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Shifting Sands

The GCC's Equity Market Transformation

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Executive Summary

The Gulf Cooperation Council (GCC) region has undergone significant transformation in its equity markets, driven by efforts to diversify economies traditionally tied to oil and gas. This shift has made GCC equities increasingly attractive to both domestic and international investors, presenting new opportunities for portfolio diversification.

In this paper, we discuss why the GCC region presents a compelling investment opportunity, with significant growth potential, diversification benefits, and evolving sector dynamics. We will show how the ambitious vision plans set by GCC governments are supporting sustained economic development — and are making GCC equities a valuable component of a well-diversified portfolio.

Evolution of GCC Equity Markets

- Historically, access to GCC equities was restricted, particularly for non-GCC investors, but markets have opened up significantly since 2015.
- GCC countries' inclusion in the MSCI EM Index has grown from 1.5% in 2014 to 6.5% by mid-2024,[1] yet the region remains underrepresented in global indices, suggesting further growth.

Performance of GCC Equities

- The GCC equity index has outperformed the broader emerging markets index over the last decade, despite external challenges.
- GCC equities exhibit a lower-than-expected correlation to oil prices, highlighting the resilience and diversification of the region's economies and equity markets.

GCC Equities in Global Portfolios

- GCC equities offer global investors unique diversification benefits due to their low correlation with both developed and emerging markets, coupled with reduced currency risk from dollar-pegged currencies.
- As sectoral diversification and liquidity improve, GCC markets are becoming increasingly attractive for global portfolios, reflecting the region's ongoing economic reforms and growth potential.

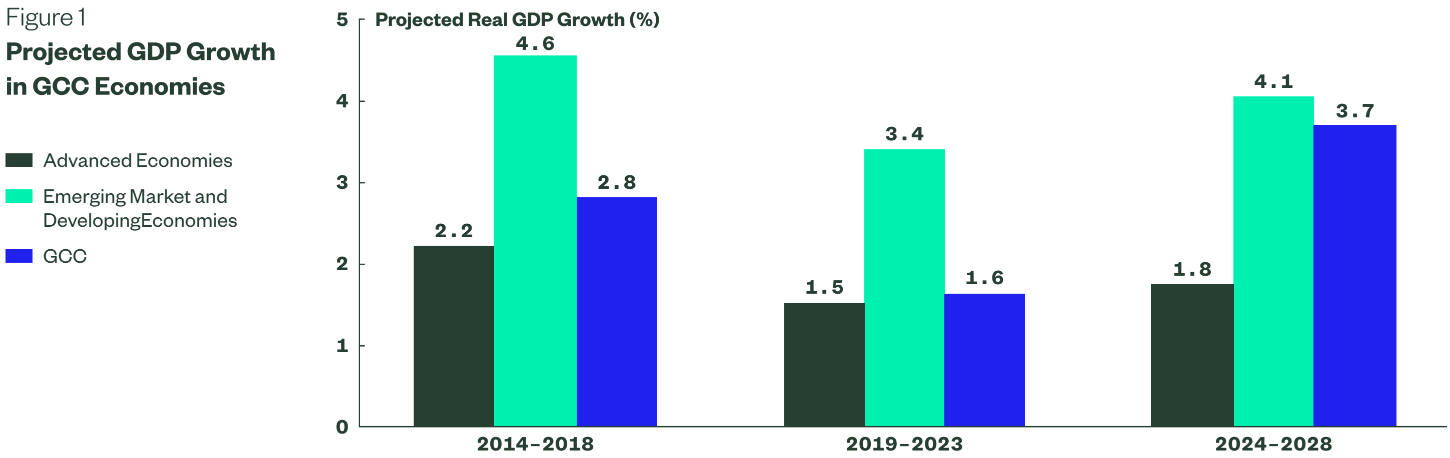
Shifting Sands

The GCC's Equity Market Transformation

The GCC region, encompassing Saudi Arabia, the United Arab Emirates, Qatar, Kuwait, Bahrain, and Oman, has experienced a profound transformation in its equity markets over the past few decades. Historically tied to energy prices due to its roles as a major oil and gas producer, the region is now making significant strides in economic diversification.

GCC economies have enjoyed significant economic growth in recent years, with the aggregate gross domestic product (GDP) of the region expected to surpass US$2 trillion at the end of 2024.[2] The International Monetary Fund (IMF) forecasts that the GCC region could grow at about 4% p.a., or more than double the advanced economies' GDP growth rate, in the five years ending 2028, as shown in Figure 1 below. This projected growth is being driven not only by the region's influential position in global energy markets, but also by the continued efforts of governments to diversify their respective local economies away from an over-reliance on the oil and gas industries. Key to this transformation are the Vision plans launched in the last 15 years, covered below.

