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2023 EEMEA Equities Outlook | EEMEA

Cyclical Shift – Downgrade Middle East; Upgrade EM Europe

After an exceptional year for Middle East outperformance, we see limited 2023 upside on shifting global and local tides. We downgrade Saudi Arabia to EW, Qatar and Kuwait to UW, and keep UAE OW as our top regional pick. Prefer Emerging Europe – upgrade Greece to OW, Poland to tactical OW.

Downgrade Saudi Arabia to Equal-weight: Saudi's multi-year structural growth story remains intact, but a continued pause to outperformance is likely with the Fed peak in sight, a 'funding conundrum' for banks (50% of MSCI Saudi), rising local bond issuance at higher-for-longer yields likely detracting from equities, and a broader EM cyclical recovery underway as per our Asia/EM strategy team's views. Our oil strategist expects Brent prices to rebound to $110/bbl in 2H23, but our new analysis indicates that should Vision 2030 reform-related lending ramp up more than expected, funding challenges will limit incremental earnings impact. A key technical upside risk is foreign ownership limit optionality; our case study indicates that for a number of Saudi stocks, a scenario of full FOL removal could drive 25%+ upside, as well as up to $11bn in passive foreign inflows.

Double downgrade Qatar and Kuwait; Keep UAE Overweight: As with Saudi, Qatar and Kuwait benefited this year from hard currency pegs, low foreign positioning, strong macro, Fed hikes, and resilient earnings. But both lack major reforms or a clear transmission mechanism for higher energy prices to equities. The UAE benefits from a structural boom in its property market, driven in part by LT geopolitical factors. Our Dubai property analysis indicates there is much further pricing upside to go. In Abu Dhabi, we see potential for loan growth upside on rising economic reforms, supported by excess liquidity in the banking sector. The UAE's valuations remain most attractive within the Middle East.

Shift to EM Europe – Upgrade Greece to Overweight; Double Upgrade Poland to tactical Overweight: We expect a continued re-rating in emerging Europe on EM cyclical tailwinds, EM FX strength, and a lot already in the price for challenging EU macro. Our preferred exposure continues to be Greece, which we upgrade to Overweight on high banks' sensitivity to ECB rate hikes, an underestimated balance sheet clean-up, low valuations, and relatively resilient macro. In Poland, we see scope for continued re-rating on exposure to global rotations and off of cycle low valuations, though we see this as a 'window of opportunity'.

In South Africa, our local strategist highlights 5 reasons she expects positive total returns over 2023, including the country benefiting from stronger China growth, potential for fund flows from high local cash positions, and low valuations. Within EEMEA, we keep South Africa Equal-weight, preferring exporters to domestics. **Overall, we see 12% upside to EEMEA equities in 2023.**

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Exhibit 1: Our New EEMEA Country Ratings for a Shifting 2023 Landscape

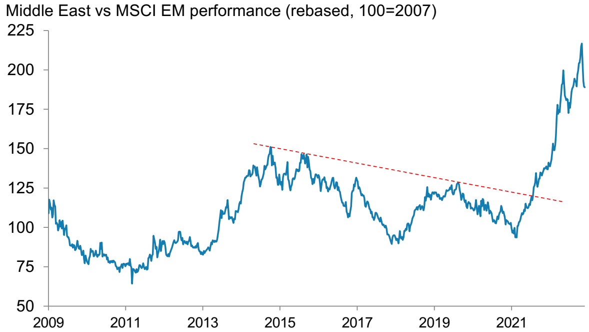
	MS Rating	MSCI EM Weight	MS Rec OW/UW (bp)
UAE	Overweight	1.35%	+20 to +50
Greece	Overweight	0.30%	0 to +20
Poland	Overweight	0.69%	-60 to +10
Saudi Arabia	Equal-weight	4.33%	+45 to 0
South Africa	Equal-weight	3.90%	0
Turkey	Equal-weight	0.51%	0
Czech Republic	Equal-weight	0.15%	0
Egypt	Equal-weight	0.08%	0
Hungary	Underweight	0.19%	-15
Qatar	Underweight	1.11%	+10 to -30
Kuwait	Underweight	1.01%	+5 to -35

Source: MSCI, Datastream and Morgan Stanley Research

What's New: Middle East Downgrade in 6 Charts

Exhibit 2: Following the M. East's sharp outperformance vs EM this year, we expect a number of factors to drive more subdued relative performance in 2023...

