Rising opportunities in GCC equities

Expert View

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We write this note at the end of what has shaped up to be the worst sentiment week for Gulf Cooperation Council (GCC) markets in a long time. The recent events such as Saudi Arabia's anti-corruption drive and deepening feud with Iran has spurred of a sell-off across the GCC region to the tune of $13 billion in last week. Much against investor's surprise Tadawul ended almost flat, not losing a dime.

Digging a bit deeper, the intra-day low of Tadawul averaged -1.8 per cent in the last five sessions starting from Sunday to Thursday (-0.8 per cent, -1.1 per cent, -3.1 per cent, -1.7 per cent, -2.2 per cent), however an invisible hand lifted the market by end of all the sessions, thus neutralising the damage.

Elsewhere, other GCC markets behaved in the most rational manner, with ADX losing 2 per cent in the week, while DFM (-4.8 per cent) just hovering above the key support level of 3400. Qatar market has been on the wrong side of the news since early June 17, extended the decline last week by 3.2 per cent. Kuwait, which was rejoicing after an aggressive FTSE run up outperformance, pulled back aggressively by 4.4 per cent to the lowest level in 10 months.

Nevertheless, on a positive spin, the reason behind the violent sell-off created conditions for a strong rebound in oil prices, with Brent reaching to two-year high ($64.30).

Many of the themes that we had expected would drive GCC markets in 2017 — such as rising US interest rates, slowing balance sheet growth in key markets such as Saudi and UAE, a likely FTSE inclusion of Kuwait has remained in play, however the rising market volatility driven by geopolitical tensions was totally unaccounted for, and took most of us by surprise. Investors for once, remain divided on their opinion on escalation of tensions in Saudi — with majority of public opinion (and hence the retail investors) voicing it as a positive move, while the institutional investors worrying that the recent act could create vulnerability to the existing businesses in Saudi as majority of the assets of the state and the ruling family are intertwined, and a clear line on the sand is hard to draw.

Challenging times

Given these challenging times, we suspect fundamental stories might not play out to its full potential and valuations could get beaten (widening CDS spread to push up the cost of equity higher, thus impacting the target prices). And hence we suspect majority of the investors could wait on the sides for the dust to settle, and play the safe strategy of investing in low beta-dividend stories, which is well termed as 'lifelines that pulls you through the worst of times'.

Investors interested in low-beta dividend stories, should focus on the stocks which have a current gross dividend yield of >7 per cent and above, 3-year average dividend yields of >5 per cent and with a higher visibility of paying dividends in current times.

On that note, Oman sits in the top of the ladder in the GCC offering an average 6.3 per cent yield for 2017E, which is driven by Telecom, and Financial sectors, particularly companies such as Omantel (13.2 per cent) and National Bank of Oman (7.9 per cent). Bahrain follows Oman, as the second highest dividend payers, with an average dividend yield of 5.8 per cent for 2017E, topped by GFH Financial Group followed by Ahli United Bank, both offering over and above 6 per cent yield for this year. Qatari companies are not far behind, with a prospective average yield of 4.9 per cent for this year. QIIB (8.9 per cent) and Doha Bank (8 per cent) tops the list as highest dividend yield plays in Qatar. However we won't place our bets on Qatari banks/companies, as they probably would need to take precautions (and preserve capital) against changing business environment. Elsewhere, Waha Capital (11.6 per cent), Emirates REIT (8.5 per cent) and Dubai Islamic Bank (7.7 per cent) tops the chart in the UAE; while Ooredoo (8.1 per cent) and Zain (7.6 per cent) in Kuwait offers the best dividend stories for this year.

On a separate note, playing Saudi could be tricky in current times. However we believe investors should stick with the heavy index-weights such Al Rajhi, SABIC, NCB, Jabal Omar, SAMBA, STC and Maa'den (altogether contributing to 42 per cent of Tadawul Index). Given Saudi's strong chances of being considered a part of MSCI and FTSE next year, it is likely that heavy weights could be supported at regular intervals to steer clear of volatility issues.

This defensive strategy showed positive results last week; NCB (+8 per cent) the top performer, followed by Jabal Omar (+4.6 per cent), SAMBA (+4.6 per cent), Maa'den (+4.3 per cent) and STC (+3.7 per cent), outperformed the Tadawul index. We expect this outperformance to continue until the mud settles, and water is clear for investing.

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