Figure 1
Projected GDP Growth in GCC Economies



Source: IMF WEO April 2024, State Street Global Advisors. Estimated growth numbers are used from 2023 and onwards.

This shift is not only reshaping the GCC economies, but also positively impacting their equity markets, making them increasingly attractive to both domestic and international investors. With such robust fundamentals, we believe an assessment of how equity markets are developing in the region is warranted. Alongside that analysis, we also study the historical performance of GCC equities, along with their role in the global portfolios.

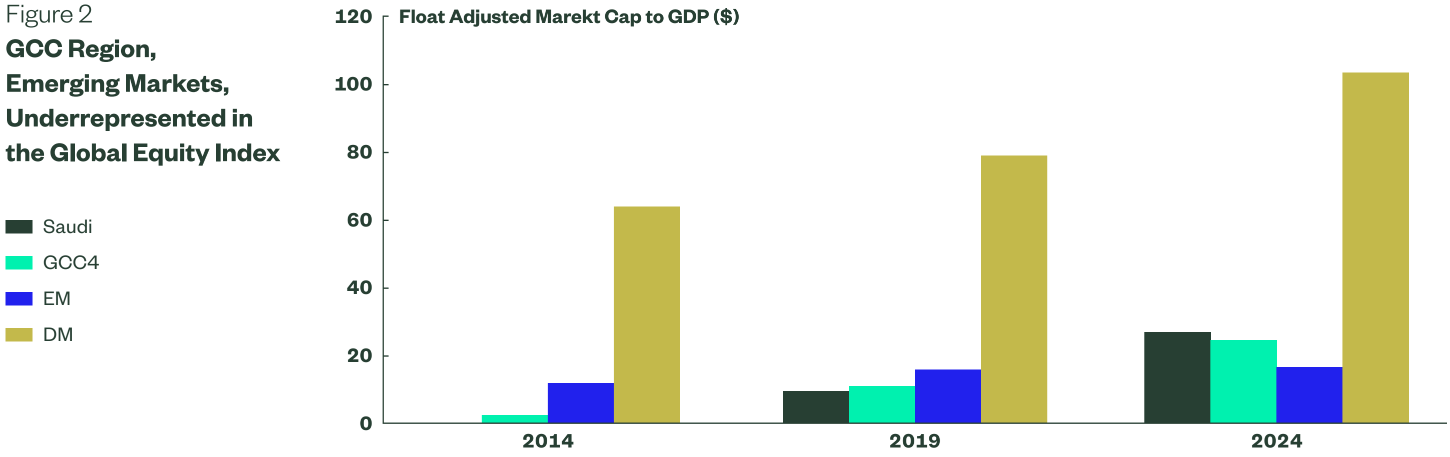
The Evolution of GCC Equities

The evolution of GCC equity markets has been nothing short of transformative, reflecting the broader economic shifts within the region.

Historically, these markets were characterised by limited access, particularly for foreign investors. Prior to 2015, Saudi Arabia – the largest market in the region — was entirely closed to non-GCC foreign investors, underscoring the region's cautious approach to market liberalisation.

However, the past decade has marked a turning point. The gradual opening of these markets has significantly increased their accessibility and global integration. The inclusion of GCC countries in the MSCI Emerging Markets (EM) Index and MSCI All Country World Index (ACWI) is a testament to this progress. Starting with the UAE and Qatar in 2014, followed by Saudi Arabia in 2019 and Kuwait in 2020, the GCC's representation in the MSCI EM Index has risen from 1.5% in 2014 to 6.5% by mid-2024, representing over $490 billion in market capitalisation across 72 stocks.[3] This increase in market value and participation has started to close the gap between the region's GDP contribution and its representation in global equities, as evidenced by the rising market cap-to-GDP ratio (Figure 2). Nevertheless, substantial potential for further growth persists.

Figure 2
GCC Region, Emerging Markets, Underrepresented in the Global Equity Index



Source: IMF World Economic Outlook, April 2024, MSCI Indices, State Street Global Advisors as of 30 June 2024. GCC4 represents Saudi Arabia, UAE, Qatar, and Kuwait. Respective year-end nominal GDP(USD) figures were used for GDP. June-ending float adjusted capitalisation is used.