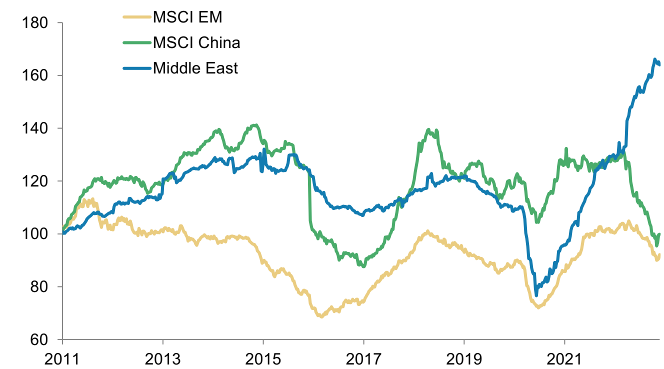
Middle East vs MSCI EM performance (rebased, 100=2007)



Source: Bloomberg and Morgan Stanley Research

Exhibit 3: ...Such as Middle East NTM earnings showing signs of peaking, in contrast to Asia/EM

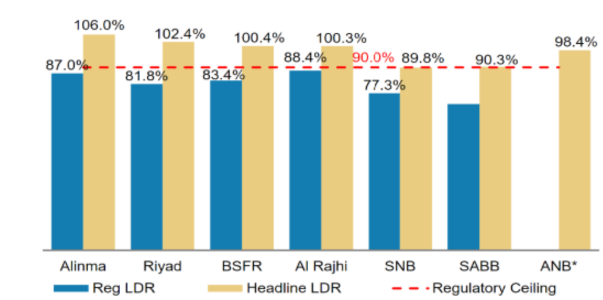
Middle East, China and EM indices: NTM EPS (rebased)



Source: Datastream, Bloomberg and Morgan Stanley Research

Exhibit 4: Saudi banks make up 50% of MSCI Saudi Arabia and are facing a 'Funding Conundrum' with LDRs nearing regulatory limits...

LDR per Bank (3Q22)



Source: Company data, Morgan Stanley Research. Regulatory LDR assigns higher weights to longer term deposits and also includes capital instruments in the denominator. According to SAMA rules, it cannot exceed 90%. SABB doesn't report regulatory LDR, During the 3Q22 results call CFO mentioned it to be in "low to mid 70s" *ANB does not report Regulatory LDR

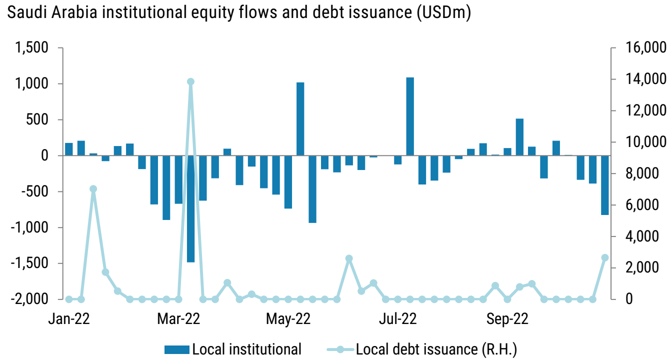
Exhibit 5: ...which means increased reliance on more expensive wholesale funding = any reform-driven upside to loan growth will have reduced earnings upside

