Confluence Investment Management

Bi-Weekly Geopolitical Report

By Daniel Ortwerth, CFA

February 10, 2025

Middle Eastern Stock Markets – An Overview

All the attention paid to the strong performance of United States stock markets in recent years can easily distract us from what might be happening in other markets around the world. A quick review of global stock markets reveals that one region, the Middle East, has seen its market capitalization grow more rapidly over the last 10 years than any other region, including the US. This prompts an investigation into the reasons. Should investors give more consideration to the Middle East, or might there be other factors at play that explain the growth without necessarily translating into investable opportunities?

This report begins with a review of the global stock market, categorized by region and country. We next take a closer look at the fastest growing Middle Eastern markets, and we finish with considerations about the potential future for Middle Eastern stocks. As always, we conclude the report with investment implications.

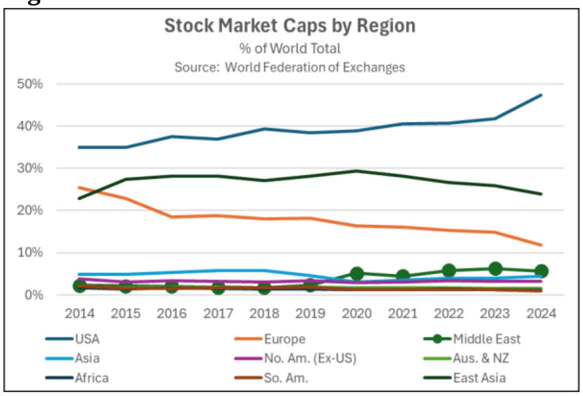
The Global Stock Market

To put today's Middle Eastern stock market in context, we begin with an overview of the global stock market.

Market Capitalization. For this report, we focus on market capitalization (market cap). A stock market can be measured in many different ways, such as the number of listed companies, number of daily trades, number of shares traded, and number of participants (i.e., traders); however, in our view, market cap best measures the market's perceived investment potential among the entire community of investors. To understand this measure, let's start with one company, whose market cap is the total value of a company's stock, computed by multiplying the total number of shares by the price of one share. To compute the market capitalization of an entire stock exchange, such as the New York Stock Exchange, add together the market caps of all the companies listed on that exchange. For a country, add the market caps of each of the exchanges operating in that country. For a region, add each of the countries' totals.

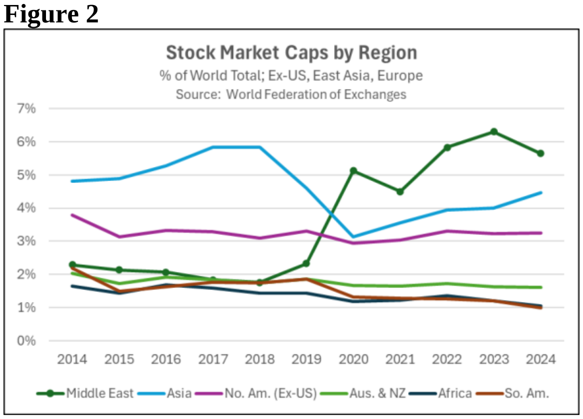
Markets of the World. Most of the data used in our analysis comes from the World Federation of Exchanges (WFE), a global industry association that encompasses most significant stock markets. The WFE provides a rich source of present and historical data on many types of capital markets, such as stock and bond markets, throughout the world. From this data, we collected market caps for 119 stock exchanges going back 10 years. We separated them into nine different regions, counting the US as its own region. This revealed insights into the relative size of each region and how each has changed over time. We paid close attention to the actual market caps, but we focused on each region's size as a percentage of the world total, which gives a sense of which regions and countries might be winning and losing the competition for global capital. *Figure 1* shows how the regions have evolved over the last decade on that basis. Notice that the combined US market cap (New York Stock Exchange and NASDAQ) was already the largest market in 2014 but has grown to nearly twice the size of the next largest region (East Asia), while the European region's share declined by nearly a quarter.

Figure 1



In *Figure 1*, we highlighted the Middle East (in dark green) with dots on each point; however, the relative sizes of the three largest regions (US, East Asia, and Europe) hide the movements of the other regions at the bottom of the figure. In *Figure 2*, we excluded the top three regions to better show the dramatic rise of the Middle Eastern market cap.

