Equity markets

GCC: Geopolitics weighed on GCC equities in 2017; Kuwait outperformed

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Most GCC markets underperformed their global peers in 2017, affected by regional tensions, though Kuwait registered its best performance in two years. Meanwhile, synchronized global growth, easy financial conditions, and stronger commodity prices led global equities to record highs, with momentum expected to carry through into 2018.

Global equities ended 2017 on a high note, with many registering record gains, supported by resurgent fundamentals, rising commodity prices and improving investor optimism. Easy monetary conditions, prolonged by stubbornly low inflation, also contributed to the rise in equity prices. Though global political risks did materialize throughout the year, they did little to derail the prevalent rallies. The MSCI world total return index finished 2017 at 6386, up 5% in 4Q17 and 19% on the year. (Chart 1.)

In the United States, both the S&P 500 and the Dow Jones Industrial (DJI) finished 2017 at record highs, displaying the strongest performance in decades. Despite some hindrances early in 2017, momentum eventually picked-up later in the year, buoyed by consistently encouraging economic and policy events. Indeed, 2017 unfolded as or better than expected: labor conditions tightened, consumer confidence strengthened, and earnings surprised. GOP tax cuts and deregulation are expected to lend a further boost to corporate earnings in 2018, which boosted US equities. The S&P 500 finished the year at 2673, up 19%, while the DJI came in at 24719, up 25%.

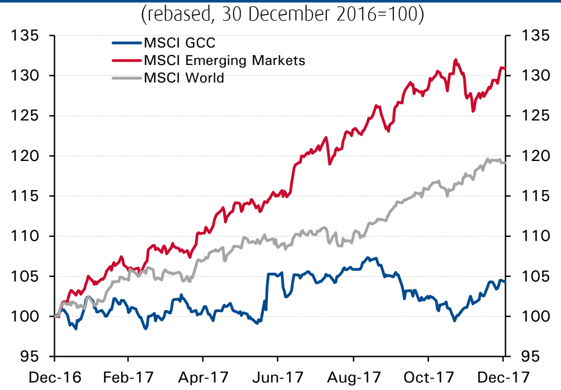
European equities were on track for a record year, but momentum was slightly derailed by the resurgence of political risk and a stronger euro. Nonetheless, strong economic activity, healthy corporate profits, decreasing unemployment, and a slow expected wind down of the ECB's quantitative easing, saw the Euro Stoxx 50 finish the year up 10%, despite contracting by 2% in 4Q17 on Spanish political uncertainty.

Emerging equities had a stellar year as well, benefitting from a weak dollar, predictable monetary tightening by major central banks, and increased investor appetite. Indeed, the IIF estimates that portfolio inflows to emerging markets have been positive for twelve consecutive months in November and totaled $250 billion. As such, MSCI's emerging markets index was up an impressive 31% in 2017. The index's 4Q17 performance, however, was its weakest all year, gaining only 6%. The latter was dampened by North Korean tensions and concerns over China's economy amidst government efforts to contain the high levels of leverage and the shadow banking industry.

GCC markets underperformed, weighed down by fiscal austerity and political upheaval. Indeed, the region's fiscally challenging environment was compounded by geopolitical tensions, eroding some of its attractiveness to foreign investors. This translated into weaker corporate revenues and subdued trading activity. The MSCI GCC price index was practically flat in 2017, and down 0.4% in 4Q17.

Chart 1: Total return indices

(rebased, 30 December 2016=100)



Source: Thomson Reuters Datastream

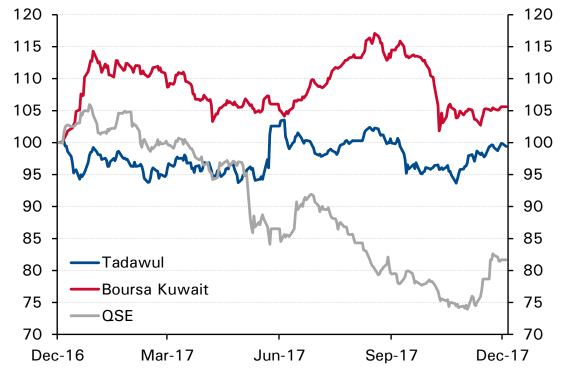
Chart 2: Oil prices and GCC markets

(rebased, 30 December 2016=100)

