The QSE in a changing portfolio investment landscape

Over recent weeks there have been many articles written about the lacklustre performance of so called 'value' markets. Most prominent is the flat line performance over almost a decade of the U.K. in contrast to the ongoing inexorable rise of the SP500. The U.K. is not alone, and many medium and smaller markets presenting a 'value' proposition such as Qatar or Singapore have also started to display some similar characteristics.

One can speculate on the reasons for this relative performance and the growing valuation divergence but at the centre one of the key reasons is that the prominent investor groups, be they local and foreign institutions, major corporations or retail investors all have in aggregate been net sellers of the market in question. The motivations in each case are obviously complex but one can summarise a list of common behavioural trends.

First, global interest rates have been rising and, with a lag, bank deposits and bond markets have been competing in investment allocations. This tends to undermine equity markets at a time when geopolitical concerns have also led investors to be increasingly risk averse.

Second, one of the prominent global trends in equity allocations has been towards indexation and the unrelenting growth of passive ETFs. For many years active managers, partly in response to this, have favoured larger companies in larger markets in terms of their allocations. In the context of recent performance patterns in global equities, the so-called 'Magnificent Seven' and a bias towards the US, have also caused significant distortions in the allocations towards other equity asset classes, including Emerging Markets.

Third, capital allocated to so-called value managers has almost certainly declined over the last decade. Growth investors prefer large total addressable markets and favour kinds of scalable, platform-based companies alongside large markets for those companies to grow in. Furthermore, portfolios have become more concentrated over time. Global/Emerging Market stock portfolios with 100+ companies used to be commonplace, now they are rare. As a result, minimum liquidity and tradability thresholds have been raised and means many managers pay little attention to peripheral markets and even certain regions.

Fourth, the growth of so called 'ESG' - related investment has tended to discriminate against global asset manager allocations in regions like the Gulf, even though their representation and accessibility in global portfolios has grown considerably in recent years. The principal reason for this in the case of the Gulf, is the oil-based nature of the economies although many, perhaps unfairly, also cite other 'negative' factors such the state ownership of companies.

These trends are currently endemic, but the nature of investment is that the picture is always dynamic and what holds today may change tomorrow. Many argue that as the US now accounts for around 60% of the world index with just seven companies a significant part of that, the global investment environment may well change shape.

To a greater or lesser extent, all Middle East markets are impacted by the factors above, but they also share some of the same influences as other regions such as East Asia, Eastern Europe and Latin America. These influences can be compounded in

smaller markets like Qatar which are buffeted by global trends outside their control, particularly when then become fully open to international investment.

Closer to home, Saudi Arabia has become a more prominent competitor for regional and global capital over the last few years. Saudi is the dominant partner in the region and is home to by far the largest company, Aramco, and has also had a healthy pipeline of new listings. Investor appetite for scalability of businesses and market capitalisation has tended to favour Saudi Arabia relative to other regional markets resulting in a valuation 'gap' to emerge in certain companies compared with neighbouring markets.

The question arises as to how Qatar, which accounts for just 0.1% of all country world index and around 10% of the regional index and should respond to these trends. The answer undoubtedly does not come in the shape of a one-off silver bullet but an evolution on multiple fronts, many of which are already in progress. The rewards will follow when the global allocation trends mentioned earlier start to modify or go into reverse. This is entirely possible in a country that will represent 40% of total global LNG exports, mainly sold on long term contracts, but only having around 1/10 of the market capitalisation of Tesla, just one stock in the 'Magnificent Seven'.

The building blocks towards a market renaissance are already in place although that building is not fully completed. Qatar clearly presents a well-regulated marketplace with excellent corporate and investor transparency. Companies generate a high return on investment and generate attractive cash flows and dividends, and the government provides a stable policy framework that increasingly encourages a dynamic private sector. Furthermore, the country Sovereign has unparalleled projected revenue flows which should benefit all stakeholders within that clear governance framework.

Importantly, the economy needs to continue to advance its green agenda, to escape the categorisation by international-by-international investors as a 'hydrocarbon economy', and therefore an economy of the future rather than of the past. This categorisation leads to a misallocation of international capital, given that LNG is now deservedly recognised as the accepted transition fuel. A demonstrable decline of methane emission cuts from LNG, a key commitment of the recent COP28, in conjunction with a clear policy of accelerating investment in green technologies should enable Qatar to re-engineer and re-brand itself ahead of regional competitors. The advance of net zero targets within the region and versus developed countries will be very helpful in this respect.

In the interim, when international equity capital is more sceptical of a hydrocarbon-based economy there is necessarily greater dependence on local and regional capital in the development of local capital markets. Arguably, this capital has a far better understanding of the opportunity set but in order to comply with the demands of ESG guidelines it has to be perceived as independent and efficiently allocated. Recent QIA initiatives are very promising in this respect and greater regional institutional involvement with capital allocation processes akin to long-term global investors will be beneficial.

In a world of deteriorating fiscal deficits and higher borrowing rates, Qatar is in an envious position to reposition itself with capital markets at the centre of this evolution. The very process of creating a growing economy and an efficient re-cycling of surpluses back into key growth sectors will create a positive dynamic. Targeted sovereign fund direct investment trends will be supportive of an ecosystem

that prevailed during earlier periods of the Hong Kong and Singapore exchanges. At this time these markets, against a tight and trustworthy regulatory backdrop, enjoyed rather higher valuations and attracted more company listings from both home and abroad.

A key area for future growth could be in attracting and growing companies that will enable Qatar to extend the next LNG cycle to the country's own benefit. There will be many new opportunities, for example, in reducing emissions levels across the production and supply chain and addressing the deployment capital in developing countries as they pursue their own energy transitions. Undoubtedly many of these opportunities will be in the private markets but exit channels in the future could and should involve the Qatar Stock Exchange (QSE).

In summary, the backdrop to the local capital markets since the World Cup has seemed somewhat moribund. This can be primarily explained by trends in global markets at a time when the local market has become far more accessible to international capital. However, Qatar remains still at an early stage in a process of re-engineering and positioning itself for the next phase of growth and development. There are many opportunities for the QSE to be at the forefront of this exciting transition at a time when there is undue attention elsewhere.