For investors, the underrepresentation of GCC equities in the global indices presents an opportunity. As the region continues to integrate into the global financial system and its markets deepen, early movers could potentially benefit from the anticipated rebalancing of global portfolios towards GCC equites over the long term. Furthermore, the ongoing reforms and economic diversification efforts across the GCC suggest that these markets are on a path towards greater sectoral breadth, providing new thematic opportunities in a number of asset classes, as we show in the next section.

Broadening Market Horizons

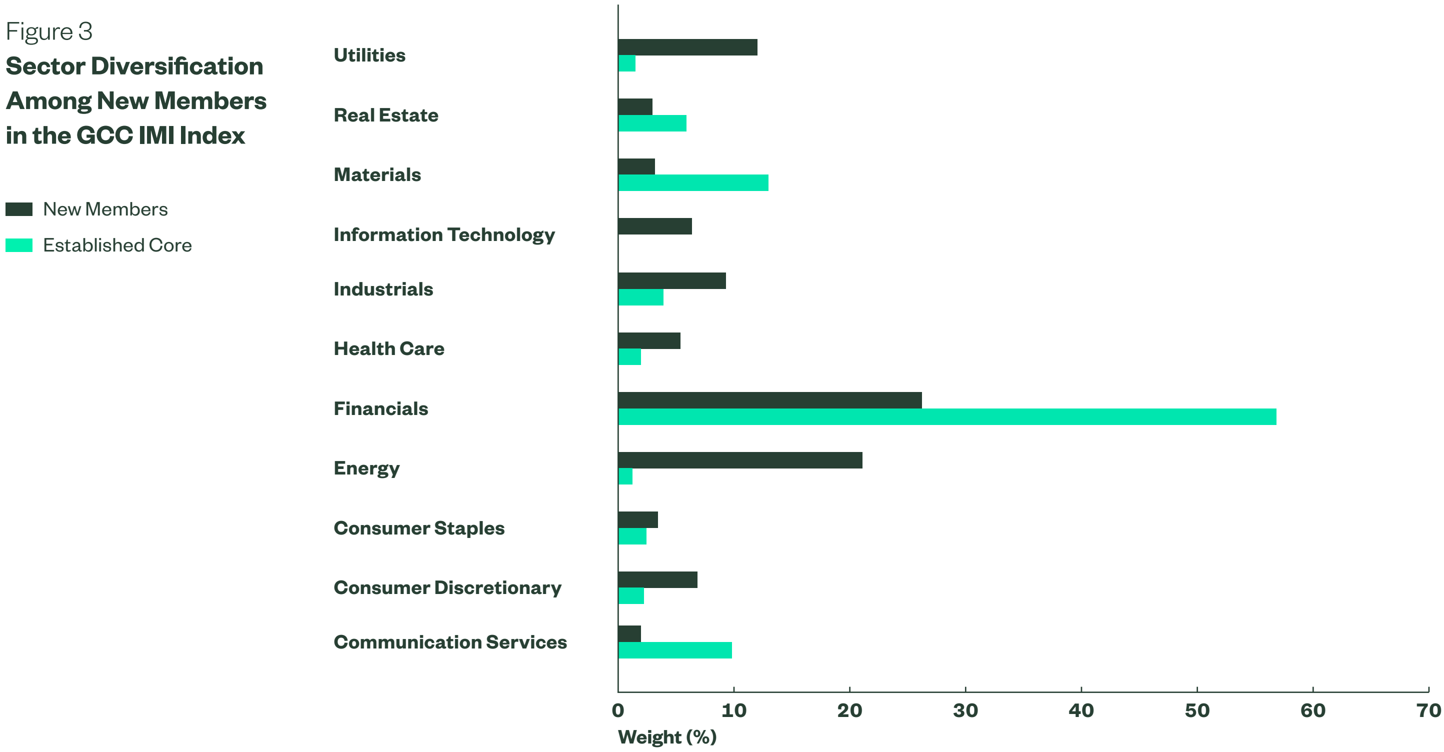
The current landscape of GCC equity markets is dominated by the financial sector, which accounts for more than 50% of the region's weight in the MSCI EM index.

However, this sectoral concentration is poised for a shift as the GCC economies continue to diversify away from the traditional sectors. This diversification is not just a policy objective but a structural transformation that is already reshaping the region's equity markets.

A closer look at the MSCI GCC IMI index reveals the early stages of this broadening. Over the past five years, more than 120 new companies (referred to as "New Members") have been added to the index. This has nearly doubled the total number of listed entities from five years ago (referred as "Established Core"). This influx of new members, many of which come from sectors outside of traditional finance and energy, is beginning to alter the sectoral composition of the index. These new entrants now constitute 48% of the index, bringing with them significant sectoral diversity, as shown in Figure 3.

