Economic Update

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Equity Markets

> Saqer Al-Zayed
Economist
+965 2259 5655
SaqerAlZayed@nbk.com

> Raja Ghoussoub
Senior Economist
+965 2259 5356
RajaGhoussoub@nbk.com

Global equities continue to advance on stimulus, central bank dovishness and recovery optimism

Highlights

- **Global markets were broadly positive in 1Q21, with the MSCI AC World index up 5.5% q/q, led by European markets.**
- **Equities continued to rally in April, with the S&P500 recording the strongest monthly gain since November 2020**
- **Markets were lifted by ongoing stimulus, Fed dovishness, the rollout of vaccines, and stronger macroeconomic data.**
- **The MSCI GCC index outperformed its global counterparts, up a solid 12.6% q/q helped by higher oil prices.**
- **High valuations, increasing inflation prospects, and virus-related headwinds remain important downside risks.**

Global markets extend gains in first quarter 2021

Global equity markets continued to rally in 1Q21, with several major indices reaching all-time highs supported by major stimulus, central bank dovishness, positive vaccine developments, and stronger macroeconomic data. Meanwhile, GCC markets outperformed, helped by additional factors including higher oil prices and the easing of pandemic-related restrictions in some countries and despite renewed restrictions in others. The positive trend extended well into April, with the S&P500 recording the strongest monthly gains (5.2%) since November 2020, despite higher volatility and weaker performance towards the end of the month, largely due to concerns related to higher inflation as the recovery progresses (reflation), the possibility of tighter policy, and pandemic-related uncertainty.

Looking ahead, perhaps the largest risk to an enduring equity rally and the economic recovery continues to be the pandemic-related uncertainty, especially amid the resurgence of the virus in some countries in Europe and Asia. Additionally, concerns that the continued accommodative fiscal and monetary policies could lead to higher-than-expected inflationary pressures,(and hence the potential for increasing interest rates) represent a further risk to equity markets.

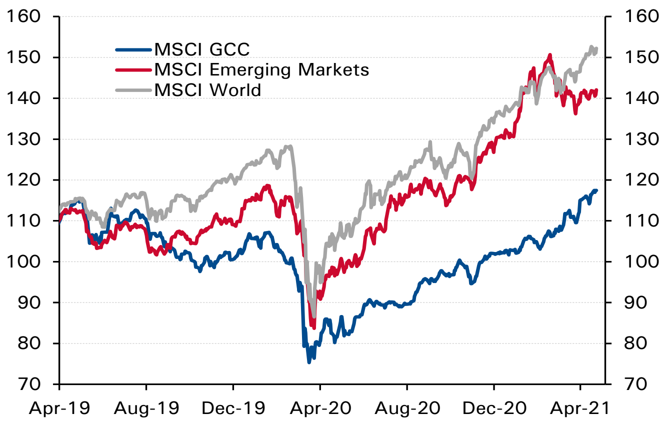
European markets lead gains on recovery prospects

Global markets were broadly positive in 1Q21, with the MSCI AC World index up 5.5% q/q, led by European equities (Euro Stoxx 50 +10.3% q/q), while the DJIA and S&P500 rose by 8% and 6% respectively. European markets, previously battered by a second wave of Covid and renewed restrictions, are expected to benefit from an expected economic recovery, especially as stock valuations remain attractive relative to the steep valuations of US stocks.

The softer performance in US markets versus European ones can also be attributed to the sharp surge in US bond yields, which has squeezed the US risk premium sparking some concerns among investors. Along the same lines, US stock performance was also impacted by inflationary concerns stemming from the economic recovery and fears that the Fed may consequently hike interest rates sooner than expected, though these concerns later eased as the Fed's reaffirmed its Dovish stance..Also noteworthy is the investors' rotation to sectors that stand to benefit the most from an economic recovery ie. stocks withbetter growth prospects in the short-term and lower valuations. This shift in investor preference can perhaps be reflected by the Russel 2000's vast outperformance of other US indices (+14% q/q) which is the main US index for small-cap stocks.

