

Increasing Investment Opportunities in the Middle East and North Africa: Countries with Reform Strategies Lead the Way

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Martin C. Schulz
Managing Director
International Equity

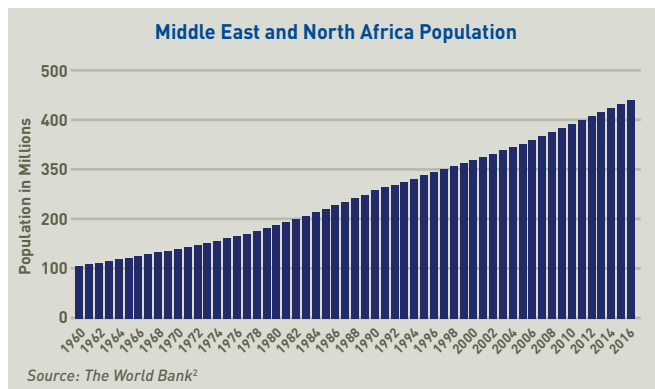


Scott Camp
Analyst/Trader
International Equity

We sense new opportunities for investors in a region normally associated with conflict. Driven by powerful demographic forces, global technological changes, and the long-term potential decline in oil demand, the Middle East is undergoing monumental changes not seen for generations. Growth expectations in the region are ramping up, particularly for those countries undertaking much-needed reforms to expand employment prospects, loosen business and social restrictions, and—especially important for petrostates—diversify their economies. We recently visited the region and have updated views on several countries, including Egypt, Saudi Arabia, and the United Arab Emirates (UAE). Based on our assessment, we believe the region is ripe for potential investments by our strategy.

Constructive, positive transformation has been underway in the Middle East for several years. The UAE was the first country in the region to identify that it needed to change course a few years ago. The Emirates determined that the long-term future of oil was in jeopardy and its dependence on oil was a risk. Initially, from an investment perspective, our main foray into the region was in fact through the UAE via investments in healthcare and property development. At the time, aside from Israel, we considered other countries in the region to be underdeveloped, too weak, and/or potentially unstable. Now, with the UAE acting as a model for others, and with real reform efforts underway, we have been expanding our research and investments across a broader swathe of the region.

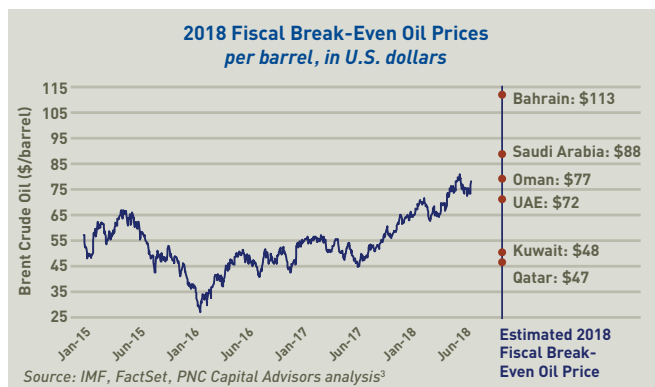
As part of our research efforts—and in spite of the fractious and riven airspace wars which made travel arduous—we visited eight countries in the Middle East and North Africa (MENA) region earlier this year, meeting with numerous banks, government officials, company management teams, monetary authorities, and local investors. In contrast to our last visit to the region in late 2015, signs of growth were palpable. We hadn't seen so many construction cranes anywhere else in the world except in China. Our observation confirmed what our top-down analytical model is increasingly telling us: opportunity beckons.



Growth is expected to speed up in the MENA region in the coming years. The greater MENA region includes close to one billion people and remains an untapped market, especially in ecommerce. Additionally, the region's unique location serves as a powerful hub connecting Asia, Africa, and Europe. In its April 2018 World Economic Outlook, the International Monetary Fund (IMF) projected the region will expand by 3.4% in 2018 and 3.7% in 2019, up from 2.6% in 2017.¹ Oil exporters are expected to benefit from increases in oil prices and spending on infrastructure for major projects,

including the Dubai Expo 2020 and Qatar World Cup 2022. Growth among oil importers is expected to improve over 2018 to 2020, as business and consumer confidence is boosted by reforms and the general expansion of the global economy. More important for the region's long-term outlook are the reforms being undertaken by forward-looking leaders who have looked to the UAE's past reform efforts, albeit incomplete, as a model for the future.