Figure 3

Sector Diversification Among New Members in the GCC IMI Index



Source: FactSet, MSCI Indices, State Street Global Advisors as of June 30, 2024. Established Core are MSCI GCC IMI constituents before June 30, 2019, with the rest forming the New Members.

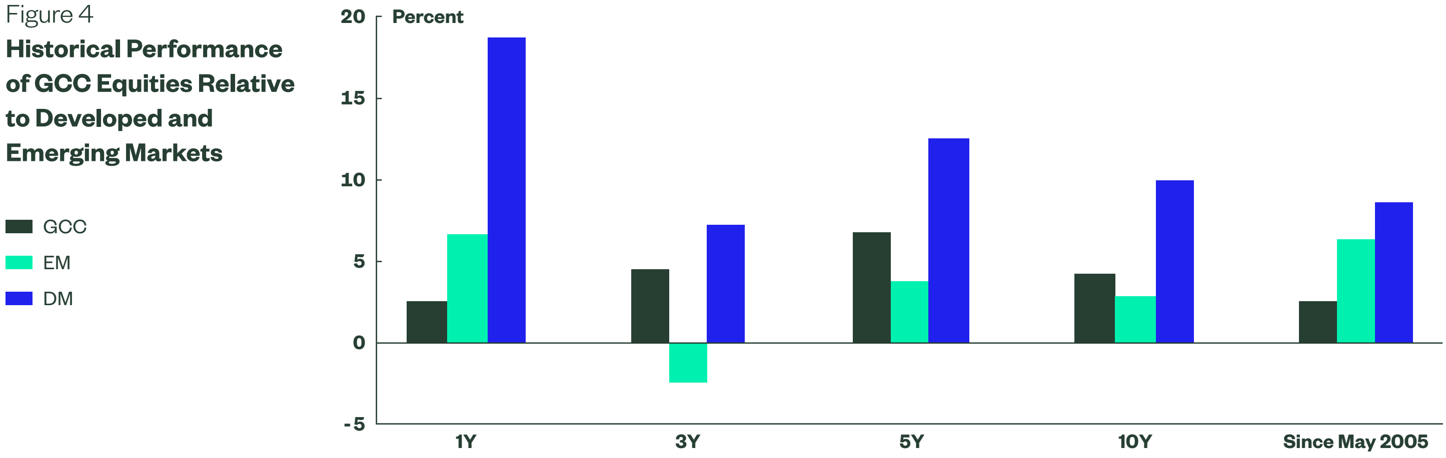
The implications of this trend are profound. As GCC governments continue to implement their Vision plans — policy frameworks aimed at economic diversification and sustainability — the equity markets are expected to reflect these broader economic changes. The newer sectors of the economy — health care and education, smart infrastructure, renewable energy, and technology — are likely to gain prominence, reducing the dominance of financials and offering investors access to a wider array of growth opportunities. New thematic offerings may provide investors exposure to include these emerging sectors that are likely to benefit from ongoing government initiatives.

Historical Performance of GCC Equities

The historical performance of GCC equities underscores the region's resilience and evolving market dynamics, particularly when viewed against the backdrop of broader global trends. Analysing the GCC Countries Combined Index, which captures the top 85% of free float-adjusted market capitalisation across the six GCC nations, reveals a compelling narrative of steady performance and adaptability.

Historically, GCC equities have moderately outperformed the broader emerging markets index while trailing behind developed markets over the past three-, five-, and ten-year periods, as shown in Figure 4.

Figure 4
Historical Performance of GCC Equities Relative to Developed and Emerging Markets

