KAFD Dialogue Report

The 2024 Investment Outlook

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January 2024

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Introduction

The KAFD Dialogues are a private quarterly dinner series that drive forward global discussions on critical challenges facing businesses and their leaders today. The mission of the KAFD Dialogues is to promote frank and candid discussion between international and Saudi business leaders, creating knowledge and understanding of how to navigate emerging opportunities and obstacles within the global business landscape.

2024 could be one of the most volatile and unpredictable years in terms of macroeconomics and geopolitics for decades. At the start of the year, interest rates were at decade highs with many markets facing the possibility of recession as growth rates slow and economies face the pinch of high rates. The World Bank believes that the global economy is set for its slowest half-decade of GDP growth in 30 years.[1] Increased volatility in energy markets caused by the Russia-Ukraine conflict and onset of a new conflict in the Middle East, complicates the picture. 2024 will also be the biggest-ever year for elections. Over a half of the world's population are heading to the polls in countries' representing over one half of the world's GDP. Significant elections are taking place in both developed and emerging markets, including the US, EU, UK, India, and Indonesia. This macroeconomic and geopolitical turbulence presents challenges for investors, as well as opportunities.

While the outlook for many global economies is bleak there remain bright spots. The World Bank expects 2024 growth in the Middle East and North Africa (MENA) to outpace the global average. Global growth is projected to slow for a third year in a row, from 2.6% in 2023 to 2.4% in 2024, whereas MENA growth is expected to pick up to 3.5% in 2024.[2] Saudi Arabia may also offer a bright spot for global investors. 2024 growth is forecasted at 4.1%[3] - The Kingdom's bid to diversify its economy away from oil is uncovering new growth sectors, whilst new regulations and economic liberalisation measures are making it easier for foreign capital to reach the Kingdom, as well as for companies to operate and grow there.

Against this backdrop, the 6th KAFD Dialogue focused on 'The Investment Outlook for 2024' and saw KAFD invite **Salman Ahmed,** Global Head of Macro and Strategic Asset Allocation, **Fidelity International; Steven Wieting,** Chief Investment Strategist and Chief Economist, **Citi Global Wealth;** and **Dr Nouf Alsharif,** Managing Director of Economic Research, **Jadwa Investment** to share their insights on the 2024 investment outlook. **Michael Lawrence** OBE, Chief Executive, **Asia House** moderated the dialogue which was attended by over 100 senior representatives from leading Saudi and international businesses.

While all discussion at the KAFD Dialogues is kept strictly off-the-record to promote a highly useful and frank exchange of views, this Dialogue Report examines the key themes covered and provides focused analysis intended to enhance knowledge and understanding of the topics discussed for the business community in Saudi Arabia and at the international level including the macroeconomic and geopolitical risk environment heading into 2024, and Saudi Arabia's growing role in global investment.

2024 Growth Projection

Global Economic Growth

2024 Growth Projection	Trend
2.4%	Decreasing for the third year

MENA Economic Growth

2024 Growth Projection	Trend
3.5%	Outpacing global average

Saudi Arabia Economic Growth

2024 Growth Projection	Trend
4.1%	Bright spot for investors

Economic uncertainty clouds the investment outlook

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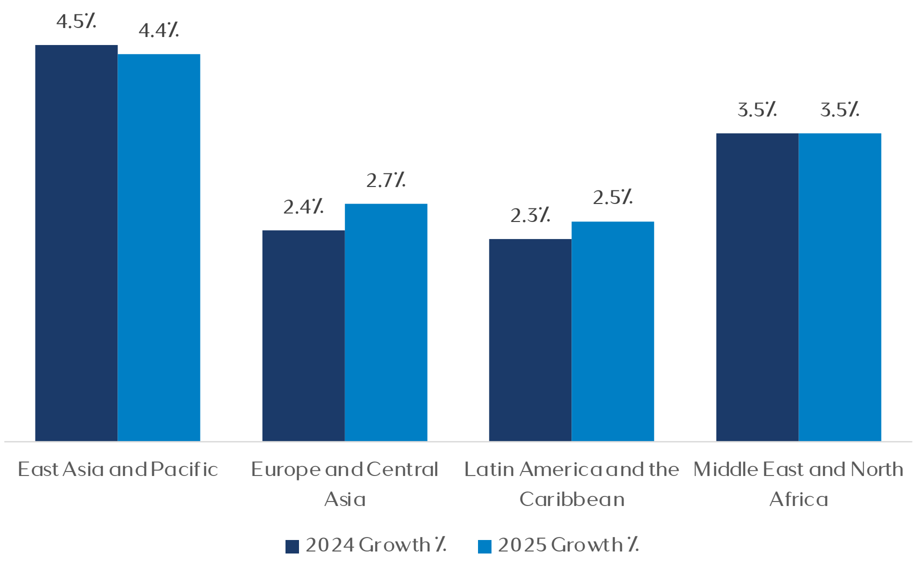
The 2024 investment outlook is clouded by economic uncertainty. A pronounced period of central bank monetary policy tightening to stem inflation after COVID-19 is starting to bite. Interest rates are at decade highs in many countries, increasing the risk of sovereign defaults, as well as limiting commercial and consumer spending by raising mortgage rates and borrowing costs. This increases the risk of recession and greater unemployment. The rate of inflation is falling in many countries but remains sticky, raising expectations that central banks will be slower to cut interest rates over the year than previously expected.

