

# Growth credentials remain intact

For all the short-term uncertainties, the Middle East is still an area of immense potential for international asset managers.

**T**hey do things differently in the Gulf region. Take recessions, for example. While much of the world is expected to contract in 2009, the International Monetary Fund is still forecasting growth of over 5% for the region this year. Granted, that is down from around 6.8% in 2008, but it would be a remarkable performance at a time when oil revenues are falling steeply. And that may be as bad as it gets. In a recent report, Citi forecast a sharp rebound in growth in 2010 with GDP growth for the UAE jumping from 2.7% to 5.3% – a near doubling.

For all that, the region has clearly not been immune to the storms raging elsewhere. Liquidity is being squeezed locally as it is internationally. The authorities in Saudi Arabia, Kuwait and the UAE have all taken steps to defend their banking systems. International investors have pulled a lot of money out of local markets. Tom Healy, Chief Executive of the Abu Dhabi Securities Exchange, said recently that the proportion of the ADX owned by non-Gulf investors had declined from 13% to 9% in the past year. Meanwhile, Dubai's overheated property market has suffered a cold dose of reality.

'But despite all these signals of contagion from developed countries,' says Jervis Smith, Head of International Managed Funds and Middle East, Citi, 'the fundamentals remain very positive – provided the oil price does not collapse further. The region is widely forecast to remain in fiscal surplus with oil at current levels. And huge public infrastructure projects are ongoing, which will sustain the profitability of local companies.'

One thing is sure: the region will remain a magnet for international asset managers. After a year or so of high activity, which saw the likes of Templeton Asset Management, BNP Paribas Asset Management and Sarasin Group all deepen their involvement in the region, the influx of new names has slowed to a trickle. But the region's attractions remain undimmed. Says Richard Street, Securities and Fund Services Head of the Middle East region for Citi: "The spread of a savings culture, the deepening of local capital markets

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and the growing number of high net worth individuals are all fuelling demand for private banking and asset management."

According to Ernst & Young, there are around 300,000 high net worth investors in the Middle East and their number is growing at just under 12% a year. There is also the fast-growing 'mass affluent' market, defined as investors with up to \$400,000 of liquid assets. They have tended to focus on local markets, accessed by way of mutual funds. The challenge for all international firms targeting the high net worth or retail segments of the market is that local banks have a head-start – making joint ventures or some other form of tie-up imperative. Local banks are expected to take significantly more of the cake in 2009 – at the expense of foreign banks. "Given a total GCC population of around 35 million people," says Street, "the emphasis has to be on the high-margin, top end of the market."

Interest in international diversification among Gulf investors remains high. The trend is particularly marked in the Shari'a-compliant funds market.

Between 2000 and 2007, the number of Islamic funds grew at a compound rate of 30% a year. Increasingly, there has been a shift away from investing in the MENA region. In 2007, two-thirds of newly incorporated Islamic funds had either Asia Pacific or global mandates. "There is increasing interest on the part of traditional western managers in launching Shari'a compliant products," says Smith.

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Unquestionably the biggest prize is in capturing some of the institutional, and in particular sovereign wealth fund, flows. The big question is where and how these funds will be invested in the future. Last year the Kuwait Investment Authority pumped several billion dollars into the local market by way of support and there may be additional domestic calls on the GCC's sovereign wealth funds in the coming months.

But, longer term, there is little doubt that recent trends toward diversification and direct investment abroad will remain intact. Last year, McKinsey & Co estimated that new outward investment from the GCC in the period to 2020 would amount to more than \$3.5 trillion. Clearly, direct investments will account for some of that outflow. As a series of investments in alternative investment managers such as Carlyle Group, GLG Partners and Och-Ziff Capital testify, the sovereign wealth funds are prepared to entertain aggressive strategies. Nonetheless, the favoured route for most of the region's big funds is still via third-party investment managers.

Against this backdrop, Citi is expanding its Securities and Fund Services offering in the region. In July last year, it launched fund servicing and custody in Bahrain and in January this year opened a direct custody and clearing operation in Dubai covering all three of the UAE's stock markets.

"The key point is that we are embedding our products and services within the region," says Street, "and bringing in global service standards as we do so. To be effective you have to be on the ground and in the time zone. We now offer a powerful combination of in-region and global investor services solutions including fund administration, custody and securities lending. Whether a firm chooses to launch a locally domiciled fund or a UCITS for broader distribution, we can deliver a globally consistent service to fit the manager's needs."

Both moves are part of a broader expansion in the region, where Citi has had a presence for more than 50 years. For much of that time it's Global Transaction Services business has been offering cash management and treasury services – including Shari'a-compliant treasury through its own Islamic bank offshoot. That bank is increasingly engaged in helping asset managers structure and gain approval for new Shari'a-compliant funds.

On the issuer services front, Citi has long provided debt capital markets (including issuer and paying serv-

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ices for sukuk issuance) and global depositary receipt services to the GCC. In April last year, it launched an on-shore securities agent and account bank, focusing initially on the UAE, Bahrain and Kuwait. Operating under local law, the bank can offer both conventional and Shari'a escrow services.

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After the recent sharp falls experienced in local stock markets, the prospects for those flows may seem questionable. And in the short term, a 'do-nothing' mentality is likely to dominate. Longer-term, however, the outlook remains positive – as the fundamentals underline.

One other factor is worth taking into consideration, says Smith: "Traditionally, Gulf investors – from the individual to the sovereign wealth fund level – have been conservative in their approach. Risk aversion has come first. By and large, that approach will have spared them the sort of losses sustained by highly leveraged players, particularly those invested in leveraged products, in other parts of the world. In turn, that should allow them to bounce back more quickly from recent reverses – as they did from the pricking of the 2004/5 bubble."

In short, the Gulf's big investors will continue to hunt out professional investment managers capable of delivering real expertise in international markets. Whatever the short-term concerns, few regions of the world offer such glittering prizes to asset managers prepared to demonstrate their commitment to the local marketplace and dig in for the long haul. ■

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