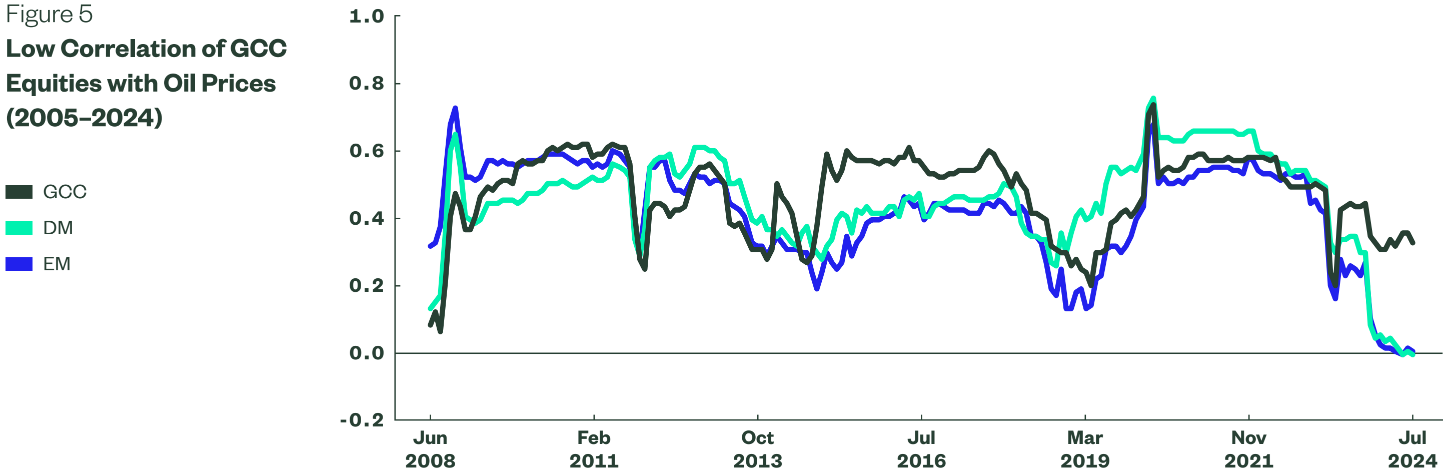


Source: FactSet, MSCI Indices, State Street Global Advisors as of July 31, 2024. Total returns in USD were used. GCC = MSCI GCC Countries Combined Index; EM = MSCI Emerging Markets Index; DM = MSCI World Index. MSCI GCC was launched in January 2005.

This relative outperformance against EM peers is noteworthy given the challenging global environment, including oil price volatility and pandemic-induced global economic uncertainty. Despite these external pressures, GCC economies have demonstrated an ability to sustain growth, reflecting the region's strategic efforts to diversify its economic base and reduce dependency on oil revenues.

What is particularly striking is the correlation of GCC equities with global oil prices. Contrary to conventional wisdom, GCC equities have not exhibited a significantly higher correlation to oil prices compared to global markets, as seen in Figure 5.

Figure 5
Low Correlation of GCC Equities with Oil Prices (2005–2024)



Source: FactSet, State Street Global Advisors as of Aug 31, 2024. Correlation is calculated using 36 month rolling return data from 06/30/2005 to 07/31/2024. GCC = MSCI GCC Combined Total Returns Index (TR); DM = MSCI World TR; EM = MSCI Emerging Markets TR.

As GCC economies continue to evolve, we expect this trend of reduced oil dependency and sectoral diversification to further enhance the stability and attractiveness of GCC equities.

GCC Equities in Global Portfolios

As the GCC region progresses with its remarkable transformation, its equity markets are becoming increasingly relevant for global investors seeking growth, diversification, and resilience.

One of the key advantages of GCC equities is their low correlation with both developed and emerging markets, as shown in Figure 6.