Source: Thomson Reuters Datastream

Chart 3: GCC markets

(rebased, 29 December 2016=100)



Source: Thomson Reuters Datastream

The regional dispute with Qatar also weighed on regional equities, with most markets down on the year; Qatar saw the largest decline. Though recent signs of capital flow stability helped prop-up the Qatari stock market in 4Q17, it still contracted by 18% in 2017. Dubai and Abu Dhabi declined in 2017 by 5% and 3%, respectively, with their performance also impacted by weaker domestic real estate markets. Saudi Arabia saw the smallest decline, down 0.2% in 2017, as solid earnings, pro-market reforms, an expansionary budget and the extension of the OPEC deal helped offset the uncertainty that accompanied the political turmoil.

Kuwaiti equities were among the best performing in the GCC, with the price index up 12% and the weighted index up a decent 6%. The market registered healthy gains throughout most of 2017, supported by the minority share buy-out of Americana by UAE investors late in 2016, its ascension to FTSE Russel's emerging market index and Omantel's acquisitions of Zain stock. However, regional developments late in the year weighed on the market in 4Q17. While a rebound in oil prices added some positive momentum around year-end, it was too little to offset the profit taking that happened in the final quarter of the year.

Corporate profits and trading activity in the GCC continued to reflect a challenging operating environment. Though profits were up 3% during the first nine months of 2017 on strong 3Q17 results, total revenues were down 7%. Meanwhile, trading activity in 2017 registered its weakest performance in seven years, with an average daily turnover of USD 1.1 billion. Volumes, however, did pick up in 4Q17 from the quarter before on defensive trades in the wake of the Saudi anti-graft campaign and the positive momentum that followed the extension of the OPEC deal and the unveiling of expansionary GCC budgets. (Chart 5.)

International investors expect 2017's momentum to carry through into 2018, with a close eye being kept on central banks and global growth. On the other hand, regional equities will continue to be driven by oil prices and the ongoing regional tensions. However, downside risks remain. Markets may see a faster pace of financial tightening, while China's economy may slow, and global geopolitics and trade disputes may worsen. The resurgence of political uncertainty in Europe could also be a source of concern for markets. In the region, further deterioration in regional ties could also hit markets.

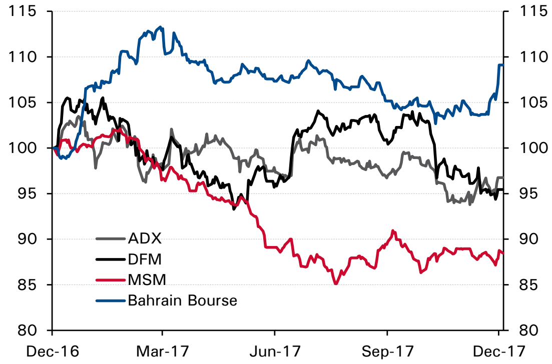
Table 1: GCC markets indicators for 4Q17

	Market capitalization (USD billion)	Average daily turnover (USD million)	Growth in 9M17 profits (% y/y)	Price/ earnings per share
Bahrain (Bourse)	21	2	3	8.3
Kuwait (Boursa)	93	50	6	14.7
Oman (MSM)	21	11	-20	12.2
Qatar (QSE)	129	49	-6	12.9
Saudi (Tadawul)	449	904	13	15.3
Abu Dhabi (ADX) & Dubai (DFM)	241	151	-5	18.5
GCC	954	1,157	3	-

Source: Thomson Reuters Datastream, Thomson Reuters Eikon

Chart 4: GCC markets

(rebased, 29 December 2016=100)



Source: Thomson Reuters Datastream

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