FUND LAUNCHED
2005

FUNDS UNDER MANAGEMENT
£512.0
MILLION

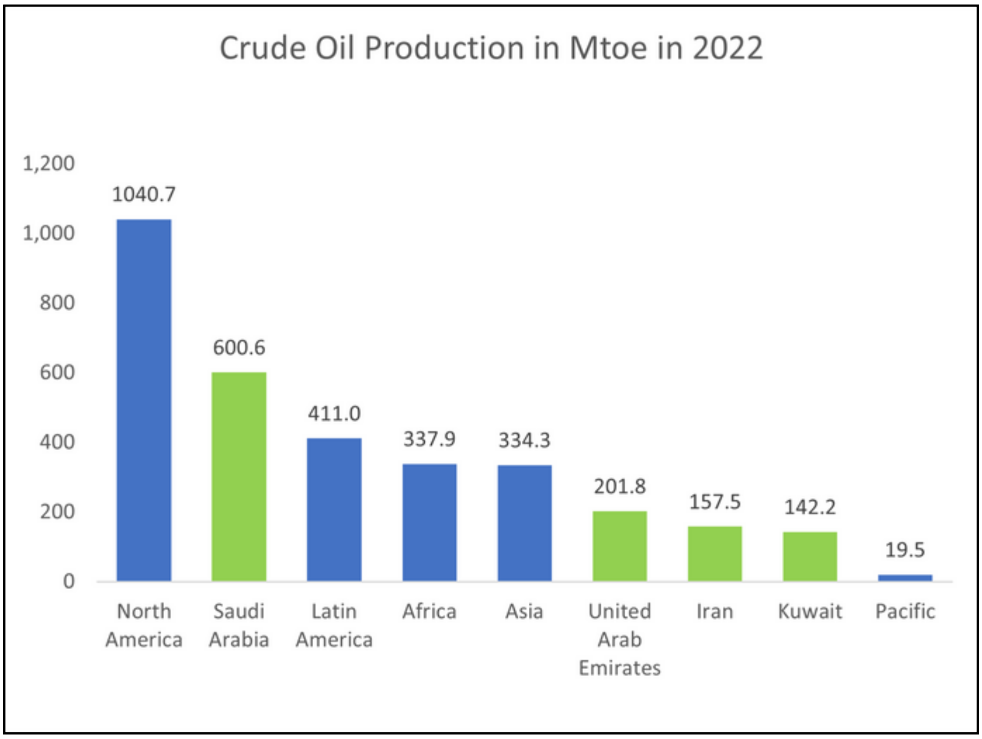
NET ASSET VALUE PER SHARE
386.4%
SINCE INCEPTION*

UTILICO
Emerging Markets Trust plc

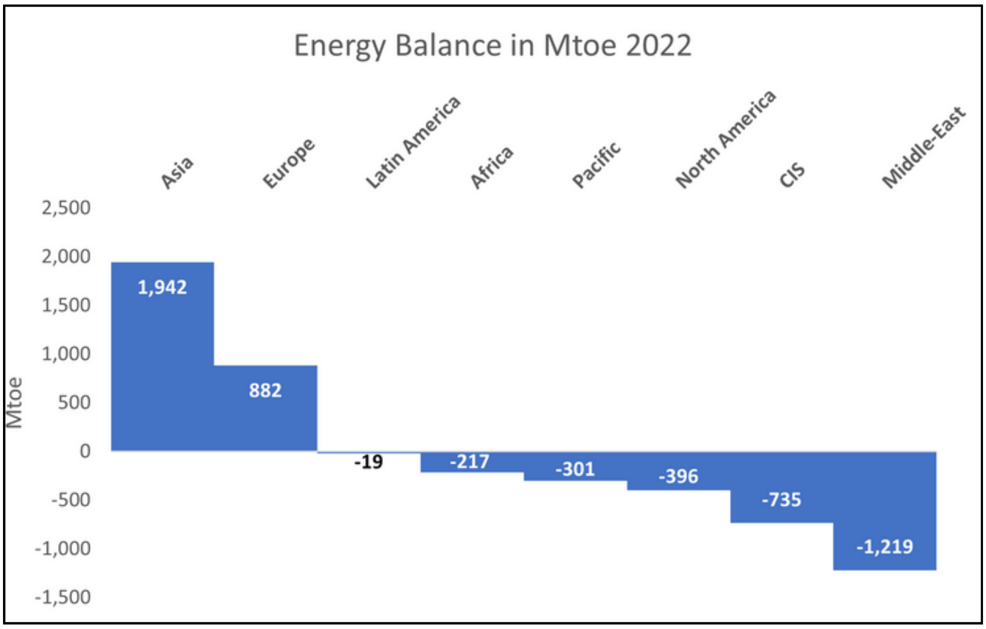
The Middle East: Navigating Regional Risks to Find Alpha