Figure 2



Since 2014, three regions' market caps have grown (as a percentage of total global market cap) at the expense of the other six.

The remarkable expansion of US markets is well known, and the third-place finisher, East Asia, essentially held position by increasing its percentage of the world total by a modest 1%. Meanwhile, second-place Middle East, with a 3.5% gain of total global market cap, caught our attention. Since it was so much smaller at the beginning of the period, this gain relative to the world total represents the greatest annual growth rate of the underlying market cap, nearly doubling the US growth rate (See *Table 1*). For perspective, the total global market cap grew at an annual rate of 5% over the period.

Table 1

Stock Market Caps by Region

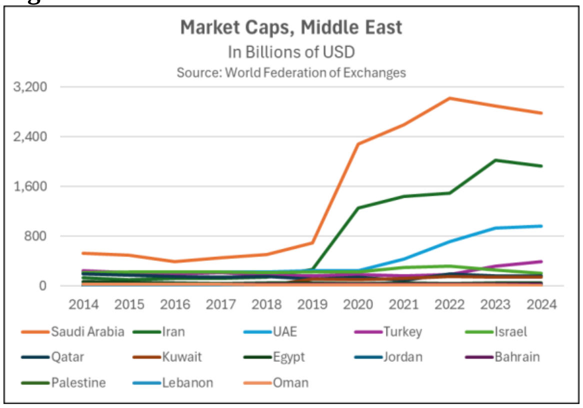
% of World Total - Change

Source: World Federation of Exchanges

Region	2014	2024	Change	CAGR
USA	34.9%	47.3%	12.4%	8%
Middle East	2.3%	5.7%	3.5%	15%
East Asia	22.9%	23.9%	1.0%	5%
Asia	4.8%	4.5%	-0.3%	4%
Australia & New Zeal.	2.0%	1.6%	-0.4%	2%
North Amer. (Ex-US)	3.8%	3.3%	-0.5%	3%
Africa	1.7%	1.0%	-0.6%	0%
South America	2.2%	1.0%	-1.2%	-3%
Europe	25.4%	11.8%	-13.7%	-3%

Markets of the Middle East. Beneath the surface, we found a wide range of different results. The WFE data includes 15 stock exchanges registered in the Middle East, in 13 different countries. For our analysis, we combined the market caps of the two exchanges in Iran and the two in the United Arab Emirates (UAE) to facilitate a country-by-country analysis. The data reveals markedly different trends within the group. Showing the data the same way that we did for the world, *Figure 3* illustrates this intraregional divergence.

Figure 3



Of the 13 countries in the Middle East, seven experienced market cap growth over the last decade, while the others either held steady or shrank. Of those that grew, one of them, Iran, experienced explosive growth, posting a period-end market cap 15 times its size from just 10 years earlier. Two others, Saudi Arabia and the UAE, experienced very strong growth, finishing the period with market caps five times greater than their 2014 levels. Beyond these three standouts, performance ranged from modest growth to complete collapse.

Table 2

Middle East Market Caps
Size & Growth
Source: World Federation of Exchanges
Figures in Billions

Country	2014	2024	CAGR
Iran	134	1,955	30.8%
Saudi Arabia	528	2,774	18.0%
UAE	214	974	16.4%
Kuwait *	107	139	5.2%
Turkey	244	393	4.9%
Israel	211	272	2.6%
Palestine	3	4	2.5%
Bahrain	0	21	0.0%
Jordan	26	24	-1.0%
Qatar	189	162	-1.5%
Egypt	70	45	-4.3%
Lebanon	11	0	-100.0%
Oman	26	0	-100.0%

** Comparable data begins in 2019.*

These results do not necessarily correspond to what we would expect in two key ways. First, we would normally expect that countries with larger, relatively diverse and developed economies would also have larger stock markets to represent them. In other words, we would expect the market cap to grow along with the underlying size and sophistication of the economy. This did not prove to be the case. For example, Israel is the only "developed" country in the Middle East, and it probably has the region's most sophisticated and advanced economy, but its stock market cap as a share of GDP is middling. Meanwhile, Turkey has the largest GDP in the region, and it is the only non-developed country in the Middle East classified as an "emerging market," whereas as the rest earn the lower classifications of "frontier" or "standalone." Absent any mitigating circumstances, we would therefore expect Turkey to have one of the biggest stock markets. Instead, its market cap as a percentage of its GDP is a humble ninth on the list.