Impact on 2023 Earnings		2023 YoY Loan Growth				
		15.0%	17.5%	20.0%	22.5%	25.0%
% of wholesale funding on incremental loan growth	100%	0.0%	-0.1%	-0.1%	-0.2%	-0.2%
	80%	0.2%	0.3%	0.5%	0.6%	0.8%
	60%	0.4%	0.7%	1.1%	1.5%	1.8%
	40%	0.6%	1.2%	1.7%	2.3%	2.8%
	20%	0.8%	1.6%	2.3%	3.1%	3.9%
	0%	1.0%	2.0%	3.0%	3.9%	4.9%

Source: Company data and Morgan Stanley Research estimates

Exhibit 6: Simultaneously, local bond issuance is on the rise in Saudi Arabia and appears to be diverting from local institutional flows...

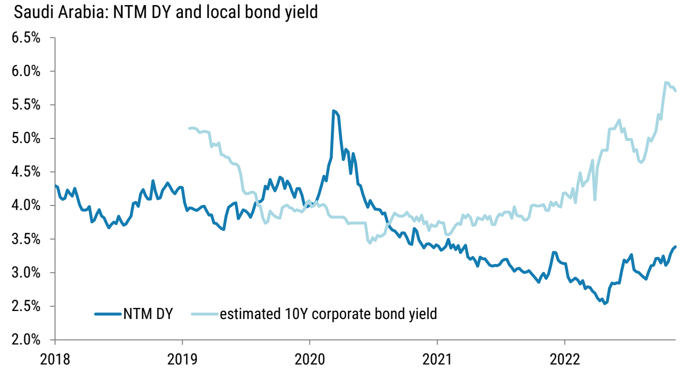
Saudi Arabia institutional equity flows and debt issuance (USDm)



Total local debt issuance including Government and Corporates; Source: Bloomberg, Eikon and Morgan Stanley Research

Exhibit 7: ... given increasingly attractive yields in local debt issuance versus the local equities market

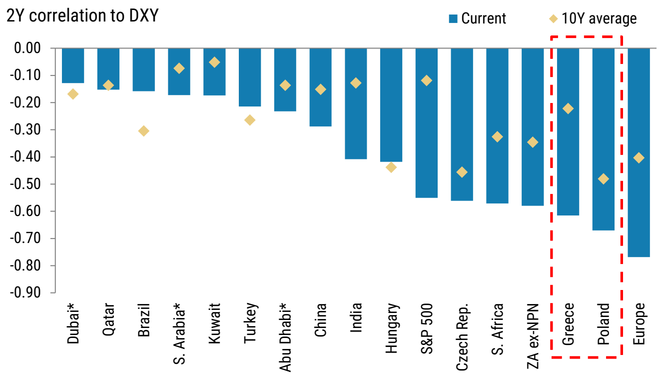
Saudi Arabia: NTM DY and local bond yield



*estimated 10Y corporate bond yield = 10Y gov't local bond yield + 125bp spread; Source: Bloomberg, Eikon and Morgan Stanley Research

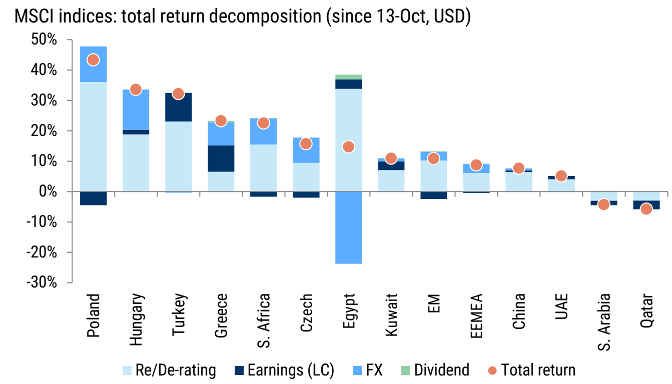
Shift to Emerging Europe in 6 Charts

Exhibit 8: Poland and Greece's negative correlation to the DXY is among the highest globally...



