

Saudi Arabia: A USD 560bn opportunity

By Julie Dickson, CFA

We are excited about the prospect of Saudi Arabia's equity markets opening to foreign direct investment. The Saudi market has, until now, remained largely unnoticed. The recent announcement that approval has been granted to open the Saudi market to foreign investors can be a game changer for the Middle East. Saudi Arabia is a big, liquid market. This market is expected to open in the first half of 2015.

Market overview

The Tadawul All Share index comprises over 160 companies with a total market cap of over USD 560bn.¹ Furthermore the market has a 90-day average daily trading volume of USD 2.4bn which currently exceeds Russia and South Africa (source Bloomberg, Deutsche Bank).

Fig 1: Saudi Arabia equity market characteristics

Exchange index	Tadawul All Share (SASEIDX on Bloomberg)
Market size	USD 560bn
Number of companies listed	162
Average daily trading volume – circa 3 million shares	USD 2.4bn
Investor profile	
Domestic	96%
GCC (ex Saudi Arabia)	1%
Foreign (ex GCC)	3%

Source: JPMorgan as at June 2014, Bloomberg (07-31-2014), Tadawul.

The Saudi stock exchange ranks as 7th amongst Emerging and Frontier Markets equity exchanges (out of 58), and ranks 20th globally.

Fig 2: Ten largest EM stock markets

Market	Size (Total Market Cap USD bn)
China	5,100
India	1,511
South Korea	1,298
Brazil	1,075
Taiwan	1,025
Russia	638
Saudi Arabia	560
Malaysia	540
South Africa	526
Mexico	509

Source: Bloomberg, as at July 2014, except China which also sourced HSBC data

Saudi companies offer a rich universe of investment opportunities, from banks to consumer-driven businesses. The Saudi market is deeper, broader and more liquid than investors think, making this, in our view, an ideal investment destination for investors seeking to diversify their equity portfolios.

Fig 3: Sectoral composition of Saudi stock market

Sectors	Weight %	No. of Companies
Financials	37.9	57
Materials	31.0	38
Telecoms	7.6	4
Consumer Staples	6.9	16
Consumer Discretionary	6.5	17
Industrials	5.7	19
Energy	1.7	4
Utilities	1.6	3
Health Care	1.1	4

Source: Bloomberg as at June 2014.

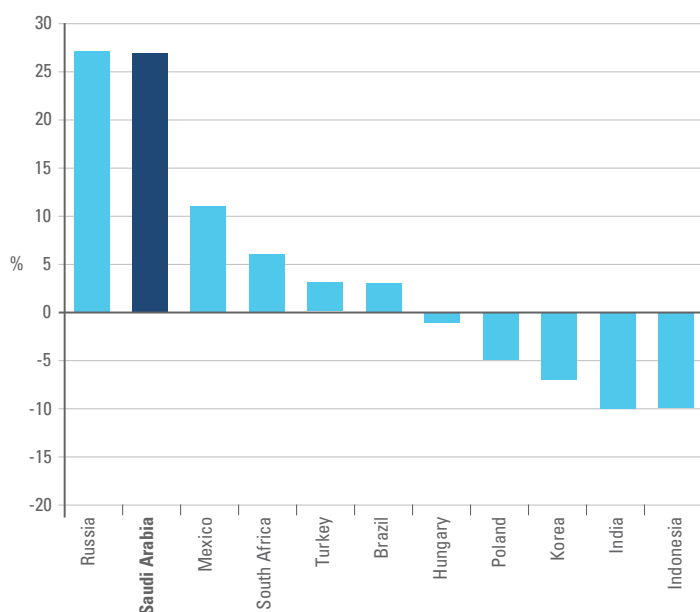
Many investors think that investing in Saudi equities means investing in oil stocks. There are, in fact, no listed oil companies in Saudi Arabia. The 'Energy' companies listed above are downstream refineries or oil services (shipping) companies, while 'Materials' includes some of the downstream petrochemical companies.

The case for investing in Saudi Arabia: consumption, young population

One of the key policies announced in Saudi Arabia was the labour reform introduced since the Arab Spring. This policy is designed to encourage employment of local rather than cheaper foreign workers. While in the near term this may mean higher wage costs and resultant slower growth, this policy also creates a catalyst for growth in domestic consumption. The government has also increased minimum wages, opened doors to allow a greater number of women to enter the workforce and introduced unemployment benefits. Together this means higher discretionary income which is driving Saudi consumer spending growth to be amongst the highest in Emerging Markets (Source: BAML July 2014).

¹ The Tadawul All Share index is the benchmark index of the Saudi stock exchange, also known as Tadawul.

Fig 4: Consumption growth as % of real GDP



Source: BAML, July 2014, 1999-2010.

