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David Stevenson: This Gulf fund shines out like a beacon

There are good reasons for Gulf Investment Fund shares to be trading at a small premium. And they're not all to do with the oil price.

BY DAVID STEVENSON

As we are knee-deep in the summer season, I thought I'd stick with my journey around the fringes of the investment universe by looking at emerging and frontier markets. Next week I'll arrive in India, the coming big market for many, but this week I want to touch down in the Middle East and look at the surprisingly successful **Gulf Investment Fund** (GIF).

This small, sub-£100m, dollar-denominated closed-end fund has been around for more than 16 years and has gone through various permutations, starting off as a Qatari-focused fund. It's now determinedly investing in the markets that comprise the Gulf Cooperation Council with a major focus on Saudi Arabia whose stocks comprise just under 60% of the total portfolio by value.

Amazingly, the investment company is one of the few London-listed funds currently trading at a small premium of 1.4% over net asset value (NAV), although over the last 12 months it has traded as low as a 7.7% discount below NAV.

Impressive performance

That premium rating is in part because – although the fund is diminutive and sub scale, and suffers from liquidity constraints with two very large shareholders owning more than two-thirds of the shares – its stock-picking track record is impressive.

Over the last ten 10 years the share price has generated a 311% total return, although the underlying NAV gain was 218%. On a five-year basis, the equivalent returns are 179% (share price) and 126% (NAV), while in the last 12 months the same numbers are up 22% in share price returns and 10.5% in NAV terms. The shares yield about 2.8%.

The lazy interpretation – which has some truth to it – is that the fund is a simple play on the oil price. According to Sharepad data, over the past five years, Brent crude has moved roughly in line with the GIF share price with a correlation of 0.76, although the correlation over two years is much lower at 0.42.

That's not surprising as economies like Qatar and Saudi are heavily dependent on either the oil price or natural gas rates.

But there's more to it than that. What most of the Gulf states are trying to do currently is move up the value chain towards industrial and societal modernisation. They've twigged that the model offered by Dubai had something to it, with its modernisation agenda, focusing on value-add industries, tourism and commerce.

These Gulf states may be ruled by autocrats, but they've worked out the 101 of economic modernisation – focus on exports, build up your consumer market and then accumulate funds that can be invested globally.

Thus, if you dig around in the Gulf Investment portfolio you will find a heavy focus on industrial stocks at nearly 30% of the portfolio plus a smattering of consumer and financials stocks.

Another example is tourism – the Saudi government aims to increase the contribution of the sector to its economy to more than 10% by 2030 from 3.2% currently. In the process, they aim to target 100m annual visitors, including 30m religious' tourists, and create more than 1mn additional jobs.

The country launched its new airline, Riyadh Air, to cater to these goals. Riyadh Air, the new carrier of Saudi Arabia, has already placed a 72 aircraft order with Boeing in March. The airline is expected to be launched in 2025. The fund plays this space through holdings in Saudi Ground Services and Seera Group Holding.

Now the fly in the ointment is that not only will all that oil (less so natural gas) cease to have much value at some stage but in the meantime energy prices could zig-zag despite the best efforts of Opec+. The danger is a global slowdown/recession which could see oil prices fall below $70 a barrel.

Gulf fund beats Saudi tracker

Performance	Year to date	One year	Three years	Five years	Since GIF strategy change *
GIF net asset value	20.60%	20.30%	107.00%	123.40%	171.10%
MSCI Saudi ETF	10.90%	2.10%	65.00%	45.90%	84.10%
Oil price	9.70%	18.20%	42.00%	77.50%	87.00%

