

## Morgan Stanley Saudi Arabia Funds

## Morgan Stanley Saudi Equity Fund

## EMERGING MARKETS EQUITY TEAM

### Performance Review

In the twelve month period up until 30 June 2024, the Fund returned 34.99% (net of fees)<sup>1</sup>, while the benchmark returned 1.92%. Since inception until 30 June 2024, the Fund returned 16.86% (annualised, net of fees)<sup>1</sup>, while the benchmark returned 5.25%.

### Market Review

The market (Tadawul All Share Index, or TASI) drifted lower in the second quarter of 2024, closing down by 5.1% and bringing year-to-date returns to 1.6% (on a total return basis). Some of the factors highlighted as reasons for the market correction include the Aramco secondary offering (totalling almost SAR 40 billion), concerns about more secondary offerings by government institutions, investors raising cash for initial public offerings (IPOs), profit-taking and concerns regarding government spending programs.

The recent announcement by the Saudi government to rationalize and refocus investments has raised concerns in the market. The message from the government is clear, aiming is to focus on projects that are strategic and/or have the ability to generate returns in the short to medium term. Availability of resources, rising costs and capital were perhaps the drivers. At this time, it is difficult to quantify the curtailment, if any, but it will become clear based on the pace of projects awarded over the next few quarters. It is also important to highlight that the earlier awarded contracts, which are at various stages of execution, will keep economic activity levels elevated in 2024 and likely into 2025.

The Riyadh Bank Saudi Arabia PMI fell to 56.4 in June compared to 57.0 in March 2024. According to S&P Global, the PMI decline is mainly attributed to a softer increase in new order volumes, with growth slowing for the third consecutive month to its lowest level in nearly two and a half years. On the other hand, business sentiment improved in June driven by improving market conditions.

According to the latest report from the General Authority for Statistics (GASTAT), in the first quarter of 2024 the unemployment rate in Saudi Arabia was relatively stable at 3.5% compared to 3.4% in the fourth quarter of 2023. The jobless rate for women was at 11.8%, while it came at 1.8% for men.

Saudi Arabia's inflation remained unchanged in May at 1.6% versus the previous two months., according to data by GASTAT. Housing and utilities continue to rise (at 8.7% year-over-year), mostly driven by higher rental costs. The population growth due to labour inflow and migration to cities are some of the underlying trends that may keep rental inflation elevated in the near term.

Geopolitical tension unfortunately remains unresolved with the Israel-Palestine conflict flare-up crossing its ninth month. The economic impact so far is minimal. The oil price has remained range bound while OPEC + announced a rollback of additional production cuts while remaining production cuts were extended.

### Portfolio Activity

During the quarter, the portfolio's banking sector exposure increased due to the allocation to stocks which are expected to benefit from interest rate cycle reversal while also offering decent volume growth. Exposure to the insurance sector also rose with an allocation to mid-cap stocks that are expected to benefit from elevated interest rates, a relatively stable pricing environment in the motor sector and diversification into protection and savings products.

On the other hand, profit-taking led to reduced exposure to the food products sector, in a specific name that had performed well during the first half of this year and seemed to have priced in near-term positives. Our exposure to the industrials sector was also lower due to profit-taking and performance-driven allocation drift.

We participated in various IPOs during the quarter, which contributed positively to the Fund's performance.

### Strategy and Outlook

As described below, compared to the first quarter of 2024, there is no material change to our investment and sector stance.

The Fund's banking sector stance is a small underweight, but the aim is to add to the allocation based on bottom-up, stock-level assessments. Corporate loan growth guidance points to strong growth while the margins outlook varies with expected cuts in interest rates later in 2024 and continuing into 2025. Some banks have reduced interest rate sensitivity, which is likely to help near-term earnings visibility.

Sector positioning is underweight on petrochemicals due to high valuation levels. The Fund's focus continues to be on stock-specific opportunities. Earnings are expected to pick up sequentially, but the outlook remains murky due to oversupply as production ramp-up continues in China.

<sup>1</sup> Source: Morgan Stanley Investment Management Limited. Data as of 30 June 2024.

Health care, education, infrastructure and tourism-exposed companies are still preferred due to their long-term earnings growth potential. In selective cases, allocation will be reduced where valuation has started to look full.

Key Risks: Sale of government-owned listed assets, adverse changes in government targets/spending plans and lower oil prices/global recession.

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## Fund Facts

Launch date	06 January 2009
Base currency	Saudi Riyal (SAR)
Benchmark	Tadawul All Share Index

## Annualized Performance in Saudi Riyal, net of fees, vs benchmark (%)

Calendar Year Returns (%)	2023	2022	2021	2020	2019
Fund	39.65	3.16	45.21	9.09	15.25
Benchmark <sup>2</sup>	14.21	-7.12	29.83	3.58	7.19

<sup>2</sup> The benchmark is a price return Index.

## INDEX INFORMATION

The **Tadawul All Share Index (TASI)** is the major stock market index which tracks the performance of all companies listed on the Saudi Stock Exchange. The Index is disseminated by the Saudi Stock Market. Volume in the index excludes small trades (trades with value less than Saudi Arabian Riyal 15000).

## IMPORTANT INFORMATION

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The investment performance of the Morgan Stanley Saudi Equity Fund is calculated on a total return basis (i.e., with cash dividend reinvested), while the investment performance of the benchmark is provided on price return basis (i.e., it does not include dividends). The dividend yield as per Bloomberg for TASI was 3.19% as of 30 June 2024.

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Funds that specialize in a particular region or market sector are

more risky than those which hold a very broad spread of investments. Where portfolio concentration is in one sector it is subject to greater risk and volatility than other portfolios that are more diversified and the value of its shares may be more substantially affected by economic events.

These investments are designed for investors who understand and are willing to accept these risks. Performance

may be volatile, and an investor could lose all or a substantial portion of his or her investment.

Please click this [hyperlink](#) to the [Information Memorandum](#) for further information-regarding the principle risks, terms and conditions of investing in the Morgan Stanley Saudi Equity Fund.