Table 3

Market Cap to GDP
Middle East Region
Source: World Federation of Exchanges, IMF
Figures in Billions

Country	Mkt. Cap.	GDP	MC/GDP
Iran	1,955	434	450%
Saudi Arabia	2,774	1,101	252%
UAE	974	545	179%
Kuwait *	139	162	86%
Qatar	162	221	73%
Israel	272	528	51%
Jordan	24	53	45%
Bahrain	21	48	44%
Turkey	393	1,344	29%
Egypt	45	380	12%
Oman	0	110	0%
Lebanon	0	n/a	NA
Palestine	4	n/a	NA

** Comparable data begins in 2019.*

We would also expect that countries with more economic and geopolitical stability would attract higher levels of investment than those experiencing either internal turmoil or protracted external conflict. Since those markets are inherently riskier, we would expect investors to generally stay away from them in favor of more secure locations. Again, this proved not to be the case. For example, Iran has been a target of prolonged economic sanctions from the West, a frequent party to regional conflict, and has experienced high, volatile inflation. Despite these problems, it now has the largest Middle Eastern market cap relative to its GDP.

The Largest Markets/Economies

These findings prompted a more thorough examination of the larger markets and economies to discover the causes of the movements and realities that we might not have initially expected.

Iran. The explosive growth of Iran's market cap, along with having become the second largest in the region, presents the most improbable and extraordinary case. As *Figure 3* shows, the dramatic growth began in 2020. This was the same time that the country was suffering from a loss of nearly 80% of its oil revenue to Western sanctions, high inflation (35% in March of that year), and unemployment in excess of 10%. Amidst these circumstances, why did Iran's stock market skyrocket? Three factors combined to fuel the rise. First, since the sanctions largely shut off the country of 90 million people from the global economy, domestic companies found themselves with a large, captive market and little to no outside competition; this proved to be a sales bonanza. Second, in the high-inflation environment, Iranian citizens turned to stocks as a store of value, using them as a way to conserve their cash in assets that they assumed would rise along with inflation. Third, a class of speculative international investors, seeing this as a possible opportunity for a quick gain, piled additional money into the flow from domestic investors. Taken together, these things caused a three-year boom. Although the Iranian stock market has given up some of those gains, most of them remain today.

Saudi Arabia. At the end of 2019 and beginning of 2020, the world's largest oil company, Saudi Aramco, launched the biggest initial public offering (IPO) of stock in history, raising nearly $30 billion dollars while listing the stock on the Saudi exchange. That event served as a spark to ignite general interest in Saudi Arabian stocks, both because it drew attention to the broader opportunity to invest in the country's petrochemical companies, but also because the Saudi government smartly timed the IPO with its introduction of a plan to diversify its economy away from its heavy dependence on oil.

As part of the "Vision 2030" program introduced in 2016, the government harnessed its Public Investment Fund (PIF) to direct large Saudi government investments and to attract international capital to implement Vision 2030. The PIF released its investment strategy for 2021-2025 at roughly the same time as the Aramco IPO, which highlighted ambitious development plans. This succeeded in attracting international capital. The Saudi stock market has enjoyed elevated market caps ever since then; however, storm clouds have been brewing recently. Some of the country's marquee investment projects, such as the futuristic city of Neom, have encountered ominous problems such as cost overruns and corruption scandals, and these problems could proliferate to the detriment of Saudi stock values.

United Arab Emirates. UAE leadership has spent the entire 21st century pursuing an ambition to develop their country into the premier financial hub of the Middle East. Along with an expansive construction program of supporting infrastructure, they have established tax codes and a regulatory structure that have encouraged participation from throughout the international investment community. These efforts have not focused on the petroleum industry. Rather, they have sought to maximize diversification across industries. As one of the clearest signs of the country's success, UAE exchanges have become known for their high volume of IPOs. The UAE continues to attract new market participants, and we expect this growth trend to continue.

