2024-2029: MENA's time to shine?

The diverse universe of global emerging markets tends to be dominated by one or two bright stars.

These are markets that capture the imaginations of investors and that are characterised by rising prices and trading volumes.

Taking a three-to-five-year view, we believe that it could well be the turn of the Middle East and North Africa (MENA) region to shine.

Why?

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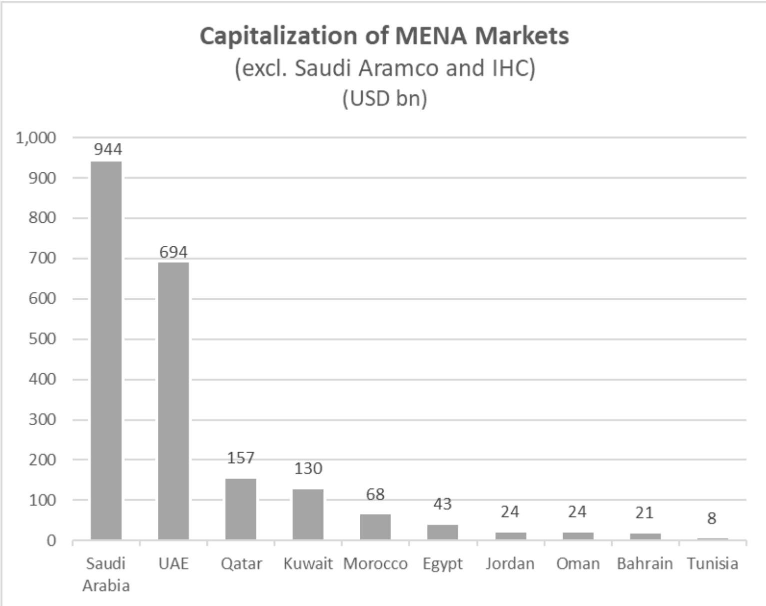
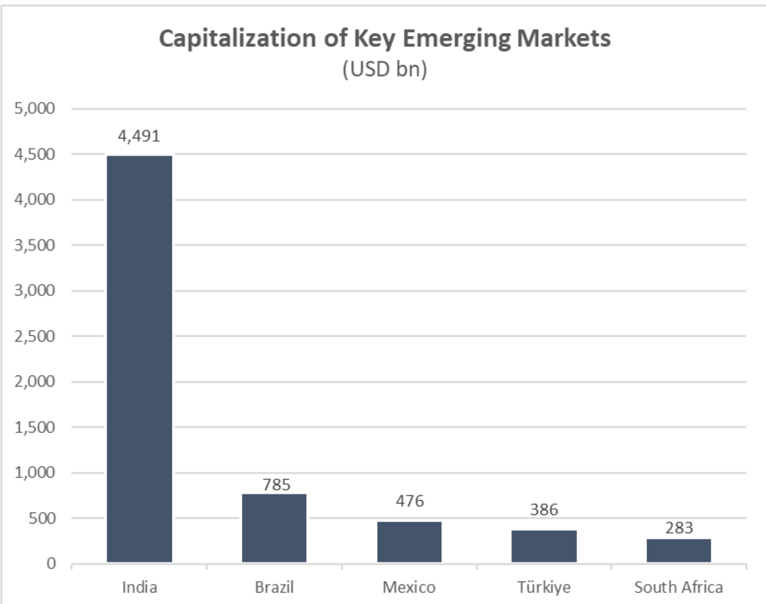
Reason #1 – MENA markets are under-owned

The combined capitalization of MENA markets stands at USD4,300 billion (or USD2,400 billion if you exclude the large but still liquid Saudi Aramco – the national oil company). Excluding Saudi Aramco from Saudi and IHC from the UAE which has a market capitalisation of ~USD250 billion, the national markets of both Saudi Arabia and the United Arab Emirates (UAE) are about USD944 billion and USD694 billion respectively. Qatar and Kuwait are the next largest markets.



Source: Bloomberg

In a global context, a capitalisation of USD2,400 billion is substantial. It is well over half the market capitalization of India – currently the world's fifth largest economy – which stands at just under USD4,500 billion. Other large emerging markets include Brazil (with a capitalization of USD785 billion), Mexico (USD476 billion), Türkiye (USD386 billion) and South Africa (USD283 billion).



