

## Notes on the Middle East

*David Lazenby, the head of Batterymarch's Emerging Markets investment team, shares his observations from a recent trip to the Middle East.*

I visited four countries in the Middle East during the latter part of March: Qatar, United Arab Emirates (UAE), Saudi Arabia and Kuwait. All are part of the Gulf Cooperation Council (GCC), a geopolitical group that focuses on shared objectives and security in the region (Figure 1). These countries are generally pro-Western and aligned with US economic and military interests. In fact, Qatar and the UAE are directly participating with NATO allies—with aircraft flying—in enforcing the no-fly zone in Libya.

**Figure 1: Gulf Cooperation Council (GCC)**



Source: [www.crealis.es](http://www.crealis.es)

the "Persian threat"—Iran by way of Syria, Lebanon and Hezbollah—as a destabilizing force in regional politics.

Tensions elsewhere in the Middle East and North Africa (MENA) region have led to the introduction and/or acceleration of development and reform plans in GCC countries and across the region. These plans, aimed at political transparency and anti-corruption, are designed to generate goodwill and improve quality of life.

Many people throughout the region seemed most worried about the unrest in Syria, with much less concern about Yemen and Bahrain, where the GCC has provided military support to the existing government. My contacts frequently referred to

### **Qatar and the United Arab Emirates**

The United Arab Emirates (UAE) and Qatar both have very small citizen populations, with an enormous number of expatriates doing the work. The two countries have among the highest per capita incomes (for citizens) anywhere in the world and are therefore largely insulated from the political and economic tensions in the broader MENA region. With their oil-intensive economies, the general perception is that Qatar and the UAE benefit from MENA turmoil through higher oil prices. They may also benefit by being increasingly seen as stable, attractive alternative locations for multinational regional headquarters, expatriate workforces and so forth.

Qatar has about 200,000 citizens out of a population of less than two million. Most of the work in Qatar is performed by expatriates, and the locals are sometimes "paid not to work." I heard stories of private-sector companies paying citizens an "inconvenience salary" of double their normal pay while they're on vacation. I also saw the citizen staff at a telecommunications company leave the office for the day at around 2:30 pm while expatriates stayed to put in a full workday.

Although Qatar is a completely oil-based economy, it recognizes a need to develop other sectors. There is no meaningful private sector, with all companies essentially government/royal-family owned. Qatar was the winning bidder to host the FIFA World Cup (soccer) in 2022. Hosting the World Cup is perceived locally as a symbol of the country's stability and its status as a good global citizen. The infrastructure development budget for the event is expected to be \$100 billion, with most earmarked for roads, rail, ports and similar projects.

Dubai is the financial hub of the UAE and a likely first choice of multinational companies seeking a presence in the region. Dubai, and to a lesser extent, Abu Dhabi, were both caught up in the global financial crisis—exemplified by state-owned Dubai World, which sought in 2009 to restructure its debts—and have still not recovered. There are many unfinished or underutilized buildings in both emirates as well as numerous asset quality problems on bank balance sheets. The level of non-performing loans may not yet have peaked.

### Additional Insights on Egypt

*During my visit to Dubai, I spoke with an Egyptian-born stock analyst who shared his insights about events in his home country. He said that the uprising in Egypt was not, as widely perceived, "all about food and jobs," and that the first protesters in Cairo's Tahrir Square were actually upper- and middle-class Egyptians intent on gaining a political voice, not just economic improvements. In his view, the Muslim Brotherhood is playing its political cards correctly. On the night when pro-government agents overwhelmed the protestors in Tahrir Square, the Brotherhood brought in busloads of supporters who pushed back the pro-government forces and left, leaving the protesters in a stronger position.*

*Only the Muslim Brotherhood and the National Democratic Party (NDP), Egypt's former ruling party, currently have the organization to get out the vote. As a result, the March 19 constitutional referendum passed overwhelmingly despite efforts by the protest organizers—who felt the vote was being held too soon—to drum up opposition via Facebook and other means. They learned that they will need to use more traditional political methods to achieve their longer-term objectives.*

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### Kingdom of Saudi Arabia

Saudi Arabia is the most strategically important country in the region because of its significant share of global oil reserves and its large population. It is the one MENA nation that clearly needs to be stable. It is also the most vulnerable of the countries I visited because of its high unemployment levels, especially among women and young people. Yet Saudi Arabia is "the safest place on earth," according to one expatriate CEO with whom I met. He argued that the country's political and economic interests are completely aligned, internally and externally, to ensure the safety and success of its development plans.

