE weighted indices

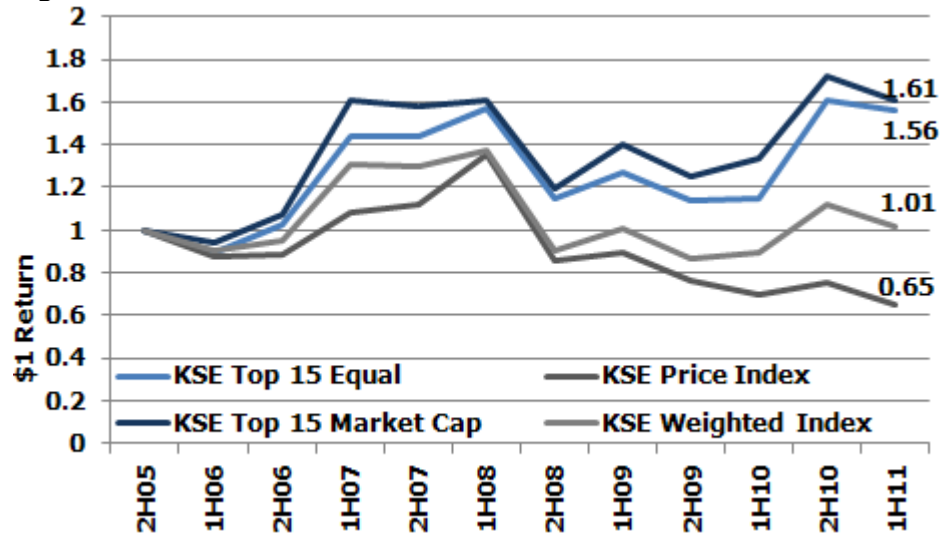


Source: Reuters and Markaz Research

On a constant annual growth rate (CAGR) basis for the period January 2006 to June 2011, both the KSE top 15 equal and KSE top 15 market cap indices have outperformed the KSE price and KSE weighted indices on a total return basis. Though the return earned by both the top 15 indices has been on the higher side compared to the current Kuwait based indices, their volatility has also been much more than the current indices. On a comparative basis the volatility measured by standard deviation of KSE top 15 equal is at 26%

versus that of KSE price index which is at 21%, whereas KSE top 15 market cap has a standard deviation of 26% versus 23% for the KSE weighted index. Based on the above calculation we can say that the new index would provide higher return for investors who are ready to take higher risks.

Figure 3: Dollar Returns



Source: Markaz Research

Appendix-1

Index Name	No. of Constituents	Market Cap (bn)	Calculation Currency	Weighting Name	Base Date
KSE Price Index	215	29.07	KWD	N.A.	N.A.
Kuwait Banking	9	12.74	KWD	N.A.	N.A.
Kuwait Investment	60	2.16	KWD	N.A.	N.A.
Kuwait Insurance	51	0.31	KWD	N.A.	N.A.
Kuwait Real Estate	40	1.64	KWD	N.A.	N.A.
Kuwait Industrial	29	2.24	KWD	N.A.	N.A.
Kuwait Services	13	7.51	KWD	N.A.	N.A.
Kuwait Food	7	0.72	KWD	N.A.	N.A.
Kuwait Foreign	6	1.74	KWD	N.A.	N.A.
DJ Kuwait Composite	N.A.	N.A.	N.A.	N.A.	N.A.
DJ Kuwait Titans 30 Index	30	82.5	USD	Liquidity-adjusted market cap	27-Aug-08
DJ Kuwait Titans Total Return 30 Index	30	N.A.	USD	Market cap.	27-Aug-08
DJ Kuwait Total Stock Market Index	N.A.	N.A.	USD	Liquidity-adjusted market cap	24-Mar-08
DJ Islamic Market Kuwait Index	30	N.A.	KWD	Liquidity-adjusted market cap	14-Aug-06
DJ Islamic Market Kuwait Total Return Index	30	N.A.	KWD	Liquidity-adjusted market cap	14-Aug-06
Kuwait DJ 50 Index	N.A.	N.A.	N.A.	N.A.	N.A.
Kuwait SE Weighted	N.A.	N.A.	KWD	Market cap/shares in issue	N.A.
MSCI Kuwait	N.A.	N.A.	N.A.	N.A.	N.A.
MSCI Kuwait Domestic	N.A.	N.A.	N.A.	N.A.	N.A.
FTSE Coast Kuwait 40 Index	40	N.A.	KWD	Liquidity-adjusted market cap	24-Jul-08
S&P Saudi Islamic Index	N.A.	N.A.	N.A.	N.A.	N.A.
Global General Index	N.A.	N.A.	N.A.	N.A.	N.A.
Global Kuwait Only Index	N.A.	N.A.	N.A.	N.A.	N.A.
KIC Index	N.A.	N.A.	N.A.	N.A.	N.A.

Source: Markaz Research

Appendix-2

Ticker	Company Name	Ticker	Company Name
NBKK.KW	National Bank of Kuwait	NINV.KW	National Investment Company
ZAIN.KW	Mobile Telecommunications Co.	AUBK.KW	Ahli United Bank
KFIN.KW	Kuwait Finance House	NREK.KW	National Real Estate Co
AGLT.KW	Agility Public Warehousing Co	ABKK.KW	Al Ahli Bank of Kuwait
NIND.KW	National Industries Group Holding	BPCC.KW	Boubyan Petrochemical Co
CBKK.KW	Commercial Bank of Kuwait	ALQK.KW	Qurain Petrochemical Industries Co
KPRO.KW	Kuwait Projects Co Holding	SAFT.KW	Al Safat Investment Co
GBKK.KW	Gulf Bank	MABK.KW	Mabanee Co
NMTC.KW	National Mobile Telecommunications Co	FOOD.KW	Kuwait Food Company Americana
TIDK.KW	Investment Dar	KIBK.KW	Kuwait International Bank
GLOB.KW	Global Investment House	BKME.KW	Ahli United Bank
BURG.KW	Burqan Bank	ALAF.KW	Aviation Lease and Finance Co
BOUK.KW	Boubyan Bank		

Source: Reuters and Markaz Research

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