

Equity markets

GCC: Geopolitics weighs on Qatar; Kuwait upgraded to emerging by FTSE

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International and regional equities continued to diverge in 3Q17. Positive economic data and hawkish central bank talk saw international markets continue their climb upwards, while the ongoing Qatari rift and weaker corporate earnings weighed on regional exchanges. Meanwhile, Kuwait was upgraded to FTSE Russell's secondary emerging market index.

International markets were buoyed by central banks, even in the face of geopolitical tension, reaching new highs in 3Q17. Hawkish monetary policy rhetoric saw money pour more confidently into equities, while positive 2Q17 earnings added to the fodder. Mid-quarter tensions over North Korea heeded some caution from investors, but concerns were later numbed by a steady flow of positive economic data. The MSCI advanced markets index was up 3% in 3Q17 and 11% year-to-date. (Chart 1.)

US equities recorded new highs in 3Q17. The S&P 500 finished above 2,500, while the Dow Jones industrial index consistently recorded levels north of 22,000 for most of September. On the quarter, the S&P 500 was up 4% and the Dow Jones 5%. Year-to-date, both indices were up 13%, outperforming other advanced economies.

The unwavering stride of US equities coincided with volatility being at all-time lows. (Chart 2.) Markets seemed complacent despite political turmoil, hurricane devastation, and North Korean brinkmanship, not to mention concerns of overvaluation. The latter, however, is more likely due the recent cyclical upturn (and the low yield environment) than to speculation. (Chart 3.) Indeed, fundamentals have strengthened, as evident in the strong 2Q17 earnings season.

In Europe, equities moved higher on the pick-up in economic growth, with the Euro Stoxx 50 finishing the quarter up 4%. Investor confidence strengthened following a stream of robust economic data. This tempered expectations of an ECB "taper" and fueled the rise in stocks. An undue consequence was the strengthening of the euro, which may have somewhat hampered momentum. A weaker electoral win for Chancellor Merkel in Germany, however, did little to faze markets.

Emerging markets continued to outperform, benefitting from harmonized global growth, but saw inflows dampened by geopolitical tension. The MSCI EM index was up a strong 7% on the quarter, and an impressive 21% year-to-date. (Chart 1.) The rebound in commodity prices, a weaker USD, and the successful implementation of reforms in some emerging markets helped support sentiment. Portfolio inflows, however, weakened mid-quarter on concerns over the North Korean crisis. The IIF estimates August's inflows at \$15.8 billion, the lowest since January 2017. These flows may slow further given the Fed's determination to tighten, and if tensions escalate. Nonetheless, annual EM inflows are set to finish the year around their 2010-2014 average of \$200 billion.

GCC markets were mixed despite firming energy prices, overshadowed by the Qatari crisis and the less-than-pleasing corporate earnings. (Chart 4.) Kuwait and Dubai led the quarter, with the

Chart 1: Total return indices



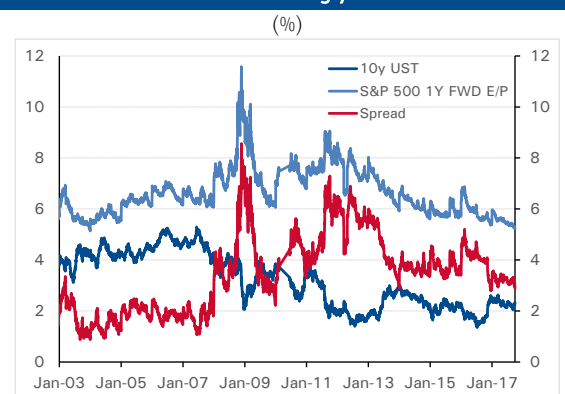
Source: Thomson Reuters Datastream

Chart 2: Volatility Index



Source: Thomson Reuters Datastream

Chart 3: Earning yields



Source: Thomson Reuters Datastream

former benefitting from a FTSE upgrade to secondary emerging market status. Saudi Arabia, Qatar, and Bahrain lagged, while the rest moved sideways. As such, the MSCI GCC index underperformed, dropping 1% in 3Q17.

Stagnant crisis negotiations weighed on Qatari equities, dragging them down by a further 6% on the quarter and 15% since the embargo began. (Chart 5.) In addition, a series of rating and outlook downgrades, coupled with news of Qatari companies being pushed out of neighboring markets, did little to allay investor concerns. Earnings for 41 listed Qatari companies were also down 9% y/y during the first nine months of 2017.

