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Gulf Fund Smiles On Manufacturing, Tourism Sector; Trims Financials' Bearish Stance

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This news service spoke recently to a fund that focuses on Gulf region countries' companies, and the investment mindset at work.

Optimism over natural gas production and manufacturing means that a London-listed fund specialising in the Gulf region is overweight industrial assets. However, it has trimmed its underweight position on financials, because negative news on this sector has been increasingly priced in.

WealthBriefing recently spoke to Bijoy Joy, portfolio manager at Gulf Investment Fund, which had $100 million in net assets as at the end of 2023. With sporting events such as Grand Prix motor races taking place in Bahrain and Saudi Arabia, they also highlighted how the Gulf's profile is rising – and largely for positive reasons.

Gyrations to the world's energy markets and rises to interest rates in much of the world have significantly influenced the fund's asset tilts. (Founded in 2007, it used to be called the Qatar Investment Fund, and changed its brand in 2017. It has since broadened its geographic scope.)

GIF aims to capture the opportunities for growth offered by the GCC economies of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates by investing in listed or soon-to-be-listed companies on one of the GCC exchanges.

There has been a relatively strong recovery by the Gulf region's economy following the pandemic lockdowns, and areas such as tourism are growing rapidly. This is driving significant infrastructure spending, Joy told this publication. In Saudi Arabia, for example, an older quota system to control tourist trips to religious sites is being eased as hotel/transport facilities are being significantly eased, he continued.

As Joy and colleagues know, the Gulf region has enjoyed something of a boom, notwithstanding wider geopolitical difficulties. Compared with parts of North America, and certainly with Europe, the region's growth is robust. Swiss Re has predicted that in the UAE, for example, the economy will grow by 4.2 per cent in 2024, supported by both the oil and non-oil sectors. As far as stock markets in the region fare, the MSCI Frontier Market GCC Countries shows total returns (capital growth plus reinvested dividends) of 8.32 per cent in dollar terms. That's slightly ahead of frontier markets as a whole.

There has also been a strong return to working in offices in the UAE – which is positive for that part of the property sector, Joy said.

"In Dubai, more than 40 hedge funds have opened offices and lots of organisations are moving to Dubai, and it is competing with Singapore, Hong Kong and London," Joy, who is based in Doha, said.

Clearly, there are risks to consider. A fall in the price of oil is the biggest risk, although as Gulf Co-operation Countries diversify away from oil and gas, this risk is lower than it was.

Joy, who has been in the job since Jubin Jose stepped down at the end of 2023 as GIF's portfolio manager, stepped up from being the assistant portfolio manager. Joy had worked with Jose for the past 10 years.

Financials and industrials

Last year the fund was heavily underweight financials because rate hikes squeezed banks' margins, he said. While it would be correct to point out that higher rates tend to boost banks' net interest margins, much of the rate hikes were already priced in. In addition, because of the fast-paced nature of the rate hikes, funding rates were repricing much quicker than the lending rates. Banks with higher share of CASA (low cost deposits) tend to benefit more when there is a sharp increase in interest rates (for instance Saudi and UAE banks). However, banks in Qatar have low CASA, and didn't see the same benefit, which is more to do with the dynamics within GCC.

Private sector lending slows when there is sharp increase in interest rates, impacting new loan originations and margins. Despite this, we are seeing low double digit lending growth in Saudi Arabia. Valuations in financials have come down, so the fund has cut its underweight stance from last year, he said.

"Lending in Saudi Arabia is rising in double digits, and rising by high double digits…Banks are not expensive and their return on equity levels are quite benign," Joy said. Most Saudi banks are trading between 10 and 12 times on price to earnings and return on equities ranging between 12 and 18 per cent.

A large overweight of the fund is industrials. Improvements to energy areas, such as Qatar's natural gas sector, and areas such as manufacturing, are reasons. "We see a lot of opportunity and a lot of growth," Joy said.

There is a link between the rise in tourism and manufacturing/industrials, such as the buoyant outlook for Saudi Catering, an aviation ground handling company, for example. "We see a lot of growth there. We are excited by large projects by this [Saudi] regime."

Tourism is a significant force, not just involving Westerners getting away from the cold American and European winters to find sun. In Dubai, meanwhile, tourism is up 19 per cent from a year ago, according to the Department of Economy and Tourism in Dubai.

There's a domestic angle happening. "People in Saudi Arabia are spending more money on internal tourism than on going abroad," Joy said, arguing that this is an historic shift.

As the fund is a closed-ended, listed vehicle, its shares can traded at a discount to net asset value. As of 27 March, the discount is 3 per cent, narrowing sharply from 13.2 per cent at the end of December.

Oil prices falling is still the biggest risk but as the GCC economies diversify away from oil and gas this risk is less than it was.

This publication asked Joy what place the fund should take in clients' portfolios.

"[It should be] as a less correlated holding to emerging markets and developed markets. The GCC is only 0.47 correlated with MSCI EM index; 0.85 correlated with FTSE Dev Markets and 0.86 correlated with both S&P 500 and MSCI World," Joy said.

Since the fund ceased to focus solely on Qatar in 2017, performance has surged – up 217 per cent.

"If we can compare on a five-year basis, our fund has outperformed both emerging and developed markets," Joy said.