GCC Asset Management

Drive Stability & Financial Growth

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Foreword

The 'GCC Asset Management - Drive Stability & Financial Growth' report has been prepared to present readers with the impact of digital innovations and impending regulatory reforms in Gulf Cooperation Council could have on fund flow and returns.

These are challenging times for the GCC banking and financial services industry, given the sharp decline in oil revenues of the member countries leading to a squeeze in capital flow and investments.

Despite numerous ensuing challenges, we are set for exciting times ahead as the report broaches upon the current investment and regulatory scenarios, impact of innovative new technologies and new trending industry topics - tokenization, blockchain, and cryptocurrency that can be tapped upon.

This would encourage the need to have professional investment research and support services to sail through market volatility as asset managers can help in strategic asset allocation and in ensuring steady returns.

We are certain that this report would be an extremely useful reference and would give all stakeholders the much needed direction towards the asset management industry in GCC.

Executive Summary

This report is an attempt to present the readers with a ringside view of the changing dynamics of the GCC asset management industry.

Globally, the asset management industry is accelerating at an exponential rate. Assets under management (AUM) has grown significantly, thanks to the increasing number of high-net worth individuals (HNWIs), a wide range of asset classes and spurring investments across retail and institutional portfolios.

The role of technology in providing momentum to the industry's growth cannot be undermined. In the coming years, latest technology platforms (big data, artificial intelligence (AI), robo advisors and blockchain technology) are expected to drive quantum change across the value chain, with focus on new client acquisition, customized investment advice, research and portfolio management, middle and back office processes, distribution and client engagement.

GCC countries have traditionally generated huge revenues from oil and gas exports. However, turn of events such as the financial crisis of 2008 and declining crude oil prices severely impacted the region's financial health, including the relatively young asset management industry.

A number of asset managers including private equity houses were exiting and investments came to a standstill. To add, the region was further affected by macro-economic instabilities primarily due to plunging oil prices and lower global demand (~60% since 2013). However, the region started to show signs of recovery after 2016 with rally in crude prices and overall financial sector undergoing a significant transformation.

Total assets managed by fund managers in GCC are expected to reach USD 110.9 billion in 2020 from USD 45.8 billion in 2016.

The government initiatives to broaden their financing mix for the liquidity needs of Islamic retail banks have driven sukuk bond issuances. Additionally, Shariah-compliant funding is gaining momentum, with Islamic banking accounting for 45% or nearly half the banking sector. Fixed income and equity securities have grown substantially as an asset class over the past decade. In spite of this, GCC is far behind in making a mark in the global investment market.

After witnessing a muted activity in 2015 and 2016, GCC's IPO market has seen a surge with 28 offerings last year. Increased listing activity on Tadawul's NOMU parallel market and the introduction of REIT listings are the key contributors to this growth.

These developments would aid in complete diversification of economies besides reducing dependency on oil.

GCC is expected to record overall 2.4% growth in the current year, up from 0.1% in 2017. The future of the asset management space is closely linked to the economy and as such would benefit from the improving economic conditions and ongoing government initiatives.

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Global Asset Management Snapshot

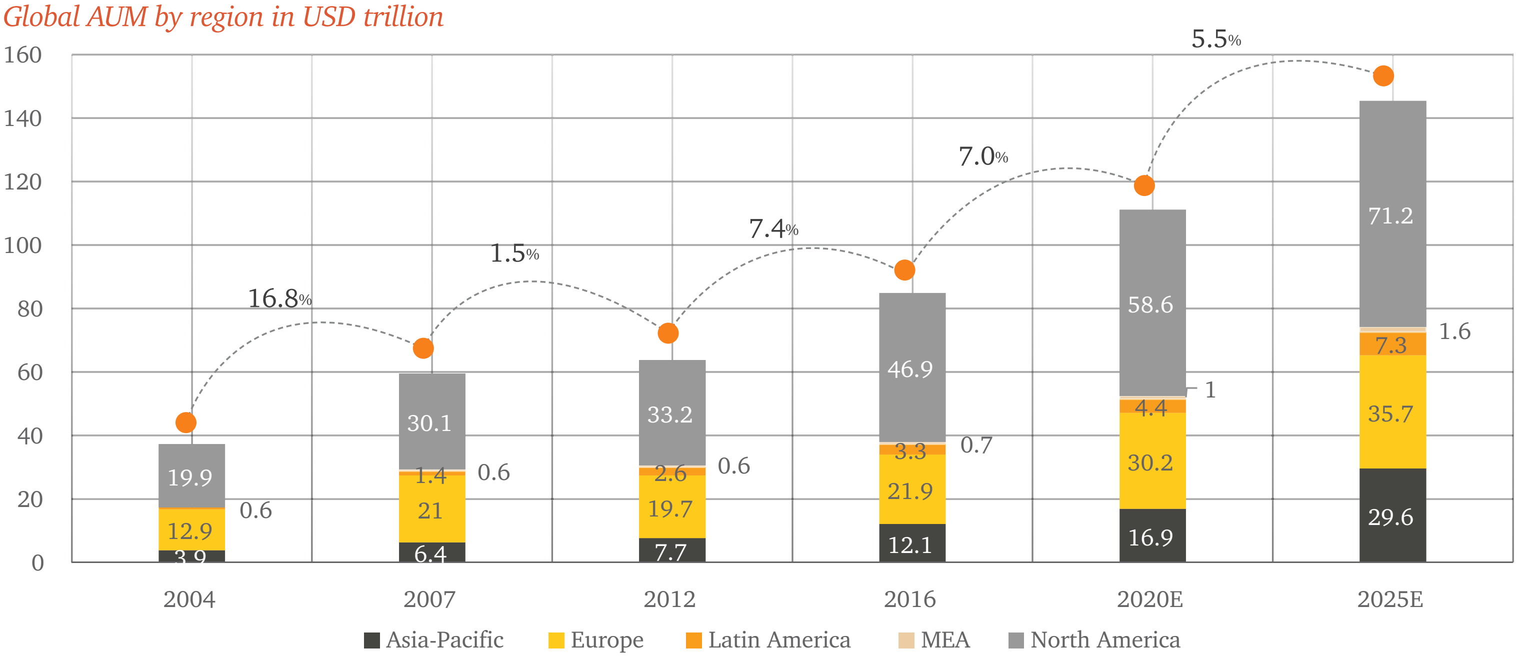
The global AUM is expected to rise by a CAGR of 6.2% from USD 84.9 trillion in 2016 to USD 145.4 trillion by 2025 owing to growing wealth of HNWIs, shift towards funded/ defined pension plans and availability of wider investment options.

A. Size of Current Asset Management Industry

The global asset and wealth management industry has come a long way since the global financial meltdown in 2008, with all regions registering a sharp decline in asset values in the past. The industry is reckoned as an important source of economic growth as it bridges the gap between savings and investment channels.

The global AUM is expected to rise by a CAGR of 6.2% from USD 84.9 trillion in 2016 to USD 145.4 trillion by 2025. The fastest growth is anticipated in the developing markets of Latin America and Asia Pacific.

Global AUM by region in USD trillion

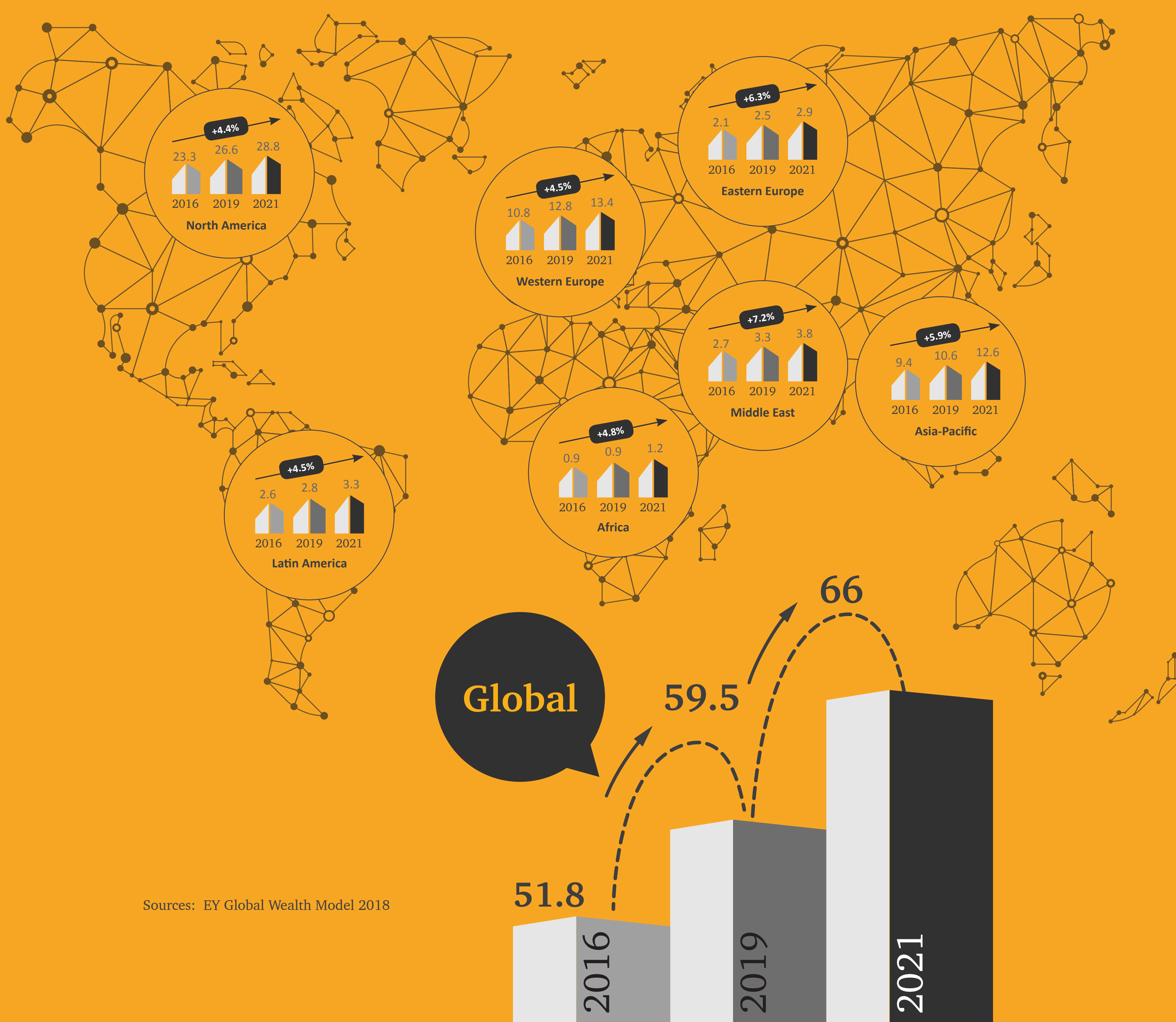


Sources: PwC

Key growth drivers:

- Growing wealth of HNWIs and the mass-affluent
- Remarkable shift towards funded/defined contribution retirement saving plans
- Investible assets that once revolved around only equities and bonds has now widened to include real estate, hedge funds, private equity, currencies, commodities, natural resources, infrastructure, and even intangibles (e.g., intellectual property rights), promoting further growth
- Wider investment options along with the increasing trend towards diversification have drawn investors to guard their portfolios from market volatility while achieving balanced/higher returns

Net investible assets of HNWIs globally are expected to increase



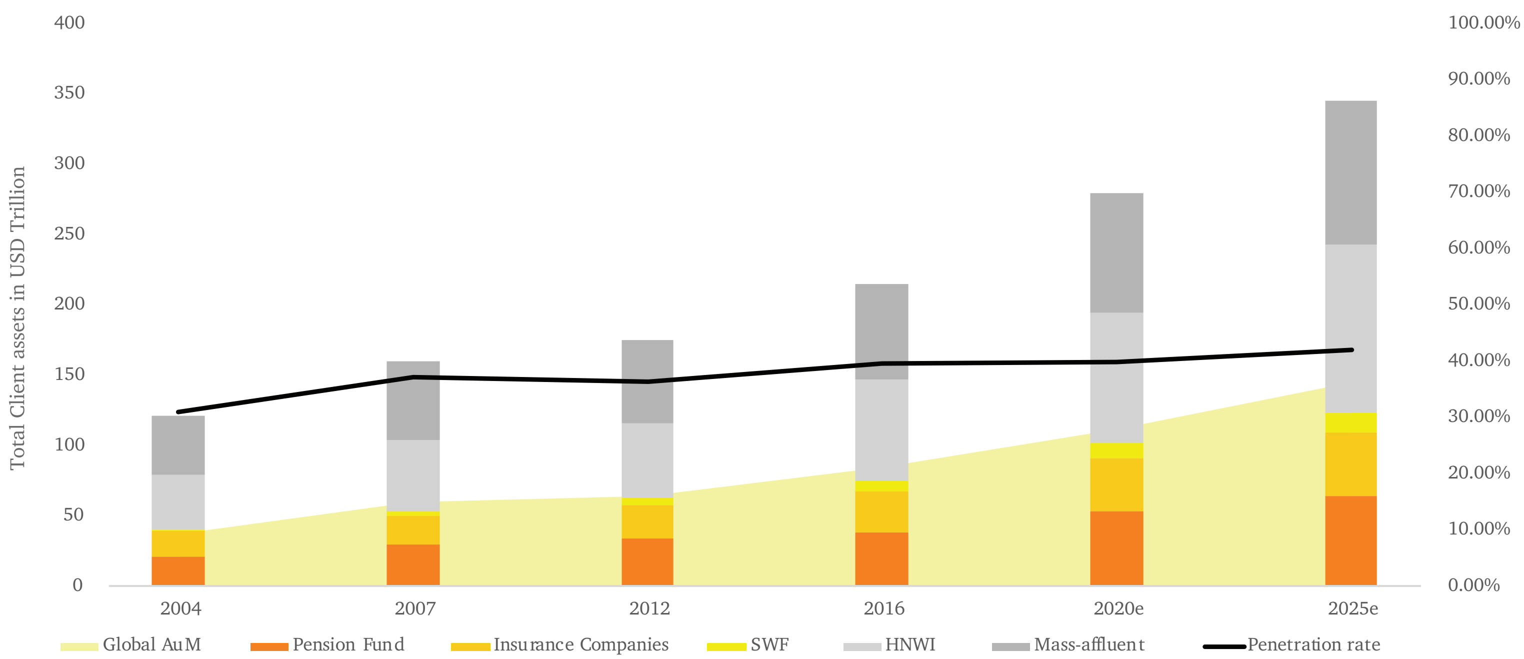
Sources: EY Global Wealth Model 2018

Besides the aforementioned factors, the rise in the value of investible universe over the last two-three decades has been driven by a host of factors such as continued global recovery, positive regulatory changes, financial savings versus local investment needs, rising financialization of world assets, and imbalances in trade-driven flows leading to trade surplus and deficits.

