Time to diversify into GCC equities

A year back, in our September 2013 report titled "Time to Embrace Qatari Equities", we strongly recommended Qatari stocks. Our rationale at the time was inexpensive valuations of many Qatari stocks, relative to their earnings prospects. We also felt there were potential catalysts ahead such as Qatar's upgrade to MSCI emerging market status, which would help global investors take notice of the compelling opportunity. Since then the market is up around 50%, and while we still see value in certain stocks, we also see several significantly overvalued stocks. **While investors could sell such overvalued stocks and switch into more fairly priced Qatari stocks, this creates concentration risk. We instead recommend that investors diversify their portfolios into the GCC region to diversify away concentration and market risk.**

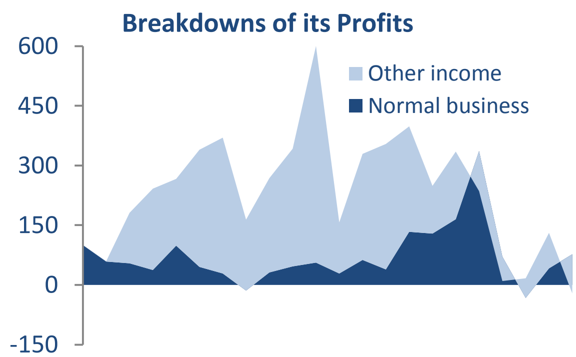
Why GCC?

- **The key reason is diversification benefits.** GCC has around 500 total stocks to choose from. Of these around 120 currently meet our liquidity and corporate governance criteria, and we expect this universe to grow.
- Similar to Qatar, other GCC countries have budget surpluses, governments with ambitious spending plans, and pegged currencies to the US dollar. GCC is thus a familiar region to Qatari investors and complements their existing local portfolios while offering a highly sector diversified exposure.
- Saudi is likely next in line for upgrade by MSCI, and offers good sector breadth and liquidity. Qatar and UAE were recently upgraded to emerging market status by MSCI and as a result saw significant inflows from both passive and active funds. The Saudi stock market is currently closed for direct investment to foreign investors. While some foreign investors invest indirectly through derivatives many institutional are not able to do so. As a result total foreign investment in Saudi is currently estimated to be only around US$ 4 billion (Source: Morgan Stanley research). Same source estimates this figure will increase to US$ 35bn after a potential MSCI upgrade. When upgraded, Saudi will be highly visible as a top 10 global emerging market alongside the likes of Brazil, India, Mexico and Russia.

Market Inefficiency in Qatar

Another reason why we recommend investors to diversify is a certain degree of market inefficiency, particularly when investing only in a single market. While most emerging markets show signs of inefficiency, Qatar being a relatively young economy it is more noticeable. The total size of professionally managed portfolios is small (around 2% of total market cap). Significant holdings are self-managed by investors who probably focus more on short term trading, without traditional fundamental approach used by professional investors.

In the past we have seen several cases where earnings of companies appeared to be high, but much of those earnings are driven by one-off gains (mostly on sale of assets) which could not be sustained for long. **The chart below shows a real example of a company's profitability and stock price evolution listed in Qatar.** The area shaded dark blue represents profits from the core underlying business, while the light blue area shows one-off gains the company was realizing. While the stock price initially went up by close to 50% in a relatively short period of time, once earnings started normalizing, the stock declined to almost where it started.



The above instance is not isolated and, in our view, a number of such overvalued cases exist in the market even today. In such a context, we would particularly caution investors against holding concentrated portfolios where such stocks could have a large impact on their portfolio returns.

Select Expensive Valuations Now

Among stocks we particularly notice for their expensive valuations are Masraf Al Rayan, Vodafone Qatar and Qatar Insurance.

- **Masraf Al Rayan's market cap at one point recently was higher than its total loans.** Currently its P/E is 24x; double that of the average of QNB, Doha Bank and CBQ, whereas its recent loan growth has been lower.
- **Vodafone Qatar's P/E valuation calculated on earnings before amortization is 63x** while Ooredoo's P/E is 11.8x. Furthermore its market cap per subscriber is US$ 3700, while the average for telecom companies in the GCC is around US$ 500.
- Lastly, **Qatar Insurance**'s **P/E excluding one-off gains is around 43x** while GCC average is 16x, and its P/B is around 3.0x vs the GCC insurance sector average of around 1.7x.

These are all good companies but their valuations have been pushed much beyond their fair value, likely by short term momentum investors who may not pay as much attention to fundamentals and relative valuation.

Amwal manages both Qatar Gate Fund and 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, but with 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 three consecutive years (2011, 2012 and 2013), 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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