Source: Bloomberg

Across the MENA region, daily turnover amounts to around USD3.5 billion: Saudi Arabia accounts for about USD2.0-2.2 billion of this. Nevertheless, and despite these substantial numbers, MENA markets have long existed on the periphery of global emerging market portfolios. Typically, allocations by mutual funds have been around 3.0%. This is in the context of the region's weighting in the MSCI Emerging Markets Index – a widely used benchmark – which exceeds 7.0%.

Individually, each of the MENA markets is under-owned in comparison to their weighting in the MSCI indices. This is particularly true in the case of Saudi Arabia. Since 2019, the country's weighting in the MSCI Emerging Markets Index has increased from 2.8% to 4.3%. Meanwhile, global emerging markets mutual funds generally have a weighting of around 2.1% to the country.

As these figures suggest, foreign investors play a comparatively small role in MENA markets. Across the region as a whole, they own about 12% of the collective markets in terms of capitalization. In the UAE and Qatar, the corresponding figures are around 16%; in Saudi Arabia, 10% or so.

Meanwhile, a transformation is underway. The markets of the MENA region are expected to rise relative to other emerging markets, so that their weighting in the MSCI Emerging Markets Index increases to 10%, from a little over 7% currently. This rise will be driven by a very active pipeline of initial public offerings (IPOs) and new listings.

As the absolute size, relative size and liquidity of the MENA markets grows, so will their appeal to global investors. It will become harder for global investors to justify being underweight to MENA – especially as ESG reporting (and corporate governance generally) are improving rapidly.

Reason #2 – The MENA region combines reform and stability

Sweeping social, regulatory, and political reforms are reshaping the landscape - particularly in Saudi Arabia. The country is set for multi-year growth driven by reforms, robust spending, and high loan growth. Some USD1,300 billion is set to be invested over the coming decade in accordance with Saudi Vision 2030: this is the official plan to create '[a vibrant society, a thriving economy and an ambitious nation']. Non-oil export revenues have risen from 10% of the total in 2016 to 38% in 2023.

Other reforms will have direct effects on Saudi Arabia's capital markets. Foreign ownership ceilings – which are currently set at 49% of capital – should be lifted. There should be new listings on Tadawul (the Saudi stock exchange) and increases in free floats. This should attract capital inflows from foreign portfolio investors.

“MENA markets are expected to rise relative to other emerging markets, following sweeping social, regulatory and political reforms.”

The UAE should also achieve superior growth thanks to further development of the tourism and real estate sectors, as well as economic and social reforms.

Traditionally, the principal exports from the Gulf Cooperation Council (GCC – Saudi Arabia, the UAE, Qatar, Bahrain, Kuwait and Oman) have been hydrocarbons – oil and gas priced in US dollars. In all these countries, currencies have been largely pegged to the US dollar at fixed rates. This has provided stability relative to other countries without fixed currency pegs.

Although policymakers in the GCC have sought to diversify their economies away from hydrocarbons, the economies continue to benefit from high and stable prices for oil and gas.

Reason #3 – MENA markets have delivered higher returns and lower risk

One compelling reason to explore the MENA region is its markets’ remarkable financial performance in recent years. Despite daunting challenges such as a complex geopolitical environment, perceived domestic political problems, oil price shocks, and the global COVID-19 pandemic, MENA markets have yielded an annualized return of 4.5% and 7.9% over the last 10 and 5 years, respectively. In stark contrast, the MSCI Emerging Markets Index had 0.5% and -0.3% annualized returns over the same periods.

Importantly, the MENA markets have delivered more stable returns. Over a 10-year period, volatility in the MENA markets was 11.4% vs. 15.7% for emerging markets overall (measured by daily volatility over 10 years).

Reason #4 – Previously rising stars are unlikely to shine

The attraction of emerging markets is well known and widely documented. Over the long-term, superior economic growth should produce superior investment outcomes. Financial liberalization is generally consistent with higher prices for financial assets. Returns from emerging markets tend not to be highly correlated with returns from developed markets.

At any one time, therefore, particular emerging markets will be stars that outshine other emerging markets in terms of investor attention and performance. However, stars do fade. Two previously rising stars that are unlikely to outshine the MENA markets over the next three-to-five years are – for different reasons – Russia and China.

