

The New Emerging-

Market Opportunity

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Since the earliest days of human civilization, the Middle East has been an important center of trade and commerce for the world. Today it is home to perhaps the most important development of our lifetimes yet eludes our positive focus. The drive and reforms of the new Middle East are so vast and staggering that they seem surpassed only by how little we hear of them.

Less than 20 years ago, the U.S. made up 70 percent of the global market capitalization of all publicly traded companies based on MSCI indexes. Today global share of publicly traded companies by market cap for the U.S. accounts for less than 30 percent and is falling. From 70 percent to 30 percent in less than two decades—it does not take a mathematician to know that returning to America's peak levels is nearly impossible. The country's economy would have to more than double and the whole world would have to stop growing just for the U.S. to reach where it once was. Sadly, like the plunging dollar and many other issues of vital global economic importance, little news coverage is given to the magnitude of the situation.

Rookie investment analysts, financial advisors and stockbrokers are taught that cries of "this time it's different" are purely alarmist. After all, the U.S. has recovered from every major market correction and its economy has continued to grow. Through Nixon's, Reagan's and Clinton's good and bad times, war and Enron, America has driven forward. But one day it will be different, will it not? Surely no one argues that the U.S. will be the undisputed economic superpower until the end of time. When does U.S. economic dominance end? Fifty years? Ten? One?

Some say America has already fought an economic battle and lost. Baby boomers remember grade-school teachings of how time will show that the Western way will win over communism. Well, Chinese students learned the same thing only in reverse, and today they cheer, "China won." Comparing America's \$9 trillion debt with their surplus and lack of product creation, exports and manufacturing in the U.S. with their dominance, one can see the reason for Chinese pride.

Yale Global reports that less than 20 percent of Americans have a passport, a statistic that

is astounding to virtually anyone else in the world. The days of not needing to understand the world are gone. Today globalization is not a buzzword or abstract concept; it's the economic force affecting everything from the clothes on our backs to the food we eat, and it's here to stay.

The good news is that massive positive change is afoot. The world is evolving for the better in many ways, and Americans can participate. In



order to continue to thrive, they must do what the Chinese have done so well—engage the world and reach out to those areas that are growing and successful. Perhaps the most overlooked area of the world

might be the most important: the Middle East.

The Middle East has been an important part of Earth since the earliest days of human existence: birthplace of civilization, the wheel and mathematics. It is home to the roots of three of the world's great religions. The area is as important today as ever. The current Middle East is the center of some of the world's largest and fastest-growing companies and economies, as well as numerous infrastructure, scientific, educational and business developments.

First, it is important to understand what exactly has happened in the region during recent years and the reinvention one might call Middle East 2.0. Most media coverage misses the real story of the region by a large gap. The real story is the massive change that economics and development have brought: construction, development and progress that are almost incomprehensible to those who have not seen it firsthand.

Many now know the economic miracle of Dubai—home to the world's largest constructed port, tallest building, indoor ski resort, finest hotel, Tiger Wood's golf event and so on. When showing someone photos of Dubai today, the typical disbelief followed by amazement is indeed a treat to observe. Dubai,

however, despite its palm tree-shaped, manmade islands the size of Manhattan, is only part of the story. The sheikdom is becoming the standard of the new Middle East rather than the exception.

Take Saudi Arabia for example. The often conservative and much larger and wealthier neighbor to the United Arab Emirates (UAE is Dubai's home country) is not to be outdone. Saudi Arabia has embarked on a project not just to create a great Dubai-like city but to create six economic supercities. While it is at it, Saudi Arabia is building not just cities (and schools and hospitals and ports and roads) but seeking to transform its entire economy and the world.

Saudi Arabia is a nation with a wealth of natural history and deep cultural roots. The leader of the kingdom takes his responsibility as the custodian of the two holy cities of Islam, Mecca and Medina, with the utmost of seriousness. In fact, King Abdullah's official title is Custodian of the Two Holy Mosques. Saudi Arabia wants to be not only a center of holy sites for a religion of 2 billion people but a continued economic, educational and social leader for the entire world.

It should come as less of a surprise perhaps that this reform-minded king has endeavored to make Saudi Arabia a great nation—not just a nation that “moves out of the Stone Age” as some detractors would say. The country strives to be a model of what a great nation should be.

Sound difficult to believe? Even laughable? Look again. Middle East 2.0 is rewriting the rules and confounding popular perception. In fact its large, seemingly insurmountable goals have started to become the hallmark of this region.

Not long ago in terms of business competitiveness, Saudi Arabia was thought to be somewhere in the vicinity of Cuba or Zimbabwe. And along with China and the U.S., it shares the distinction of being one of the most protested and criticized nations on Earth. But a few years ago, reform-minded leaders decided that to become a truly great nation, Saudi Arabia would need to become a leader in global business competitiveness. If a nation leads in business; then, by definition, it has education, wealth, low crime rates, justice, health care and other traits that contribute to greatness.



As it happens, the World Economic Forum ranks competitiveness of nations based on a list of objective criteria. Saudi Arabia underwent an enormous transformation in areas from international contract law and employee benefits to lifting foreign ownership restrictions and easing immigration policy. The reinvention, along with nearly incomprehensible infrastructure investment, caused the nation to leap from the bottom of the list to number 28 globally, now ahead of Spain and Italy.

To move this far ahead, this fast is truly astounding. It required changes in not one or 10 or 100 areas but in more than 300 metrics tracked by the study. Led by the Saudi Arabian General Investment Authority and its leader Governor Amr Al Dabbagh, the country's stated goal of becoming a top-10 competitive economy by 2010 is not only not laughable but now realistic.