December 2023

The Middle East continues to be a focal point globally as fighting resumes between Israel and Hamas. The conflict between the two sides carries risks of spilling over into a broader regional conflict with even bigger human tragedies and economic disruption. However, excluding the countries of the Levant, the Middle East and North African (MENA) economies are so far unaffected by this conflict and are expected to grow 2% this year and reach 3.4% growth in 2024[1], backed by powerful structural drivers and global megatrends. In this note we look at some of these trends and the investment opportunity for equity investors.



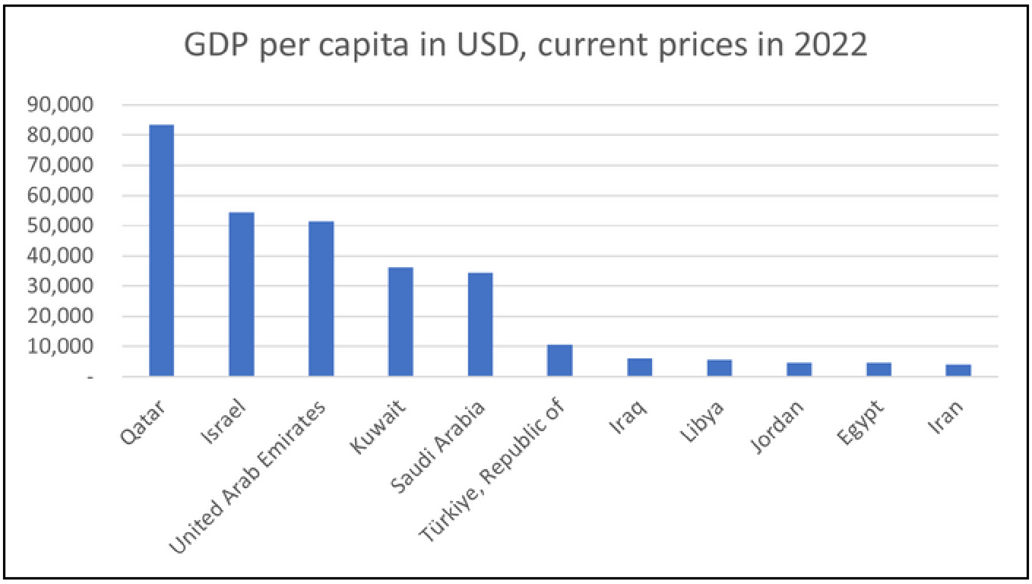
Source: Enerdata, 2023



Source: Enerdata, 2023

MENA is the biggest net exporter of energy in the world and its total energy production has been increasing at 2.1% CAGR[2] for the period 2000-2022, outpacing global production growth of 1.9% CAGR. As such, regional tensions have often led to crude oil price volatility and in 1973 an outright oil crisis was caused OAPEC's oil embargo after the Yom Kippur War. As of the time of writing, the global energy markets appear unphased and crude oil (WTI) remains below $100 per barrel, but the risks remain.

It is important to note that the vast majority of oil production in the region is concentrated in Saudi Arabia, UAE, Kuwait, Iran, Iraq and Qatar. As such there are significant differences between the economies of North Africa, the Levant and the GCC. The oil-rich countries tend to have higher level of economic development – as measured by GDP per capita – but also lower quality of export and economic diversification, leaving them susceptible to global economic cycles and the price of oil. For example, the oil component in public revenues in Saudi Arabia reached 68.2% in 2022[3] and in UAE extractive industries accounted for 17% of its real GDP[4] in 2020. For that reason, the GCC countries are making great efforts to diversify their economies and reduce their reliance on both the energy markets and on foreign labour.