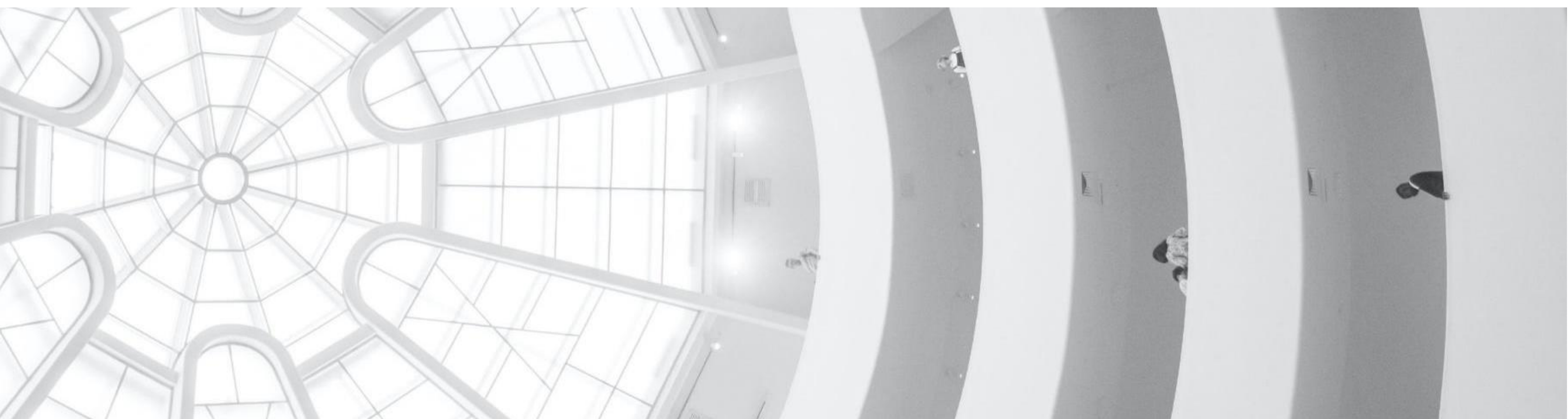
Russia's market was excluded from all emerging markets benchmark indices in the wake of the invasion of Ukraine in February 2022. Today, it is far less certain than previously that Russia is moving towards greater integration with global financial markets.

Its exclusion from the benchmarks means that Russia's market lacks the visibility and credibility that it used to enjoy. Its access to foreign capital has been reduced. Russia's long-term growth prospects have been hindered. Investors who have been focused on Eastern Europe have tended to increase allocations to the region's other larger markets such as Poland or Türkiye.

Meanwhile, China's capital flows have emerged as a critical factor shaping the fortunes of many emerging markets over the last three years. During that period, China has experienced significant outflows of capital, driven by factors such as regulatory crackdowns, economic uncertainty, and geopolitical tensions. These outflows have had far-reaching implications for some emerging market economies and stock markets.

The problems of China have been good news for some of the larger emerging markets. Investors have, for instance, been attracted to India and Taiwan. India appeals because of its favourable (young) demographics, rising population and prospects for stable economic growth. Taiwan's attraction has been its apparently unassailable global dominance as a supplier of semi-conductors.

For the foreseeable future, emerging markets investors will likely seek opportunities outside Russia and China. As they broaden their focus (or continue to look intensely for other opportunities), it is a reasonable bet that they will increase their allocations to the MENA markets.



The bottom line on why the MENA region's star is in the ascendant

- MENA markets are under-owned.
- The region combines reform and stability.
- MENA markets have delivered high returns and low risk.
- Previous rising stars are unlikely to shine.

In the meantime, the region's economies should grow steadily thanks to an oil price that is stabilizing above USD70/barrel and interest rates in major economies nearing a peak.

In summary, MENA markets look as though they should shine over the coming three-to-five years. Further, we suggest that, over that period active management should be able to add up to 3.0% of alpha annually (based on Azimut EM PMs' track record). This is because of the current under-development of the local institutional investor base and market inefficiencies – but that is another story.

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- The group is listed on Euronext and has a market cap of $3bn. The stock is very liquid with 74% of floating shares. Around 22% of shares are owned by management and employees.
- Azimut manages $100bn+ of assets, spread across 18 investment centres worldwide (LaTAm, US, Europe, Middle East, Asia and Australia)
- Broad product offering, including:
    - Public and private markets
    - Conventional and Islamic
    - Global and regional

Figures as at 31 Dec 2023

Sources used in this paper: Bloomberg and Azimut Group