There are tremendous growth opportunities in professional asset management services, given the assets of pension funds, insurance companies, sovereign wealth fund (SWFs), HNWIs are likely to multiply.

Despite such favorable factors, certain geo-political and economic factors like increasing populism worldwide, evolving trade regulations, Brexit negotiations, China's transition to a consumer driven economy, and changes in interest rates and taxations could put spoke to the growth story.

Global AUM



Sources: PwC

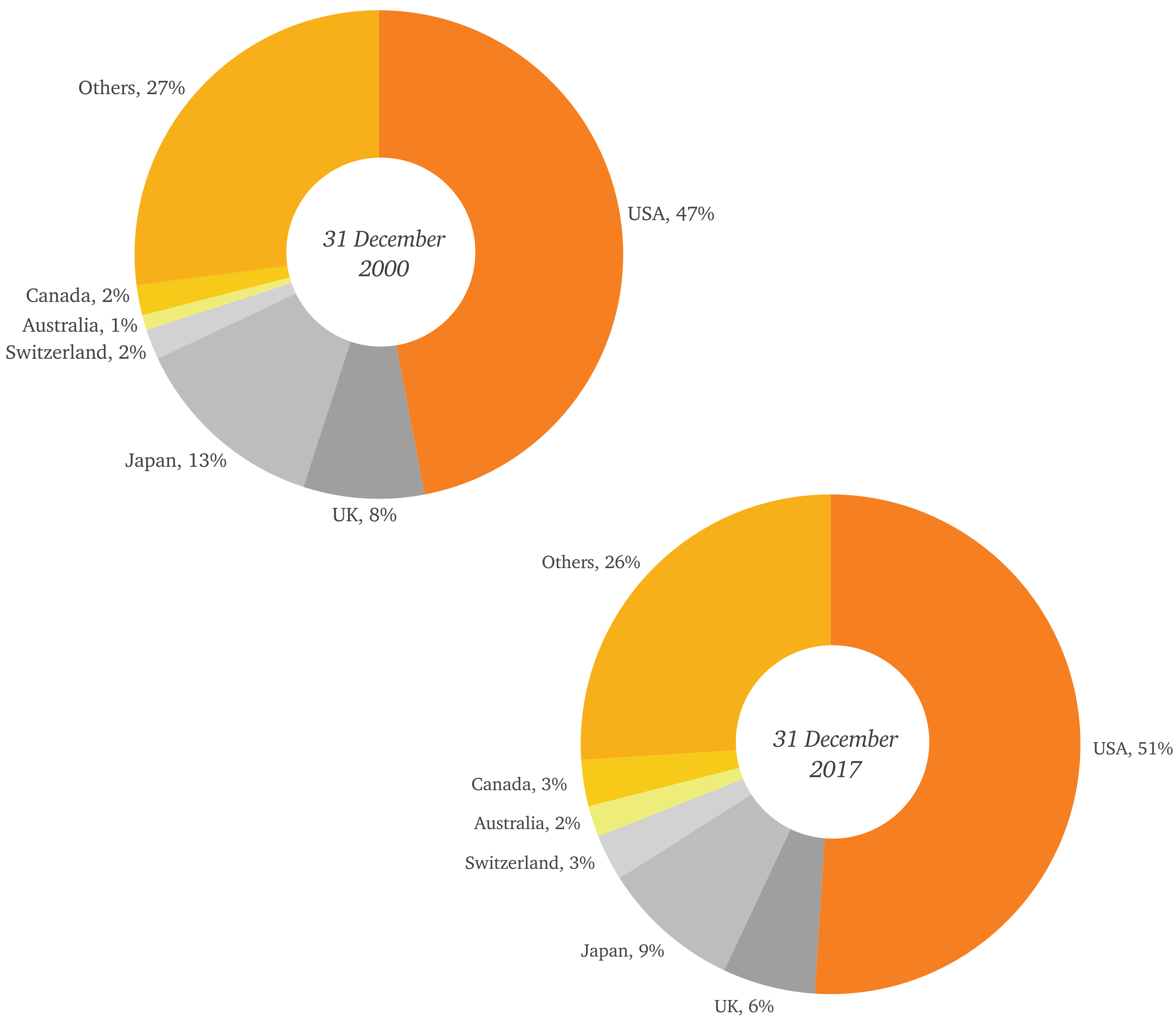
Note: Foundations and Endowments assets were not included as their total global assets represent less than 1% of all client assets.

B. Asset Classes and Past Performance

I. Equities

Equity markets have grown in size and sophistication over a century, with the US market becoming the most dominant equity market in relative terms across the world. Emerging markets stocks in the year 2017 yielded a 38% return against developed markets (23%).

Fig: Relative sizes of world stock markets – 2000 vs 2017

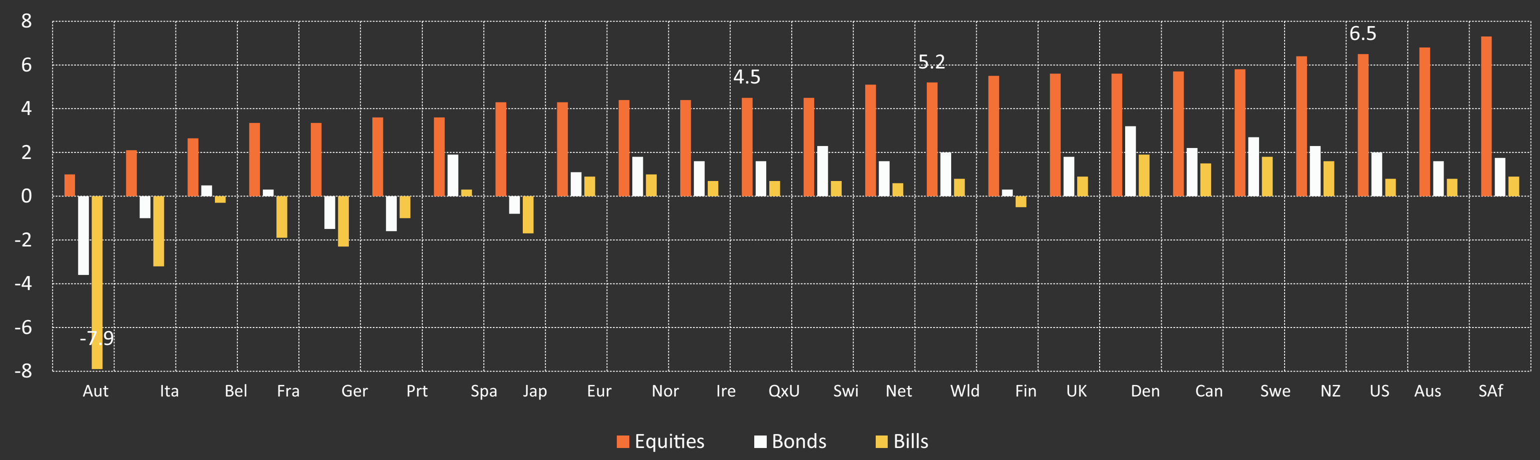


Source: DMS database, FTSE Analytics

II. Fixed income asset class

Since the year 1900, global equity markets have outperformed cash (Treasury bills) and bonds by 4.3% and 3.2% a year, respectively. Countries with poor bond returns were also among the worst equity performers.

Real annualized returns (%) on equities versus bonds and bills internationally, 1900-2017



Source: Triumph of the Optimists, subsequent research

III. Real-Estate

Real-estate could generate higher returns and act as a diversification option, but many institutional investors view it as a high risk play, especially in developing countries. Since 1900, house prices in real terms have appreciated by approximately 0.4% per year before costs and quality adjustments.

IV. REITs

REITs are akin to mutual funds as an investment concept wherein the instrument draws its strength from the underlying pool of real estate assets. REITs offer significant advantages compared to owning a physical real estate. Investors get to own a pie of vast pool of realty assets which in itself helps reduce risk as returns are derived from a diversified asset pool. The ease at which REIT can be sold over the exchange lends remarkable liquidity compared to the time and effort involved in selling physical realty. Cash flows rental income move in tandem with inflation and provides a natural hedge and makes REIT a perfect investment option for investors who seek superior returns and risk hedge. Transparency of price and returns and professional management renders REITs a safe investment haven. The real estate securities have posted better risk adjusted returns compared to the most popular and large asset class like equities. In fact, REITs market in USA is said to be $5 trn and has outpaced S&P500 in the last eight years.

C. Emerging Trends

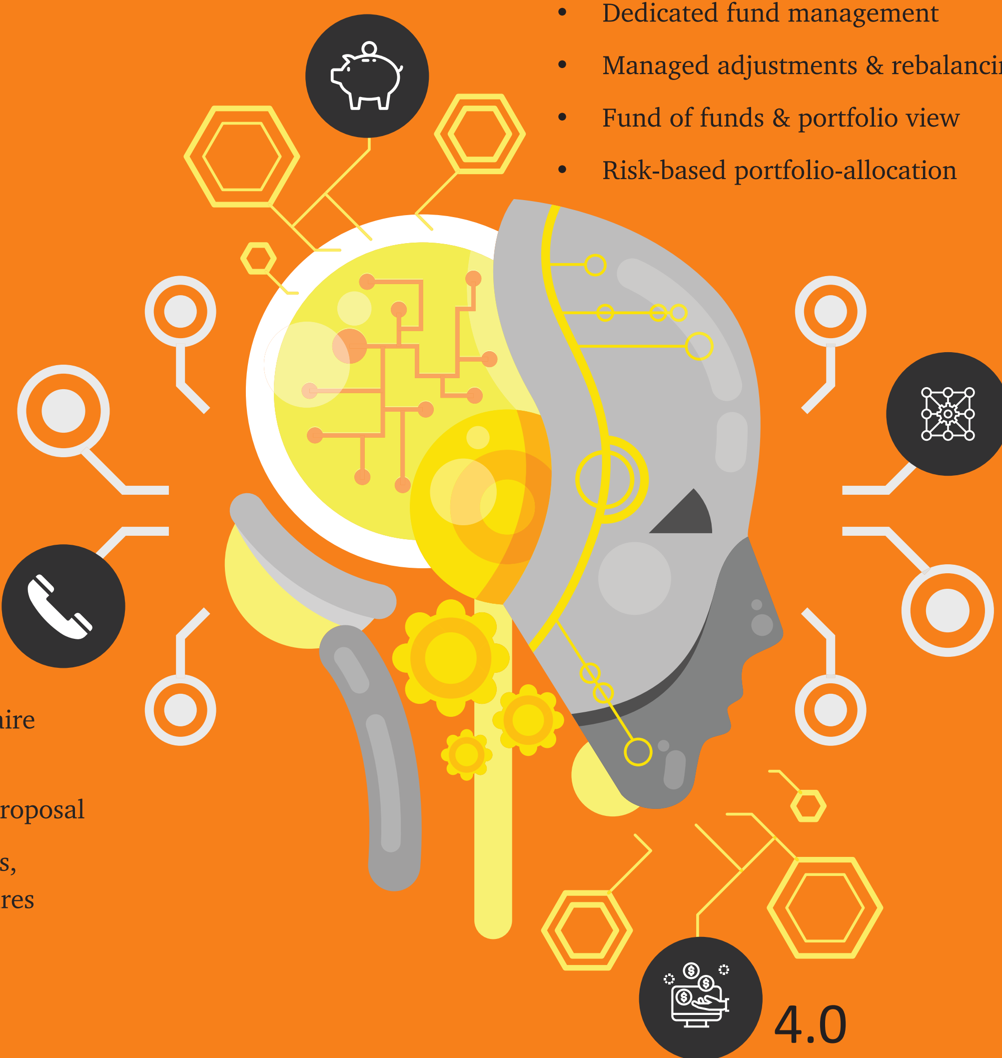
I. Big data & Artificial Intelligence (AI)

Asset managers who are able to capitalize on data, machine learning, and artificial intelligence (AI) will be in the best position to thrive in a future increasingly marked by lower fees and weaker fund flows. Possible applications of AI in asset and wealth management include research analysts having their own bots using real time big data to perform a major chunk of their market and financial analysis, and even assemble reports and recommendations to the CIO.

II. Robo Advisors

Robo-advisors use computer programes to find optimal investment strategies for clients. Given their easy, automated and user friendly processes, low-cost portfolio management and solid performance, robo-adivosry can be integrated with traditional asset management to help achieve cost efficiency.

Robo-Advisory market's Assets under management (AUM) is estimated to reach between USD 2.2 trillion and USD 3.7 trillion in 2020. By the year 2025, this figure is expected to rise to over USD 16 trillion AUM.



1.0

- Online questionnaire
- Product or portfolio proposal
- Listed ETFs, bonds, shares

2.0

- Dedicated fund management
- Managed adjustments & rebalancing
- Fund of funds & portfolio view
- Risk-based portfolio-allocation

3.0

- Algorithm based adjustments & rebalancing proposal
- Pre-defined investment rules-sets

4.0

- Fully-automated investments
- Self-learning algorithms
- Automatic asset shifts

Source: Deloitte

III. Environmental, Social and Governance (ESG) investment

Environmental, Social and Governance (ESG) investment is seen as another mega-trend as more investors seek to pump their money in responsible businesses from an environmental, social, and governance perspective.

From 2014 to 2016, sustainable, responsible and impact investing enjoyed a growth rate of more than 33%, increasing from USD 6.57 trillion in 2014. It comprises more than one out of every five dollars under professional management in the US today.

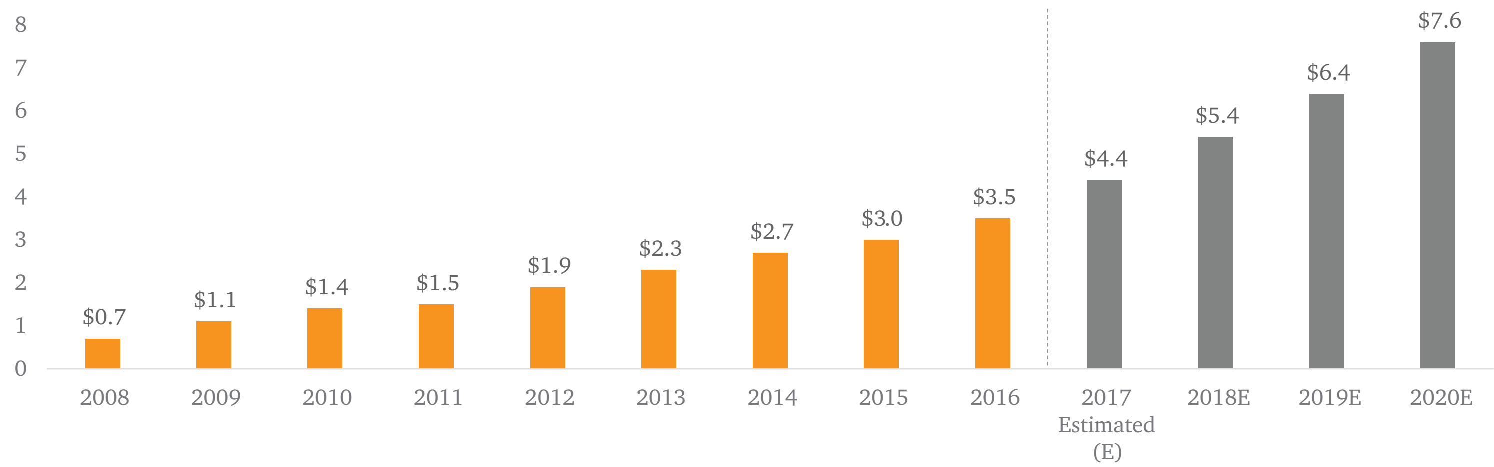
IV. Explosive growth in ETFs

There has been an explosive growth in this category as institutions increase their use of ETFs in a variety of ways.