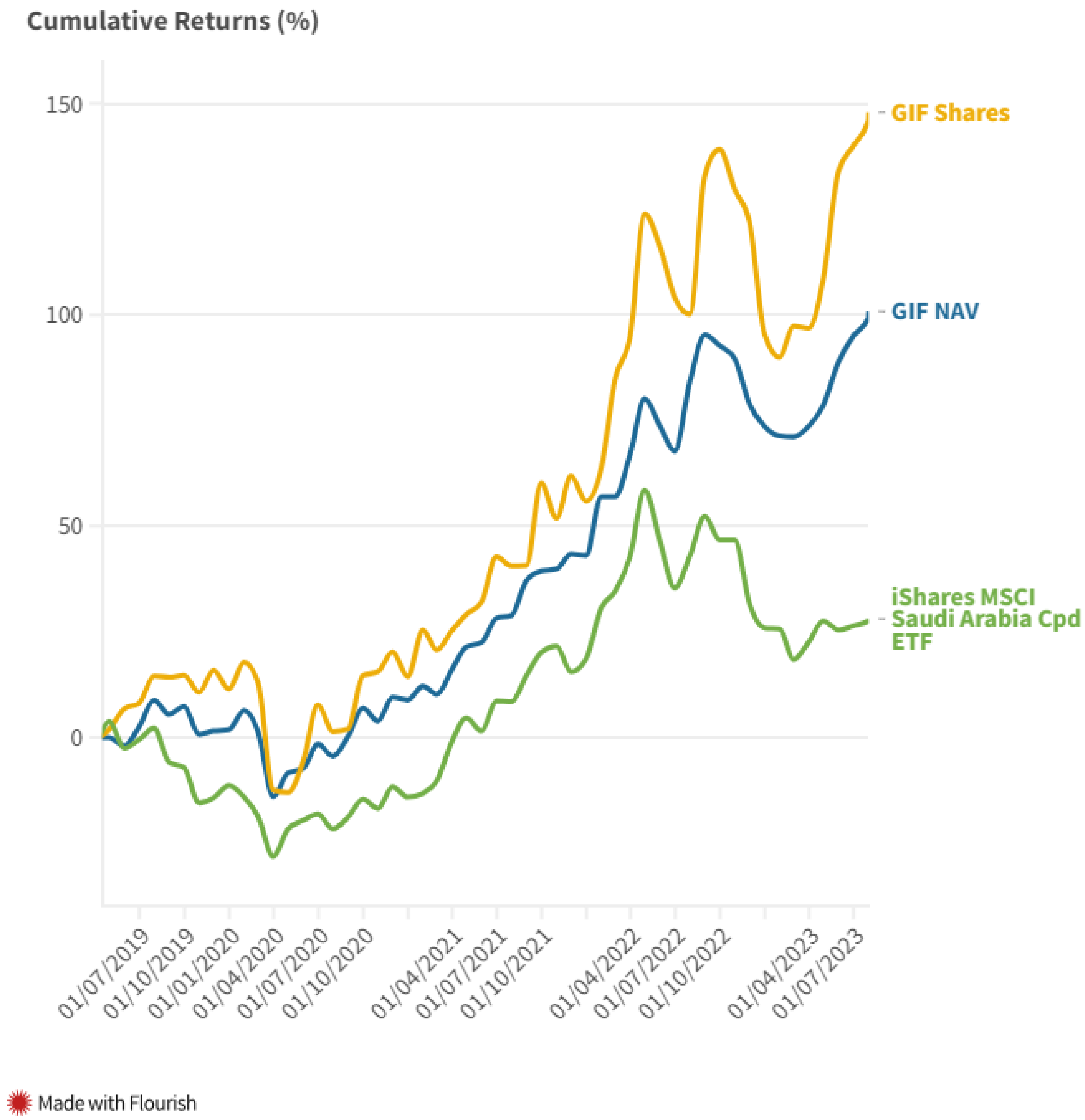
*Source: SharePad. Data up to 30 June 2023. * Strategy change 7 December 2017*

I have my doubts about that scenario in the medium term. While I accept a sharp slowdown could see prices crater, as they have done recently when futures prices briefly went negative, in a few years I can't see prices staying too much below $70. Demand from developing countries is still strong, the major energy corporates have under-invested over the last decade and the US unconventional sector is holding back on ramping up supply as it has done in the past.

Opec would also dearly like to keep prices above $70-$80 if only because so many of its members depend on balancing their books at that price range. Most observers reckon the GCC region is forecast to grow by 2.9% in 2023 and 3.3% in 2024, much of that powered by energy-related trade.

So, in sum, I think the odds are that prices will stay in the $70-$80 range and could even head higher if developed world demand surges again in 2024 at some stage. That's good news for the Gulf states and for the fund.

But there are other reasons for the fund's premium rating – its strong performance from superior stock picking is demonstrated by the way GIF has in recent years shot away from the IKSA iShare exchange-traded fund tracking the Saudi stock market (or the iShares MSCI Saudi Arabia Capped UCITS ETF to give its full name), which launched in 2019.



Cumulative Returns (%)
150
100
50
0
GIF Shares
GIF NAV
iShares MSCI Saudi Arabia Cpd ETF
01/07/2019
01/10/2019
01/01/2020
01/04/2020
01/07/2020
01/10/2020
01/04/2021
01/07/2021
01/10/2021
01/04/2022
01/07/2022
01/10/2022
01/04/2023
01/07/2023
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Another reason for the fund's outperformance has been tight liquidity. As mentioned above, two large institutional holders control more than three-quarters of the shareholder base and the fund has also been active in making sure that discount remains under control or eliminated. In March this year for instance it launched a tender offer at NAV less costs. Alongside that, the fund has also been quietly issuing shares to satisfy demand when appropriate.

There are of course plenty of things that could go wrong, quite apart from plunging oil prices. I'm not quite as sanguine as some about political risk in Saudi Arabia and then there's always the joker in the pack in Iran which could cause trouble at any moment, as well as Israel's propensity to galvanise sentiment across the region.

Another geopolitical risk is Egypt, which is in effect increasingly a subsidiary of its richer Gulf cousins – its government is inept, corrupt and liable to break at some point, pushing waves of instability out across the whole Middle East.

Overall though I think your bet with this fund is that the Gulf states become bigger, more modernised and continue to milk their energy reserves to pay for various transitions. If that happens the room for an active stock-picking fund manager with a focus on small to mid-cap stocks (61% of the fund) could pay dividends.