Chart 1: Global equity markets

(rebased, 28 December 2018=100)

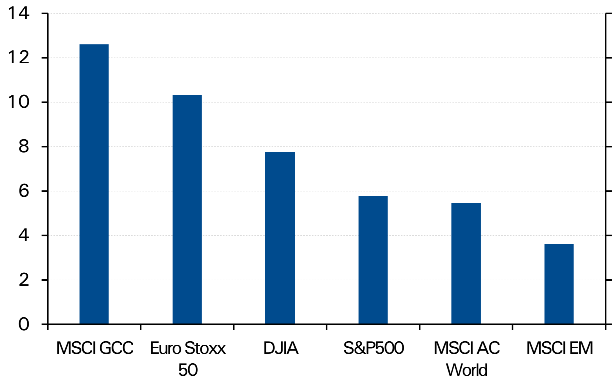


Source: Refinitiv DataStream

Equity markets could do relatively well in 2021 as virus risks diminish, policy remains highly accommodative and the economic recovery progresses. However, some downside risks remain, generally centered around virus uncertainty, which can affect the economic outlook. Specifically for the US, relatively high valuations, rising inflation expectations, and a sooner-than-expected winding down of monetary easing are the main risks in our view.

Chart 2: Global equity markets in 1Q21

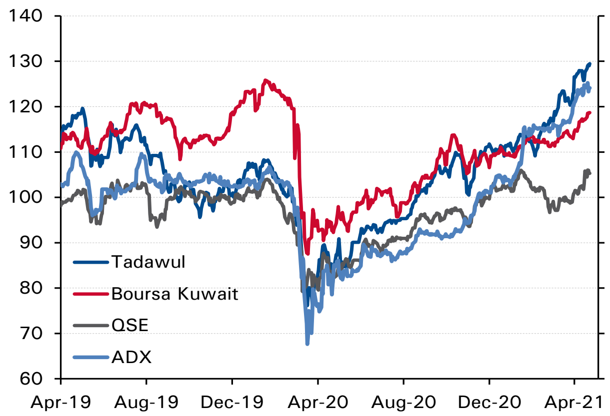
(% q/q)



Source: Refinitiv DataStream

Chart 3: GCC equity markets

(rebased December 2018 = 100)



Source: Refinitiv DataStream

Regional markets outperform amid higher oil prices

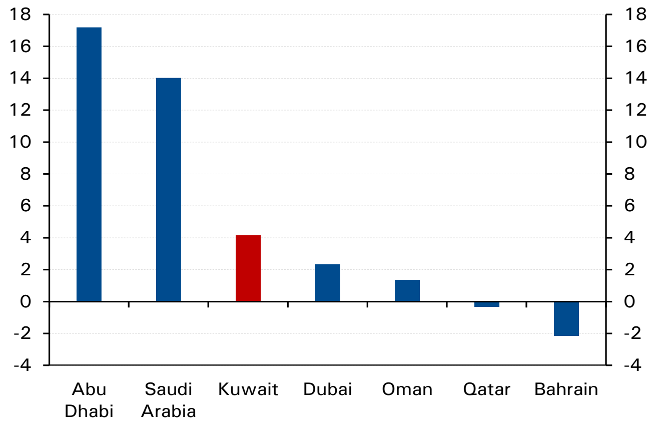
GCC markets outperformed their global counterparts, with the MSCI GCC up a solid 12.6% q/q helped by higher oil prices, vaccine rollouts, and a better fiscal outlook. In the lead were Abu Dhabi and Saudi Arabia, up 17% and 14% respectively with investor confidence in the latter also boosted by the announcement of a series of large investment plans as part of a major economic diversification push.

Meanwhile, Kuwait's All-Share index rose a decent 4.1% q/q, pushing market capitalization to a 15-month high (KD 34bn). The All-share index was lifted largely by the premier market (+4.5%) with the technology, real estate, and financial sectors in the lead. The average daily traded value stood at KD 39 million, reflecting continued interest in local stocks and a healthy level of market activity, though net foreign inflows slowed considerably to around KD 6 million in 1Q21, largely due to the end of the market upgrade related flows of 2020.

Looking ahead, the easing of virus concerns amid the rollout of vaccines and a positive economic outlook should be supportive of regional market sentiment. With that said, these markets will continue to be influenced by oil prices, the pace of structural reforms, geopolitics, and pandemic-related developments.

Chart 4: GCC equity markets in 1Q21

(% q/q)



Source: Refinitiv DataStream

A positive but uncertain outlook for equities in 2021

Record-low benchmark interest rates, continued central bank dovishness, and growing signs of an economic recovery will likely continue to lend support to markets going into 2021. This bullish sentiment is reflected in global stocks continuing to set all-time highs, with softer demand for safe-haven assets such as gold and the USD. With that said, near-to-medium term market prospects are subject to a notable degree of downside risks stemming from pandemic, inflation, and policy-related uncertainty (tapering stimulus, higher interest rates), factors which have led to increased market volatility as of late.

Further, the Biden administration proposed raising the capital gains tax in the US, which will likely weigh down on US markets if approved as proposed. Potential headwinds can come from a renewed increase in US bond yields, though possible increases could be kept in check by ongoing Fed purchases, uninterrupted issuances by the treasury, and foreign inflows given lower yields elsewhere in developed markets.