From a cultural perspective, this year marks the seventh anniversary of the Arab Spring, when parts of the MENA region were engulfed in protests. Many of the elements that caused the widespread outrage— inflation, poverty, corruption, lack of opportunities for the young— remain generally unresolved. From 1980 to 2000, the region's population had essentially doubled, and employment growth failed to keep pace. According to the IMF, the Middle East has the highest rate of youth unemployment in the world. In a region with the youngest population outside of India, this is problematic. Gainful employment is in short supply due to an overreliance on the public sector, in which locals opt for more comfortable employment, mismatched skills, and weak private sectors, even as an estimated 5 million workers are set to enter the job market every year. In our view, all of the region's governments must quickly address youth unemployment. If they fail to do so, young people could turn to more extreme ideologies for answers.



Younger generations will play an increasingly important role in shaping the politics of the land given the increasing adoption of new technologies that interconnect people and foster the exchange of ideas. Younger generations are more tapped into the rest of the world, less bound to the region's social and religious conventions, and are in a position to demand greater economic opportunity. The massive changes brought on by digitization and social media are revolutionary in their own right for any society, not to mention ones that have been effectively closed off from the

rest of the world. To maximize their political gains with young Arabs, several countries are altering the role of religion within society and undertaking far-reaching social and economic reforms.

Other challenges include ongoing religious rifts, relatively high local unemployment, heavy reliance on expatriate workers, and dependency on an inefficient government sector to drive growth. Each nation in the region struggles with its own unique circumstances, although most face the hurdle of building strong private sectors.

In our view, the most important concern facing the region is the future of energy. Oil-exporting MENA countries consequently have an additional set of concerns: They are in a race against time as the global importance of oil wanes, which will undermine their ability to fund social programs and military operations. The displacement of petroleum is a real threat, as renewable energy technology improves and its use expands globally. The date for peak-oil demand is estimated by some analysts to be as soon

as 2030, giving a real sense of urgency for leaders in oil-producing economies to diversify. Post the global financial crisis, the economic impact of lower oil and gas revenues in recent years helped focus the region's leaders on strategies to diversify their economies, develop the private sector, reform their labor markets, and jump-start growth and innovation.

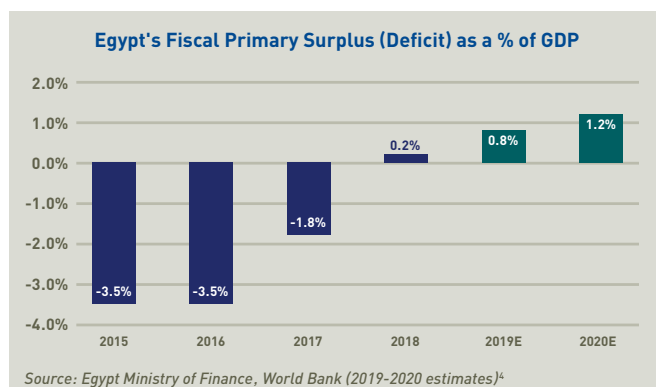
Our investment approach has always attached a premium to finding the best growth companies in markets that have attractive relative valuations, competitive currencies, strong or improving trade positions, and positive leading economic indicators. Given the unique circumstances and challenges of the region and its potential renaissance, we also favor nations that are taking the needed actions to adapt. Our focus in this paper is on Egypt, Saudi Arabia, and the UAE, three countries that we believe have brightening prospects over the mid- to long-term investment horizon.

LOOKING TO PLACE EGYPT ON THE PATH OF SUSTAINED GROWTH

Egypt is the most populous country in the Arabic-speaking world, with a population that has almost doubled since 1990 to now approach approximately 100 million. However, until recently, Egypt has been the poster child of a nation requiring transformational change. Not only is the country's economy dependent on tourism, trade, and agriculture, it has also been highly centralized since the 1960's and has struggled with high levels of external debt. While the country has a burgeoning youth population, with an estimated 75% of Egyptians under the age of 25, youth unemployment exceeds 30%. Egypt's infrastructure is underdeveloped and it has been a net importer of oil for generations, dependent on the U.S. and its neighbors for assistance. Additionally, Egypt's military is powerful and has had an inordinate amount of influence on the economy and its politics. Finally, the country is still recovering in some ways from the effects of 2011's Arab Spring, which jarringly upended the political landscape for years.

However, substantive change finally seems to be underfoot, led by an unlikely source—Egyptian President Abel Fattah el-Sisi, who was recently re-elected in March in a landslide vote to another four-year term. The strongman—the Middle East has a lot of these—has held the presidency since ousting the Muslim Brotherhood from power in mid-2013. With weakening growth, rising inflation, soaring public debt, and a worsening trade balance, Egypt was in awful shape at the time he took office. The central bank was spending more than half its foreign reserves propping up the Egyptian pound, and investors and tourists had virtually abandoned the country.

