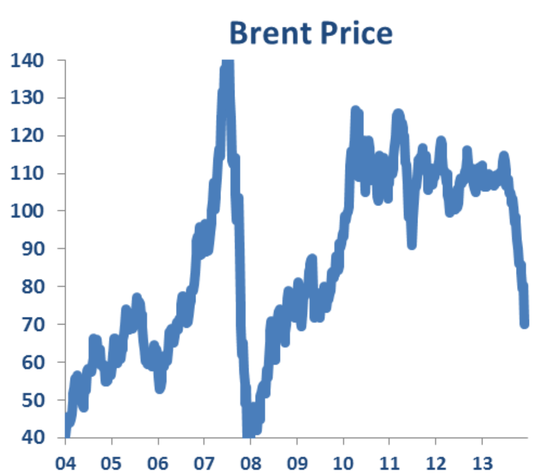
Is it time to buy Qatari equities?

Whilst OPEC's decision not to cut production has ensured it maintains its market share, it has contributed to the drop in oil prices and stocks. Most GCC markets dropped by around 4-6% yesterday while the Qatari market dropped 4.3%, with some "overvalued" stocks dropping as much as 7%. In our earlier report (Time to diversify into GCC equities, September 2014), we highlighted that certain stocks were overvalued and posed significant downside risk to investors. Many investors are now probably contemplating their next moves, buy or sell, or even exit the market.

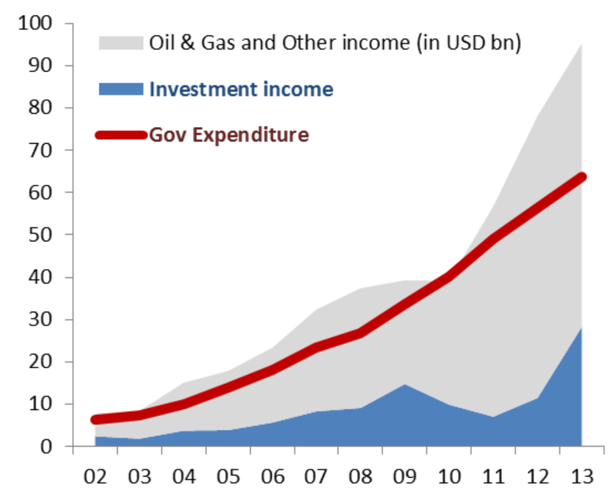
Oil's impact on GCC economies

Let us first analyze oil. Compared with an average price per barrel of around US$ 100 in the last five years, Brent has fallen to US$ 70 over the last three months, and may slide further. As hydrocarbon revenues drive the bulk of government revenues and economies in GCC, this drop will naturally have an impact on GDP and corporate profits.



Based on latest reported earnings, stocks are now trading at a P/E of c. 14x. The key question however is what would projected future earnings be, if Brent stays put at US$ 70 per barrel for an extended period? At a lower oil price, some stocks' future earnings will be directly impacted (such oil services companies, chemicals producers, etc.), whereas others may suffer a knock-on effect (i.e. as government spending begins to be more tightly managed). A significant portion of the GDP growth in Qatar and other GCC countries is driven by government spending.

The chart below shows the historical relationship between Qatari government revenues and spending.



The level of spending increase over the past five years is obvious (from around US$ 34bn to US$ 64bn), and was also the driver behind the rapid growth of the economy during that period. Similar increases in government spending were seen in other hydrocarbon-rich GCC countries. For example, the Saudi government increased spending from US$ 160bn in 2009 to around US$ 260bn in 2013.

This increase has also led to strong corporate earnings growth of around 70% in Qatar and around 50% in the broader GCC region. Should oil however remain at $70 or lower, this will inevitably result in depletion of surpluses and will most likely result in a near to medium term adjustment in the fiscal budgets.

So what is our view on oil?

Looking at the history of oil price, one can see that US$ 110 per barrel was a high level. Though there were factors beyond pure demand and supply affecting this, such as the decline in the US dollar due to increase in US money supply. Comparatively, oil's supply is limited and its demand keeps growing alongside global GDP growth. In our view, there is a correlation between the speed at which mature economies invest in finding alternative energy sources and the price of oil. At US$ 70 per barrel, there will likely be a marked slow-down in those investments and therefore the dependence and demand for oil is likely to continue. Given the supply-demand dynamics for oil today, we think Brent should stabilise between US$ 80-90 per barrel in the near to medium term.

Overall we are not excessively worried about the prospects for long term oil price, or the region's growth. Surely, investor view of the region's stocks may not be as rosy as when oil was at US$ 110 per barrel, but then again to expect oil to remain at those elevated levels was not the right assumption to start with.

At Amwal, our investment process is driven by fundamental analysis, and making sure our long term assumptions are sound and reasonable is a key part of it. In our view this is what helped us outperform our peers and the benchmark over the long run, with much lower volatility. On a 5-year cumulative basis, our flagship fund Qatar Gate Fund is around 15% higher than the average fund in Qatar and around 10% higher than the closest competitor. Furthermore, the annualized downside volatility of the fund (11%) has been significantly less than for the index (15%), which demonstrates that while it might not be possible to eliminate volatility, with sound fundamental analysis one can both perform well and have lower downside volatility over the long run.

In times like these we recommend those investors who have a long term horizon to take advantage of it. We are currently experiencing a window of finding good "cheap" stocks, but proper analysis continues to be key. At lower oil prices, certain stocks will see lower profits ahead, but others will not be much affected and hence the recent fall in stock prices just makes them more attractive for the long run.

Amwal manages both the Qatar Gate Fund and the Al Hayer GCC Fund. Qatar Gate Fund is an equity fund with fundamental approach to investing in Qatari equities with an aim to achieve above average long term capital appreciation. The Al Hayer GCC Fund has a similarly fundamental approach fund, and a broader focus on GCC equities.

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, 2012, 2013 and 2014), 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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