Factors driving growth:

- Institutions are integrating ETFs in risk functions and liquidity management
- ETFs are being employed as a replacement for active mutual funds
- Institutions are investing in smart beta ETFs to help navigate the challenges posed by low interest rates and rising market volatility
- Managers are adopting ETFs for cost-efficiency and flexibility in implementing their dynamic investment strategies
- Bond ETFs are helping investors to overcome the liquidity

The future growth of global ETFs



Source: Morningstar Direct

V. Factor investing:

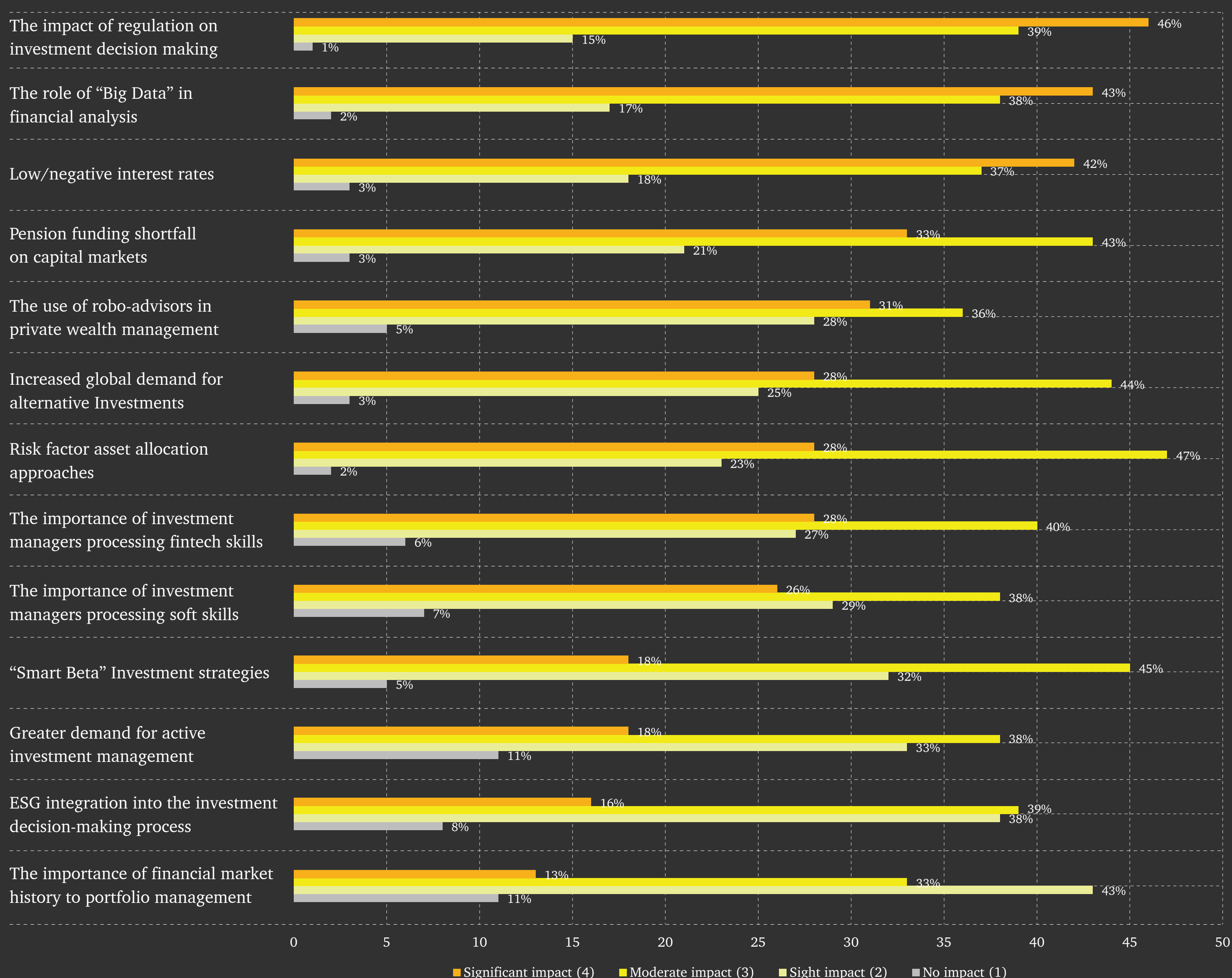
Growth and value styles have been successful strategies in the past but there have been extended periods when particular styles have underperformed relative to the other. Value investing style took the hardest hit after the global financial crisis with the growth investing style outperforming it.

Factor investing can better suit the diversification needs and investment objectives by helping construct a risk exposure optimized portfolio.

VI. Blockchain Technology

With the implementation of a blockchain technology, stocks can be issued, derivatives created, instant cross-border money transfer executed, IPOs floated and land rights registered without requiring an intermediary. By 2022, blockchain technology is expected to save USD 20 billion in securities transaction costs.

Nasdaq was the first global stock exchange to publicly launch a blockchain platform for its private market clients. Following is the result of the industry survey conducted by the CFA Institute studying the impact of several factors on investment management practice over the next three years.



Source: "CFA" Program 2017 Practice Analysis Survey"

Note: Percenatges on the above chart may not add to 100% due to rounding

04

Asset Management in GCC

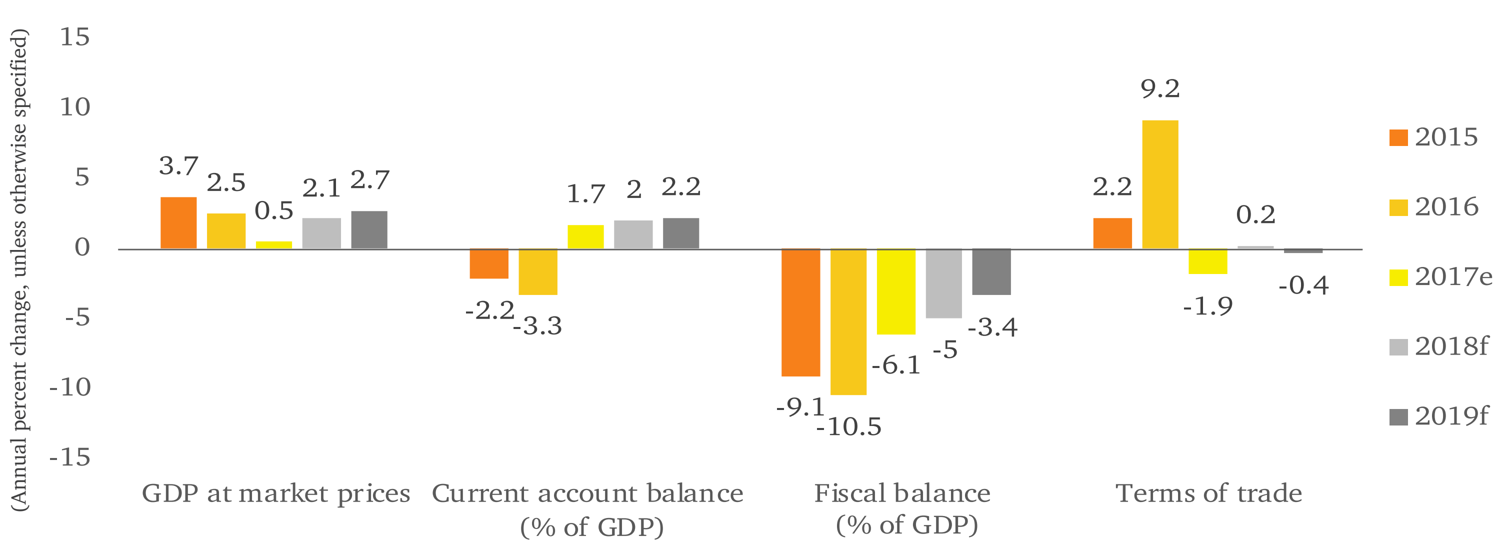
The total assets under management in the GCC are expected to reach USD 110.9 billion in 2020. GCC markets have also witnessed an unprecedented rise in IPO numbers with 28 stock market floatations in 2017, compared to just four in 2016.

A. Macro-economic Snapshot

GCC countries are currently plagued by macro-economic instabilities due to plunging energy prices. The current account deficits had widened and growth was muted throughout the region. However, with upswing seen in oil prices from 2016, economic pressure has eased.

The GCC clocked GDP growth of just 0.5% in 2017, recording its weakest since 2009. This came on the back of lower oil production and tighter fiscal norms. External debt issuance continued to rise in order to fund large fiscal deficits.

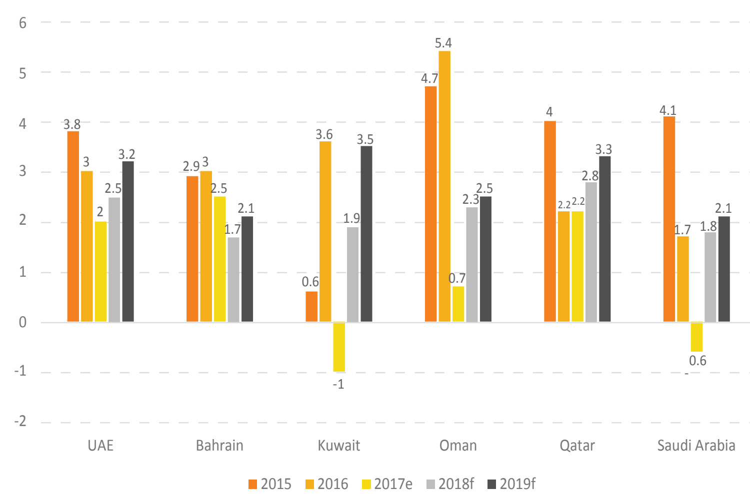
Macro factors Aggregate GCC countries



Source: World bank group

The UK's decision to exit from the European Union and the election of Donald Trump as President of the US in 2016 shook the GCC financial markets for a brief period.

GDP at market prices



Source: World bank group

Crude oil price history

Source: Thomson Reuters Eikon

The GCC economy is expected to strengthen gradually, helped by the recent partial recovery in crude oil prices, expected expiration of oil production cuts after 2018, and easing fiscal austerity.

The World Bank predicts growth to firm at 2.1% in 2018 and further rise to 2.7% in 2019. Saudi Arabia's economic growth is expected to rebound close to 2% in 2018-19. Similar positive growth trends are expected throughout the GCC countries.

B. GCC Asset Management Industry – Current Size

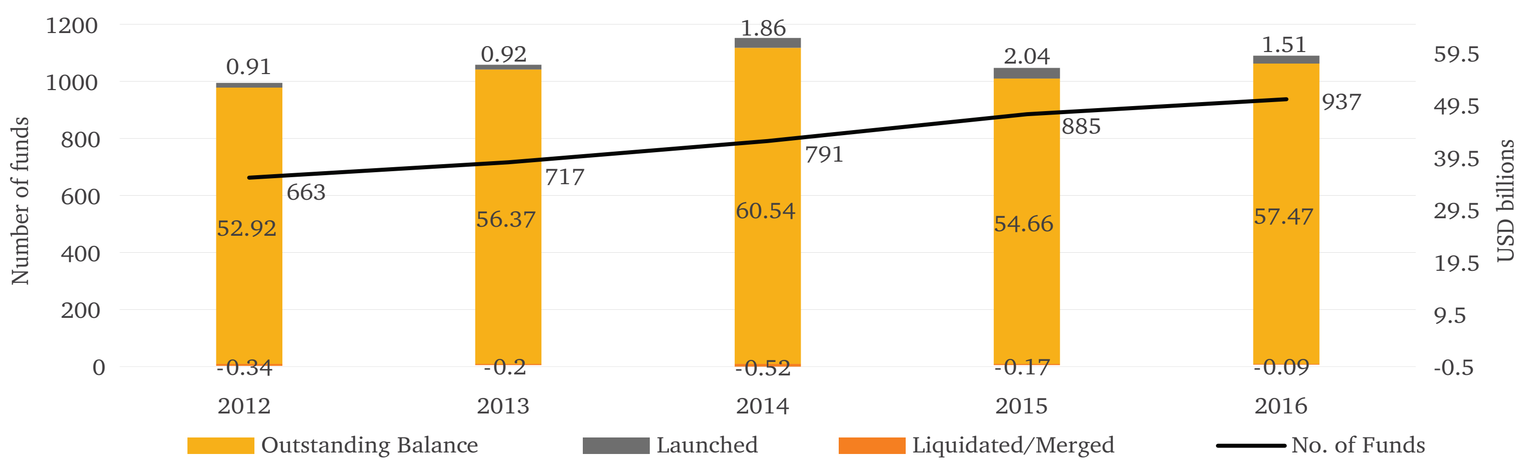
The total wealth in the region was estimated at USD 8 trillion in 2015 and is expected to grow to USD 11.8 trillion by 2020 (8% annually, faster than the global average of 5.9%).

At the end of 2016, institutional investors based in GCC countries had around USD 3,500 billion in combined AUMs. An industry body research report reveals that the total assets managed by fund managers in the GCC are expected to reach USD 110.9 billions in combined AUMs in 2020 from USD 45.8 billion in 2016.

