Markets continue to be bullish on hopes of rate cuts, but trade and geopolitics weigh

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

Highlights

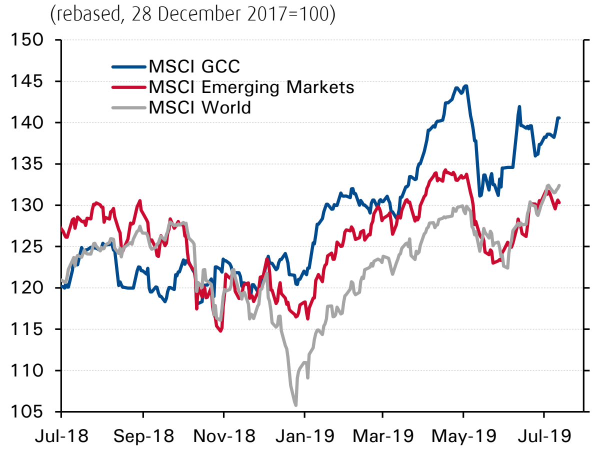
- Developed equity markets continued to gain in 2Q19 albeit at a slower pace than before.
- Emerging markets lagged in 2Q, weighed down by trade tensions and investor caution in China.
- GCC equity performance was mostly strong on better fiscal positions, good sentiment, and strong foreign inflows.
- Kuwait is currently the best year-to-date regional performer, gaining more than 20% in the All-share index.
- Geopolitics, the chance of lower oil prices, and profit-taking may pose downside risks for GCC equities in 2019.

Equities less bullish in second quarter of 2019

Global and regional stock indices gained in the second quarter of 2019, albeit at a noticeably slower pace than in Q1. The slowdown was evident in both regional and international markets. Lack of progress in the US china trade dispute, conflicting economic data, weaker than expected growth in corporate earnings, and rising geopolitical tensions in the Middle East have raised uncertainty and weighed on markets, partly offsetting the good sentiment from an expected Fed interest rate cut (mostly already priced in) and previously higher optimism about reaching a trade deal.

Chart 1: Global equity markets

(rebased, 28 December 2017=100)

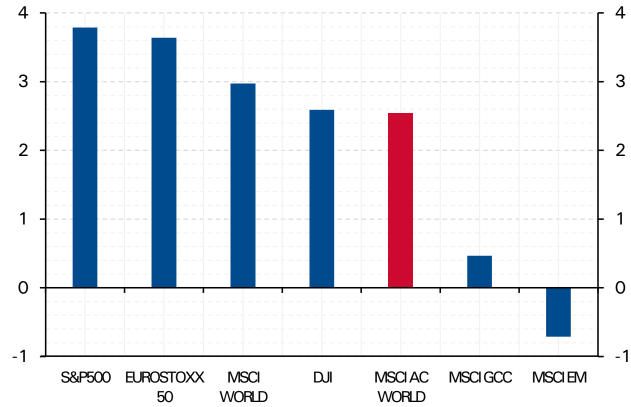


Source: Refinitiv Datastream

However, with bond yields having declined considerably this year, investors shifted to equities, willing to take the additional risks that come with equity investment. US and European stocks were the best performers in 2Q19, underperformed by the GCC, while emerging markets trailed behind in negative territory, weighed down partly by weakness in Chinese markets (Chart 1).

Chart 2: Global equity markets

(% q/q, 2Q19)



Source: Refinitiv Datastream

International markets

Developed equity markets fared relatively well in the second quarter, outperforming emerging markets by a considerable margin. The MSCI world index gained 3% q/q, led by the S&P500 (3.8%) and the Eurostoxx 50 (3.6%), while the DJIA trailed behind (2.6%), affected more by trade dispute effects (Chart 2). These effects were felt across international markets, with a noticeable slowdown in stock performance compared to the first quarter. This coincides with seemingly waning optimism regarding the possibility of a trade deal between the US and China. Additional factors weighing on stocks include mixed earnings estimates and conflicting economic data, leading to rising uncertainty among investors. Industrial (freight and transport stocks) in particular were affected, as second quarter earnings were impacted by the effects of tariffs. Nonetheless, markets continued to be fairly bullish, lifted by the Fed's view about the state of the economy, and investors' expectations of a 25-50 bps rate cut in July. The ECB is expected to follow suit, having recently sent dovish monetary policy signals, while Eurozone circumstances (low inflation, sluggish growth) remain accommodative. Further support to equity markets likely stems from low bond yields, providing incentive for investors to take on the risks of equities.

By contrast, emerging markets fared poorly, yielding negative returns, with the MSCI-EM index down 0.7% q/q (Chart 2). The Shanghai Shenzhen CSI 300 was down 1.2% q/q and was subject to major volatility in the second quarter amid slower growth and trade tensions as investors reassessed their risks and positions.