Figure 6
GCC Markets Exhibit Low Correlation with Global Equities

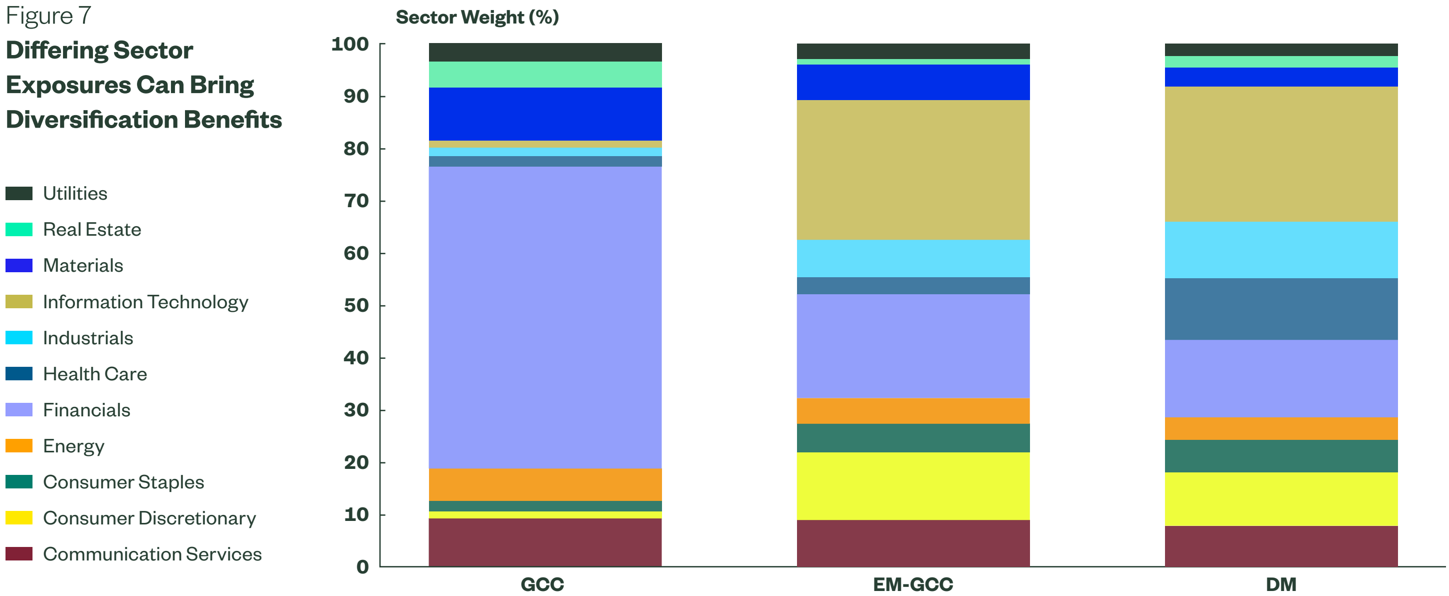
06/30/2005 to 07/31/2024	S Arabia*	UAE	Kuwait	Qatar	Bahrain	Oman	DM	EM
Correlation with GCC	0.52	0.51	1.00	0.42	0.55	0.42	0.49	0.44

Source: FactSet, MSCI Indices, State Street Global Advisors from 06/30/2005 to 07/31/2024. GCC = MSCI GCC Combined Index. Correlation with Saudi was based on data from 05/30/2014 when it first opened to non-GCC foreign investors.

This low correlation stems from the region's distinct sectoral exposure, which contrasts sharply with the high concentration of technology sectors in the global markets. For instance, the information technology sector constitutes only about 1% of the GCC index, compared to over 25% in both the developed market index and the EM markets (excluding GCC) index, as shown in Figure 7.

Figure 7

Differing Sector Exposures Can Bring Diversification Benefits

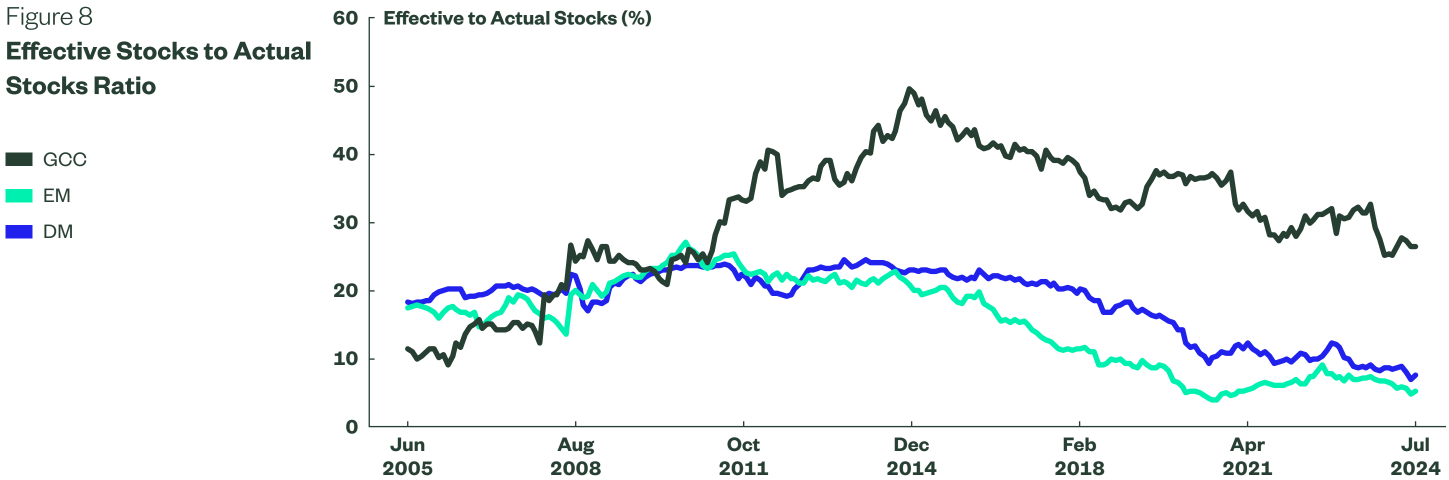


Source: FactSet, MSCI Indices, State Street Global Advisors as of June 30, 2024. GCC = MSCI GCC Combined Index.