Growth is primarily driven by:

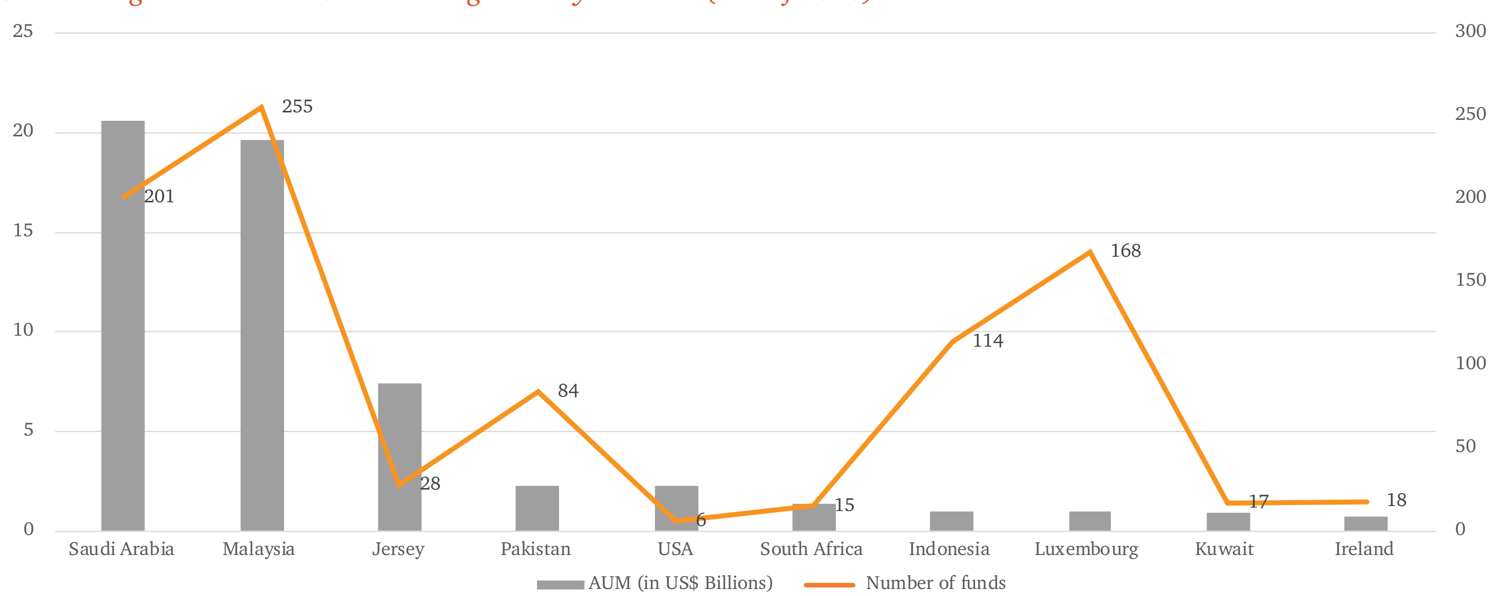
- A small number of SWFs that account for about a third of the region's assets
- Increasing number of mass-affluent and HNWIs in emerging markets including the Middle East
- Islamic asset management continues to grow at a moderate CAGR of 2.4% since 2012 to reach USD 58.9 billion in AUM by the end of 2016 in the GCC region.

AUM of Global Islamic Funds Outstanding



Source: Thomson Reuters Lipper

Outstanding Islamic Assets Under Management by Domicile (End of 2016)



Source: Thomson Reuters Lipper

C. Constituents and their Performances

I. Equities

Corporate earnings in the GCC rose by 16% for the full year compared with 2016, according to the latest report by the Kuwait Financial Centre

Sector-wise performance:

On aggregate, commodities, banking and construction were the top performers, with earnings growing at 29%, 9% and 6%, respectively. The recovery of oil prices and improved interest margins helped the commodities and banking sector companies post higher profitability.

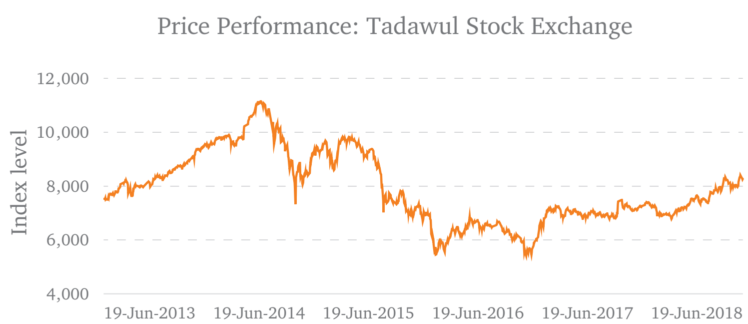
Geography-wise performance:

In 2017, the UAE, Kuwait and Saudi Arabia recorded growth in earnings of 62%, 10% and 9%, respectively.

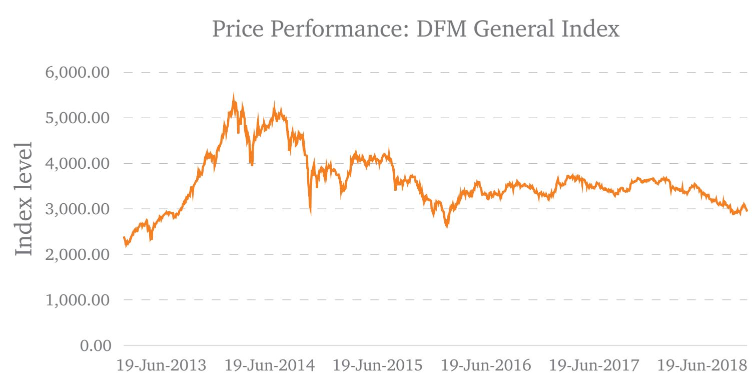
- The UAE recorded such a high rate due to low base
- Saudi Arabia's growth was largely helped by the momentum seen in its non-oil sectors such as banking, telecommunications and utilities
- Kuwait's GDP growth was driven by commodities and real estate sectors

Economic heavyweights of the region, the UAE and Saudi Arabia, are expected to see their corporate earnings rise by 4% and 7%, while earnings in Kuwait are expected to remain flat. The earnings for both Qatar and Oman are expected to expand by 3%, while Bahrain is likely to see contraction by 1% during 2018.

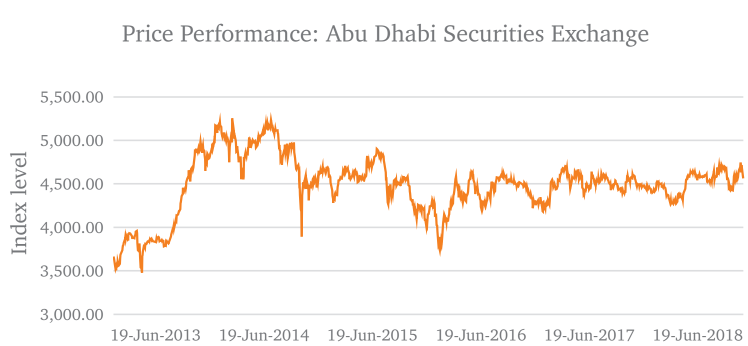
Saudi Arabia: Representative index TASI Tadawul Stock Exchange



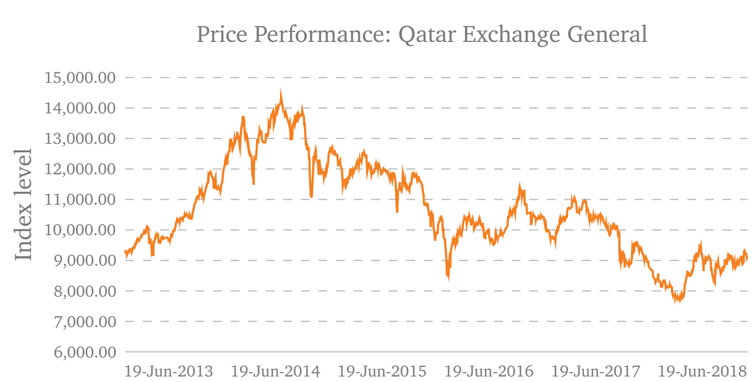
Dubai Financial Market



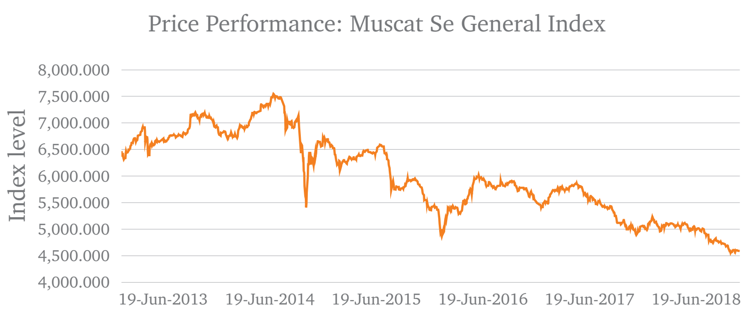
UAE: Abu Dhabi Securities Exchange



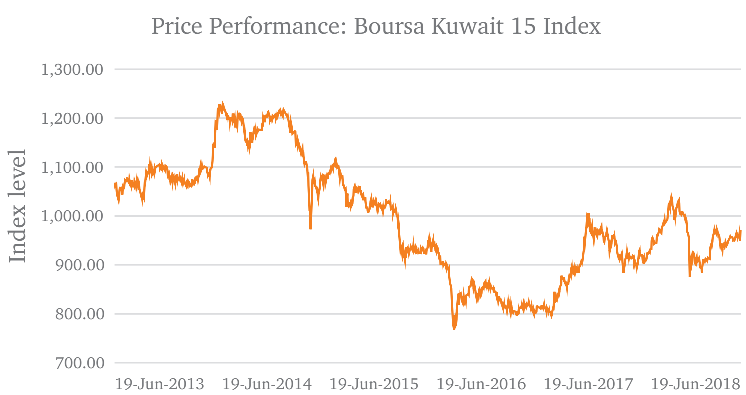
Qatar : Qatar Main 20



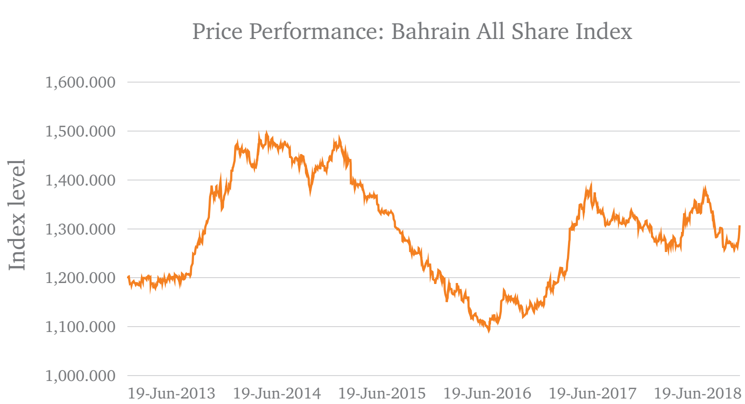
Oman: Muscat SE General Index



Kuwait: Boursa Kuwait 15 Index



Bahrain : Bahrain All share index



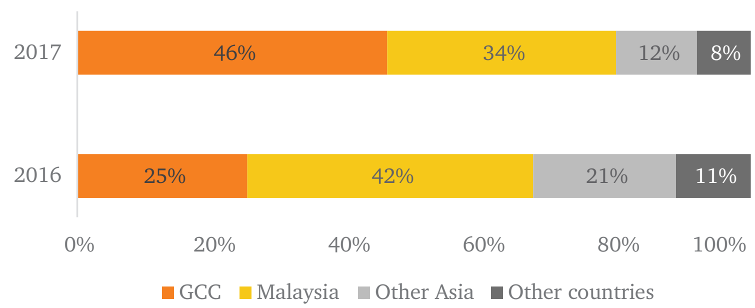
Source: Thomson Reuters Eikon

II. Sukuk bonds

Sector-wise performance

Heavy funding requirements by GCC countries have paved a way for growth in sukuk bond issuances. Following the recent plunge in oil prices, for example, Saudi Arabia had to draw down its reserves to fund budget deficit (budget deficit was forecasted at 10.7% of the GDP in 2017)

Sukuk Issuance By Region

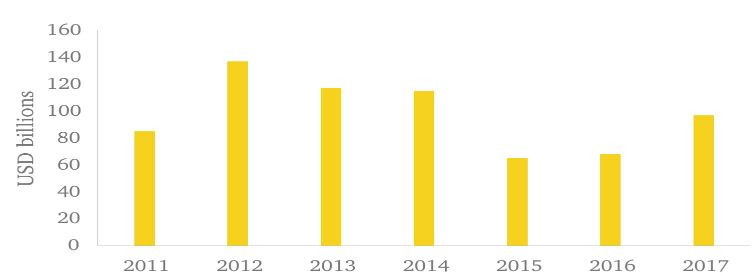


Source: S&P Global Ratings, Eikon

The increase in sukuk bond issuances is supported as the government looks to broaden the financing mix for liquidity needs of Islamic retail banks and narrower spreads over conventional bonds.

According to Moody's, the total sukuk issuances will reach around USD 95 billion by the end of 2017 as against USD 85 billion in 2016, including more than USD 50 billion by sovereigns. Sukuk issuances by sovereigns are expected to reach ~USD 148 billion in 2018.

Global Sukuk Issuance



Source: S&P Global Ratings, Eikon

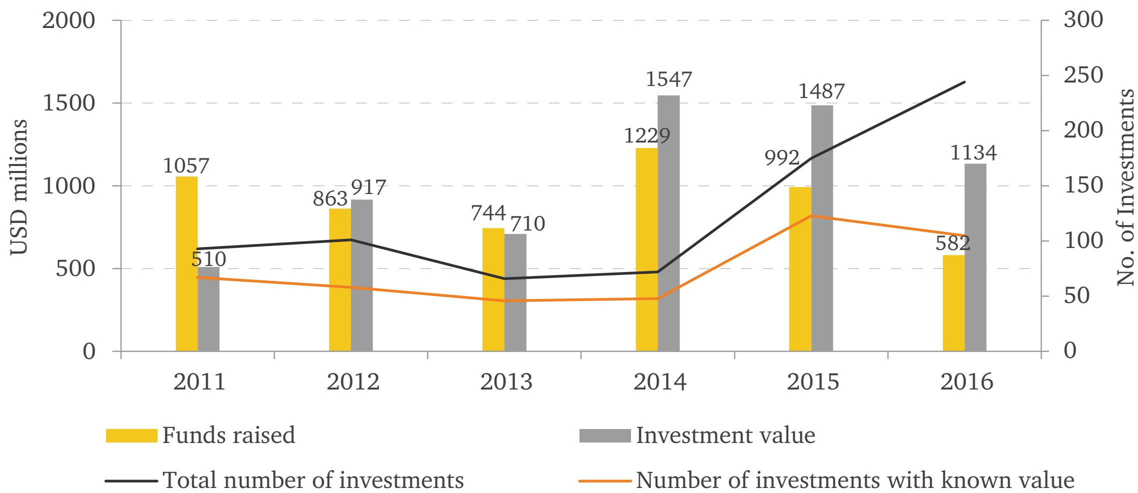
GCC countries dominated sukuk issuances in 2017, with Saudi Arabia raising a total of USD 17 billion or 40% of global long-term sovereign sukuks issued in the first eight months of the year. Issuances in Oman and Bahrain are estimated to be 11.9% and 13.4% of GDP in 2017, respectively. Additionally, Shariah-compliant finance is now nearly half of the GCC banking market.

