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# MSCI ASCENSION SHINES SPOTLIGHT ON UNTAPPED SAUDI ARABIA

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In June, Saudi Arabia was approved for an upgrade from its standalone classification to the MSCI Emerging Market Index. The country will become 2.6% of the MSCI Emerging Markets Index when it is eventually included in the benchmark in mid-2019.

Over the next three to five years, we envisage the Saudi component of the MSCI Emerging Markets Index could rise to upwards of 9-10%. The widely-expected IPO of the country's oil giant Aramco would likely see a doubling of the initial Saudi weighting, while the country also has a pipeline of around US $150bn of potential IPOs coming to market over the coming three-to-five years – which would further increase the benchmark weighting.

## UNTAPPED INVESTOR POTENTIAL

As witnessed in other recently-upgraded countries, the upcoming ascension into the MSCI's flagship EM index will likely underpin Saudi equities over the coming year and beyond, as global investors cast an eye on a market that is almost exclusively owned by domestic investors.

While the Saudi authorities have improved the prior arduous process for overseas investors to take stakes in the country's companies over the past 18 months – in a campaign to obtain the MSCI upgrade – foreign investors still only account for about 3%[1] of total market ownership. The untapped potential is huge, particularly considering average foreign ownership across the EM universe today is 14.4%[2].

We have been bullish on Saudi Arabian equities for some time, largely sparked by the country's ongoing reform programme. This has been most ambitiously outlined in the country's Vision 2030 blueprint – an ambitious reform plan being spearheaded by Crown Prince Mohammad Bin Salman, commonly known as 'MBS', the heir apparent and son of King Salman.

A kingdom led by the 32-year-old MBS is an exciting prospect for the investment community, given his focus on important reform measures vital to unlocking the country's substantial economic potential. Before MBS' reform efforts, the business community in Saudi Arabia was too reliant on the government's system of subsidies.

## THE RIGHT SIDE OF CHANGE

As investors, we have been very careful to find companies on the right side of change. We have identified a number of attractive investment opportunities within the country – primarily in the banking, consumer and healthcare sectors.

[1] HSBC, 31st March 2018
[2] Tadawul Exchange, 31st December 2017

High quality Saudi banks – which continue to trade at the lower-end of historical valuations – are beginning to feel the effects of the improving economy, with loan growth increasing as the recent oil price rise begins to filter through.

Saudi banks are also direct beneficiaries of the US Federal Reserve's rate hike cycle. As the Saudi riyal currency is pegged to the dollar, Saudi interest rates traditionally mimic any Fed action, which could boost bank net interest income. We see Saudi British Bank – a subsidiary of HSBC, which is currently merging with RBS subsidiary Alawwal Bank – as a leader in this space. This is due to the synergies of this merger, its experienced management team, as well as its balance sheet buffers and high return-on-equity profile. The sector also offers healthy, dollar-pegged, yields of 4-5%[3].

We are also bullish on the prospects of the Saudi healthcare space, as the government understands the need to improve the level of care offered to its citizens. There is an acute need for the government to spend more on healthcare, as evidenced by the undersupply of hospital beds. Saudi Arabia currently has just 2.2 hospital beds per 1,000 people – below the 2.5 global average and far lower than the 6.3 average in Europe[4]. We believe companies such as hospital group Al Mouwasat Medical will be at the forefront of the growth likely to be witnessed by this sector.

[3] T. Rowe Price analysis
[4] Morgan Stanley Research, July 2016

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