A comparative analysis shows that, while GCC markets started with a higher concentration in specific sectors, similar to early-stage emerging markets, there has been a marked improvement over time. This improvement is represented by the widening gap in the ratio of effective to actual number of stocks for GCC as compared to global markets. This shift toward a broader, deeper, and more balanced sectoral composition makes GCC equities a compelling addition in global portfolios.

Figure 8

Effective Stocks to Actual Stocks Ratio



Source: FactSet, State Street Global Advisors, MSCI Indices as of July 31, 2024. The effective number of stocks is calculated as the inverse of Herfindahl-Hirschman Index (HHI), and a higher ratio of effective to actual stocks indicates a less concentrated and more diversified index.

Another strategic advantage of investing in GCC equities is the region's lower currency risk. Most GCC economies have their currencies pegged to the US dollar or a basket of major world currencies, providing stability and reducing the foreign exchange risk that typically accompanies investments in emerging markets.

However, it is important to acknowledge that GCC markets still face challenges, particularly in terms of liquidity. While the region has made significant strides in improving market access and attracting foreign investment, liquidity remains lower compared to major emerging markets. That said, liquidity is on an upward trajectory as the region continues to integrate into the global financial system and attract institutional investors. The ongoing market reforms and efforts to enhance transparency and regulatory frameworks are likely to further improve liquidity, making GCC more accessible and attractive to a broader range of investors.

Vision Plans and the Opportunities for Thematic Investment

All six GCC countries have launched strategic visions and national development plans with the ultimate goal of diversifying their economies. In all cases, these plans should reduce dependence on oil, and enhance social and sustainable economic development across the region.

Launched in April 2016 by Crown Prince Mohammed bin Salman, the most high-profile plan in the region has been Vision 2030 for Saudi Arabia. Its goal is to make the Gulf state a global investment powerhouse and an economic hub connecting three continents: Asia, Europe, and Africa. While diversifying, one of the objectives is to increase the private sector's contribution from 40% to 65% of GDP. Among the eye-catching major projects are NEOM (a futuristic city integrating smart technology and sustainability), the Red Sea Project (a luxury tourism and residential development), and Green Riyadh (an initiative to plant millions of trees to improve air quality and reduce temperatures).

As we are now in the second decade of these Vision plans, the results should be feeding through to GDP growth and, at the same time, providing new thematic opportunities for investors. In the table below, we summarise the highlights of each plan.

Country	Vision Plan	Year of Launch	Main Objectives Include	Targets Include
Saudi Arabia	Vision 2030	2016	• Reduce dependence on oil • Diversify economy • Develop a vibrant society • Promote private sector investment • Develop tourism and entertainment industries • Improve education and health care	• Increase non-oil GDP to 50% by 2030 • Create 1 million jobs in the private sector • Achieve a top 10 ranking in the Global Competitiveness Index • Enter the top 15 world's largest economies
United Arab Emirates	National Vision 2021	2010	• Build a knowledge-based economy • Promote innovation and entrepreneurship • Enhance quality of life • Develop a world-class education system • Invest in renewable energy • Promote sustainable development	• Achieve a top 10 ranking in the Global Innovation Index • Reduce carbon emissions by 75% by 2050 • Increase the per capita gross income by 65% • Make the UAE the safest place in the world
Qatar	Qatar National Vision 2030	2008	• Transform into a leading advanced economy • Focus on human development, economic diversification, and environmental sustainability • Develop a knowledge-based economy • Invest in education and health care • Promote sustainable tourism	• Achieve a top 10 ranking in the Global Competitiveness Index • Achieve a top 10 ranking in the Human Development Index • Reduce carbon emissions by 25% by 2030 • Digitise 90% of government services provided to citizens
Oman	Oman Vision 2040	2021 (Updated from original 2020 plan)	• Diversify the economy • Reduce dependence on oil • Improve quality of life • Develop tourism and manufacturing sectors • Promote innovation and entrepreneurship • Invest in renewable energy	• Increase non-oil GDP to 50% by 2040 • Create 100,000 jobs in the private sector • Achieve a top 50 ranking in the Human Development Index • Produce 30% of electricity from renewables by 2030
Kuwait	Kuwait Vision 2035	2017	• Transform into a global financial and commercial hub • Diversify the economy • Promote private sector investment • Develop a knowledge-based society	• Raise non-oil GDP to 50% by 2035 • Increase Kuwait's GDP by 1.5% • Increase enrollment rate in higher education to 40% • Achieve a top 10 ranking in the Global Competitiveness Index
Bahrain	Economic Vision 2030	2008	• Diversify the economy • Reduce dependence on oil • Improve quality of life, develop tourism and financial sectors • Promote innovation and entrepreneurship • Invest in renewable energy	• Reduce oil contribution to under 30% • Create 50,000 jobs in the private sector • Double household disposable income