III. Private equity and venture capital

The UAE accounted for 62% of the Middle East and North Africa (MENA) private equity investment activity by value and 34% by number of deals in 2016.

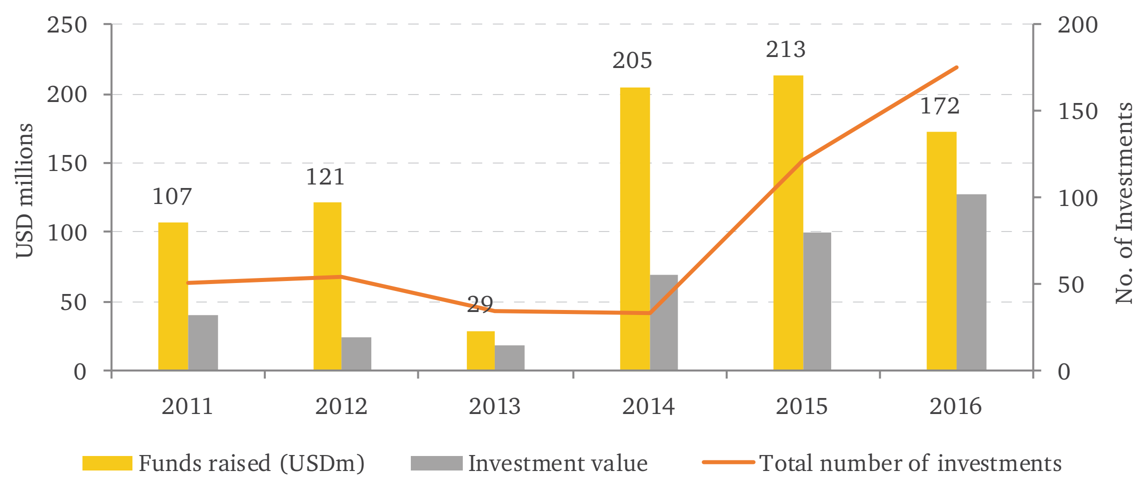
The promotion of the venture capital industry has become increasingly prominent, with number of incubators and accelerators increasing, alongside a developing legislative framework in the UAE.

Private equity in MENA



Source: Thomson Reuters and Deloitte

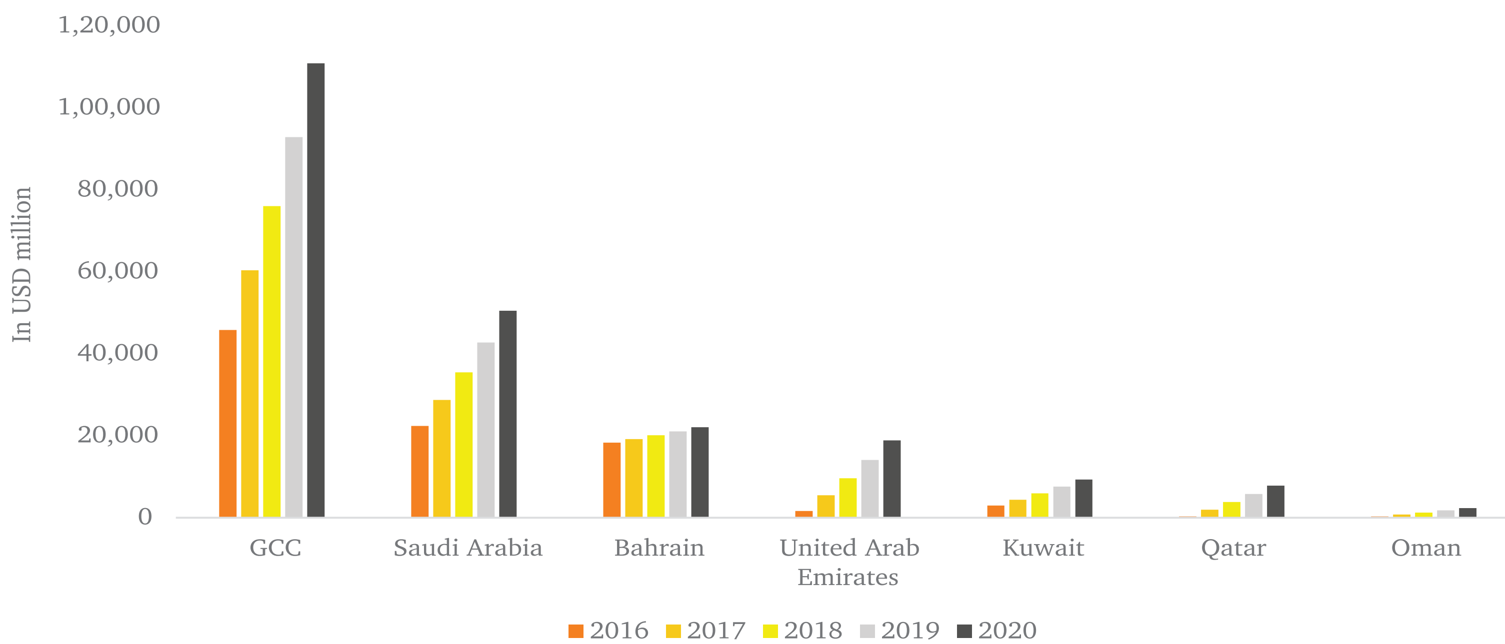
Venture investments and deal activity in MENA



Source: Thomson Reuters and Deloitte

D. AUM Projections by Geography

AUM Projections



Source: Thomson Reuters Projections

E. Transaction Infrastructure Evolution

Tadawul being the biggest stock market in the Middle East (with a market cap of around USD 450 billion) seeks to attract overseas investments in Saudi Arabia. The move is to help achieve its mission i.e. Saudi's 'Vision 2030'.

In 2017, Tadawul rolled out a series of market reforms to improve access and efficiency. One of the reforms that has been implemented allows foreign investors to now appoint a global or local custodian bank to hold their assets in Saudi Arabia instead of depending on a local broker. New procedures will also be introduced to mitigate credit risk associated with the settlement process for all candidates.

Since foreign ownership of Saudi stocks remains the lowest across all emerging markets, Tadawuls' inclusion in the emerging markets index would considerably boost foreign participation. Additionally, Tadawul will find itself at the center of global attention when 5% shares of state-owned Saudi Aramco would be listed. It would be the biggest IPO in history and could net about USD 100 billion.

Another important market reform include a shift from a volume weighted average price to an auction method to determine closing prices for both - the main market (Tadawul) and Nomu parallel market.

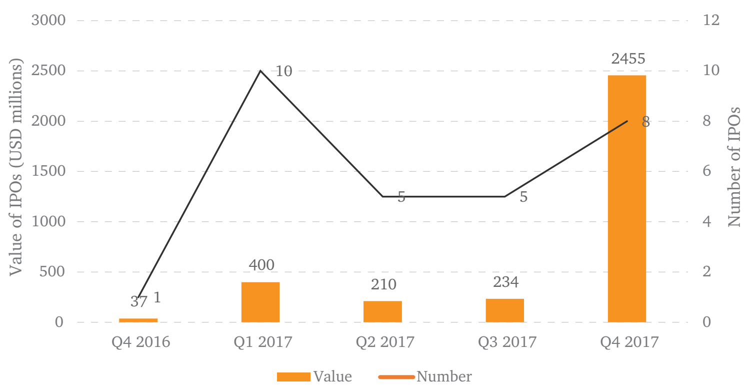
Apart from this, additional areas that look beneficial to the GCC asset management arena include:

- Tightening of tax laws for offshore investments in countries such as India and the UK will hand an opportunity to financial centers like Dubai that offer similar incentives
- Kuwait is in the process of offloading its stake in the national stock exchange known as Boursa Kuwait in the first quarter of 2019. This privatization will garner investor interest that will deliver liquidity and scale to the region's capital markets

F. Transaction Activity (Bond Issuances, IPOs)

I. Rise in IPO numbers

GCC quarterly IPO Activity



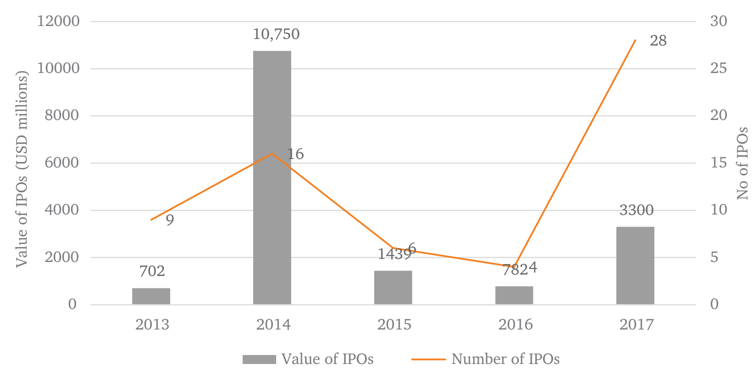
Source: PWC report

In recent years, GCC saw a significant surge in IPO activity. There were 28 stock market flotations in 2017, compared with just four in 2016.

This was attributed to:

- Higher listing activity on Tadawul's NOMU parallel market with nine IPOs (32% of 2017 GCC volume)
- Introduction of REIT listings that also saw nine IPOs across the GCC
- Proceeds in 2017 leapt by 322% (USD 2.5 billion) compared with 2016, mainly due to the IPO proceeds raised by Emaar Development PJSC (USD 1.3 billion) and ADNOC (USD 850 million).

GCC 2013 to 2017 Yearly IPO Activity



Source: PWC report

II. Inclusion of Saudi Arabia in the FTSE Russel and MSCI

Saudi Arabia's inclusion in the FTSE Russell's secondary emerging markets grouping, effective March 2019, would mean giving the country a 2.7% weightage in the compiler's main emerging market stock benchmark. This move could potentially draw in investments worth USD 3 billion. The emerging-markets designation by the FTSE could also trigger influx of about USD 5 billion from passive investors tracking the index.

The MSCI revealed that about USD 1.7 trillion of assets were benchmarked against its emerging market indices at the end of June 2017, of which about a fifth was from passive investors. Therefore, passive investors could inject around USD 13.6 billion into Saudi stocks. Saudi Arabia will have a weighting of approximately 2.6% in the MSCI emerging markets index. If active investors also widened their Saudi exposure to weightings following a Saudi Aramco IPO, the total inflows could be USD 68 billion.

On the other hand, Kuwait is joining FTSE EM indices this September. In addition, MSCI has placed Kuwait on the official review list for potential classification to EM (decision in June 2019), which could potentially drive USD 900 million inflows into Kuwait in total.

05

Benefits of Investing Through Asset Management

Implementation of risk management techniques coupled with optimal asset allocation is essential for wading through market volatility and informational asymmetries. Asset managers can help facilitate sound asset allocation through offering investment research using sophisticated valuation methods.

A. Expertise of Asset Managers

Asset managers play a crucial role in wealth management by offering the right solutions i.e. strategically moving money to appropriate assets for a given set of objectives.

Asset managers can offer value in the following key areas :

Managing retirement funding –

As stated previously in this report, there is a remarkable shift towards defined contribution pension plans and retirement fund management. With growing life expectancy, it becomes inevitable to ensure capital appreciation of planned assets and maintain a steady flow of income without drawing down on savings. Asset managers can help assess behavioral aspects of their clients and accordingly customize their asset allocation to achieve desired returns over the long term.

Flexibility in trades and liquidity –

Asset managers can direct trades at appropriate times in a bid to ensure higher liquidity and better price realization. They can provide better execution and value using research, experience and their network of brokers and other market intermediaries.

Disciplined investing –

Asset managers try to gauge the requirements and risk tolerance levels of their clients and help in achieving their financial targets through long-term investment strategies. To avoid deviation from strategic asset allocation due to short-term market volatility, asset managers typically formulate an Investment Policy Statement (IPS) that enlists long-term objectives and constraints of the clients. Asset allocation is then implemented based on the requirements as mandated in the IPS. The IPS can be amended on regular intervals or based on evolving needs of the clients.

Price discovery –

Asset managers aim to uncover as much information as possible about security. These details are then incorporated in the share price that represents the amalgamation of all of their views. This provides an overall outline of how the market prices an asset, which is useful in allocation of funds.

Rolling out complex trading strategies –

In some cases, complex trading strategies pertaining to risk management, commodity hedging, exposure to global markets, swaps, etc. would necessitate the expertise of asset managers and their network of market intermediaries. Asset managers can help in masking large trades by implementing block trades or leveraging algorithmic trading strategies that spread the order into smaller trades over a specified period.

B. Research Support

Investment research can facilitate sound asset allocation with the help of sophisticated valuation methods in order to arrive at the fundamental values of assets. Implementation of risk management techniques coupled with optimal asset allocation is essential for wading through market volatility and informational asymmetries.

Unlike other emerging markets, GCC lacks research support and coverage mainly due to limited presence of international players and independent research houses.

The inflow of institutional and retail investments in GCC is subdued. In addition, the GCC markets exhibit low liquidity and depth along with lack of transparency and openness with respect to information dissemination.

The four largest GCC stock markets together have less than a third of research coverage of other regions, with majority only covering the large stocks. Coverage is the highest in Saudi Arabia, followed by Qatar, the UAE and Kuwait. All other GCC countries barring Qatar have more than 88% analyst coverage for large-cap stocks owing to the popularity among investors. Asset managers can provide in-depth research coverage for the GCC markets on both buy-side and sell-side segments.

Company	SABIC	TCS	Apple Inc.
Market Cap (USD billion)	100.8	112.5	1099.5
Analysts following (No.)	14	47	44

Source: Thomson Reuters Eikon
Note: Accessed on 31st August 2018

The extent of analyst coverage is restricted in GCC due to the following factors:

- Uneven corporate disclosures across the region
- Lack of investor interest in mid and small-cap segments coupled with low liquidity
- Low research consumption owing to inadequate analyst write-ups in Arabic
- Delays in acquiring time-sensitive data and minimal public disclosures
- Growing reporting and compliance costs due to heightened market regulations
- Lack of strict enforcement of corporate governance and stock exchange rules
- Nascent stages of GCC stock markets

Country specific coverage:

- Saudi Arabia and the UAE are the only regions where more than five analysts cover large-cap stocks
- Despite its prominence as a financial hub, the UAE still lags behind Saudi Arabia and Qatar in terms of analyst coverage of its markets, with just over one-third of stocks covered

C. Optimal Asset Allocation Based on Risk Appetite and Investment Goals

Optimal asset allocation (dividing the investment portfolio across various asset classes such as stocks, bonds and money market securities) allows to cut down risks while potentially increasing gains.