Turkey. The Turkish stock market has suffered from the effects of a government that frequently intervenes in the country's fiscal and monetary policies. Making matters worse, Turkey's president, Recep Tayyip Erdoğan, who has been in power since 2002, has a reputation for erratically changing course on his domestic economic priorities, including the hiring and firing of finance ministers and central bank governors at will. This kind of policy volatility and uncertainty has bred problems such as high and volatile inflation and wild swings in the value of its currency. These policies and their effects have undermined investor confidence and kept international investors at bay. The country has recently enacted reforms meant to improve the investment climate, and the Turkish stock market has performed well over the last two years. Nevertheless, it remains to be seen whether the president, with his near-dictatorial power, will stick with the reforms long enough to sustain the stock market's positive performance.

Investment Implications

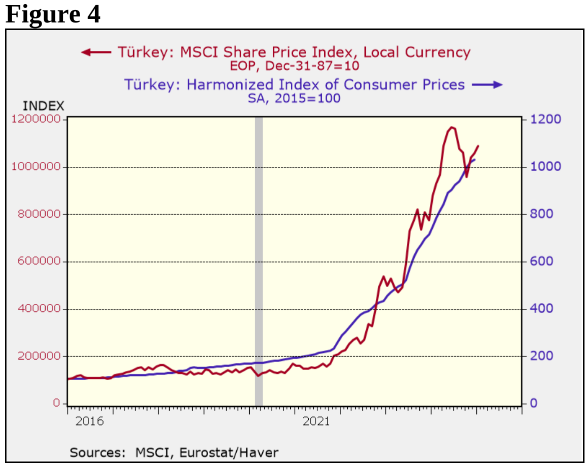
With regard to Middle Eastern stocks and the markets that serve them, appearances can be deceiving, and the story changes from one country to the next. In our view, the UAE's stock market is the only one whose strong growth seems to reflect truly encouraging and sustainable underlying factors. This is a market we will more closely monitor for suitable opportunities in the future. In each of the other cases, impressive growth seems to have been the result of questionable factors involving significant risk. With this in mind, we highlight certain additional considerations.

Role of Oil. Historically, oil has played a dominant role in Middle Eastern economies, and disruptions or threats to the flow of oil have frequently caused economic and financial havoc. This report has shown examples of attempts to diversify away from this influence, and the last year was a period of surprising stability in the price of oil, despite numerous destabilizing geopolitical events. Only time will tell how long this trend of relative stability will last. Oil remains the dominant driver of Middle Eastern prosperity, and the recent period of price stability may have contributed to the rise of Middle Eastern market caps. If volatility returns to the oil market, stock prices throughout the region, regardless of economic sector, could suffer.

Bloc Formation. We have frequently emphasized the theme of global fracturing and bloc formation along the lines of the global geopolitical competition between the US and China, and we expect this theme to play a dominant role in all regions of the world in 2025. Virtually every country of the world will likely face a choice at some point to more closely align itself with one bloc or the other. One potential consequence of this could be the relative opening or closing of the capital markets of any given country to Western investors. Just because a country's stock market rises does not necessarily mean it will be a welcome market for all investors as the bloc formation proceeds. A country such as Turkey or the UAE may well succeed in "straddling the fence" between the two powers, but another country, such as Saudi Arabia, might choose to tailor its policies to favor one or the other with consequences for investors.

Role of Inflation. Finally, from a much broader perspective, we note that the jump in the Turkish and Iranian stock markets reflects how equities can serve as a hedge against inflation. As shown in *Figure 4*, the strong rise in the Turkish stock market has allowed that country's investors to protect themselves against Turkey's skyrocketing inflation in recent years. As noted above, we suspect that the strong rise in the Iranian stock market reflects a similar dynamic. Of course, higher inflation rates and inflation volatility have historically been correlated with weaker stock valuations in the US; however, that relationship encompasses decades-old periods when US investors had few financial tools to protect themselves from rising consumer prices. Buying stocks, options, commodities, or other hedges was expensive or impossible, so consumers were left with few possibilities other than hoarding. These days, because of regulatory and technological changes, it is much easier for investors in the US, and even in countries such as Turkey and Iran, to buy stocks. In the future, if US inflation accelerates as we expect, we think US investors may turn to stocks to protect their purchasing power.

Figure 4



Daniel Ortwerth, CFA
February 10, 2025

This report was prepared by Daniel Ortwerth, CFA, of Confluence Investment Management LLC and reflects the current opinions of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward-looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.