



TASI on the ascendency

- The Tadawul All Share Index (TASI) has risen by around 15 percent since the beginning of 2019, and is currently trading close to four year highs (Figure 1).
- Besides investor positioning prior to the first tranche of passive inflows in relation to the FTSE EM index inclusion, we see other supportive factors driving TASI in recent months.
- During Q1 2019, oil prices rose back above \$65 pb, whilst the largest ever fiscal budget was announced by the Saudi government in late 2018. Additionally, a pause in US interest rate hikes has helped bring about a rebound in equity flows to emerging markets in general.
- All in all, at the end of Q1 2019, net purchases of SWAPs and buying by qualified foreign investors (QFIs) hit record levels, at SR12 billion, just over double the SWAP and QFI inflow seen in 2018 as a whole.
- Looking ahead, based on the experiences of other regional equity markets, investors entering the market prior and during inclusion into emerging market indices, are expected to drive TASI performance even higher.
- That said, we believe that the Saudi stock market will not succumb to a heavy correction post MSCI EM inclusion, as has been the case for regional indices in the past. This is because Saudi Arabia's upgrade is different than that of the others, with multiple FTSE EM and MSCI EM tranches occurring concurrently throughout 2019 and early 2020.

For comments and queries please contact:

Asad Khan
Head of Research
rkhan@jadwa.com

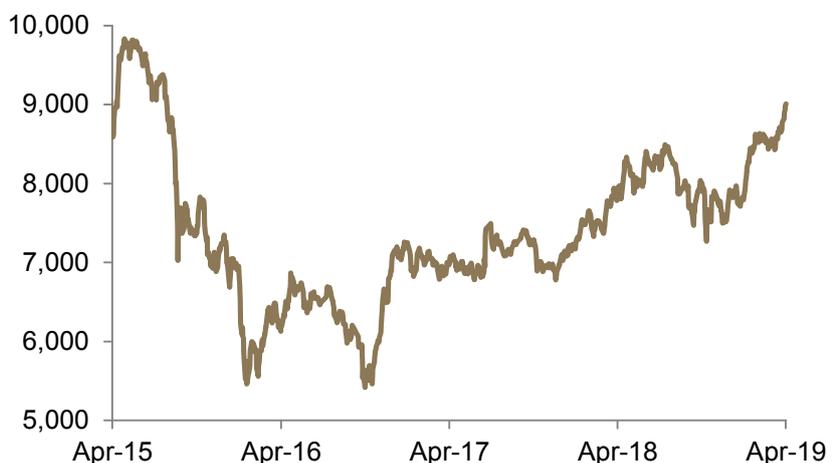
Head office:

Phone +966 11 279-1111
Fax +966 11 279-1571
P.O. Box 60677, Riyadh 11555
Kingdom of Saudi Arabia
www.jadwa.com

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Figure 1: TASI approaching four year highs





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...and led to an improvement in the performance of the Saudi stock market.

In fact, the Tadawul All Share Index (TASI) has risen by around 15 percent since the beginning of 2019...

...and is currently trading at its highest level in almost four years.

A combination of investors positioning prior to anticipated flows from both MSCI EM and FTSE EM...

Overview

In the last few months we have seen a number of positive developments that has lifted investor sentiment in the Kingdom and led to an improvement in the performance of the Saudi stock market. In fact, the Tadawul All Share Index (TASI) has risen by around 15 percent since the beginning of 2019, and is currently trading at its highest level in almost four years. Whilst part of the rises in Q1 2019 have been related to investor positioning ahead of anticipated flows related to inclusion of TASI into both the MSCI emerging market (EM) and FTSE EM indices, we see there being other supportive factors as well. Indeed, an expansionary fiscal budget announced at the end of last year (please refer to our [2019 Saudi Fiscal Budget](#) report published December 2018), and improving sentiment linked to higher oil prices are also relevant. Additionally, a pause in interest rate hikes by the US Federal Reserve (Fed), and corresponding increased equity flows to emerging markets, in general, has also helped. Lastly, we view continued efforts in striving towards the goals of the Vision 2030 (Vision), and targets under the National Transformation Program (NTP), as being a crucial backdrop for better TASI performance.

TASI Performance

A combination of investors positioning prior to anticipated flows from both MSCI EM and FTSE EM, a rebound in oil prices, an expansionary fiscal budget, and slower anticipated hike in US interest rates, were some of the factors behind TASI's rise in early 2019 (Figure 2).