Another key feature of Saudi Arabia that stands to support consumption in the medium to long term is its population demographic. According to UN data, nearly 50% of Saudis are less than 30 years old, with just over 3% above the age of 65. While Saudi Arabia's population is ageing, the repercussions will not be felt for several decades.

Returns, Volatility, Correlations

One of the key benefits of including Saudi Arabia in an Emerging or Frontier Markets portfolio is diversification. Figure 5, below, outlines the returns, volatility and correlations of the Tadawul All Share Index, bearing in mind that the Saudi currency is pegged to the US dollar.

Fig 5: Saudi stock market – comparative statistics

		Tadawul All Share	MSCI Emerging	MSCI World
Returns:	1 year	25.5%	-5.0%	24.1%
	5 years	12.2%	12.1%	12.5%
Volatility:	5 years	17.8%	22.6%	17.3%
Sharpe Ratio:	5 years	0.68	0.54	0.73

Correlation	Tadawul All Share	MSCI Emerging	MSCI World
Tadawul All Share	100%	–	–
MSCI EM	40%	100%	–
MSCI World	39%	88%	100%

Source: Ashmore, Bloomberg.

The tables above show that investing in Saudi equities can offer the same risk-reward benefits as Emerging Markets or developed markets – but with far less correlation. This means that adding an allocation to Saudi equities within an equity strategy can lower overall risks without necessarily sacrificing returns.

Including Saudi Arabia in a portfolio: Emerging or Frontier?

It is difficult to say how index providers will include this new market in their indices once it opens, nevertheless their inclusion alone will finally enable investors to have an 'on-benchmark' exposure to a market that, in our view, has been overlooked for too long. We do not expect inclusion to occur overnight, nor to be fully reflective of the total size of the market. The Saudi government will be issuing rules for foreign investors (Qualified Foreign Investor) and is also likely to introduce foreign ownership limits (FOL). The degree to which an index will include Saudi Arabia will depend on how accessible the market will be to a wide range of investors; its weight in the index will generally be driven by the level of FOL: the lower the limit, the smaller the weight.

According to MSCI,² based purely on the existing size of the Saudi market, Saudi Arabia would have an equivalent weight of 63% in the MSCI Frontier Markets index, and about 4% in MSCI Emerging Markets. The index house has already stated that a market does not necessarily need to pass through Frontier status before entering the Emerging Markets universe. It is hard to say when this will occur, but index addition is unlikely before mid-2016.

As a result, investors who seek exposure to Saudi Arabia will either have to acquire the QFI licence and/or invest with a manager who is able to provide exposure. In our view, inclusion in one benchmark or other is not a significant driver of investment decisions in our strategies; Saudi Arabia will continue to be included in our Middle East regional portfolios as well as our Emerging Markets and Frontier strategies.

² <http://blogs.wsj.com/moneybeat/2014/07/24/qa-msci-talks-on-the-future-of-saudi-arabias-stock-market/>

Contact

Head office

Ashmore Investment Management Limited

61 Aldwych, London
WC2B 4AE

T: +44 (0)20 3077 6000

 @AshmoreEM

www.ashmoregroup.com

Beijing

T: +86 10 5764 2601

Bogota

T: +57 1 347 0649

Jakarta

T: +6221 2953 9000

Istanbul

T: +90 212 349 40 00

Mumbai

T: +91 22 6608 0000

New York

T: +1 212 661 0061

Sao Paulo

T: +55 11 3556 8900

Singapore

T: +65 6580 8288

Tokyo

T: +81 03 6860 3777

Washington

T: +1 703 243 8800

Other locations

Shanghai

Bloomberg page

Ashmore <GO>

Fund prices

www.ashmoregroup.com

Bloomberg

FT.com

Reuters

S&P

Lipper

No part of this article may be reproduced in any form, or referred to in any other publication, without the written permission of Ashmore Investment Management Limited © 2014.

Important information: This document is issued by Ashmore Investment Management Limited (Ashmore), which is authorised and regulated by the Financial Conduct Authority. The information and any opinions contained in this document have been compiled in good faith, but no representation or warranty, express or implied, is made as to accuracy, completeness or correctness. Save to the extent (if any) that exclusion of liability is prohibited by any applicable law or regulation, Ashmore, its officers, employees, representatives and agents expressly advise that they shall not be liable in any respect whatsoever for any loss or damage, whether direct, indirect, consequential or otherwise however arising (whether in negligence or otherwise) out of or in connection with the contents of or any omissions from this document. Past performance is not a reliable indicator of future results. This document does not constitute and may not be relied upon as constituting any form of investment advice and prospective investors are advised to ensure that they obtain appropriate independent professional advice before making any investment.