Substantial funding for the plans has originated from government oil reserves, Sovereign Wealth Funds (a good example being the Public Investment Fund in Saudi Arabia), and public funding, with some countries, like the UAE, introducing new tax measures to increase government revenues. There have also been collaborative agreements between government entities and private companies (PPPs) to finance and deliver large-scale infrastructure projects, as well as Foreign Direct Investment, attracted by tax-friendly policies.

As referenced earlier, capital markets are maturing quickly, being crucial for attracting foreign investment. This provides increased optionality for bond and equity investors, both domestic and international. Governments have issued bonds in various currencies, including US dollars, euros, and Japanese yen, to tap into a wide investor base. Alongside this, Sukuk bonds, which comply with Islamic finance principles, have gained popularity as an alternative investment option for investors seeking Shariah-compliant investments. Green bonds, earmarked for environmentally friendly projects, have attracted growing interest from investors seeking to align their investments with sustainable goals. (For more detail, read our 'GCC Fixed Income: An Alternative Diversifier to Core Allocations' article on ssga.com.)

Initial Public Offerings (IPOs) are playing a crucial role in the economic diversification efforts as part of the Vision plans. Governments are pushing for privatisation of state-owned enterprises, using IPOs as a mechanism to transfer ownership to the private sector. Meanwhile, families that were once closed to third-party equity investments are now looking at IPOs as an effective means to boost growth and diversify their wealth. This is all fueling activity levels, particularly in the UAE and Saudi Arabia. In order to ease investor access, more exchange-traded funds (ETFs) are likely to be developed for these bonds and new publicly listed companies. At the same time, we expect the ecosystem to develop, offering structured products that incorporate various strategies, including options, swaps, and other derivatives.

The advantages of ETFs, such as low costs, diversity of investment, transparency, and liquid trading platforms are helpful to development. For example, ETFs have attracted a wide range of investors, including retail and institutional investors, to Asian markets. In turn, the increased activity in trading and a larger pool of investors has led to greater market depth and liquidity.

Despite these developments, current regulatory frameworks could see new ETFs launched more quickly outside the GCC in established financial centers like the US, Europe, or Hong Kong. Larger, more established markets often have greater market depth and liquidity which could be beneficial for investors in ETFs. However, it will not be long before markets in the Gulf region follow suit at scale.

Conclusion
A Dynamic Investment Destination

The GCC region has emerged as a dynamic investment destination, offering a compelling blend of growth potential, diversification benefits, and complementary sector exposure.

The transformation of GCC equity markets over the past decade is nothing short of remarkable. The region has evolved from a collection of markets heavily influenced by oil prices, into a more diversified and resilient investment destination. Today, we see a region where markets are increasingly open to foreign investors, with a growing presence in global indices. The sectoral landscape is expanding, reflecting broader economic reforms aimed at reducing dependence on hydrocarbons.

Despite these advancements, the GCC's equity markets remain underrepresented in global indices relative to their economic contributions, and challenges such as liquidity still persist. However, the trajectory of growth and integration into the global financial system is clear. Moreover, the region's lower currency risk, underpinned by the stability of dollar-pegged currencies, adds an additional layer of appeal in a volatile global economic environment.

The ongoing transformation of the GCC economies necessitates a fresh perspective on the region's equity markets, challenging traditional investment approaches and mandates. As the region continues to mature and evolve, GCC equities present a unique opportunity for investors seeking growth and diversification, making GCC equities a valuable addition to any well-diversified investment portfolio.

Endnotes

1 Source: MSCI Indices, FactSet, State Street Global Advisors, as of June 30, 2024.

2 IMF World Economic Outlook April 2024.

3 Source: MSCI Indices, FactSet, State Street Global Advisors, as of June 30, 2024.

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* Pensions & Investments Research Center, as of December 31, 2023.
† This figure is presented as of June 30, 2024 and includes ETF AUM of $1,393.92 billion USD of which approximately $69.35 billion USD is in gold assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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