The consensus amongst asset managers and banks is that high interest rates will bite in the fist half of the year, prompting economic slowdown or even a first cyclical recession in some markets. Central Banks will then begin to reduce rates to encourage a soft landing and potentially a rebound in the second-half of 2024.[4]

The World Bank believes that the global economy is set for its slowest half-decade of GDP growth in 30 years.[5] The medium-term outlook for developing economies has dwindled amid slowing growth, monetary policy tightening, and trade growth turning negative in 2023.[6] South Asia has the highest growth prospects of the developing economies, with 5.6% growth expected in 2024. Developed economies are also languishing, with Europe slowing down faster than the US.

The World Bank's Outlook for Regional Growth [7]



A higher US Federal Reserve rate has appreciated the US dollar as investors allocated capital into US fixed income markets. This has increased the attractiveness of fixed income and savings accounts compared to other asset classes, and also a depreciation of other global currencies. With US interest rates expected to fall over the year, traders holding US dollar investments may reallocate assets away from US fixed income markets. This could positively impact emerging markets.

The challenging economic environment has put pressure on asset managers. Higher borrowing costs, higher cost of living, more generous returns on saving products, and dampened market sentiment has encouraged outflows from investment portfolios. This has been compounded by investors' flight to passive funds. 2023 saw global assets held in passive equity funds overtake active equity funds for the first time. Passive equity fund assets stood at US$15.1 trillion at the end of December 2023, whereas active fund assets stood at US$14.3 trillion.[8] This has led to downward pressure on asset managers' fees. As a result, 2024 is expected to see asset management firms recalibrate by reducing costs, which may see job losses as well as the closing or restructuring of funds.

Geopolitical turbulence also presents challenges

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2024 will see over a half of the world's population vote in countries accounting for over one half of the world's GDP. Significant elections are taking place in the US, EU, India, Indonesia, and likely the UK. November's US Presidential election in particular could have a significant impact on the future direction of the US economy and US-China relations. A packed election calendar could also impact investment strategies beyond the outcome of individual elections. Incumbents may be motivated to increase spending to enhance their popularity, affecting both debt and inflation in these markets.

US-China tensions continue to be at the forefront of investors' minds, with any escalation in tensions potentially impacting individual investments in these countries, as well as global growth prospects. China's economic slowdown continues to concern investors. Its stuttering growth since COVID-19 and downturn in its property market saw Chinese stocks continue to slide in 2023. China's CSI 300 index fell more than 11% in 2023.[9] China's growth rate remains positive despite dampened investor sentiment, and could improve if Beijing stabilises the property market.[10] While US-China tensions

remain a risk that investors will need to navigate in 2024, it may lead to opportunities in some markets. 'Reshoring' and 'nearshoring' has increased as companies with supply chains in the US and China look to hedge against geopolitical uncertainty by moving their supply chains and operations into third markets. Saudi Arabia, a country looking to bolster its domestic logistics, manufacturing, and industrial base as part of its economic diversification efforts, could stand to benefit.

Ongoing global conflicts further complicate the investment environment. The Russia-Ukraine conflict continues to risk spillover into wider Europe and causing energy price shocks that undermine the global economy. The Israel-Gaza conflict has also increased regional volatility. Houthi attacks against shipping in the Red Sea and Gulf of Aden, has already had a material impact on trade, increasing insurance premiums and shipping costs as global shippers opt to bypass the Red Sea and take longer routes around South Africa's Cape of Good Hope. Other potential flashpoints exist, including increased insurgent activity against US forces in Iraq, Syria, and Jordan, as well as ongoing border clashes between Israel and Hezbollah in Lebanon. Amid this geopolitical uncertainty we could see a rise in demand for 'safe-haven' assets, such as the US dollar, Yen, Gold, and short-term US treasuries, as well as asset allocations towards defence firms.

Saudi Arabia's growing role in global investment

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Saudi Arabia's importance within global investment is rising. The Kingdom's economic diversification and introduction of economic liberalisation measures are uncovering new growth opportunities for investors. At the same time, Saudi Arabia is deploying more capital overseas to grow its sovereign wealth.