Passive inflows:

TASI recently received the first tranche of passive inflows for the year. Around \$600 million (SR2.2 billion) inflows were seen in March, in relation to the FTSE EM index inclusion. According to FTSE Russell, the index provider, a total of \$6-7 billion (SR23-26 billion) in passive inflows are expected over the course of Saudi Stock Exchange's transition into EM status. Further FTSE EM tranches include circa \$900 million (SR3.3 billion) in April, and further three tranches in June, September and March 2020, all around \$1.5 billion

Figure 2: TASI's recent performance

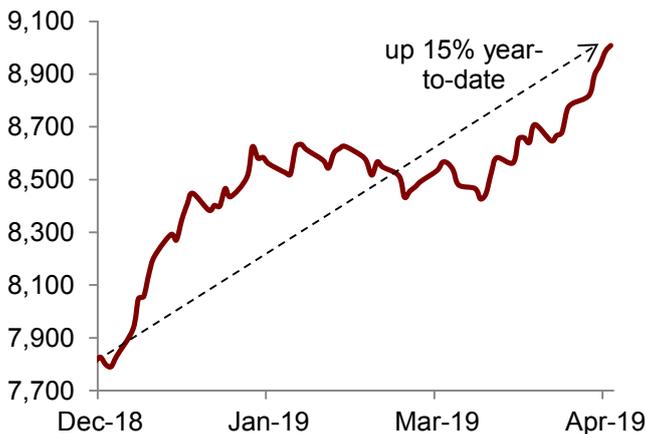
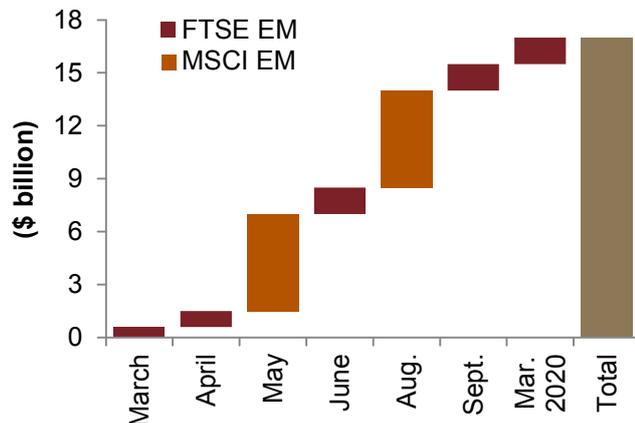


Figure 3: \$17 billion in passive inflows expected from MSCI EM and FTSE EM during 2019/20





(SR5.6 billion) each. Additionally, passive flows related to MSCI EM index inclusion will take place over two tranches, one in May 2019 and another in August 2019, which in total will see around \$11 billion (SR41 billion) of inflow. The combination of both FTSE EM and MSCI EM inclusion is therefore expected to bring in around \$17 billion (SR64 billion) in passive inflows in the year to March 2020 (Figure 3).

Rebound in oil prices:

Brent oil prices recovered to above \$65 per barrel (pb) mark recently, as official data showed that OPEC drastically cut oil output during January and February, in-line with a recent agreement. Brent oil prices have now risen 38 percent since the beginning of the year due to OPEC’s output reductions and improving sentiment over a trade deal between China and US, two of the world’s largest oil consumers. Despite the correlation between TASI and oil prices being dislocated somewhat recently, there are still sentimental effects of oil prices on the stock market, especially following sharp changes in the price of oil (Figure 4).

Economic growth and clarity:

Whilst economic reform is still currently under way, latest full year GDP data for 2018 shows that the economy was able to absorb most of the disruptive effects of necessary economic reform enacted last year. According to provisional full year data published by the General Authority for Statistics (GaStat), the Saudi economy grew by 2.2 percent in 2018 compared to a contraction of 0.7 percent year-on-year in 2017. Looking ahead, the economy will continue to benefit from an expansionary fiscal policy, with budgeted government spending set to hit record highs for a second successive year. Overall, in 2019 & 2020, a consolidation of efforts to push towards the goals of the Vision as well as the targets set under the NTP, will see overall growth reaching 2 and 2.2 percent respectively, with non-private sector growth rising by 2 and 2.4 percent (Figure 5) over the same period (for more on this please refer to our [Saudi Economy in 2019](#) report published February 2019).