Components of asset allocation process

I. Portfolio construction process

Portfolio construction process includes defining investment objectives, conducting research and analysis, defining asset allocation, managing risk, portfolio monitoring and communicating with client.

The portfolio construction process is supported by Investment Policy Statement (IPS).

This statement outlines general investment goals and objectives of a client and describes the strategies that the manager should employ to meet these objectives.

II. Investment approach

Mean Variance Optimisation (MVO)

It is essential to allocate investments between different assets to maximise returns per unit of risk. Mean variance optimization (MVO) is a quantitative tool that helps understand this allocation better by considering the trade-off between risks and returns.

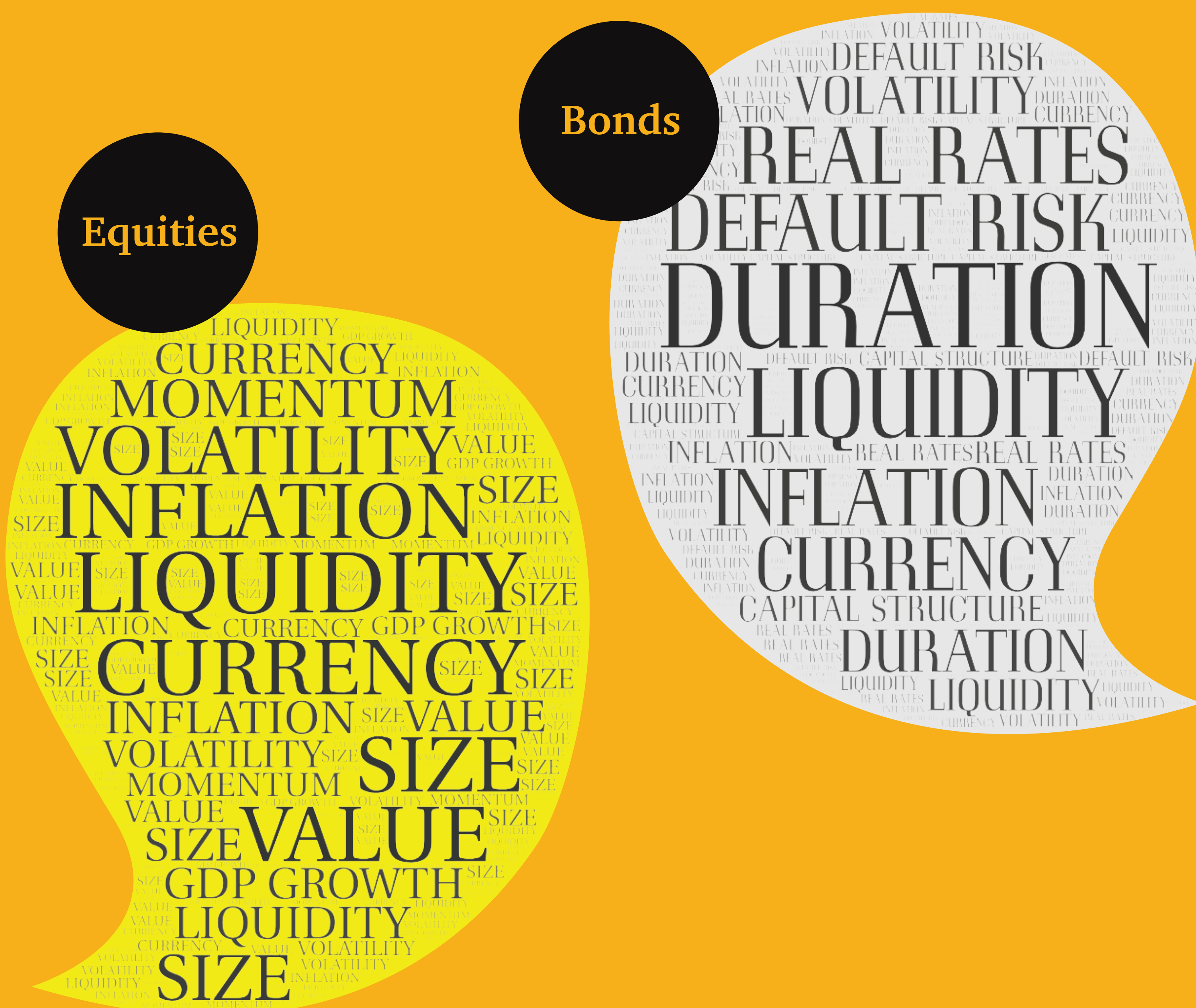
MVO helps asset managers in identifying portfolios that yield highest returns for a defined level of risk. Investors can therefore choose the most optimal portfolio allocation according to their risk constraints and targeted return.

Factor-based investment approach

A factor-based investment approach allows the asset manager to remix the factors into portfolios that are better diversified and more efficient than conventional portfolios. Seemingly diverse asset classes can have unexpectedly high correlations—a result of the significant overlap in their underlying common risk factor exposures. These high correlations cause many portfolios to exhibit poor diversification during market downturns. Portfolios that appear to have a diversified exposure to major components of equity, fixed income and a full range of possible substyles may nonetheless suffer from surprisingly higher levels of internal correlation within each block.

Examples of factors are as follows:

Common Factor Exposure across Asset Classes



06

Asset Management Space

GCC has experienced many changing developments in asset management space namely inclusion in the MSCI, increase in the number of IPOs, improving market liquidity and increase in REIT listings.

A. Superior Asset Classes

I. Fixed Income Securities

Fixed income in GCC has grown exponentially as an asset class over the past decade mainly due to:

- Issuances from sovereigns and quasi-sovereigns seeking to address budget deficit gaps caused by falling oil prices since 2013
- Corporates looking to raise capital in a slowing economy
- In recent years, investors outside GCC, especially in Asia, have upped their investments in the GCC sovereign and quasi-sovereign bonds, thanks to improving credit ratings and relatively superior yields

II. Equities

Tougher fiscal environment and renewed goal of diversification are reshaping the region’s investment landscape while acting as a catalyst for a more active M&A market.

Key developments expected in 2018 include:

Inclusion in the MSCI

- Saudi Arabia's official inclusion in the MSCI emerging markets index
- Kuwait on the review list for potential reclassification to EM

Representation in EM Index

- Combined GCC region (Saudi Arabia + Qatar + the UAE) expected to account for more than 4%
- A 4% - 6% weight in the MSCI EM Index will allow GCC to claim a permanent allocation of any global EM portfolio

Tadawul Growth

- Tadawul joined the FTSE global equity index series in March 2018
- Hopes to be included in the S&P by the end of this year

Investment climate

- Opportunities presented by early economic reforms, liberalization efforts, stronger oil prices and other major privatization deals across the region set to promote investment in the GCC equity

IPO boom

- More than 30 companies (excluding REITs) to go public, including Saudi Aramco
- Majority to be listed on the local markets

Large size listings

- Sizable private IPOs (including GEMS Education in the UAE and ACWA Power in Saudi Arabia add to the total value of new listings that potentially could set records even without Aramco)

SWFs

- More activity from SWFs as they restructure their portfolios to take advantage of privatization in the GCC

III. REIT

REITs in GCC

Saudi Arabia has registered a phenomenal growth in terms of issuance of REITs and holds the highest market capitalization of over USD 3.2 billions, the highest in GCC. The number of REITs has more than doubled since the past few quarters with a total of 8 new funds issued in 2018 totalling to 15 REITs listed on the Tadawul as of August 2018.

This growth has come on the back of regulations supporting REITs as well as awareness about alternative investments.

Other GCC countries have also shown activity in the REITs market by introducing the regulatory framework for the same.

Along with Saudi Arabia, the UAE and Bahrain too have an established public REIT regulations, while Oman became the latest member to introduce these regulations. Following the market regulator's announcement, three Omani companies are planning to establish their REIT fund in the coming months.

Kuwait and Qatar are yet to introduce established regulations for the trading of REITs on their stock exchanges. However, the Qatar Stock Exchange is currently in the process of introducing REITs into the local market.

Information	Saudi Arabia	Dubai, UAE	Abu Dhabi, UAE	Bahrain	Oman
Introduction of Regulatory framework	2016	2016	2015	2016	2018
No. of REITs	15	2	3*	1	-
Market Capitalization (Aug 16, 2018)	USD 3.2bn	USD 504mn	-	USD 50mn	-

*incorporated as private REITs

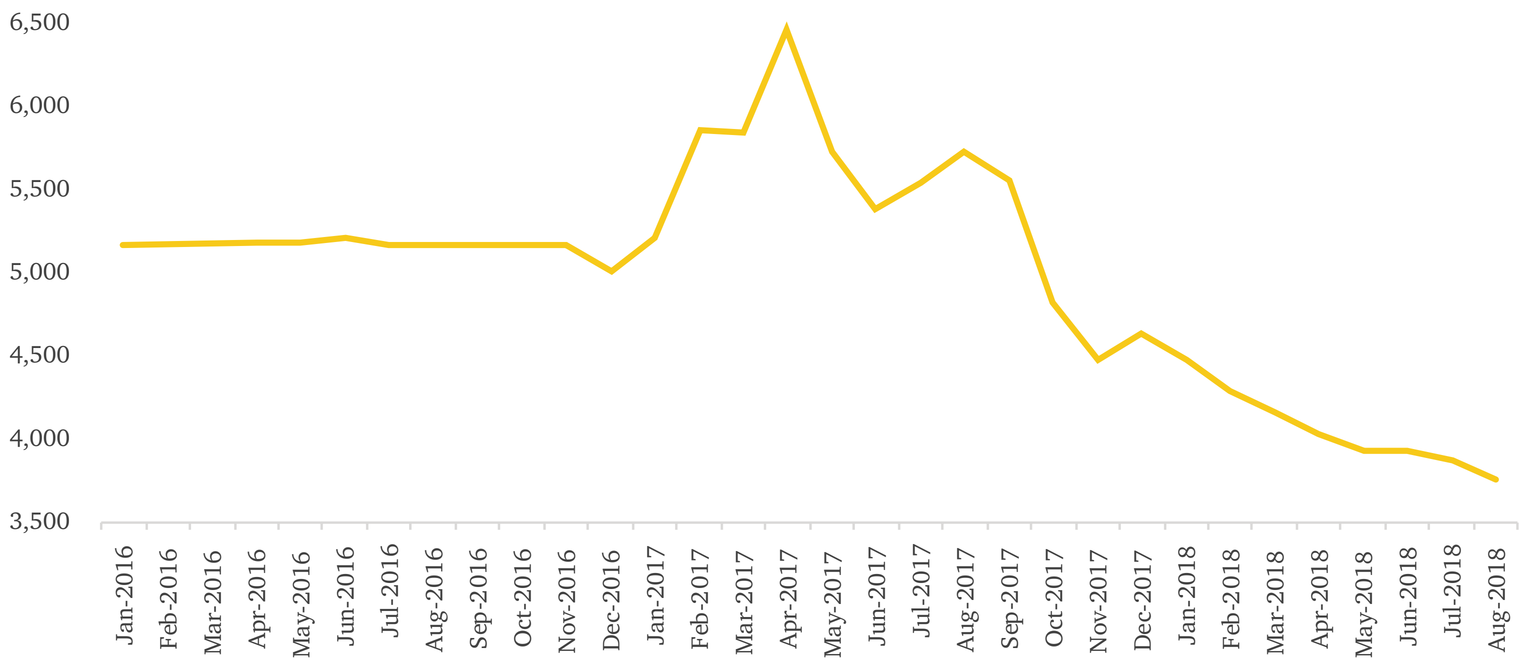
Source: Real Estate Investment Trusts Knight Frank

REIT issuances in Saudi Arabia:

REIT	Country	Listing Date	Paid-in capital (SAR billions)	Sector Exposure
Riyad REIT Fund	Saudi Arabia	13-11-2016	1.63	Office, Stores, Hotels
AlJazira Mawten REIT Fund	Saudi Arabia	15-02-2017	0.12	Warehouses
Jadwa REIT Al Haramain Fund	Saudi Arabia	30-04-2017	0.66	Residential, Commercial, Educational, Warehouses
Taleem REIT Fund	Saudi Arabia	30-05-2017	0.29	Educational
AL Maather REIT Fund	Saudi Arabia	22-08-2017	0.61	Residential, Offices, Stores, Warehouses
Musharaka REIT Fund	Saudi Arabia	01-10-2017	0.88	Residential, Warehouses, Hotels
Mulkia Gulf Real Estate REIT	Saudi Arabia	05-11-2017	0.60	Residential, Offices, Stores, Industrial
AlAhli REIT Fund 1	Saudi Arabia	08-01-2018	1.38	Stores, Hotels
Al Mashaar REIT	Saudi Arabia	18-01-2018	0.57	Stores, Hotels
Jadwa REIT Saudi Fund	Saudi Arabia	11-02-2018	1.58	Residential, Commercial, Educational, Warehouses
Al Rajhi REIT Fund	Saudi Arabia	20-03-2018	1.22	Commercial, Educational, Offices, Warehouses
Derayah REIT Fund	Saudi Arabia	26-03-2018	1.08	Residential, Offices, Stores, Warehouses
SEDCO Capital REIT Fund	Saudi Arabia	01-05-2018	0.60	Retail/Office, Residential, Hospitality
Bonyan REIT Fund	Saudi Arabia	25-07-2018	1.63	Commercial, residential
Swicorp Wabel REIT Fund	Saudi Arabia	06-08-2018	1.18	Commercial sector (retail shopping malls)

Source: Tadawul

Tadawul REIT Index (Thomson Reuters)



Source: Tadawul

Outlook

The real estate industry across GCC is maturing and is poised for growth in the longer term given the improving regulations, solid macroeconomic fundamentals, rising public private partnership and big ticket infrastructure projects. The region is now positioned to greatly benefit from its optimistic real estate sector outlook as it has also emerged as a preferred destination for global investors. Although, the market has corrected in the last few quarters this may be considered as an investment opportunity to enter the markets for higher returns in the long-run.

The top trends expected from REITs are that

a. REITs would act as an alternative income-generating investment vehicles providing diversification benefits,

b. Focus will shift on sector-specific REITs offering investor with sector specific investment opportunities and

c. Share prices will reflect the quality of underlying assets as the market depth and offerings increase.

B. Liquidity Scenario

Among the six countries in GCC, Saudi Arabia has the most developed debt securities market, while the UAE and Bahrain are not far behind. The Saudi Stock Exchange (Tadawul) is the largest (by market capitalization) and the most liquid stock market in GCC, whereas Qatar has liquidity challenges due to ongoing GCC crisis and Saudi Arabia's radical domestic reforms.

Bond and sukuk liquidity

Sukuk and bond issuances have been increasing at a slower pace owing to fiscal consolidation measure. However, the outlook for 2020 shows that sovereigns will need to continue borrowing in order to fund their ambitious capital expenditure plans, especially for infrastructure and energy. Facing tighter liquidity and costlier bank credits, corporates will need to turn largely to the capital markets through bond issuances and IPOs.