Earlier this year, John Chambers, CEO of CISCO Systems, may have said it best: "It's my job to understand emerging markets. I've seen this before—in China 14 years ago and in India six years ago. I believe Saudi Arabia will be a top-five global economy." Chambers should

know; CISCO is helping to develop technology infrastructure for part of the economic supercities that, among other benefits, will yield Internet connection speeds 10 times faster than the fastest in the world today.

What happens when all the Middle Eastern oil runs out? How about if prices fall significantly? These questions are common and on the minds of many observing the region's economic boom with caution. The question is relatively new for most Westerners, but it's one that business and political leaders in the region have been considering for decades. Most people in petroleum-related industries or financial analysts in the U.S. typically can tell you the daily oil production or remaining reserves of a given country. In oil-producing nations such as Bahrain, these statistics are so well known that even high-school students can tell you the price of a barrel of oil and the average number pumped, exported or used that week in a given country. The region has been planning for peak oil for some time. Dubai, in fact, was one of the early high-profile successes in diversifying its economy from oil dependency.

The upside of the economic growth, especially the largely government-funded infrastructure development, is, of course, dependent on oil but the downside, not as much. Most estimates for government spending projects account for oil prices in the \$40 per barrel range or in some cases as low as \$20 per barrel. If oil goes below this level, it simply means the projects take longer. Anything more than say \$40 is generally pure surplus.

Sure, having \$100 billion in surplus is not as good as \$400 billion but oil needs to drop a long way for it to seriously dent the surplus spending and overall economies of these oil-producing nations. In fact, some oil drilling and acquisition costs are as little as \$5 to \$10 per barrel, meaning that even if oil hit \$20 a barrel, it still nets large profits. Remember that when oil was at \$20 a barrel, it was still a cash cow.

Essentially oil-exporting nations have a window of perhaps 15 to 20 very good years ahead during which they can invest in alternative energy sources and continue to grow and diversify their economies. As the economies further diversify (Dubai for instance now has about 85 percent of its economy in nonoil industries), the economies become even more independent of oil.

“With bottom line earnings of companies growing at compounded annual rates of return of around 27 percent over the past seven years with current P/Es that are in the low to midteens in some of the fastest-growing economies in the world, it may be only a matter of time before investors take advantage of this proposition and it’s low correlation to world markets and bring valuations and share prices closer to those of China, India and some of the more commonly sought-after emerging market plays,” says Haissam Arabi, managing director of SHUAA Asset Management based in Dubai. Despite the hypergrowth of the region, with many markets having averaged 20 percent growth rates for the better part of a decade, P/E ratios and outside investment, especially from the U.S., are relatively low. In terms of gross domestic product and market cap, the region is larger than Russia or Brazil and nearly as large as India, but U.S. investment is a fraction of what it is in economies as small as Australia. Even with some of the leading stocks in these markets, it’s not uncommon to see P/E ratios under 15 or even in the single digits.

So how does one participate in what may be one of the great growth stories of our times?

The Middle East, and more specifically the Gulf Cooperative Council, or GCC (an economic block of oil exporting nations including Oman, Kuwait, Qatar, Saudi Arabia, the United Arab Emirates and Bahrain), is still clearly an emerging market. Information flow does not work the same way as it does in New York and London. But other emerging markets such as India have seen such a large flow of U.S. capital that information access has followed amply.

These emerging markets require some networking, knowledge of the language and culture, and understanding of the exchanges. In some cases, this expertise is not enough; an investor legally needs to be an entity located in the GCC to purchase shares.

However, some markets such as the UAE allow foreign purchasers, so U.S. investors can buy directly through a broker who has access to these markets. For now, some markets restrict any purchases from outside investors. The only way to get access to these markets is through specialized vehicles often available only to accredited high-net-worth or institutional investors. American firms that specialize in the

region may offer additional ways to access these markets. As regional growth continues, more access tools are likely to come online. But the sometimes rudimentary availability of Middle Eastern markets does not mean that listed stocks on those markets are rudimentary in any way. Take Emaar for example, the Dubai-based construction firm founded barely more than a decade ago that is now one of the largest developers and construction firms worldwide. The company is building the planet’s tallest tower and has projects in India, Turkey, Morocco and even the U.S. By the way, it’s Emaar and a related spinoff that is the lead developer for King Abdullah Economic City, one of the six Saudi Arabian supercities.

Another example is SABIC (Saudi Basic Industries Corporation), a leader in the Saudi concept of focusing on areas in which the country is a low-cost provider. SABIC manufactures chemicals, fertilizers and metals, and achieved more than \$20 billion in sales last year. Furthermore, Emirates Airlines now advertises itself as the world’s fastest-growing airline and adds new cities and planes, while other airlines seem to shrink. New and fast-growing manufacturing companies, banks and financial companies, tourism-related industries, construction, and other sectors all have successful players in the region.

What will the future hold as the GCC continues its construction boom and as Saudi Arabia opens the doors on a top-five endowment university and other GCC nations continue massive development and economic diversity? It is hoped that we will ultimately see a better world, a world where education, science, cooperation and mutual respect through investment, trade and communication creates change for the well-being of all. I am optimistic that we can reach out to those in the Gulf, who have so much more in common with our values than we may realize, with increased investment and business cooperation. Our world is changing. It is an overwhelmingly positive story and one with potential for continued profit for those who participate.

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