Sisi promised Egyptians stability and prosperity, and he has generally delivered. Since coming to power, he has led the government into action, proactively working to make Egypt a more investment-focused economy with a number of bold reforms. Acting forcefully to address the nation's imbalances, Sisi reduced costly fuel subsidies and introduced a value-added tax (VAT) to help trim the budget deficit. He jump-started an initial public offering program for a number of state-owned companies and pushed a large-scale privatization effort. He also let the country's currency float in 2016, resulting in a big drop in its value. In addition, the central bank raised interest rates to rein in inflation. As a result, GDP growth is strengthening and inflation is declining. The government trimmed the budget deficit, tourism revenues and remittances are increasing, and the country's foreign exchange reserves have been rebuilt. An increase in income taxes, VAT revenues, and the introduction of a real estate tax have resulted in the Egyptian budget registering its first primary surplus in 10 years, according to the Egyptian Ministry of



Finance. Additionally, the government has approved several measures to improve the business climate, including reducing the amount of red tape in industrial licensing and providing easier access to financing for small- and medium-sized enterprises. Sisi has further decreed the expansion of the Suez Canal, initiated a plan to reclaim more than a million acres of desert, is likely to balance the budget in three years, and ordered the construction of a mega city be built near Cairo.

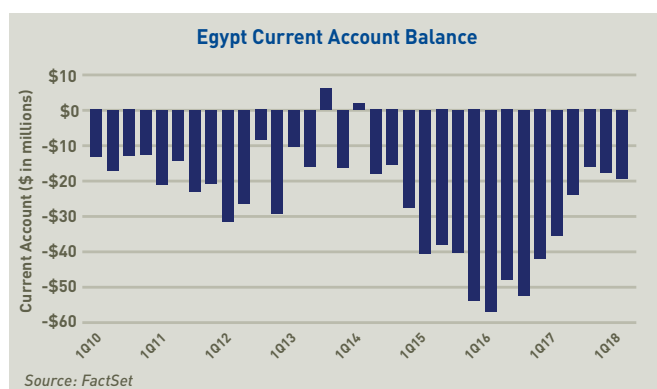
Although Sisi has turned primarily to the military to help fix the stumbling economy, he is now focusing on reforming and rebalancing it. Importantly, he has brought back confidence in the Egyptian people, who are yearning for a better future. In the Gulf, wealthy monarchies count Egypt's government as a firewall against a repeat of further popular upheaval, as witnessed during the Arab Spring.

The government has acted to increase employment and labor force participation of women and youth, similar to its regional peers. Unlike the Gulf Cooperation Council states (Bahrain, Saudi Arabia, Oman, the UAE, Qatar, and Kuwait) that mainly rely on social engineering and technology to provide a path forward for its young populations, Egypt still leans on outside support to some degree—Saudi Arabian financial support, Russian and Chinese expertise, and international institutions like the IMF—to help strategize how to achieve a more modern and vibrant private sector. To help working women, funds have been designated to improve the quantity of and access to public childcare centers. Plans are underway to improve the safety of public transportation, while specialized training programs and job search schemes for youth have been launched.

In another positive economic development, after years of relying on imported energy to meet domestic energy demands, Egypt is closer to meeting its goal of energy independence. A potential energy bonanza is in the offing that will further boost the long-term prospects for the nation, as the country's long-awaited Mediterranean gas bounty is suddenly within reach. Production began in the Zohr offshore gas field in December 2017, a development that has major implications for Egypt's economy. Zohr has estimated reserves of about 30 trillion cubic feet, making it the largest gas discovery in the Mediterranean Sea.

The IMF and the World Bank have each provided credit to support Egypt's economic reforms. The IMF reported that Egypt's GDP grew 4.2% in 2017, with projections for GDP growth of 5.2% in 2018 and 5.5% 2019.¹ Inflation is expected to decline steadily, and the move to a floating exchange rate has improved competitiveness and provided a much-needed boost to industrial activity and exports. With improved external competitiveness, reforms to the business environment, and a further recovery in tourism, the current account deficit is expected to narrow from 6.5% of GDP in 2017 to 4.4% in 2018 and 3.9% in 2019. The primary fiscal balance is also projected to improve from a deficit of 2.8% of GDP in 2017 to a deficit of 1.1% in 2018, turning into a surplus of 1.3% in 2019.¹

While Sisi and the Egyptian government have made enormous strides toward improving the economy and business climate, Egypt ranks only 128th out of 190 countries in the World Bank's assessment of ease of doing business. Egypt's government could help strengthen its private sector by diminishing the role of its state-owned enterprises and reducing the perception of corruption. The government also needs to collect more revenue to pay for social services and to invest in health, education, and infrastructure, as the IMF has recommended. While there is more work to do, the reforms introduced thus far are steps in the right direction.

