MarketWatch

WEEKEND INVESTOR

May 6, 2011, 12:01 a.m. EDT

With bin Laden death, Middle East stocks may rise

Investors focus on risk and opportunity after 'Arab spring' awakenings

By Myra P. Saefong and Robert Daniel, MarketWatch

Reuters

Saudi Arabian protesters demand the release of political prisoners in March 2011.

SAN FRANCISCO (MarketWatch) — In a sea of political change among many of the nations in the Middle East and North Africa, stability — and investment opportunities — will be tough to find.

But so far, countries such as Egypt and Tunisia, whose leaders stepped down amid protests earlier this year, are at least headed in the direction of stability. And all of the political conflicts in the region have called attention to just how crucial these nations are to the global economy — and can be to investors.

The death of Osama bin Laden, the world's most wanted terrorist, at the hands of U.S. forces has brightened that spotlight, and is prompting investors to take a closer look at the region.

"The death of bin Laden, the rise in oil prices and the political protests across the region all help highlight the importance of this region to the global economy," said Paul Herber, co-portfolio manager of the Forward Frontier Strategy Fund (NASDAQ:FRONX) (NASDAQ:FRNMX) . "Increased investor focus on the Middle East and North Africa will be positive, with eventual winners and losers determined by the level of genuine change in each country."

If the world's stock market reactions to bin Laden's death offer any hint of what's in store for the Middle East North Africa (MENA) markets, the outlook is still one of high volatility and substantial risk. Most exchanges

English soccer clubs.
- **Fund firms face shifting investor needs**
- **New ways to play the IPO market**
- **Silver pullback is a buying opportunity**
- **Xerion's Arbess calls gold 'one-trick pony'**
- **Cracks in the market are cause for concern**
- **Relive May 6, 2010, 'flash crash' in real time**

saw only a short-lived rally earlier this week after news of the al Qaeda leader's demise.

"The Middle East and North Africa offer long-term opportunity to invest in rapidly growing economies," said Herber. But "investors should always be cognizant of the risks inherent in investing in any undeveloped region."

Those risks aren't likely to end anytime soon. The uprising in the Arab states has seen millions of people demand greater political participation and economic opportunity.

It began in Tunisia in December, when a vegetable seller set himself on fire in protest against the authorities there. A month later, widespread demonstrations drove President Zine al Abidine Ben Ali from office. Read a January report on the Tunisia market.

In February, Egypt's president, Hosni Mubarak, stepped down under the pressure of a popular uprising. In addition to widespread demonstrations in which hundreds were killed, the country's bourse was closed for almost two months.

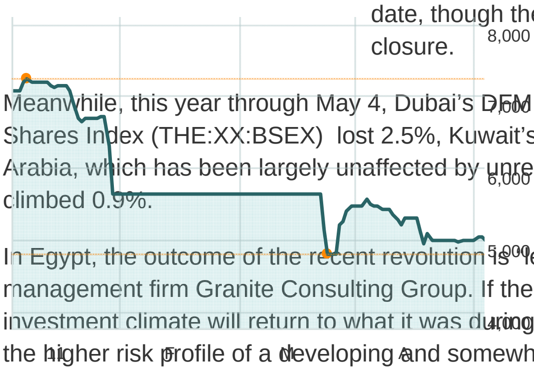
"Major institutional investors who seek global risk/reward exposure in this region will want to see the political conflicts end," said John O'Donnell, chief knowledge officer for Online Trading Academy, which teaches investors how to trade different markets, including the Middle East. "They will need transparency [to know] that local and regional capitalism can prosper in the Middle East and North Africa regions and that their leaders will respect the rule of law and lead in the favor of democracy."

Risk and reward

Despite all that's happened in the MENA region, not much has changed in terms of its investment outlook — at least not yet.

"There is some calm, but not enough to let us know if this is just calm before the storm," said Usha Haley, an expert on emerging markets and chaired professor of international business at Massey University in Auckland, New Zealand. "Most circumspect investors will take a wait-and-see attitude on increasing investments in the Middle East."

EGX30 **4,937.06**, -45.41, -0.91%



The political conflicts have certainly taken a toll on MENA stock markets. Egypt's benchmark EGX 30 (EGYPTIAN:XX:EGX30) has dropped more than 30% year to date, though the data were skewed by the Jan. 28 through March 22 stock market closure.

Meanwhile, this year through May 4, Dubai's DFM Index (DUBAI:XX:UAEDFMGEN) had slipped 0.8%, Bahrain's All Shares Index (THE:XX:BSEX) lost 2.5%, Kuwait's KSE fell 6.6% and Morocco's MADEX was 5.3% lower. But in Saudi Arabia, which has been largely unaffected by unrest in the region, the Tadawul All Share Index (SAUDI:XX:TASI) had climbed 0.9%.

In Egypt, the outcome of the recent revolution is "less than clear," said Michael Bechara, managing director at risk-management firm Granite Consulting Group. If the country sees a return to a Mubarak-style government, the investment climate will return to what it was during the Mubarak years, he predicted — "plausible to invest [in], but with the higher risk profile of a developing and somewhat corrupt political system."