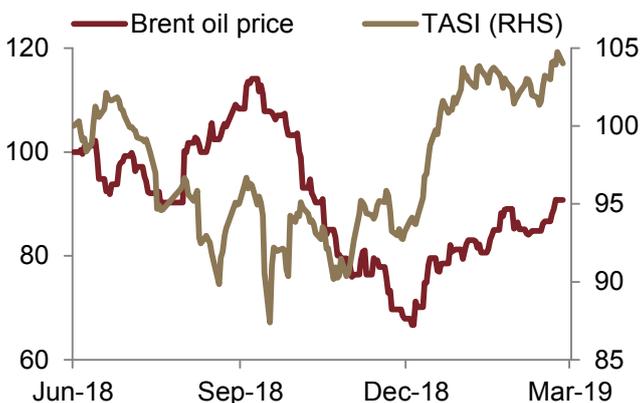
More generally speaking, in recent years, and in-line with the Vision, significant efforts have been made to improve reporting standards through the dissemination of relevant data, and guidance on macro-

...a rebound in oil prices...

...an expansionary fiscal budget...

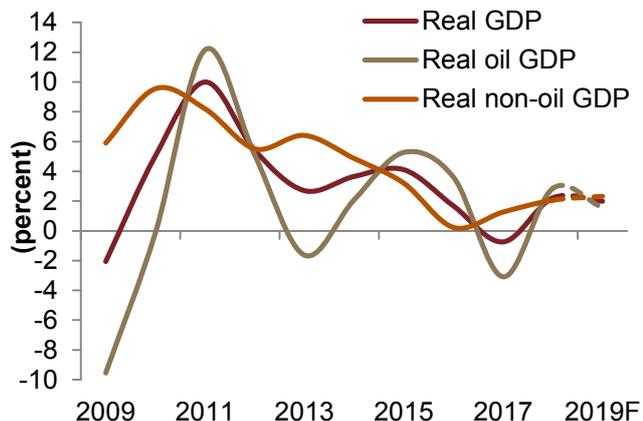
...with a consolidation of efforts to push towards the goals of the Vision...

Figure 4: Brent oil prices and TASI*



* Brent oil and TASI index rebased to 100 at end of June 2018

Figure 5: Saudi economic growth





... as well as the targets set under the NTP...

level economic policy. For example, all major economic decisions that have been implemented to date, or are planned to be implemented, are highlighted in the Fiscal Balance Program (FBP). Further efforts have been made to provide a fuller and more transparent picture of the impact of fiscal policy on the economy, through the release of a preliminary budget, quarterly budget statements and more detailed annual fiscal budget reports. Additionally, we have also seen clearly defined and specific objectives relating directly to the Saudi capital market under the [Financial Sector Development Program](#) (FSDP) and the Saudi Capital Market Authority's (CMA) Financial Leadership Program.

All in all, having the availability of timely and consistent data as well as providing greater clarity in economic policy, goes a long way in helping nurture sophisticated and smooth functioning stock markets.

...and slower anticipated hikes in US interest rates...

Key Trends

EM flows & comparative performance:

During most of last year, concerns over slower global growth, US-Chinese trade dispute, and expectations over continued US Fed rate tightening led to EM equity outflows. In the new year, some positives in trade talks between the US and China have been reported, whilst there has also been a softening in the tone with respects to interest rate hikes from the Fed. This, in turn, has contributed to raising global investor risk appetite and precipitated a reversal in equity flows to EMs (Figure 6). As a result, most EM indices have risen since the start of the year, with TASI being among the better performing equity markets amongst them. In fact, when looking on a regional level, TASI has been the stand out market relative to other Gulf indices, with year-to-date performance superior to the MSCI EM index (Figure 7).

...were some of the factors behind TASI's rise in early 2019.

Net inflows remain strong:

Net purchases by foreigners continued to be positive in Q1 2019. Specifically, net purchases of SWAPs and buying by qualified foreign investors (QFIs) totaled SR12 billion in Q1, just over double the SWAP and QFI inflow seen in 2018 as a whole (Figure 8). As highlighted above, based on passive inflows alone, we expect the foreign inflow to continue.

Net purchases by foreigners continued to be positive in Q1 2019....