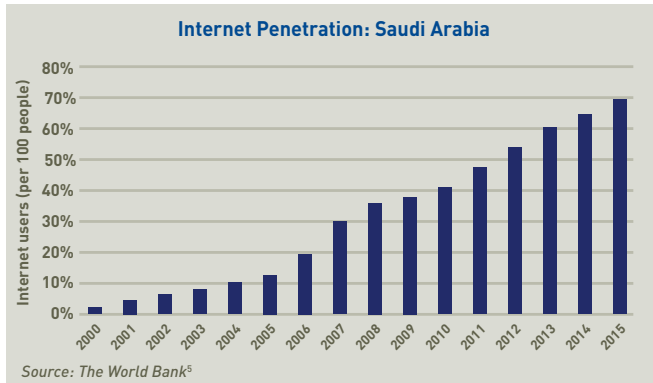


Ultimately, we believe Egypt is making necessary structural changes that should improve its business climate and investment prospects. Its currency is stable, the gas story is just beginning, tourism is making a strong recovery, its central bank has started an easing cycle, and it has a shrinking current account balance. In our view, the biggest challenge for Egypt will be to balance the need for economic progress with democratic reforms. After the tumult brought on by the protests in Tahir Square and the Arab Spring, few Egyptians seem willing to endanger

the country's current relative stability and economic progress. But Egypt has a large, urbanized young population, a bloated public sector, and an economy that is dominated by the military and corruption. Any spike in oil prices or inflation, especially in food prices, which helped spark the Arab Spring in the first place, would be most unwelcome. Meanwhile, terrorism and national security also remain significant concerns. Egypt has its work cut out for itself, but it is definitely making progress.

SAUDI ARABIA: A YOUNG CROWN PRINCE TAKES CHARGE OF A YOUNG COUNTRY

Slightly further east, the Kingdom of Saudi Arabia (KSA) is undergoing its own monumental transformation on a much larger scale—both in economic terms, but significantly, in religious and social terms as well. The KSA is the birthplace of Islam and ranks as one of the top 20 largest economies in the world. The vast majority of Saudi citizens were once poor, nomadic or seminomadic peoples with a history of relentless tribal rivalry. Oil has made the nation rich, enabling it to finance large-scale social and military spending, but the country's reliance on oil has simultaneously stunted its ability to diversify and lure investment to the private sector. While the KSA possesses 20% of the world's oil reserves, non-oil GDP is below 50%. The country's budget largely depends on the oil price staying above \$70 per barrel, and oil accounts for over 60% of budget revenues. Similar to other countries in the region, demographic changes are also a big economic driver. It is a young country with approximately 50% of the population under 25 years old.



As Saudi Arabia begins to embark on historical economic and cultural changes, the country's history serves as an important marker of progress. 1979 was a watershed year for Saudi Arabia, as the entire Middle East region was convulsed by the Iranian Revolution and the country withstood an attempted takeover of the Grand Mosque in its holy city of Mecca by Islamic extremists. It was a defining moment for Saudi Arabia, and since that time, the house of Saud has cozied up to the religious right and enforced Sharia law.

However, the KSA is now in full reform mode under a new leader, trying to change its image at home and abroad and to hastily prepare the nation for the future by instituting bold economic and social reforms.

Just over one year ago, in June 2017, 31-year-old Prince Mohammed bin Salman bin Abdel-Aziz Al Saud (or MBS, as he is known) was named by the king as Saudi Arabia's new crown prince. A strong man in the making, MBS is the most dominant Arab leader in a generation. He has been called bold and a visionary by supporters, but also impulsive and reckless. We've learned from our contacts in the region that he is a workaholic who requires little sleep and is a known risk taker. MBS is sharply focused on implementing Saudi Arabia's economic plan, dubbed Vision 2030, which was closely modeled after the UAE's Vision 2021. Vision 2030 is a wide-ranging and ambitious reform plan to modernize the kingdom's society, diversify the economy, and reduce its dependence on oil. Saudi Arabia's economy is overwhelmingly oil-based, accounting for 85% of export earnings and the vast majority of government revenue. If successful, Vision 2030 would transform the country's economic model by making the private sector the engine of growth and reducing government sector influence.

Vision 2030 has several ambitious targets to reach in 12 years.⁶ The main ones include:

- Moving the economy from the 19th largest in the world into the top 15.
- Increasing the private sector's contribution from 40% to 65% of GDP.
- Increasing foreign direct investment from 3.8% to 5.7% of GDP.
- Raising the share of non-oil exports in non-oil GDP from 16% to 50%.
- Growing non-oil government revenue from SAR (Saudi riyal) 63 billion to SAR 1 trillion.
- Increasing the number of tourist and pilgrimage visitors from 8 million to 30 million annually.
- Raising assets in the Public Investment Fund—the kingdom's sovereign wealth fund—from SAR 600 billion to more than SAR 7 trillion.