The riskiest MENA markets are Libya, Yemen, Iran and Iraq — followed closely by Egypt and Tunisia, according to Matt Lasov, practice leader of Frontier Strategy Group's Quantitative Analytics, citing FSG's MarketView Platform political risk data.

"In the longer term, Egypt may become an attractive opportunity but should be considered a high-risk market at this point," Lasov said. But, he added, "election announcements, corruption inquiries and legislation designed to facilitate [foreign direct investments] are all positive signs."

Michael Daoud, head of Middle East equities at international broker-dealer Auerbach Grayson & Co., said opportunities exist in Egypt, but advised investors to steer clear of companies with "major issues that won't be resolved easily."

Real estate development companies, which face disputes with the government over land holdings, are among those areas to avoid. The Egyptian government, for example, recently annulled a 1 million square meter land agreement with Palm Hills Development. Trading in shares of the company were briefly halted on Monday and the stock has declined since.

For investment, MENA is “not one of the best picks short or longer term,” said Kathleen Brush, a global business consultant and author of “Leadership: Get Ready for the Latest Global Challenges.” “There is still a ton of work that needs to be done to lay a foundation for somewhat predictable economic growth.”

Hunt for opportunity

Even so, opportunity often accompanies risk.

“Perhaps, between seeing the budding democracies of North Africa and achieving some psychological closure regarding 9/11, global sentiment may improve,” said Ahmed Fattouh, chief executive officer at Globalist Capital Management in New York.

But, he said, “the real case for investing in the Middle East is underpinned by high energy prices continuing to fill [Gulf Cooperation Council] coffers and these governments’ increased spending to ease the tension of their populations.”

Among the sectors, oil services, telecommunications, consumer discretionary as well as infrastructure plays all should benefit from high oil prices and increased spending within the Gulf Cooperation Council (GCC), he said. Crude futures, even after Friday’s sharp drop, are still around 9% higher so far this year. Read more: Oil futures drop on demand fears, metals selloff.

Among the nations that may benefit are those that have largely sidestepped the political turmoil and are major oil producers, said Herber — including Kuwait, Qatar, Saudi Arabia and Oman.

The region itself posses 57% of the world’s proven oil reserves and 40% of the proven gas reserves, according to Daniel Broby, chief investment officer at SilkInvest in London.

“Part of the upside” for the region “is based on the crude-oil story but not all,” he said, adding that in Saudi Arabia, non-oil exports increased year over year by 23% in 2010.

Saudi Arabia’s market is at “the high end of the valuation range,” in large part because it has a massive fiscal stimulus and no debt, Broby said.

Egypt, on the other hand, is at the bottom of the valuation range because of the unrest and closure of its stock market for many weeks, he said, but he noted that the economy is “intact and has already resumed growth.”

Among areas of investment in Egypt, Auerbach Grayson’s Daoud said telcos such as mobile provider Mobinil and consumer names like Juhayna Food Industries, a maker of dairy and fruit products, and Egyptian International Pharmaceuticals, or Eipico, are worth considering.

Cyclical, economically sensitive stocks won’t likely do well, Daoud added, but he said he does favor Sidi Kerir Petrochemicals, a majority-owned government company known for a stable dividend.

Those looking for broader participation in Egypt can check out Market Vectors Egypt ETF (CONSOLIDATED:EGPT) . The exchange-traded fund has lost about 30% so far this year.

Arab summer

Arabian Gulf markets, as well, have seen attractive buying opportunities emerge because the selloff across the wider region has been “indiscriminate,” said Mohammed Al Hashemi, head of asset management at Invest AD, an Abu Dhabi government-owned asset manager.

In the GCC nations, investors should watch for the emergence of globally competitive companies, he said. “The region has real advantage, primarily a surplus of capital and easy access to hydrocarbons, so has the potential to become a powerhouse in areas such as petrochemicals, energy-intensive industries such as aluminium, and capital-intensive industries such as aerospace.”

Daoud said the UAE and Qatar are insulated from the regional unrest. Qatar, in particular, is a great macroeconomic story, he said, with “the lowest political risk in the region.”

Meanwhile, the Palestine Exchange has a number of listed companies showing “solid business performance, transparency in operations and return on investment,” according to Maan Bseiso, vice chairman of United Securities in Ramallah.

“All the risk is discounted,” Bseiso said. “Palestine is not a state, doesn’t have a real economy, we are divided as a people, everything bad that could happen has happened.” Companies that have grown and have good prospects, he said, include Palestine Telecommunication Co., National Insurance Co., Bank of Palestine, Al-Quds Bank and Jerusalem Pharmaceuticals.

Overall, political and economic stability returning to MENA countries will “attract more global investors’ capital to the region,” Online Trading Academy’s O’Donnell said. But, he cautioned, “Capital can be moved with a mouse click if stability is not secure.”