> Saudi Arabia wants inward Foreign Direct Investment (FDI) to increase to 5.7% of its GDP by 2030, up from 0.7% in 2022.[11]

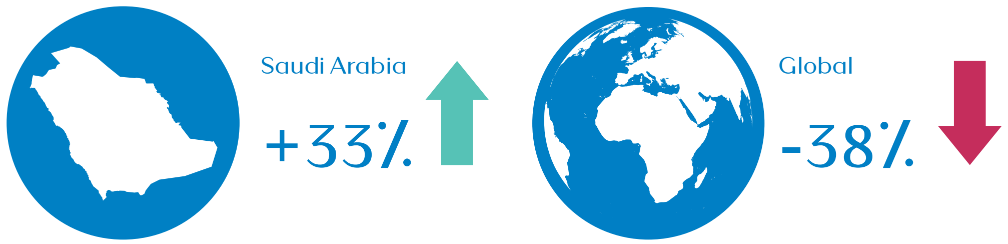
To achieve this, the Kingdom is introducing new regulations to liberalise its economy, expand its private sector, and make it easier for foreign companies and investors to deploy capital into the Kingdom.

Saudi Arabia's capital markets have undergone fast-paced regulatory reform since the launch of Vision 2030. The easing of listing requirements has made it easier for firms to list on Saudi Arabia's main exchange, Tadawul. Whereas the creation of the Nomu – Parallel Market has enabled smaller Saudi firms to explore utilising capital markets as a pathway to growth. Capital market reform has led to Tadawul's inclusion in emerging markets indexes, including those of FTSE Russell, MSCI, and S&P Dow Jones, which has led to billions in passive investment into the Kingdom. The launch of derivatives trading as well as new products, such as this year's launch of the TASI50 Index, which tracks Tadawul's top 50 companies by market capitalisation, will offer investors new avenues to pursue growth.[12] Saudi Arabia's efforts to modernise its capital markets are showing signs of success with Tadawul up 14% over the course of 2023.[13]

Saudi Arabia has ambitions for Tadawul to be a top 3 exchange globally, and is encouraging more firms to list. While global equities rallied in 2023, high interest rates created a muted global IPO market in 2023, with IPO proceeds and volume falling by 33% and 8% over the year.[14] The Kingdom could offer a potential bright spot for global IPO investors: 39 public listings took place in 2023, raising US$3.6 billion. In addition, 27 firms have also announced plans for future listings.[15]

In terms of alternative investments, the Kingdom currently ranks first in MENA for Venture Capital (VC) funding, securing 52% of total MENA investment. VC funding for Saudi start-ups increased by 33% in 2023.[16] This goes against global trends. Total global VC investment fell by 38% in 2023.[17]

VC Funding Trends: Saudi Arabia vs. Global



The Kingdom is increasingly becoming a force in global investment, deploying its sovereign wealth abroad to generate returns and further fuel its economic diversification. Saudi Arabia's main sovereign wealth fund, the Public Investment Fund (PIF) deployed around a quarter of total sovereign wealth fund investment in 2023, deploying US$31.6 billion in total.[18] It should be noted that Saudi Arabia has ambitions for PIF to become the world's largest SWF, increasing its assets from US$700 billion to US$2 trillion by 2030.

Conclusion: The Investment Outlook for 2024

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As investors grapple with economic turbulence and brace for a wave of significant elections, it will be crucial for investors to monitor geopolitical risks, with portfolio diversification being a possible tactic to manage uncertainties. With interest rates expected to come down over the course of the year, investors may look to lock in high yields in the fixed income market, before potentially redeploying capital in the latter half of 2024.

ESG and technology investments will continue to be key trends. ESG considerations will continue to impact investment decisions, with investors looking to deploy capital in renewables and sustainable technologies as countries transition away from fossil fuels. A key challenge for green investment will be meeting investors' demands in terms of generating returns from sustainable investments. The last quarter of 2023 saw global sustainable funds experiencing net quarterly outflows for the first time, with investors withdrawing US$2.5 billion[19] The US accounted for much of this, with net outflows of US$5 billion in the fourth quarter. Net outflows may reflect broader global trends, but may also reflect investors seeking more predictable returns from more traditional sectors at a time when high interest rates are dampening global growth prospects.

Technology will also continue to play a role in the investment outlook for 2024 as investors anticipate advances in generative AI enhancing efficiency and productivity across sectors. Global AI startup funding increased by 9% to reach US $50 billion in 2023 and investors will likely deploy further capital into AI in the year ahead.

At the same time, economic uncertainty and higher rates have ushered in a period of introspection for asset managers. The global shift towards passive investment vehicles, coupled with challenges posed by higher borrowing costs and dulled market sentiment, is prompting a recalibration in the asset management industry, with investors looking for bright spots in the global economy.

Saudi Arabia's growing prominence in global investment offers opportunities. The Kingdom's economic diversification and liberalisation measures, and ambitious plans to grow and modernise its capital markets could offer attractive avenues for investors. As Saudi Arabia strengthens its position as a global investment force, it may attract greater attention from investors. With more high-net-worth individuals (HNWIs) heading to the Middle East[20], the Kingdom's strong non-oil sector growth, and strong stock market performance, Saudi Arabia could attract asset managers to play an important role in shaping the future of the global economy.

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