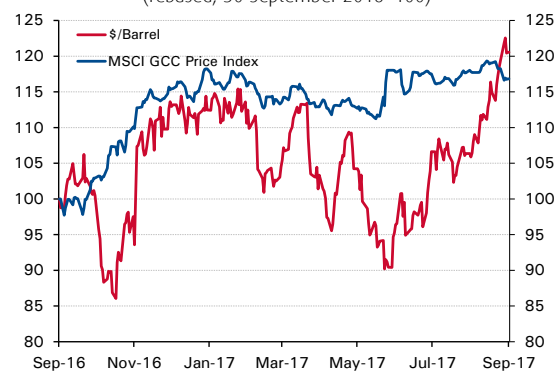
GCC-wide corporate earnings disappointed as they came below expectations, reflecting tougher operating conditions. Overall, net profits were up 3% y/y in the first nine months of 2017, but the pick-up stemmed from cost cutting rather than higher revenue. Indeed, total revenue growth across Kuwait, Saudi, and the UAE was flat and up 1% as a whole for the GCC.

Kuwait's upgrade to emerging market status by FTSE Russell will be a boon to an already over performing market. Analysts are predicting passive inflows of \$600-\$800 million as foreign investors reallocate to track the Bursa Kuwait index. Flows were already bolstered when consideration began in 1H17: foreign and GCC inflows are estimated to have totaled as much as \$350 million year-to-date. Bursa Kuwait's weighted index was up 8% in 3Q17 and 13% year-to-date. (Chart 5.)

International equities will look to central banks and global growth for direction, while regional equities will be driven by oil prices and the ongoing Qatari crisis. Downside risks remain, however. Market complacency could erode if the "global taper" proves bumpy. In fact, untimely monetary tightening could force a correction in the 8-year bull market. Political uncertainty, over the North Korean crisis and the Trump agenda in the US, could also be a source of concern for markets. In the region, further deterioration in the Qatar crisis could also hit markets.

Chart 4: Oil prices and GCC markets

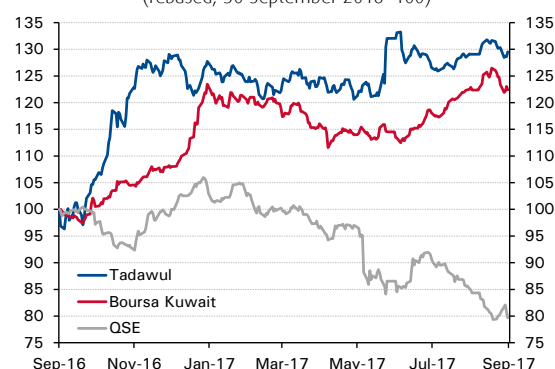
(rebased, 30 September 2016=100)



Source: Thomson Reuters Datastream

Chart 5: GCC markets

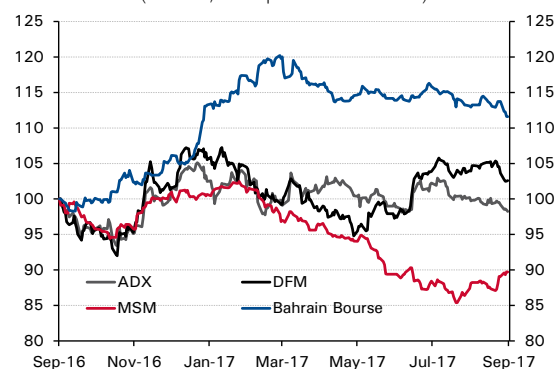
(rebased, 30 September 2016=100)



Source: Thomson Reuters Datastream

Chart 6: GCC markets

(rebased, 30 September 2016=100)



Source: Thomson Reuters Datastream

Table 1: GCC markets indicators for 3Q17

	Market capitalization (USD billion)	Average daily turnover (USD million)	Growth in 9M17 profits (% y/y)	Price/earnings per share
Bahrain (Bourse)	21	2	20	8.4
Kuwait (Boursa)	100	57	16	16.8
Oman (MSM)	21	8	-29	13.9
Qatar (QSE)	124	55	-9	12.3
Saudi (Tadawul)	454	722	10	16.3
Abu Dhabi (ADX) & Dubai (DFM)	243	115	-3	20.1
GCC	962	960	3	-

Source: Thomson Reuters Datastream, Thomson Reuters Eikon

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