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11% rental yields in Riyadh, and UAE tops world popular locations with higher rental yields

ALKHABEER CAPITAL's PUBLISHES STUDY ON INCOME YIELDING OPPORTUNITIES FOR GCC INVESTORS

AS PART OF THE INVESTMENT DIVERSIFICATION STRATEGY IN THE GCC, INVESTORS SERIOUSLY LOOK AT INCOME YIELDING ASSETS

Jeddah, Saudi Arabia – 12 August 2015: Alkhabeer Capital has released its report on income yielding opportunities for GCC Investors. The report considers equities, fixed income and rental yields from real estate as income yielding opportunities, as well as the need to consider these opportunities and options available to investors in this asset class in the region.

Need for Income Yielding Opportunities

As reported by Alkhabeer Capital, The GCC region offers immense investment potential given its favorable demographics, high infrastructure spending and massive wealth. This is clearly evidenced by the fact that in the past one year, infrastructure contracts of about $172 billion have been awarded in the GCC region for 2015. However, risks remain, both within the region and those emanating from outside. These include low oil prices, situation in Greece, outlook for Chinese growth and recurring global geopolitical tensions. These risks are significant and can lead to volatility in capital values. Investors need to be cognizant of these risks and should seriously look at income yielding assets within the GCC region as a diversification strategy. The report also explores the need to look at these opportunities and the options investors have to take exposure to such assets in the region.

Global risks continue to be high

Alkhabeer Capital's report adds that almost seven years after the financial crisis in 2008, global risks have not fully abated. Over the years, unconventional and aggressive expansionary policies by global central banks have been required to support growth. Most leading global economies continue to be plagued by high levels of leverage which is limiting credit growth and hence broader economic growth. On the other hand, fears of a renewed global property bubble are rising as capital values of properties across the globe continue to appreciate on account of sustained investor demand. Moreover, real estate investments remain highly susceptible to rising interest rates and, therefore, could experience significant volatility in the times ahead. Investor capital is largely at risk given the global economic uncertainty.

The US interest rate cycle could be challenging for riskier assets

The US Fed has clearly stated its stance of hiking interest rates later this year. The normalization of interest rates in the US could be challenging for many assets classes across the globe, particularly those in emerging markets. There could be significant bouts of volatility as emerging markets and other developing markets could witness large capital outflows. In such a situation, a contagion affecting GCC markets cannot be ruled out.

Income yielding opportunities in the GCC

In this note, we broadly discuss three key income-yielding assets in the GCC region, namely equities, fixed income and rental yields from real estate. We have evaluated these asset classes in terms of their risk-return trade off, challenges faced and factors that could make these asset classes more effective. We have also discussed what opportunities and strategies could help an investor in his investment decisions.

We believe that a carefully selected portfolio of stocks of companies with growing earnings, robust free cash flow and a fundamentally strong business model will prove to be successful in times of uncertainty. Higher dividend yields for companies in the region are usually a result of higher cash levels and healthier balance sheets and are suited to weather market volatility better than others. Additionally, other income-yielding assets such as fixed income and rental yields from real estate would also help the investor in diversifying his portfolio while maintaining a steady source of income.

1. GCC Equities

Equities in the GCC remain the most preferred asset class amongst investors. During the first nine months of the previous year, strong corporate earnings reports and optimism over regulatory reforms in many GCC countries had pushed GCC indices to multi-year highs. However, this led to stretched valuations to levels that were deemed to be expensive. During the final months of 2014, equity markets experienced high correlation to oil prices. Oil prices dropped by about 50% and resulted in investor sentiment in the GCC to plummet over the short term, effectively wiping off most of the 2014 returns from equities. As a result, valuations are now in a range comparable to emerging markets.

GCC markets offer strong dividend yields, Dubai & Bahrain lead

The GCC markets are well known for the high dividend yields that they offer compared to most other emerging and developed markets. Higher dividend yields for companies in the region are usually a result of higher cash levels and healthier balance sheets and are suited to weather market volatility better than others.