Equity markets liquidity

Stock markets in all GCC countries are well developed and regulated, and should continue to offer a good source of funding for corporates as well as sovereigns and quasi-sovereign entities through privatization.

C. Other Factors Affecting Asset Classes

Ease of doing business

Ease of doing business impacts the trade, investment and entrepreneurial activities in a country.

In the ease of doing business index, GCC countries currently stand as follows:

Country	Global Ranking in Ease of doing Business
The UAE	21
Bahrain	66
Oman	71
Qatar	83
Saudi Arabia	92
Kuwait	96

Source : World Bank
Note : The rankings for all economies are benchmarked to June 2017

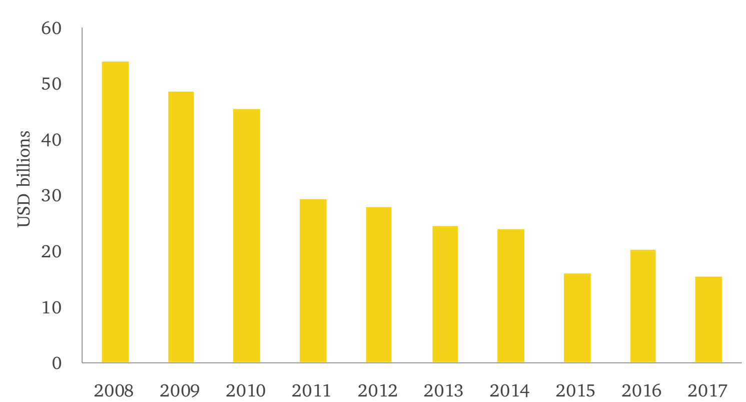
In order to improve its ease of doing business ranking, Kuwait has made land registration process easier by ensuring transparency. Business in Kuwait has also improved with the help of an online registration system for land records. Meanwhile, the UAE and Qatar have improved access to credit information. Credit scores are now being provided to banks and financial institutions. In Oman, cross-border trade has been made easier by introducing an online single window system for exports and imports, thereby reducing the time required for documentary compliance.

Foreign Direct Investments (FDIs)

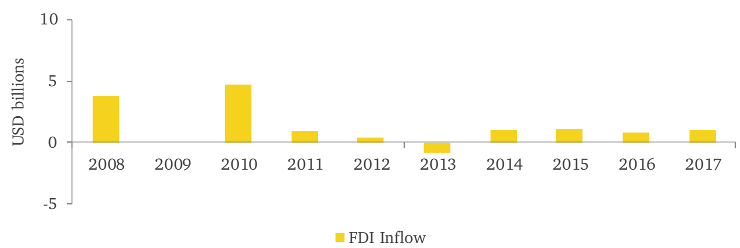
GCC has introduced several measures of fiscal consolidation and institutional reforms to secure long-term economic sustainability while contributing to regional private sector development.

Measures are being formulated to attract higher investments in all GCC economies, leading to output growth in the near term.

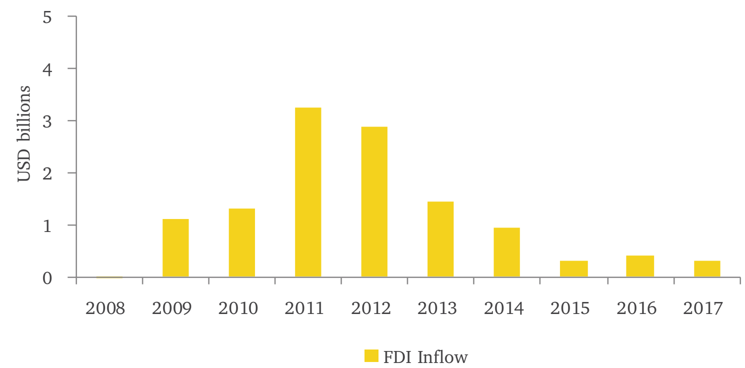
FDI Inflows to GCC Countries



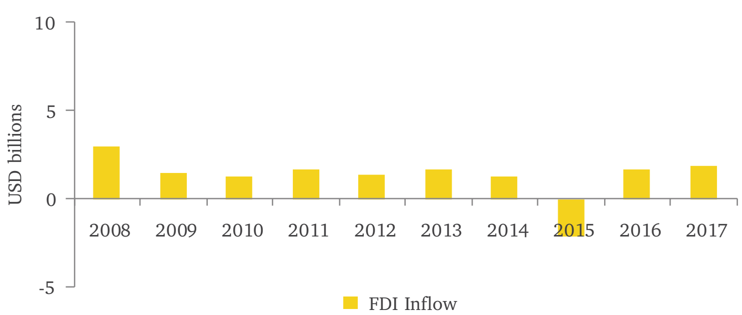
FDI Inflows to Qatar



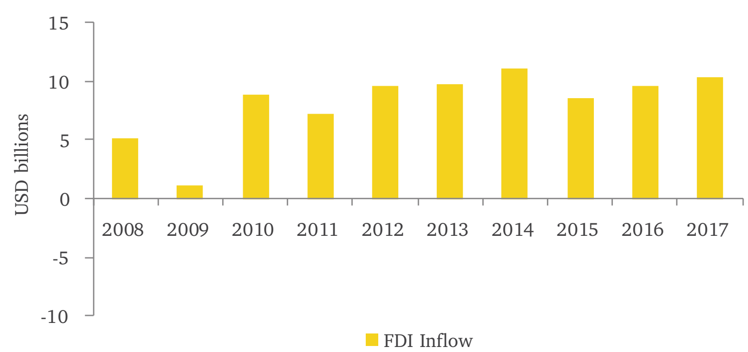
FDI Inflows to Kuwait



FDI Inflows to Oman

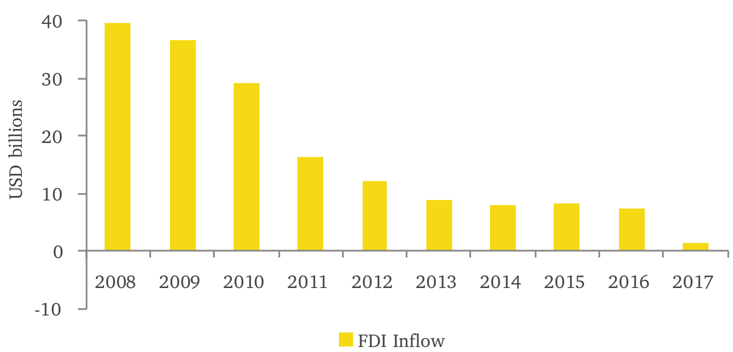


FDI Inflows to UAE



Source: UNCTAD STAT Database

FDI Inflows to Saudi Arabia



Foreign ownership

Here is a snapshot of the most recent foreign investment reforms in the GCC:

Country	Regulations
The UAE	• Up to 49% ownership • Up to 100% in free zones
Saudi Arabia	• 100% ownership in certain industries (sectors excluded are oil exploration, real estate, military equipment production among others) excluding those on a negative list
Qatar	• Up to 49% ownership • 100% in some sectors (2016 draft law allowed full ownership in all sectors provided the non-Qatari has a Qatari services agent. Not yet enacted)
Kuwait	• 100% ownership through a foreign owned branch
Bahrain	• 100% ownership possible in most sectors (excluding those on a negative list)
Oman	• Up to 70% (further conditional exceptions)

Source: European Trade Commission

Security issues - Cyber threat in GCC

Data integrity directly impacts the financial decision making and therefore, should be a top priority for businesses and governments alike.

Businesses in GCC currently face a major cybersecurity threat, with private-sector and government websites being repeatedly targeted by ransomware, malicious software, virus attacks and most recently by crypto jacking.

To thwart the rate of cyber-attacks, GCC countries are now looking to garner investments and set up a transparent business environment. To achieve these goals, it is imperative for GCC member states to adopt internet security solutions, minimizing their vulnerabilities to cyber-attacks.

Cyber secutity preparedness in GCC countries (2018-19)
(0= High preparedness; 4=Low preparedness)

Country	Score
Oman	0
Qatar	0
The UAE	1
Saudi Arabia	2
Bahrain	2
Kuwait	3

Source: The Economist Intelligence Unit

Saudi Arabia is yet to upgrade its cyber security and related technology to be at par with global standards. Apart from Saudi, Kuwait is also the most susceptible country to cyber-attacks.

It is noted that not much is being done to tackle internet security issues, albeit pouring investments in cyber solutions and technology.

Companies in GCC understand the importance of cybersecurity in business but lack awareness and training in this arena. Anti-cybercrime measures have not been accompanied by the required recruitment, governance and processes. As a result, corporate investments in cybersecurity has had a limited impact.

D. Areas that Contribute Positively to GCC Markets

Initiatives taken towards improving the GCC market offerings include:

Short-selling

- Introduced in Tadawul and regulated SS in DFM in 2017
- Provide market participants with new tools
- Brought a new dimension in the equity markets strengthen their trading activities

Gold Derivative

- Launched in 2017, DGCX offered first-ever offshore Chinese-linked gold derivative in international markets
- DSGC is the only Shariah-compliant listed derivative in the world
- Attracted interest and participation from traders worldwide

Long futures and options

- Kuwait - the only stock market to provide these features
- Limits hedge funds to indulge in synthetic shorting by applying various long/short strategies elsewhere in the region

E. Manpower

High-skilled employment across the region stands at 21% on average, while middle-skilled roles account for 66% of all formal sector jobs. The World Economic Forum's Human Capital Index finds that the Middle East and North Africa (MENA) region currently captures 62% of its full human capital potential, slightly below a global average of 65%.

Country	Total Population	% of Nationals	% of Foreign Nationals
Bahrain	1,314,562	48%	52%
Kuwait	4,294,171	30.6%	69.4%
Oman	4,419,193	54.6%	45.4%
Qatar	2,404,776	10.1%	89.9%
Saudi Arabia	30,770,375	67.3%	32.7%
UAE	8,264,070	11.5%	88.5%
Total	51,467,147	51%	49%

Source: National Institutes of statistics
Note: Period available as of 20 April, 2016

Expatriate employees continue to be a more attractive option for employers. Skills gap is getting wider due to which companies find it difficult to fill up positions in high-skilled finance, international business and real-estate sectors.

To overcome this situation, the government is being proactive about addressing private sector needs through implementation of programs for skilled local workforce.


$820.51
$697.98
$507.74
$284.48
$316.40
Textiles
Wool
Fur
Sateen
Silk

07

Opportunities in Asset Management Space

Demographics of the GCC countries remain optimistic for pension systems coupled with increase in the AUMs of SWFs. There are also a few key changes in the rules and regulations pertaining to the asset management industry.

A. Potential for Asset Management Companies and the Market

01

Regulatory environment

- Increasing government support for funneling capital into Shariah-compliant and other institutional funds
- Push for low-cost solutions such as exchange-traded funds (ETFs)

02

Pensions and retirement savings

- Diversification of pension fund portfolios
- Growing focus on pension plans for local and foreign population

03

Wealth management and private banking

- Rising transactions to and from the GCC by private banks
- Enhancing Islamic asset management product offerings

04

Technology & Asset services

- Integrating latest digital innovations
- Distribution of wealth management products via local partnerships

B. New Trends

Technological Advancements and benefits	01 There are logistical, operational and financial benefits for fund houses in going digital. Leveraging technology will further drive customer engagement, data mining, operational efficiency and reporting	02 ADX used blockchain in its e-voting services for the annual general meetings of its listed companies, making it the first stock market in the Middle East and North Africa region and the third globally to adopt blockchain in its services
Increasing collaboration between government bodies, FinTech companies and service providers	01 Growing partnerships between the government bodies and FinTech firms enable sharing of knowledge on the latest research and trends in financial technology	02 Dubai International Financial Centre and Accenture Sign Agreement to Dubai Financial Services Authority and the Securities and Futures Commission in Hong Kong entering into an agreement recently to cooperate and share information surrounding FinTech innovation in their respective markets

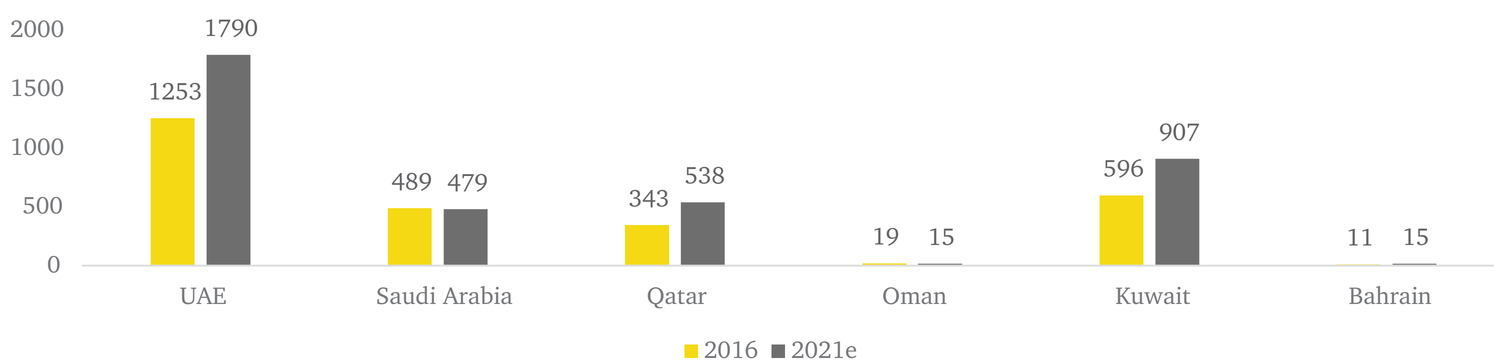
C. Key Investor Groups

Asset managers bringing in local and global expertise can assist institutional investor groups (pension funds, sovereign wealth funds (SWFs), and others) with strategic asset allocation.

GCC SWFs play several favorable roles in the region including creating economic stabilization, investing for the long term and seeking high financial returns.