Head Office

Kuwait
National Bank of Kuwait SAKP
Shuhada Street,
Sharq Area, NBK Tower
P.O. Box 95, Safat 13001
Kuwait City, Kuwait
Tel: +965 2242 2011
Fax: +965 2259 5804
Telex: 22043-22451 NATBANK
www.nbk.com

International Network

Bahrain
National Bank of Kuwait SAKP
Zain Branch
Zain Tower, Building 401, Road 2806
Seef Area 428, P. O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

National Bank of Kuwait SAKP
Bahrain Head Office
GB Corp Tower
Block 346, Road 4626
Building 1411
P.O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

United Arab Emirates
National Bank of Kuwait SAKP
Dubai Branch
Latifa Tower, Sheikh Zayed Road
Next to Crown Plaza
P.O.Box 9293, Dubai, U.A.E
Tel: +971 4 3161600
Fax: +971 4 3888588

National Bank of Kuwait SAKP
Abu Dhabi Branch
Sheikh Rashed Bin Saeed
Al Maktoom, (Old Airport Road)
P.O.Box 113567,Abu Dhabi, U.A.E
Tel: +971 2 4199 555
Fax: +971 2 2222 477

Saudi Arabia
National Bank of Kuwait SAKP
Jeddah Branch
Al Khalidiah District,
Al Mukmal Tower, Jeddah
P.O Box: 15385 Jeddah 21444
Kingdom of Saudi Arabia
Tel: +966 2 603 6300
Fax: +966 2 603 6318

Jordan
National Bank of Kuwait SAKP
Amman Branch
Shareef Abdul Hamid Sharaf St
P.O. Box 941297, Shmeisani,
Amman 11194, Jordan
Tel: +962 6 580 0400
Fax: +962 6 580 0441

Lebanon
National Bank of Kuwait
(Lebanon) SAL
BAC Building, Justinien Street, Sanayeh
P.O. Box 11-5727, Riad El-Solh
Beirut 1107 2200, Lebanon
Tel: +961 1 759700
Fax: +961 1 747866

Iraq
Credit Bank of Iraq
Street 9, Building 187
Sadoon Street, District 102
P.O. Box 3420, Baghdad, Iraq
Tel: +964 1 7182198/7191944
+964 1 7188406/7171673
Fax: +964 1 7170156

Egypt
National Bank of Kuwait - Egypt
Plot 155, City Center, First Sector
5th Settlement, New Cairo
Egypt
Tel: +20 2 26149300
Fax: +20 2 26133978

United States of America
National Bank of Kuwait SAKP
New York Branch
299 Park Avenue
New York, NY 10171
USA
Tel: +1 212 303 9800
Fax: +1 212 319 8269

United Kingdom
National Bank of Kuwait
(International) Plc
Head Office
13 George Street
London W1U 3QJ
UK
Tel: +44 20 7224 2277
Fax: +44 20 7224 2101

National Bank of Kuwait
(International) Plc
Portman Square Branch
7 Portman Square
London W1H 6NA, UK
Tel: +44 20 7224 2277
Fax: +44 20 7486 3877

France
National Bank of Kuwait France SA
90 Avenue des Champs-Elysees
75008 Paris
France
Tel: +33 1 5659 8600
Fax: +33 1 5659 8623

Singapore
National Bank of Kuwait SAKP
Singapore Branch
9 Raffles Place # 44-01
Republic Plaza
Singapore 048619
Tel: +65 6222 5348
Fax: +65 6224 5438

China
National Bank of Kuwait SAKP
Shanghai Office
Suite 1003, 10th Floor, Azia Center
1233 Lujiazui Ring Road
Shanghai 200120, China
Tel: +86 21 6888 1092
Fax: +86 21 5047 1011

NBK Capital

Kuwait
NBK Capital
34h Floor, NBK Tower
Shuhada'a street, Sharq Area
PO Box 4950, Safat, 13050
Kuwait
Tel: +965 2224 6900
Fax: +965 2224 6904 / 5

United Arab Emirates
NBK Capital Limited - UAE
Precinct Building 3, Office 404
Dubai International Financial Center
Sheikh Zayed Road
P.O. Box 506506, Dubai
UAE
Tel: +971 4 365 2800
Fax: +971 4 365 2805

Associates

Turkey
Turkish Bank
Valikonagl CAD. 7
Nisantasi, P.O. Box. 34371
Istanbul, Turkey
Tel: +90 212 373 6373
Fax: +90 212 225 0353