Source: IMF, 2023

The investable universe

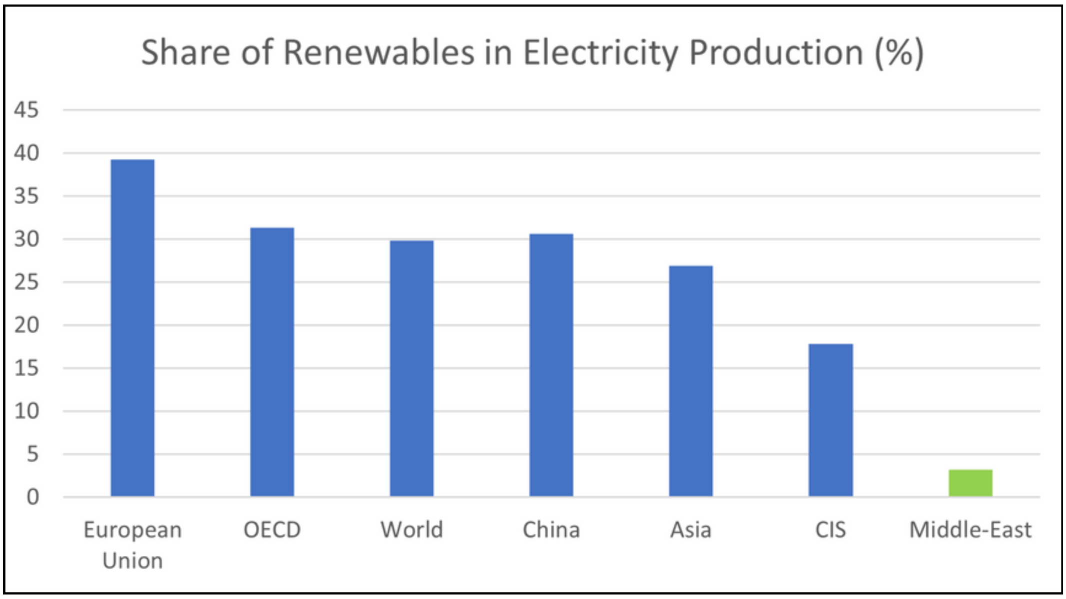
Five countries from the Middle East (we exclude Türkiye), constitute 7.50% of the MSCI Emerging Markets Benchmark[5] and six countries form c.16% of the MSCI Frontier EM index. Nearly half of the market cap of this investable universe is in the financials sector as many of the region's biggest banks are listed. However, there are also listed names in the telecom, utilities and transport infrastructure space. These companies tend to trade at a premium valuation to their emerging market peers due to having lower FX risks (GCC currencies are mostly pegged to the USD), stable dividends and organic growth backed by positive demographics and steadily growing economies.

Energy transition

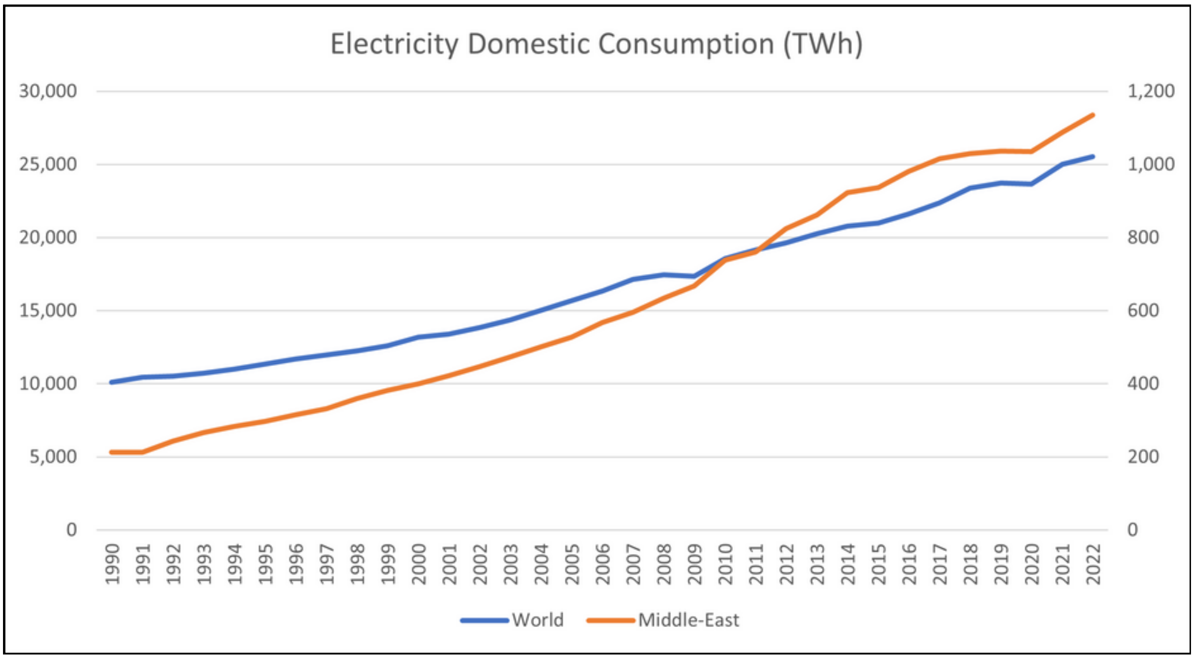
MENA has one of the lowest shares of renewables in the world, despite excellent potential in terms of solar irradiation and wind resource. To be specific, solar plants in the region can expect up 1,930 hours of operation per year, more than twice the average of Western Europe,[6] and the region's long coastlines are suitable for both onshore and offshore wind farms.