I. Sovereign Wealth Funds (SWFs)

Estimated AUM of SWFs, end 2016 (USD Bn)



Source: SWF Institute; Marmore Research

Note: SWF assets at end 2016 are estimates and may differ marginally from actuals

II. Pension Funds

Country	2016 Real GDP USD billions	Pension assets as % of GDP	Native population (millions)	Income per capita (USD)
Saudi Arabia	697	40%	21.2	13,169
Kuwait	134	50%	1.2	56,136
UAE	365	7%	1.1	24,578
Qatar	215	7%	0.3	45,349
Oman	72	17%	2.5	4,940
Bahrain	65	18%	0.7	17,229

Source: Marmore Research; EY

D. Asset Management Industry – Regulation means Transparency

The UAE

- International AM companies are required to inform the regulator about the authorized distributors they wish to work with
- New promoter license has to be applied by these distributors
- New rules for unit-linked insurance policies
- Introduction of higher capital requirements for insurance brokers
- Implementation of the Value Added Tax (VAT)

Bahrain

- For funds, the investor profile determines the fund licensing type (either open- or closed-ended)
- Retail collective investment undertakings (CIUs) must be authorized and carry significant restrictions on the types of assets that can be invested and maximum concentration in a single position or issuer's securities

Saudi Arabia

- New rules that opens access to markets for local entities and foreign institutional investors as part of 'Vision 2030'
- Minimum net assets required to be considered an "investment company" reduced to SAR 10 million from SAR 50 million
- Requirement for "management activities" license also reduced substantially.
- Two new types of activities permitted: managing non-real estate investment funds and portfolios of small experienced investors

Kuwait

- Units in funds established outside of Kuwait may not be marketed within the country without prior approval. Any units in foreign funds also may only be offered in Kuwait using a licensed local agent
- Increase in the remit to cancel the marketing permission of a foreign fund following any breach of Capital Markets Law and/or regulations
- The rule for qualifying as a private placement have been amended
- Requirements for foreign funds (for private placement) at par with those for domestic funds

08

Outlook

GCC is expected to clock overall 2.4% GDP growth in the current year, up from 0.1% in 2017. In asset management, implementation and development of Artificial Intelligence and blockchain technologies is still at its nascent stages but is quickly gaining momentum.

A. Industry Forecast

Economic outlook looks optimistic this year and in 2019, thanks to improving oil prices, expansionary fiscal policies and focus on non-oil sector. GCC is expected to clock overall 2.4% GDP growth in the current year, up from 0.1% in 2017.

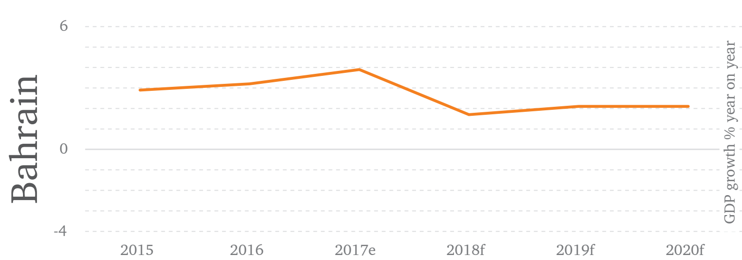
GCC governments are set to ease up on fiscal austerity in 2018, benefiting from higher oil prices and from the measures they have taken in the past few years to restrain spending, reform subsidies and raise non-oil revenue.

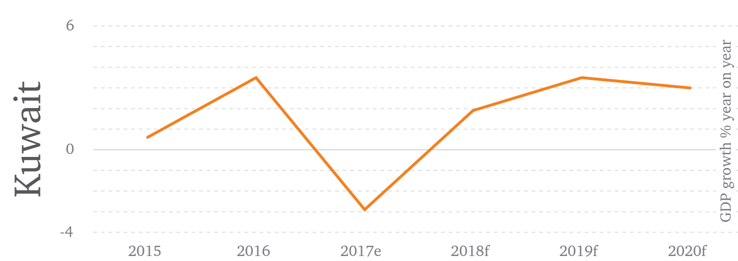
To continue with this growth story, more and more reforms need to be in place to address the fundamental problems hampering growth for many years including:

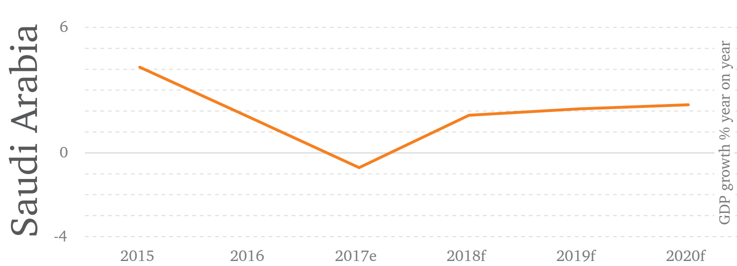
- **Preventing high unemployment rates**
- **Promoting fair competition by encouraging privatization**
- **Improved policies and regulation**

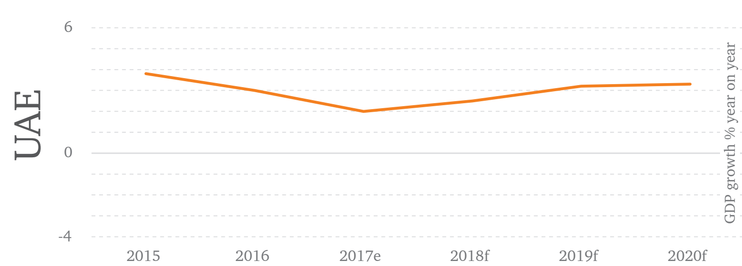
The GCC region is currently plagued by some unfavorable circumstances such as:

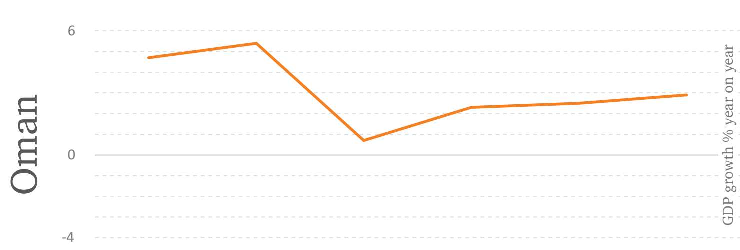
01	Impacts bonds i.e. sovereign bonds and sukuks issues on the rise. There is an upward pressure in the country risk premiums
02	Growing geo-political tensions in the region
03	Oil demand could see a slight shift due to move away from fossil fuels
04	Currencies of GCC nations are pegged to US dollar. A quick tightening of policy rates in the developed economics can spike borrowing costs
05	Geo-political developments (removal of Venezuelan and Iranian barrels from the global market) create a demand and supply deficit. OPEC and non-OPEC countries intend to boost oil production in order to support burgeoning demand

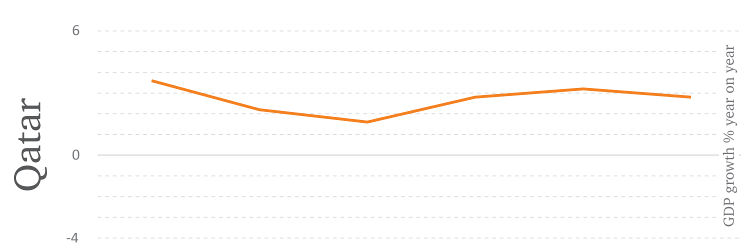




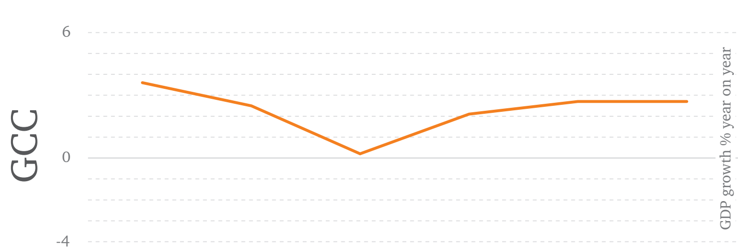








Source: World Bank Group



B. Stock Markets

GCC being a highly volatile stock market, managing this risk becomes a key cause for concern for any institutional investor entry. Availability of wider risk management tools such as derivatives (options and futures) can provide the much needed impetus to manage volatility. Additionally, a framework for stock lending and short selling could improve the overall market functionality, although these initiatives may complicate the current market infrastructure.

Moreover, bigger markets would help to boost market liquidity and limit volatility. This would enhance confidence for market participants and consequently, provide an attractive destination for international institutional investors. It would also promote the research industry as analysts would be able to execute research assignments on a larger pool of stocks with more comparable companies.

C. Upcoming Government Initiatives

GCC countries are gearing up to implement economic reforms such as:

I. The UAE to permit 100% foreign ownership

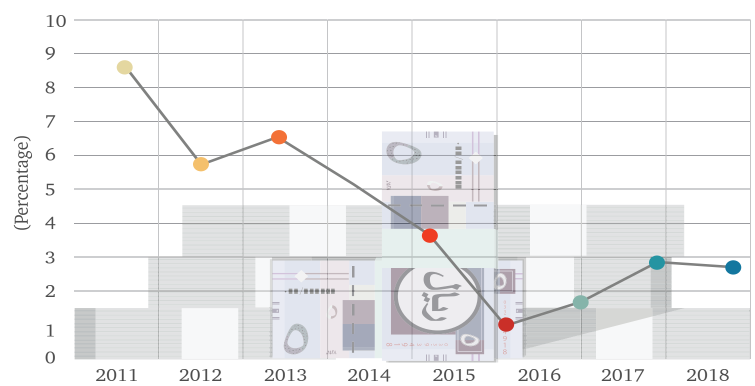
The UAE is to allow 100% foreign ownership in companies, a major change from the current practice of requiring an Emirati partner with a majority stake. Further, foreign investors establishing a business or investing money in the UAE will now be eligible for a visa of up to 10 years. Such reforms would open up new busines opportunities in the form of start-ups, city-based trades etc.

II. Saudi's 'Vision 2030'

As of last year's second quarter, non-oil growth in Saudi Arabia is stagnant. The country's 'Vision 2030' goal is to bolster its non-oil economy through diversification and minimizing the dependency on oil GDP.

Expansion of non-oil economy is a key part of the 'Vision 2030' transformation plan

Saudi Arabia Non-Oil GDP Growth



Source: International Monetary Fund

Another initiative dubbed the "Quality of life 2020" program eyes 20% GDP growth by means of lifestyle amendments coupled with cultural and infrastructural developments. The goal is to strengthen the role of private sector by unlocking state-owned assets for investment.

VISION رؤيـــة
2030
المملكة العربية السعودية
KINGDOM OF SAUDI ARABIA

III. VAT Implementation

The Value Added Tax (VAT) was implemented in the UAE and Saudi Arabia in January 2018 as part of the efforts to boost non-oil income & to narrow wide fiscal deficits caused by years of low oil prices. Besides additional revenue generation, it will promote trade across borders within the GCC and with the outside world.

Bahrain is set to become the third Gulf Cooperation Council (GCC) country to implement the unified agreement on Value Added Tax (VAT) on goods and services from January 1, 2019 as per government run news report agency. Introduction of VAT comes as a part of a larger effort to restructure Bahrain's public finances.

D. Artificial Intelligence in Asset Management

In asset management, implementation and development of AI technologies is still at its nascent stages. AI algorithms could come with their limitations in managing long-term portfolios. AI could face challenges when analyzing the future trends while looking at the past data due to too many moving parts and financial structures that are susceptible to black swan events.

However, AI in asset management is slowly gaining momentum with its application in areas such as asset correlations, social media analysis, sentiment analysis, and data from search engines. The AI technologies help to gain deeper and newer insights on the subject. In future, AI offers excellent opportunities with more sophisticated modules such as big data, advance machine learning etc. As part of this transformation, the UAE and Saudi Arabia have set on a mission towards AI-driven transformation of various sectors in the GCC region by 2031. Having launched their AI strategies, both nations are set to pump in USD 96 billion and USD 135 billion respectively on AI and Internet of Things (IoT).

Contribution of Artificial Intelligence to economy in 2030 (%GDP)

13.6% United Arab Emirates

12.4% Kingdom of Saudi Arabia

8.2% GCC4 (Bahrain, Kuwait, Oman, Qatar)

Source: PwC

E. Crypto Currency and Blockchain in GCC Asset Management

I. Blockchain based system

In a bid to draw more investors to real-estate asset class, a blockchain based system could be put in place. This would hasten the transaction process with readily available latest data and ownership chain.

The Dubai Land Department ('DLD') is set to migrate its land records to a blockchain based system to simplify the property transaction process. This will help boost the liquidity and tradability.

II. Tokenization of real-estate assets

Tokenization of real-estate assets implies that the ownership in real world asset would take form of a digital token held in a digital wallet. Asset-backed tokenization has the potential to lower liquidity obstacles with respect to the time taken during any sale and purchase transactions and eliminate the requirement of any third parties and intermediaries.

The key application areas include:

1. Enhancing REIT liquidity:

Tokens could further boost the degree of liquidity for real-estate investors in the following ways:

- Division into much smaller units
- Ability to tokenize an individual real-estate asset rather than having a basket of assets as with a REIT and
- Providing a crypto market place that is always open at any time of any day in any place in the world

This minimizes the required liquidity premium for REITs.

2. Fractional and proportional ownership:

This is one of the more interesting potential applications for real-estate asset class. Token ownership of a multi-let commercial property could give the token holder a fractional property ownership, proportionate right to rental income and proceeds of sale upon disposal.

3. Payments using digital currency:

Faster, cheaper and more transparent cross-border transactions have started to gain traction as payments can be settled using blockchain software. Saudi's central bank is working with the UAE's central bank to enable cross-border transactions between the two countries by means of a digital currency.

09

Conclusion

Reforms ushered in by the GCC governments to bridge the budgetary deficit caused by sliding crude oil prices augurs well for the economy and regional financial markets in the medium to long run. Hopefully, these measures shall gather the attention of global asset managers towards markets and assets in the region.

Inclusion of Saudi Arabia and Kuwait in MSCI EM index has set the tone as huge inflows are likely to improve the liquidity and depth of the markets.

The GCC is witnessing exciting times, thanks to a slew of IPOs likely to hit the markets. There has also been a considerable increase in issuances of REITs, sukuks and Sharia-compliant financial products.

Government-backed initiatives coupled with factors such as transparency, reduced dependency on oil revenues and a host of reforms (privatization of state-owned companies, increasing FDI limits, opening up markets to global investors, to name a few) can all help unlock GCC's real market potential.

What's more, latest technological innovations in REITs and land transactions along with the use of digital currency for cross-border transactions could transform the face of realty market in the region.

On the financial front, product enhancements like regulated short selling in Dubai is expected to add to the financial management and asset allocation arsenal of asset managers.

In our opinion, MENA region particularly the GCC, should focus more on professional asset management of funds and portfolios as we believe that even though the market is currently developing and attracting global institutional investors & funds, it is in the nascent stage. Consequently, asset managers can help wade through this complex and evolving market by providing sound investment research and advice. Investors can invest in new asset classes which previously had high barriers to entry through the use of structures like REITs and funds mechanisms.

Asset managers can also provide their clients with in-depth research using software technologies such as AI, blockchain, big data, etc.

Investing through the use of professional asset managers will help in supporting the economy while also helping in reducing the operational risk that might be caused through the use of foreign fund managers.

With macro-economic and governmental regulations gradually changing in the wake of crude price crash, financial market intermediaries and asset managers are well placed to capitalize on the emerging opportunities.

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