Figure 6: Portfolio equity flows in 16 EMs and global risk appetite

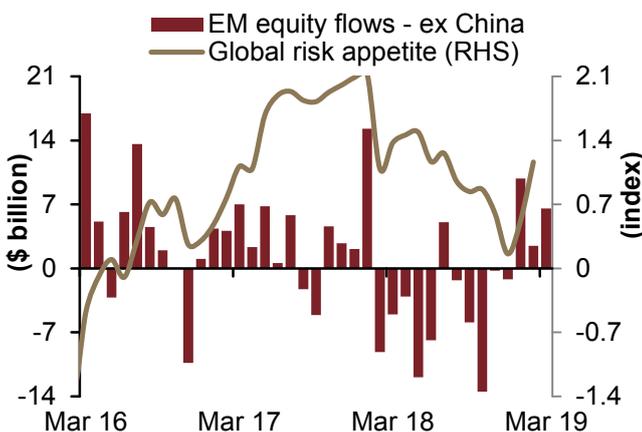
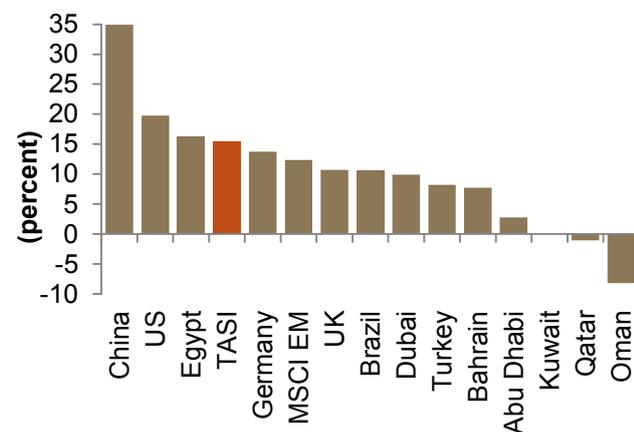


Figure 7: TASI's year-to-date comparative performance





...with net purchases of SWAPs and buying by qualified foreign investors (QFIs) totaling SR12 billion in Q1.

We expect a pick-up in ADVs going forward, on the back of inflows from foreign investors.

In tandem with the upward momentum in TASI, valuations have also risen recently...

...but so far, TASI has not exhibited such a steep incline when compared to regional peers over a similar period.

Based on the experiences of other regional equity markets...

One of the metrics under the FSDP's 2020 commitment states that foreign investor ownership as a percentage of equity market capitalization should be a minimum of 10 percent at the end of 2019, rising to a minimum of 15 percent in 2020. According to the latest Tadawul market report, the combined ownership of foreigners, including strategic ownership, stood at 5.1 percent at the end of March 2019, equivalent to SR105 billion.

Traded values expected to improve:

So far this year, a rise in net purchases of SWAPs and buying by QFIs has not helped raise liquidity in the market. To date, average daily traded values (ADV) have declined by 20 percent over full year 2018 averages, to SR2.7 billion. That said, we expect a pick-up in ADVs going forward on the back of inflows from foreign investors. For example, the SR64 billion or so in passive flows expected in the year ahead, represents an equivalent of 23 days ADVs, with a yet to be determined active flow likely to add to ADVs.

Comparatively slower rise in valuations:

In tandem with the upward momentum in TASI, valuations have also risen recently. Currently, TASI's price-to-earnings (PE) ratio of 19.8 is the highest in two and a half years, and at an 12 percent premium to its two year average of 17.7. That said, as we have highlighted on a number of occasions previously, it is quite normal for indices to exhibit sizable premiums in valuations in the run-up to MSCI EM inclusion. Thus, Dubai's (DFM) PE rose circa 37 percent over two year average, whilst Abu Dhabi's (ADX) PE rose by around 42 percent over two year average in the run-up EM indices inclusion (Figure 9). Looking ahead, whilst we see the inclusion of the Tadawul into MSCI EM allowing for further rises in valuations, so far, TASI has not exhibited such a steep incline when compared to regional peers over a similar period.

Outlook

TASI trending higher:

As highlighted above, we expect to see passive inflows of around \$17 billion by March 2020, directly as a result of both MSCI EM and

Figure 8: Net purchases of SWAPs and buying by QFIs has totaled SR12 billion so far this year