2. Fixed Income

Global financial markets have witnessed robust issuances of sukuks lately. Standard and Poor's (S&P) expects sukuk issuances to exceed $100 billion in 2015, after clocking $116.4 billion in the previous year and $111.3 billion in 2013.Global sukuk outstanding stood at a record $300billion by the end of 2014.

Structural changes will add depth to the GCC market

In the midst of the aforementioned shortcomings, there is an urgent need to foster development of the sukuk market. Despite rising interest for sukuk instruments, the absence of a vibrant debt market has hindered issuers from tapping funds from markets in the Middle East. Officials in the Middle East need to administer an array of steps in order to promote debt markets. There is a need to promote a ratings culture, initiate steps to encourage transparency and formulate regulations to promote institutional participation. In its 2015-2019 strategy paper, the CMA said that it would ease the regulatory approval process for debt products, regulate the listing of private placements on the exchange, and develop securitization to improve financing options for issuers with low credit ratings.

3. Real Estate

While capital appreciation in the GCC property markets has been strong, it is the steady income from rental yields that has been attracting investors into the market. Currently property investors in the GCC continue to receive a healthy rental yield in excess of 6% compared to mature markets of the US and Europe, where rental yields stand at around 2%-4%. Within the GCC, the UAE has higher rental returns than most popular locations for property investment in the world as rental income is tax-free, and there are no capital gains tax. Following the global downturn, prices have stabilized in premium locations and yields currently stand at around 8%-9%. Key markets in Jeddah and Riyadh in Saudi Arabia are also witnessing a spurt in rental yields, currently at around 7.5% nation wise with Riyadh scoring first with 10.74% in outside of centre.

Reduced affordability of new house purchases in Saudi Arabia

In Saudi Arabia, residential properties look attractive driven by an under-supplied market and rapidly growing local population. Moreover 30% down payment requirement is reducing affordability of new house purchases. The Saudi government is mulling a tax on vacant land to ease land supply. In both Saudi Arabia as well as Qatar demand is expected to remain robust for mid to low-end residential units on account of limited supply and high demand.

Office Segment

On the commercial real estate front, Dubai has remained the most preferred destination in the GCC countries given the ease of doing business and transparent real estate dealings. Rental rates have started stabilizing since the fourth quarter of 2014. Office space worth 900,000 square meters is expected to enter the market by the end of 2015, which is likely to weigh on rental yields in the near term.

In Saudi Arabia, rentals across the office space did not witness much change since the beginning of 2015. New supply is expected to enter the commercial segment across major Saudi markets. However, considering that the Saudi bourse has opened its doors for foreign investors, possibilities of a higher demand for office space is likely to keep rental yields buoyed going forward.

Investor Strategy

Every asset class has its own set of risk and returns trade-offs, hence a diversified portfolio can help investors to generate attractive income distribution. Investment in income yielding assets is desirable as they ensure inflows to investors in addition to possibilities of capital returns. Additionally a multi-sector approach can also help investors to tap the promising sectors of the GCC economies such as infrastructure, healthcare, transport & tourism, to name a few. Needless to say, all this will only be possible though informed decisions which are an outcome of market understanding and rigorous research exercise. For their investment needs, investors should seek the expertise of fund managers who widely track these individual asset classes.

Alkhabeer Capital, a leading asset management and investment firm based in Saudi Arabia, and authorized by the Capital Market Authority (license number 07074-37).

Full details of the report can be found here

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About Alkhabeer Capital

Alkhabeer Capital is a leading asset management & investment firm providing world-class investment products and services, that endeavors to help institutions, family groups and qualified investors access to and/or allocate capital in ways that deliver real and enduring economic value.

It is licensed by Saudi Arabia's Capital Market Authority (CMA) license # 07074-37. The asset management area provides investment opportunities through a large and growing portfolio of public and private funds in the areas of real estate, private equity and capital markets, while the investment banking area offers specialized Sharia compliant capital raising and M&A advisory services to businesses, private investors and families.

Alkhabeer Capital has offices in Jeddah and Riyadh.

For more details on Alkhabeer Capital, please visit www.alkhabeer.com

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