Vision 2030 has both economic and social goals. It aims to reduce unemployment among Saudis from over 12% to 7%. Goals also include increasing female participation in the workforce from 22%—one of the lowest in the world—to 30% and to open up opportunities for youth, who in particular are increasingly

using social media as an escape. Naif University of Security Sciences estimates around 35% of young Saudis are unemployed today, which is especially worrisome for Saudi Arabia, where about 70% of the population of 28 million is under 30.⁷

Another important piece of MBS’s strategy to fund his initiatives will be to monetize ownership in the state-owned oil company, Saudi Aramco, with a potential public equity listing of shares. Private and foreign investors may possibly be able to buy shares in Aramco in 2019, and the proceeds will be used to finance a large sovereign wealth fund, which will serve as a centerpiece of the country’s diversification efforts. Saudi Arabia plans to sell a 5% stake in the company, which is expected to raise \$100 billion. If successful, it could well be the largest initial public offering (IPO) in history, toppling the current record holder, China’s Alibaba, which listed in 2014 with an IPO total of \$25 billion. The company is almost totally debt free, enjoys production costs that are a fraction of the industry standard, and currently produces more crude than the top four publicly traded oil companies combined. Challenges to a successful share sale of Aramco include the price of oil, regulatory risks, competing government projects demanding attention, and ultimately, global investor interest and demand.

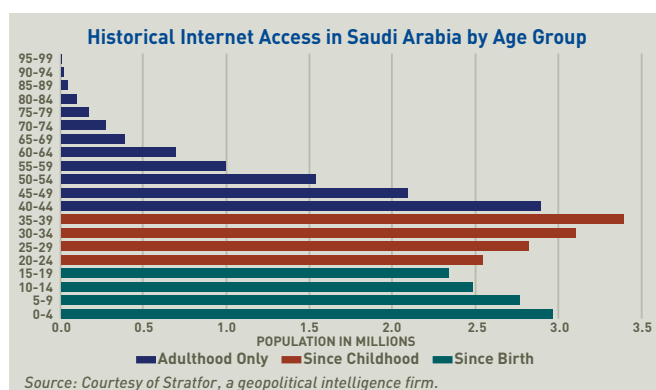
Historically, due to its oil largess, Saudi Arabia has been dependent on expatriates to meet the nation’s demand for labor at all levels. However, Vision 2030 mandates the kingdom take a new approach to its labor needs. Officially known as Saudization, the Saudi nationalization plan is designed to increase the share of Saudi labor among the total workforce and to expand opportunities for Saudi women and youth. The program requires Saudi enterprises to fill their payrolls with Saudi nationals up to certain mandated levels. It is currently estimated that 10 million expatriates, primarily blue-collar workers from Southeast Asia, remain in the country, down from a peak in 2015. It is expected that another one to two million expats will leave the kingdom in the next few years.

We witnessed an early manifestation of Saudization during our recent trip, where a Saudi in the customary local dress handled a retail transaction—a task that would likely have been performed by a foreigner just a short time ago. Currently, Saudis comprise about 15% to 20% of the workforce, with over 60% employed by the government. MBS aims to reduce the proportion of Saudi labor in government roles to 30% by 2030. Furthermore, MBS believes the government must take steps to wean Saudis from a welfare-state mindset that basically subsidized everything from cradle to grave, including medical costs, gasoline, education, and electricity, with limited or no taxes. For example, he’s taking steps to cut back on subsidies for fuel, power, and water, and Saudi citizens have begun paying a VAT on the goods and services they buy. During our visit, a local baker said that he now had to pay \$30 to fill up his SUV, which had once cost him only \$7. Additionally, his water bill had grown from \$2 each quarter to \$30 every month.

However, change in Saudi Arabia is not limited to economics. Not to be discounted is the massive cultural shift underway, also led by MBS. Like some three-fourths of his countrymen, MBS is under 35 years old. He is the first prince in modern history whose constituency has not been within the palace walls, but with the young Saudis on the street. He understands them and uses their apps; he speaks their language and understands their frustrations. MBS is the bridge between the generational divide that currently exists and he wants desperately to drag his country into the 21st century.