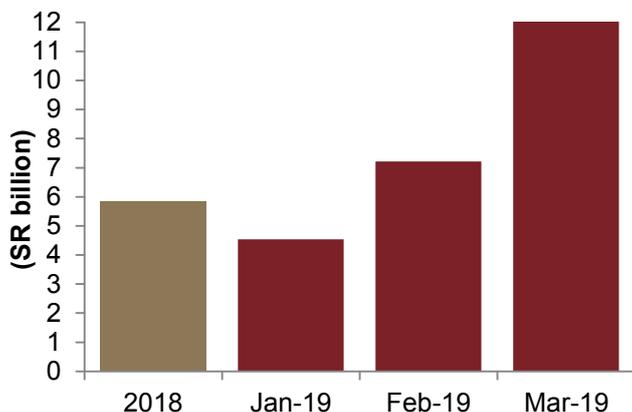
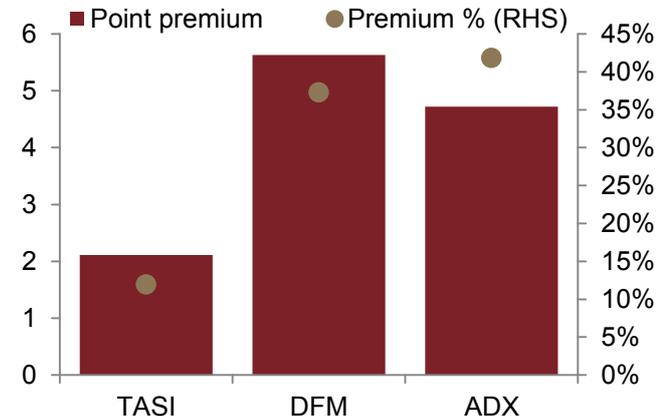


Figure 9: TASI PE still below peak of ADX and DFM valuations in run-up to inclusion





...active investors entering the market prior to, or in Saudi Arabia's case during inclusion, is expected to drive TASI performance even higher.

As we stated previously, TASI could hit 10,000 points in May 2019.

We believe the Saudi stock market will not succumb to such a heavy correction seen by the likes of regional peers...

...this is because Saudi Arabia's upgrade is different than that of the others.

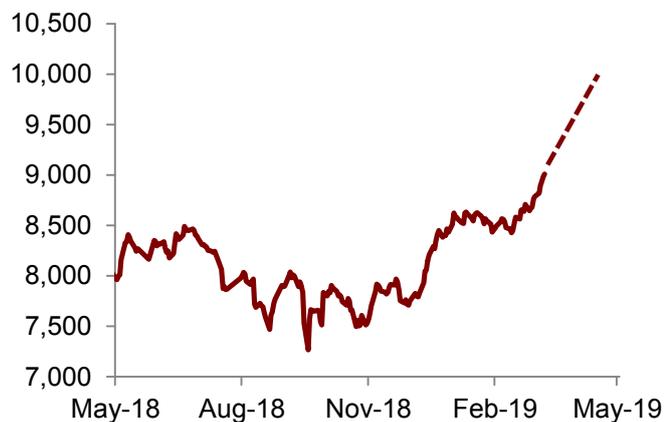
FTSE EM inclusions. That said, considering around 70-75 percent of investors benchmarked to the MSCI EM index are active investors, we would expect a sizable amount in active inflows as well.

Based on the experiences of other regional equity markets, active investors entering the market prior to, or in Saudi Arabia's case during inclusion, is expected to drive TASI performance even higher. For example, DFM, ADX and Pakistan's (KSE) equity markets all exhibited strong performances in the year between announcement and implementation of the upgrade into MSCI EM. In fact, the DFM rose 108 percent, whilst ADX rose 40 percent in the year to June 2014, whilst KSE rose by 33 percent in the year to June 2017. In our previous [Stock Market Update](#), we explained that a similar pattern was likely with TASI too. In fact, we stated that TASI could hit 10,000 points in early 2019, and although TASI is currently trading at around 9,000, we still see upside momentum. More specifically, due to the larger value of funds tracking the MSCI EM index, we see it totally plausible for TASI to rise to 10,000 in the next month or so, in the lead up to the first tranche related to MSCI EM inclusion (Figure 10).

Post MCSI EM May inclusion:

Whilst we still see upside momentum to TASI in the months ahead, we believe the Saudi stock market will not succumb to a heavy correction after MSCI EM May inclusion, as seen by the likes of DFM, ADX and KSE. This is because Saudi Arabia's upgrade is different than that of the others. Crucially, as we have pointed out, there will be multiple FTSE EM and MSCI EM tranches of passive inflow occurring concurrently throughout 2019 and early 2020. The UAE, for example, saw a near four year gap between FTSE EM inclusion (in September 2010) and MSCI EM inclusion (in May 2014). Furthermore, a major decline in oil prices in the second half of 2014, is likely to have aggravated the correction in both DFM and ADX, particularly towards the latter half of 2014. Currently, oil prices remain supportive of investor sentiment, and we still see some upside to oil with year-to-date Brent averaging close to \$63 pb, whilst our forecast for the whole of 2019 is at \$66 pb (for more on this please refer to our [Quarterly Oil Market update](#) report published January 2019).

Figure 10: Still possible for TASI to hit 10,000 points in May 2019*



* Past performance is not indicative of future results



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