TENZING PACIFIC
INVESTMENT MANAGEMENT

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HOLDING: ISHARES MSCI QATAR CAPPED ETF (QAT)

Summary

The iShares MSCI Qatar ETF seeks to track the investment results of a broad-based index composed of Qatar equities. The top sectors include financials (54.15%), Industrials (15.91%), Real Estate (11.13%). Its total expense ratio is 0.64%

What the bulls say:

- Qatar economy expanded by 5.5% in 3Q17, the strongest quarterly growth since 2010 and well above the forecast of 3.6%. This is noticeable as its neighbor countries imposed a diplomatic and trade embargo in June ’17. With new regulations passed recently, easing requirements for citizenship and ownership for foreign investors, Qatar expects to see new wave of investment and capital going to the country.
- Over 50% of QAT holdings exposed to the financial sector. Non-resident deposits made up roughly 24% of Qatari banks’ total deposit in May ’17, the pre-crisis month. Since then, however, it dropped by 8% M-o-M in June and July and the drop slowed down to 5.2% in August and 4.2% in September. The government intervention with capital injections has provided crucial support for its financial system. In addition, other major sector holdings including real estate and industrials are beneficiary of the state budget plan for 2018 as 41% of the budget is set aside for key transport, health and those related to the 2022 FIFA World Cup.
- Major Qatari stocks currently trade at steep discount to their historical P/E and P/B, respectively standing at 12.92 & 1.38 as of 1/12/18, and their peer nations in the Middle East region, making immense room for QAT price growth this year as many giant investment funds are betting big on Qatari economy.

What the bears say:

- Sovereign rating downgraded by all 3 major credit rating agencies with negative outlook. With foreign exchange reserves halving since June ’17 and its plan to issue debt to finance key domestic projects, it may result in higher debts and dampen the government’s ability to provide support to the financial sector that makes up over 50% of QAT market value.
- The blockade has no end in sight in 2018 or beyond. This geopolitical crisis remains the key issue to the Qatari economic growth. The little to no progress in resolving it will likely avert foreign investors from investing in the country’s equity market.

Risks:

- The diplomatic rift with the neighbor countries, though so far having limited impact, will likely to weigh on Qatari economy this year if the boycott is not put to an end. Qatar had relied on those countries for supply of a wide range of necessities and services to maintain its society’s well-beings. The boycott has forced Qatari government to reach farther countries for new sources, including other geopolitically unstable countries such as Iran and Turkey, at much higher costs.
- Despite efforts to diversify the economy, Qatar still relies heavily on hydrocarbon energy export, 82% of total export and 93% of government revenues in 2016. Demand for energy historically has widely swung volatility, resulting in much less credible forecasts of energy price. While prices of oil and natural gas have showed signs of growth so far in 2018, there is no guarantee that those sign will materialize into a sustainable trend for this year.

4 reasons to buy/sell:

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- Qatar ETF, down roughly 15%, was one of the worst performing country ETF in 2017. This was largely due to the investors' fear of the diplomatic crisis between Qatar and its neighbors, including the most influential regional power, Saudi Arabia. With most of its major economic indicators have been showing positive signs of a strong recovery in 2018, QAT price is very likely undervalued at a steep discount. Qatar's GDP annual growth for 2018 is projected to be within the range of 2.7%-3.1% in 2018.
- In August '17, Qatar approved a legislation that allows foreigners to acquire its privilege citizenship. Recently, it also passed another investment-focused law that legalizes 100% ownership for foreign investors in several sectors of the economy and other provisions that would provide foreign companies with incentives and tax exemption if they meet certain criteria. These transformative moves toward a more open economy and society will benefit the country in long-term as it will attract new inflow of foreign capital and business activities.
- The government plans spending in 2018 to edge up by 2.4% compared to 2017. The state budget will focus on developing local industries and the private sectors as the country work to make itself self-sufficient amid the boycott by other Arab states. While spending increases, the annual deficit forecasts to decrease by at least 1%, under the assumption that oil price will level around $45/barrel. With oil price is widely expected to stay around $55-$60/barrel, the state budget deficit will likely to be lower much lower.
- QAT fundamental valuations are significantly cheaper than its Middle East peers. It also offer a much higher dividend, currently around 3.91%. Since its 3-year low in Dec '17, the ETF price has rallied 30% and currently has the best performance among Middle East country ETFs in 2018.

Recommendation:

We recommend a BUY rating on QAT.

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