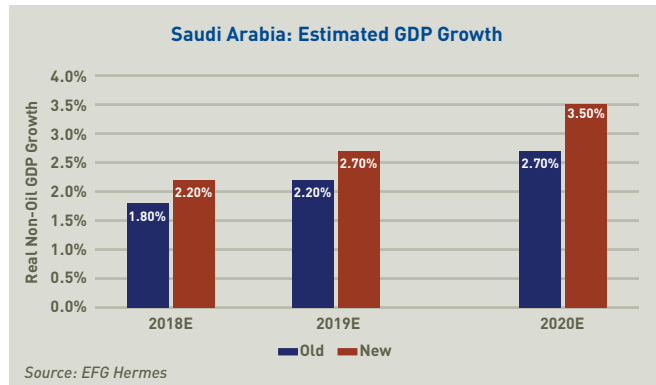
MBS is influencing a number of social reform efforts. He is revising the role of Islam in public life, which is expected to aid the monarchy in appeasing its growing young population, counteract the appeal of

violent extremism, reduce the influence of the clerical class, and ultimately centralize power. Beginning this year, Saudi women are now permitted to drive, start businesses, take off their head scarves in public, join the military, and attend sporting events. These are monumental changes not to be underestimated. Allowing Saudi women to drive could add as much as \$90 billion in economic output by 2030 by increasing the number of women seeking jobs, thereby considerably boosting the workforce, unleashing innovation, and lifting overall



incomes and economic output. In addition, new entertainment centers and movie theaters are opening, and the religious police are being reined in.

Vision 2030 also targets growth in tourism and entertainment, as well as extensive reforms to the education system. If successful, these efforts could have a significant impact on loosening social restrictions and lessening the influence of Saudi clerics. For one week each year, two million people gather in Mecca for the annual Hajj, a trip every Muslim is expected to make in their lifetime. MBS wants to expand the appeal of tourism to Saudi Arabia beyond this annual religious pilgrimage. For example, the government recently announced a \$64 billion investment in the entertainment sector. The first movie theater to open in over 40 years opened in Riyadh, Saudi's capital city, earlier this year. Black Panther



played to sold-out audiences, as Hollywood and globalization swept into the kingdom. And Saudi Arabia hosted its first-ever Arab fashion week this spring. These developments represent a massive change in mentality.

The financial world seems to be taking notice of these positive developments and tantalizing capital investors. A leading Middle Eastern financial services firm, EFG Hermes, recently raised its GDP growth expectations for Saudi Arabia over the next several years, as did the IMF. Goldman Sachs announced plans to deploy its own money for the first

time in the kingdom and embark on a major expansion. In addition, some global equity index providers have announced intentions to include Saudi Arabia in their emerging markets indices. FTSE Russell announced that Saudi Arabia, which currently has a market capitalization of approximately \$500 billion, a little less than half of the market capitalization of Apple, will be included in its secondary emerging markets grouping effective March 2019. MSCI also plans to add Saudi stocks to its emerging market index in May 2019. With the index announcements and a possible Aramco IPO, Saudi Arabia has seen record foreign inflows over the past year, with even larger inflows of foreign money expected over the next year. In fact, Saudi Arabia could see over \$40 billion in portfolio inflows in the next few years if it reaches the same foreign ownership level as the UAE. This will help the country boost foreign reserves to support its currency, support a pickup of private investment, rebuild its financial reserves, and fund its aggressive investment plans.

MBS has to strike the right balance as he seeks to socially and economically transform the kingdom, and it will not be easy. His turbulent and sweeping corruption crackdown, including when he imprisoned members of the ruling elite at the Ritz-Carlton (some for months), highlights the risks and for some, smacks of desperation. And many companies are struggling to meet the local hiring quotas by tapping into a labor force that sometimes lacks the job skills and motivation to fill private-sector positions. Despite his strides thus far, domestic consumption remains weak. MBS is in a race against time—he has to transform his country without upsetting the old guard while at the same time avoiding disappointment amid the heightened expectations among the young. His bold actions have naturally produced critics on both sides. However, Saudi Arabia is likely at the start of what could be an exciting age of economic diversification and social change. Time will tell whether MBS is a true reformer who has the capability and foresight to drag the kingdom into the current century.

Putting Vision 2030 into action will not be simple, and the risk of overplaying his hand will make MBS vulnerable. He embarked on a global, whirlwind tour earlier this year when he visited the U.S., UK, Europe, and allies in the Mideast, which unleashed a flurry of deals worth billions, ranging from aerospace to technology and media to energy, as well as massive media attention. The intent of this public relations charm offensive was meant both for external and domestic consumption. Wooing foreign business investment, countering Iranian influence in the region, modernizing Saudi society, and offsetting the long-term, declining trend in oil consumption will be tricky. The success or failure of the Aramco listing will be telling, as it is a focal point of Saudi Arabia's biggest economic shakeup since the founding of the modern state in 1932. The question is whether MBS has set an unrealistic timetable. Time will tell whether the promise of a vibrant economy and more open society will come to fruition.

