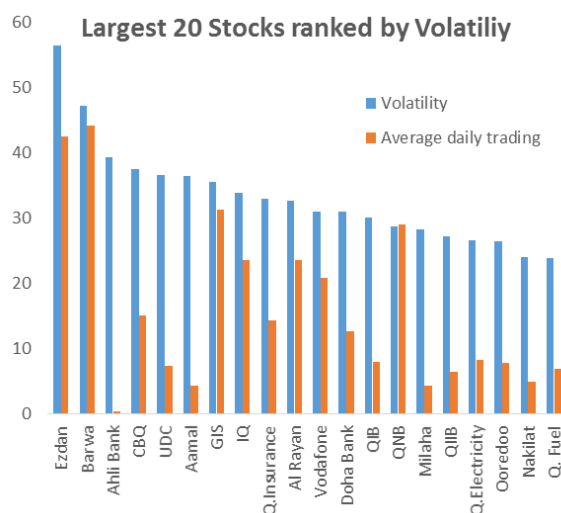


# Volatility and Market Efficiency in Qatar

## #1 A volatile market despite good liquidity

We find volatility in Qatari stock prices is generally high despite the strong macro environment. In an emerging market context, lack of liquidity is often a key reason for stock market volatility, but this is not the case in Qatar. For example, Ezdan Holding which is one of the most liquid stocks, has also been one of the most volatile Qatari stocks, with an astonishing annualised volatility of 60% in the last 5 years. So what explains this high volatility? We examine three reasons below.



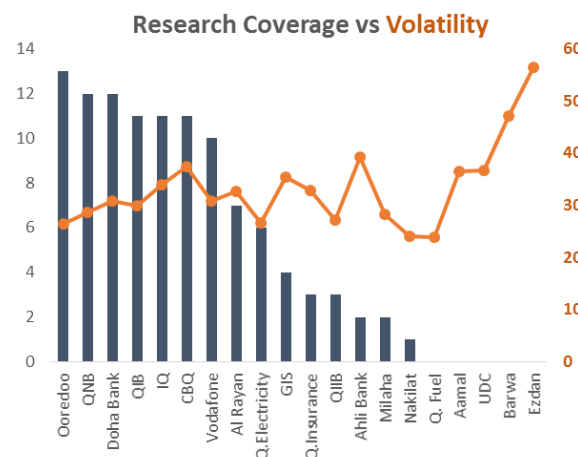
Source: Bloomberg

## #1 Non-institutional investors dominate

Qatar is a “young” market and it has a very large individual investor base. Professional investors (local and international) make up less than 10% of the market. This is different from other emerging markets where a significant portion of the free float is usually held by foreign and domestic institutional investors.

## #2 Published research is limited

Another differentiating factor is the lack of published equity research for nearly half of Qatar’s large cap stocks which likely makes it more challenging for investors to make informed investment decisions. From Bloomberg data, only 10 of the 20 QE index stocks are covered widely by more than a couple of analysts, and 5 of the large cap stocks are not covered at all. Among those not covered include names like Ezdan Holding which has a 12% index weight.



Source: Bloomberg

## #3 Disclosure levels need to be improved

When compared to other emerging markets, we find corporate disclosure to be particularly lacking. It is also concerning in some cases to note disclosure levels dropping when companies go through restructuring or a tough economic environment. When disclosure is limited, stocks are more difficult to evaluate and this opens the market up for rumor-driven speculation, compounding the issues of limited professional investors and independent research.

## Assessing quality of earnings

There are several factors to watch out for but an obvious one is to assess whether or not a company's earnings are sustainable. This is particularly important because many companies in the past years had "one-off" gains. When investors value stocks, they generally look at its P/E multiples, and when "one-off" earnings have been reported for several years, it is easy to mistake it for normal recurring income.

The value of a stock or any asset is the present value of all "future income" (expressed more technically "future cash flows"). Using single year's earnings as the denominator of the P/E is only appropriate if that year was representative of the "future". Often when valuing companies, analysts adjust for any income that is non-recurring or one-off in nature.

## Where do "one-off" gains come from?

Many Qatari companies own shares in other listed companies, resulting in a web of inter-company holdings. In one extreme example, market value of such investments make up more than 70% of the company's market cap. What makes it misleading for investors is when companies sell these old equity investments every year and realize profits. This is different than trading income from buying and selling shares. Often these shares have been acquired during their IPOs, and have appreciated between 5-10x times since IPO. While these are admittedly real gains, they cannot be considered recurring.

In markets with mature disclosure standards, such income is usually booked as extraordinary income but in Qatar it tends to be reported as "investment income" with generally little or no mention of it being "one-off". If a fund owned the

same stocks, the fund would be valued at current market value of the underlying portfolio, and not at a multiple of reported earnings.

## What can disciplined investors do?

Qatar's economy and stock market has grown very rapidly over the years, and investing in the stock market has been particularly rewarding for those early investors. However, valuations have reached a certain level and going forward being selective is crucial.

Investing in stocks can be very rewarding in the long run, but in the short run there can be more volatility than returns. As illustrated earlier average stock volatility has been around 30% per annum in the last 5 years. This compares with average annual returns of around 12% during the same period. This should remind us of the risks of stock investing that is not grounded with fundamental analysis.

## Amwal's investment process

In addition to conducting basic but essential analysis like understanding the sources of income, we carefully analyze companies, their industries and competitors before forming an opinion about their future profitability prospects. We then select stocks that offer the best upside relative to their future profitability prospects.

Further, we conduct more complex stock as well as fundamental factor correlation analysis, to construct an optimal portfolio that reduces overall volatility compared with owning a concentrated portfolio. Over the last 5 years, compared with average stock volatility of around 30% in Qatar, the volatility of Amwal's Qatar Gate Fund has been 13.5%.

## About Amwal

Amwal LLC is wholly owned by Sheikha Hanadi Nasser bin Khaled Al Thani, founder of the first regulated investment company in Qatar in 1998. Amwal LLC is authorized by the QFCRA and is a leading independent asset management firm serving institutional clients, family offices and high net worth individuals. The Amwal group has pioneered the Qatar financial services industry for over a decade, with a number of firsts to its credit, including the first to offer financial planning and wealth management, first mutual fund, first Islamic mezzanine private equity fund and first money market fund.

Amwal has received awards for Best Asset Manager in Qatar from EMEA Finance for four consecutive years (2011-4), Best Investment Bank in Qatar from World Finance (2012), and Qatar Deal of the Year from Islamic Finance News (2008). Qatar Gate Fund, managed by Amwal, was ranked the #1 equity fund in the MENA region ranked by 3-year returns in a report prepared by MENA FM (April 2013).

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