Since late February, Saudi Arabia has announced two social spending packages totaling \$136 billion. The announcements, which were timed to offset calls for a "day of rage" on March 11 and another on March 20, appeared to be successful since the protests amounted to nothing, though partly due to a greater police and military presence. The largest public displays in recent weeks have apparently been in celebration of the social expenditures, which included direct payments to citizens. While Saudi Arabia has the money for social spending and development, it has historically failed to follow through. The current perception, however, is that regional tensions will prompt Saudi leaders to deliver this time.

King Abdullah is well respected and regarded as relatively liberal both within Saudi Arabia and around the GCC. The conservative force in the country is the clerics, who have an unwritten contract with the royal family in terms of influence. The king has reportedly appointed less conservative clerics to try to ease the path toward reform and progress. He is 86 years old and in frail health; Crown Prince Sultan is only one year younger, yet there is no clear succession plan, which adds to concerns about the Kingdom's vulnerability.

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## Kuwait

Kuwait, which has had a parliamentary system since 1962, is viewed in the GCC region as an example of how "democracy doesn't work here," because Kuwait has consistently failed to carry out significant reforms and strategic development plans. The royal family still controls the government and, therefore, the implementation of such plans. They also nominate half the members of Parliament. Some of my contacts also faulted the MPs themselves for poor execution, describing them as more conservative than government leaders and accusing them of "milking the government." Kuwait is currently in the midst of a five-year development plan but after two years has made questionable progress. Corruption is clearly an issue that tops reform agendas in the region.

Ninety-five percent of Kuwaiti government income comes from oil. There is a more distinct private sector in Kuwait than in Qatar and the UAE, although government/royal ownership still dominates.

As in Saudi Arabia, meaningful social spending has been announced since the MENA turmoil began, including direct payment to all citizens of 1,000 dinar—about \$3,600. In 2009, Kuwaiti officials pegged the average total monthly income at 2,200 dinar. The only segment of the Kuwaiti population generating some political tension is a small number of disenfranchised Bedouins, many of whom likely were or are citizens of other countries but would like to be recognized as Kuwaitis to take advantage of the benefits. Kuwait was described to me as being "tribal but inclusive." The problems in other MENA countries are seen from a Kuwaiti perspective as the result of non-inclusive political cultures.

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## An Investment Perspective

During my week in the four GCC countries, I met with approximately 20 listed companies that are exploring the investment opportunities in the area. I frequently heard from corporate managements that they are looking at opportunities elsewhere in the MENA region and, in some cases, beyond. Companies in the United Arab Emirates in particular are focused outside their own country, looking increasingly to Saudi Arabia for growth, although they are also interested in the longer-term opportunities resulting from the current turmoil in Egypt and its neighbors. As already noted, Qatar and the UAE are also working hard to brand themselves as stable business destinations in a troubled but potentially attractive region.

Unfortunately, most of the potential investment targets among listed equities—primarily in the finance and property sectors—are still recovering from the global financial crisis. I met two UAE-based construction contractors who described Saudi Arabia as their best growth opportunity but pointed out that they can enter only in partnership with established contractors and appear to be limited to projects their local partners can't handle on their own.

Even the huge infrastructure investment planned for tiny Qatar in anticipation of the World Cup may be difficult for them to access. My sense is that the South Korean construction companies, which have been big winners in the construction of hydrocarbon-related plants and other infrastructure projects, will continue to be the main beneficiaries of further development.

Limited liquidity in target companies also constrains current investment opportunities within the GCC. The CFO of a Qatar industrial company that ranks well in Batterymarch's quantitative model acknowledged that lack of liquidity is a primary concern for investors. He said that free-float decisions are made by Saudi Arabia's Minister of Energy, who also functions as the company's Chairman and Managing Director. Of the four countries I visited, the Saudi Arabian market accounts for over half of the 60 companies that currently meet the liquidity and data requirements for our systematic ranking process. Unfortunately, Saudi Arabia is difficult for foreign investors to access. Most foreign equity investors who are active in the market enter through swap arrangements and don't have direct access with standard custody agreements and other such provisions.

I returned home with a fairly clear confirmation from people much closer to the MENA political turmoil that the revolutionary change now underway will likely have very positive implications, though not without risk. While there are clearly sectarian and/or religious influences evident in the conflicts, the driving force is a desire for economic opportunity, government transparency and a political voice. I also have a greater awareness of Saudi Arabia's significance in world events and its potential influence over time. The country's vast oil reserves are common knowledge. It is Saudi Arabia's continuing effort to reconcile traditional ways with social forces and to more effectively share its wealth with the broader population that bears careful attention.

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