THE CITY OF SKYSCAPERS COMES OF AGE: THE UAE WAS THE FIRST TO REFORM, BUT IS NOW EXPERIENCING GREATER REGIONAL COMPETITION

In December 2015, we wrote a piece on the unique characteristics that made the UAE a promising investment option from a long-term perspective (*The United Arab Emirates: Excellent Prospects for the Middle East's Trading Hub*), and we remain invested there. As noted then, the UAE is a free-trade zone and maintains a strong trade surplus, a valued characteristic in our top-down investment strategy. The country has an open economy and is taking steps to decrease its reliance on fossil fuel production by diversifying its revenue streams through its own economic plan, Vision 2021. With economic and social change underway in other parts of the Middle East, the UAE's reform efforts are facing stiff competition from others in the region. A reboot may be required for the UAE to compete, as the City of Skyscrapers comes of age.

The country's high oil revenues still enable it to play a prominent role in the Middle East, and its per capita income rivals the levels achieved by leading Western European nations. The UAE is a member of the GCC. While the UAE may not be benefitting from the normalization of Iran's international relations as we anticipated, it remains the major trading hub in the region.

Like the KSA, the UAE wants to increase non-oil revenue from innovation and efficiencies in industrial processes, expansion of financial services, a focus on new manufacturing industries, such as chemicals and polymers, and growth in tourism. Non-oil sector growth is projected by the IMF to rise from 1.9% in 2017 to 2.8% in 2018, and to continue climbing to between 3.3% and 3.5% in 2020.¹ The government has signed several major off-shore concession deals with Asian players, which are shaking up the landscape of its upstream energy sector.

Tourism remains a focus, particularly to the popular city of Dubai. But with fewer Saudis traveling to the UAE due to their own domestic, social-reform efforts, Dubai is being squeezed. Dubai is hosting Expo 2020, which will generate activity in the construction sector along with an increase in business tourism. Dubai also remains focused on medical tourism, which could produce growth in the healthcare sector and medical technology businesses. In addition, information technology and telecommunications benefit from sites such as Dubai Internet City and Dubai Media City.

The IMF forecasts that the UAE's GDP will rebound from 0.5% growth in 2017 to 2.0% in 2018 and 3.1% in 2019,¹ driven by firming oil prices, a pick-up in global trade, investment for Expo 2020, and easing fiscal consolidation. The IMF has noted that the UAE has more fiscal flexibility than many of its neighbors, thanks to an economy that is successfully diversifying. The UAE eliminated subsidies on fuel and deregulated fuel prices, and the recent introduction of a VAT also strengthens the Emirates' fiscal position. Rents and real estate investment are not subject to VAT, which should help the market gain strength in the long term. The IMF expects the UAE's consolidated fiscal deficit, including the federal government and all seven emirates, to shrink to 1.3% of GDP in 2018 and gradually disappear in subsequent years.¹

Due to its continued dependence on foreign workers, the country has recently increased the time expats can stay from three to 10 years. Foreigners make up more than 80% of the 3 million UAE population. While the UAE has had scant success in weaning the country off foreign workers (UAE nationals comprise less than 4% of the private sector workforce), the UAE's strategy of economic diversification is being referred to as a model for other Gulf countries. Dubai's petroleum exports peaked in the early 1990's and have been declining steadily since. When asked at the Arab Strategy Forum 2017 what set the UAE apart from the rest of the region in economic terms, Dr. Jihad Azour, director of the Middle East and Central Asia Department at the IMF, had a ready answer. Azour said: "The UAE has the most diversified economy in the Arab world, and it is this diversification that will stand it in good stead moving forward, driven by strong improvement in the non-oil sector." The government wants to make research and development and technology the cornerstones of the economy.

Finally, the UAE is the regional leader as a gateway to the African continent. The country is continuing to expand its transshipment advantages as a central location to build influence across Africa. It is laying the foundation for strong trade relations with Africa and seeking to establish itself as the economic gatekeeper to the young and growing continent. The UAE alone is now home to more than 10,000 African companies, and African trading firms are profiting from the UAE's superior shipping and port infrastructure to send their products to markets around the globe.

WHAT COULD GO WRONG?

Geopolitical risks in the Middle East remain elevated. The feud with Israel has always dominated the region, but the Saudi-Iran competition is heating up. It is playing out in Lebanon and Yemen, where the two sides are conducting a veritable proxy war. To make matters worse, four countries (Bahrain, the UAE, Saudi Arabia, and Egypt) imposed an air, sea, and land blockade on Qatar in 2017 because of its alleged support for terrorism. As one might expect, this has been disruptive, making travel and trade challenging. Qatar, while cut off from its neighbors, remains defiant, has raised billions in foreign debt, is speeding up its own reform efforts, and is building new alliances.

Most significant among the region's risks, weaker-than-expected global oil prices could dampen the growth prospects of the region's oil exporters. If oil drops below \$60, many governments will have to draw down reserves to pay their bills. And while reforms are expected to support growth and enhance the business climate, entrenched interests may offer stiff resistance to market liberalizing initiatives.