Given the finite nature of the region's carbon resource and global environmental trends, the major oil-exporting economies of the region are looking to transition to renewables. UAE is aiming to increase the contribution of clean energy in the total energy mix to 50% by 2050[7] and Saudi Arabia is targeting the same by 2030.[8] Notably, some of the world's largest renewables projects are based here such as the Mohammed bin Rashid Al Maktoum Solar Park in UAE with projected capacity of 5GW by 2030[9] and the Dumat al-Jandal Wind farm in Saudi Arabia with 400MW capacity.[10] The region also has the potential to become an exporter of green hydrogen. The ambitious Neom city project in Saudi Arabia is targeting production of 600t of green hydrogen per day powered by 4GW of wind and solar,[11] which can be exported to support the global transportation industry.

All of these trends are expected to push renewables to 15% of the energy mix across the region by 2030[12] compared to the low levels of today, ~3.2%. This would require significant capital expenditure in both the renewables projects, as well as the electricity grids of these countries. However, this would also necessitate significant policy changes such as scrapping existing thermal power subsidies and offering support for green energy projects in order to achieve attractive returns on investment.



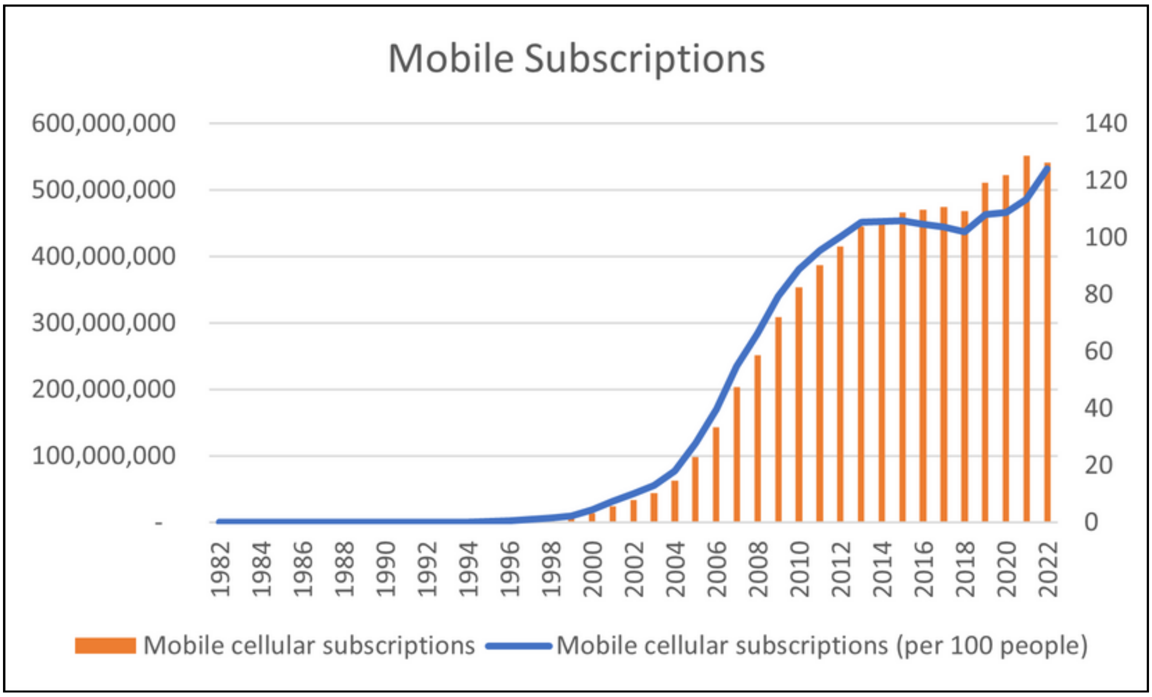
Source: Enerata, 2023



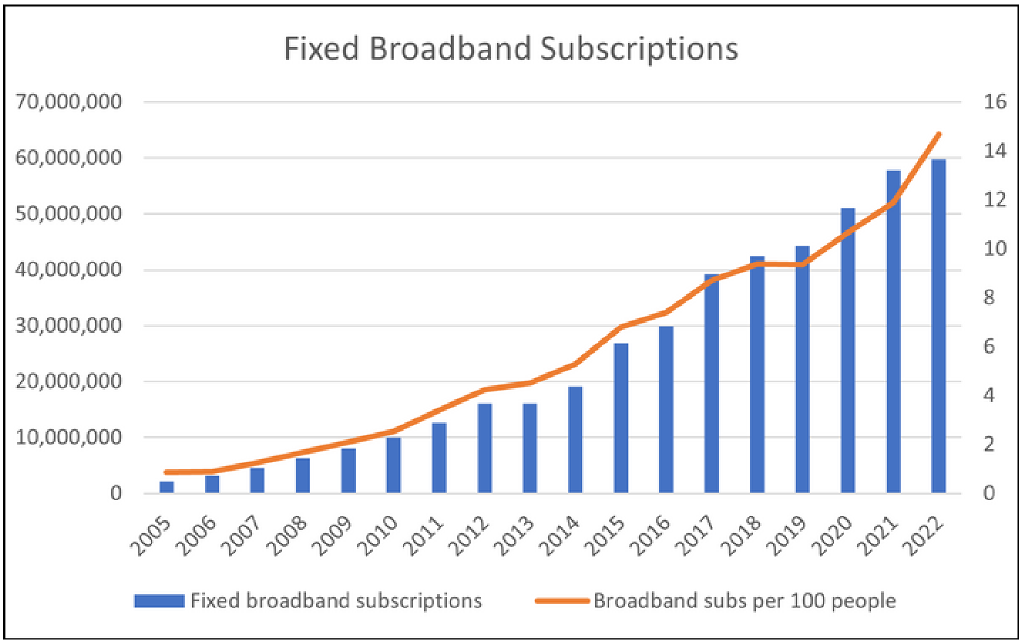
Source: Enerdata, 2023

Digital transformation

MENA is home to a growing population of 500 million, of which over 77% have access to the internet and 30% are under the age of 15 (World Bank, 2023). The mobile telecom market can be categorised as mature given high levels of cellular penetration (1.22 cellular subscriptions per person) and growth is driven primarily by demographic trends. On the other hand, broadband penetration is lower (0.14 broadband subscriptions per person) and is rapidly rising with plenty of room for growth in fixed broadband and fibre-to-the-home (FTTH). The combination of a growing population and increased digitisation will structurally drive the telecoms space for the coming years and support organic growth for telecom and IT services companies.