Chinese markets were further impacted in June when the US released a blacklist of Chinese firms which includes tech giant Huawei. However, China is responding with measures that include the release of its own 'unreliable entity' list of select US firms, and the recent launch of a large technology board dubbed 'Star' paving the way for the listing of Chinese tech stocks which surged massively in their trading debut on July 21, thereby restoring confidence and sentiment to an extent. Further support likely stems from pro-growth and financial market reforms such as an increase in corporate foreign ownership limits. Low short-term borrowing rates could continue to lend support, as well as the possibility of some forms of government stimulus.

Regional markets

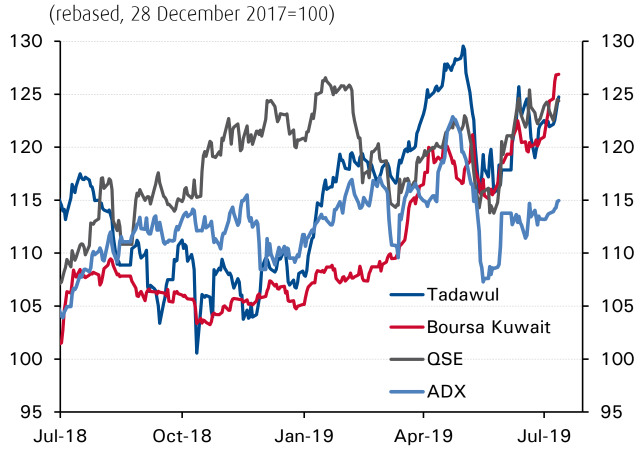
GCC market performance over Q2 was mixed but overall positive, with the MSCI GCC gaining 0.5% q/q. Although most markets showed strength, the composite index was weighed down by laggard performance in Saudi Arabia, Abu Dhabi and Oman (Chart 4). Oman, burdened by pending reforms and weak credit ratings, was the weakest performer, while Saudi Arabia's previous winning streak was snapped by geopolitical tensions, and possibly some profit-taking after gaining strongly in 1Q19, and ended the second quarter nearly flat q/q.

Kuwait has benefited from a stable economy, good corporate earnings, and the MSCI-EM index inclusion (to be implemented in June 2020 subject to conditions) which lifted sentiment and attracted large foreign inflows. Among the best performers of 2Q, Kuwait is also currently the best year-to-date performer, with gains of about 14.8% and 21% in the All-share and Premier indices. Kuwait's market also benefitted from being relatively undervalued at the start of the year compared to peer markets. Dubai, having suffered large declines in 2018 on weakness in the real estate sector, saw a rebound in 2Q19, also likely due to undervaluation and the somewhat improved performance of property stocks. Finally Bahrain led the region with gains of 4.1% q/q. benefitting from recently enacted fiscal reforms, stable credit ratings and GCC aid packages.

Overall, GCC markets may also have benefited from improved fiscal positions and relatively low risk free returns, possibly boosting the risk premium of equity holdings, in addition to improved fiscal positions.

Chart 3: Select GCC markets

(rebased, 28 December 2017=100)

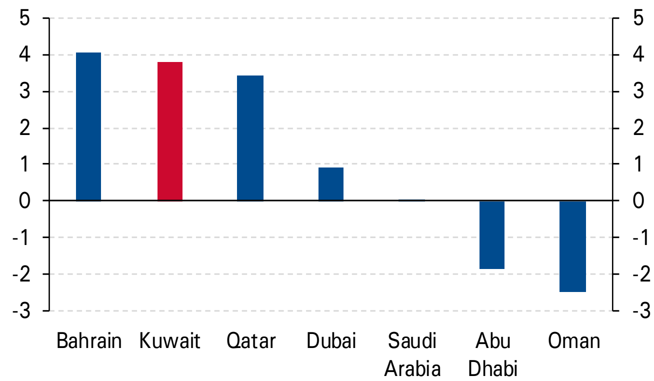


Source: Refinitiv Datastream

Although GCC markets have mostly done well in Q2, and with momentum expected to extend into the near-medium term, downside risk is present. Geopolitical tensions and oil price volatility may weigh on confidence. Should international markets slump, there is the risk of contagion, as we have seen in the past. Finally, there may be a need for a fresh catalyst after the market reclassification euphoria fades in Saudi Arabia and Kuwait, in addition to the risk of profit taking and/or corrections after strong gains, of which we have recently seen signs in Saudi Arabia and Kuwait.

Chart 4: GCC equity markets

(% q/q, 2Q19)



Source: Refinitiv Datastream

Head Office

Kuwait
National Bank of Kuwait SAKP
Abdullah Al-Ahmed Street
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
(International) Plc
Paris Branch
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
38th Floor, Arraya II Building, Block 6
Shuhada'a street, Sharq
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