The populace is ready and willing to take to the streets if its needs are not addressed. Rising inflation remains a real threat to the long-term plans of developing Middle Eastern countries. Finally, there's the risk that comes with changing from an environment where the government met everyone's needs to one that is more market-driven. Private sector success is often quite cyclical in nature. And in a region dominated by strongmen who want to retain maximum control, natural economic cyclicality poses clear risk. With most countries in the region posting nearly 30% youth unemployment, it will be a fine balance to manage employment and economic growth.

A REGION UNDERGOING GREAT CHANGE IS AN OPPORTUNITY FOR INVESTORS

With demand for oil from Western countries declining, public expenditures increasing, and the regional security environment becoming more challenging, there are definitely risks to investing in the Middle East. The young populace has shown it is ready and willing to take to the streets to demand economic and political opportunities if its needs are not addressed. All the countries in the region are attempting to maintain a fine balance, as they struggle to reduce budget-draining subsidies, while simultaneously avoiding backlash from the entrenched societies that have become accustomed to them. Although anti-Israel sentiment is always present, the Shia-Shiite rivalry is more significant, as exemplified by the quagmire in Yemen. Armed conflicts in fragile economies can spill over into neighboring countries and disrupt progress, with the ongoing refugee crisis placing fiscal and social strains on host countries.

Even with the risks noted above, we believe the outlook for the entire MENA region is continuing to improve, particularly for select countries. With close to one billion inhabitants, rising disposable incomes, and a burgeoning, increasingly tech-savvy young middle class, the region is in the potential early stages of an e-commerce boom. The 2022 World Cup will also bring greater interest, tourists, and exposure to the region. With the upcoming inclusion of Saudi Arabia in international equity indices, the MENA region is expected to experience close to a 5% increase in exposure within emerging markets benchmarks. We view the region as an investment opportunity in its own right, but especially as these markets possess positive attributes uncorrelated to other markets in the world.

Saudi Arabia has followed the UAE in attempting to develop strategies to create a modern society composed of citizens equipped with the skills to succeed in a global economy. Both are diversifying their economies and providing opportunities for the private sector and their citizens. The UAE is experiencing a strengthening economic recovery, an improving current account, consolidating its banking industry to become more competitive, and upping spending on infrastructure in preparation for the 2020 World Expo.

Saudi Arabia is a young country in a very old part of the world. It has fiscal spending issues, but is using its oil cash to boost its sovereign wealth fund and its drive towards modernization. The country has decent growth, low valuations, is leveraged to rising U.S. interest rates, and is undergoing ambitious and unprecedented social, religious, and economic reforms. It is actively encouraging a more open society, tapping into the potential of their female workforce to try to encourage foreign investment and develop a local culture that is more open to innovation and creativity. For the near term, it is all about the Aramco IPO and Vision 2030. While risks are ever present—no one thinks this will be a cakewalk—we believe Saudi Arabia may enjoy its place in the sun in the next few years.

Increasing Investment Opportunities in the Middle East and North Africa: Countries with Reform Strategies Lead the Way

Egypt is also implementing structural reforms designed to improve the business climate and expand opportunities for Egyptians, while the country is preparing to benefit from a recently developed natural gas field. It has an improving current account, low inflation, increased currency reserves, improving fiscal conditions, and a growing consumer class. We will continue to evaluate potential investments in these countries and throughout the MENA region, especially in the healthcare, consumer, logistics, and financial industries.

Indeed, the region has a long journey ahead. Risks abound as they always do. And real change is never easy. But with the right mix of demographics, growth-oriented public policy prescriptions, and strong leadership, we can envision a bright future for the region and are investing our client's capital accordingly.

¹ International Monetary Fund, World Economic Outlook, April 2018, retrieved from <http://www.imf.org>, June, 27, 2018.

² The World Bank, World Development Indicators, Data Catalog, retrieved from <https://datacatalog.worldbank.org>, August 8, 2018.

³ International Monetary Fund, Regional Economic Outlook Update: Middle East and Central Asia, May 2018, Statistical Appendix, retrieved from <https://www.imf.org/en/Publications/REO/MECA/Issues/2018/04/24/mreo0518>, July 31, 2018.

⁴ The World Bank, Arab Republic of Egypt Economic Outlook – Spring 2018, retrieved from <http://documents.worldbank.org>, August 1, 2018.

⁵ The World Bank, Internet users for Saudi Arabia [ITNETUSERP2SAU], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/ITNETUSERP2SAU>, August 1, 2018.

⁶ <http://vision2030.gov.sa/en>

⁷ Halawi, Dana. "Small steps: The long road ahead to meeting Saudi unemployment goals." AMEinfo, January 16, 2018, <https://ameinfo.com/money/economy/long-road-saudi-unemployment-goals/>

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