Source: World Bank, 2023

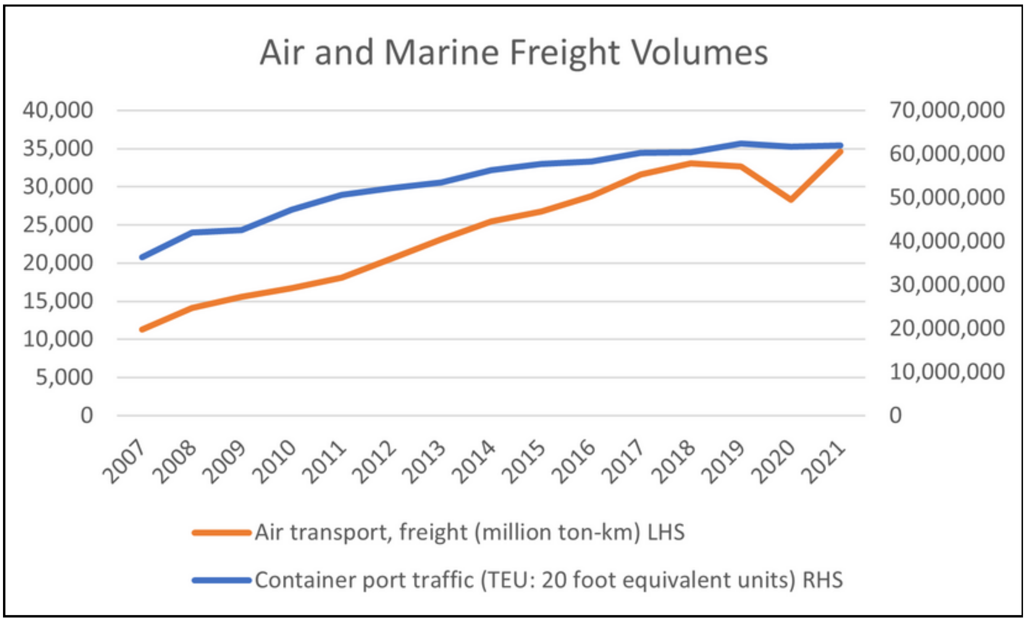


Source: World Bank, 2023

Global and regional trade drives infrastructure capex

The Middle East is positioned at the crossroads of Europe and East Asia. The Suez Canal handles 12% of global trade[13] and 30% of shipping container volume, while the Strait of Hormuz is one of the most important oil transport routes, through which 20% of the globe's oil consumption passes through daily.[14] Besides being a major connector for Eurasia and North Africa, the region's own rapid economic development is leading to increased demand for physical infrastructure such as ports, railroads and new highways. MENA's GDP of $7.9tn or 5.2% of the world's total,[15] makes it an important contributor to global growth in itself.

Marine transport, airport passenger volumes and road traffic have all been rising in line with the growth in GDP and the population size. As the number of middle-class consumers continues to increase, we expect these trends to continue. There are a number of high-profile and world-leading listed companies operating in the transport and the logistics space that we expect to benefit.



Source: World Bank, 2023

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Opportunities for investors
MENA presents investors with unique challenges but also exposure to a set of highly favourable structural themes. Utilico Emerging Markets is currently invested but underweight in this region, due to our disciplined bottom-up investment approach and premium valuations for the companies in the sectors we like. We are also highly cognisant of the present regional risks, and continue to carefully monitor and manage our portfolio's exposure to them.

In the long-term, we continue to watch out for high quality companies trading at reasonable valuations and believe the region's fundamentals could offer significant potential.

George Velikov
1 December, 2023

Source Data: ICM Limited,

[1] https://www.imf.org/external/datamapper/profile/CAQ
[2] https://www.enerdata.net/
[3] https://kpmg.com/sa/en/home/insights/2022/12/saudi-arabia-budget-report.html
[4] https://www.statista.com/statistics/1143052/uae-distribution-of-real-gdp-by-sector/
[5] https://www.msci.com/documents/1296102/38312924/MSCI+Emerging+Markets+Indexes.pdf
[6] https://www.strategyand.pwc.com/m1/en/reports/2018/the-outlook-for-renewable-energy-in-the-gcc.html
[7] https://www.globaldata.com/data-insights/macroeconomic/uae-macroeconomic-country-outlook/
[8] https://www.climatechangenews.com/2021/03/31/saudi-arabia-aims-50-renewable-energy-2030-backs-huge-tree-planting-initiative/
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[12] https://www.petroplan.com/blog/2023/01/the-rapid-rise-of-renewable-energy-in-the-middle-east-/94
[13] https://www.bbc.co.uk/news/world-middle-east-56505413
[14] https://www.eia.gov/todayinenergy/detail.php?id=7830
[15] https://istizada.com/mena-region/

*Total return is calculated based on undiluted Net Asset Value, plus dividends reinvested and adjusted for the exercise of warrants and subscription shares

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