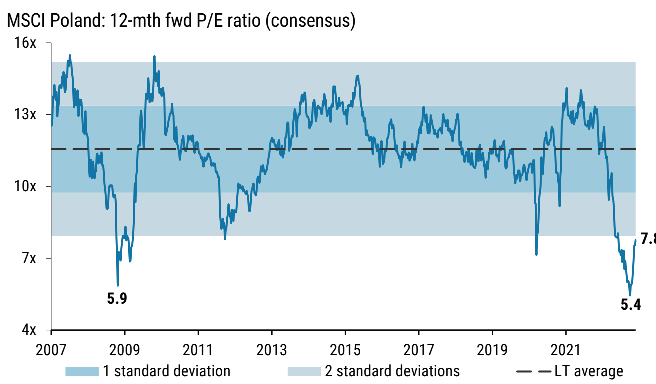
Source: Bloomberg and Morgan Stanley Research

Exhibit 9: ...with EM FX exposure now shifting to a tailwind from a headwind, fueling outperformance in EM Europe



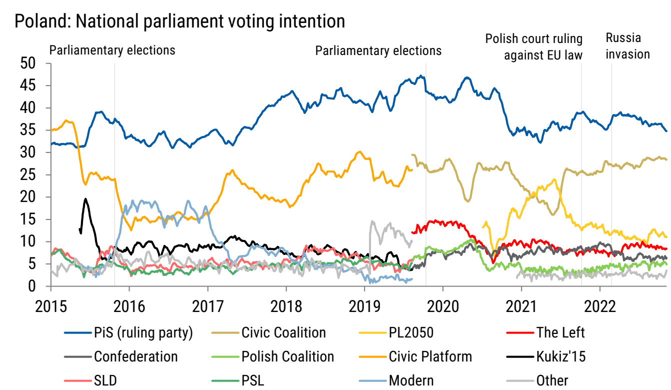
Source: IBES, Datastream and Morgan Stanley Research

Exhibit 10: Poland has re-rated from near-GFC low NTM P/E levels of 5x to a still fairly depressed 7.8x, 2.1 S.D.'s below its LT avg



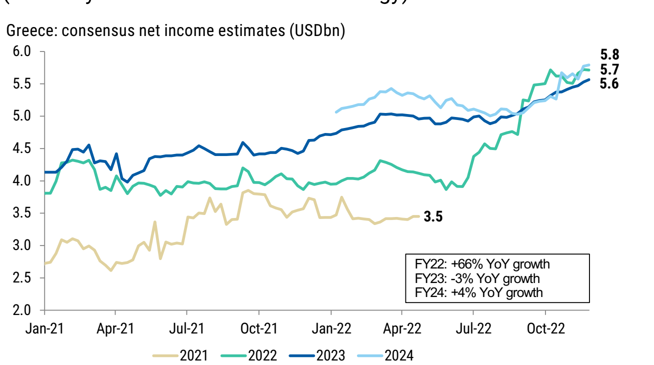
Source: Eikon and Morgan Stanley Research

Exhibit 11: Some equities investors are already starting to look ahead to Poland's parliamentary elections, scheduled for Autumn 2023



Source: POLITICO and Morgan Stanley Research

Exhibit 12: Greece's aggregate 2022 earnings are on a rising path (driven by rate-sensitive banks and energy) ...



Source: Bloomberg and Morgan Stanley Research

Exhibit 13: ...While Greece's valuation discounts vs EM and Europe remain high, roughly in-line vs CEE, despite lower regulatory risks and more resilient macro

	Relative to EM		Relative to Europe		Relative to CEE	
Valuation metric	**Current**	**S.D.**	**Current**	**S.D.**	**Current**	**S.D.**
NTM P/E	-33%	-1.2	-38%	-0.7	-1%	0.4
NTM DY	39%	0.6	34%	1.4	-10%	-0.1
NTM PBV	-38%	2.0	-50%	1.7	-1%	2.3
NTM ROE	-8%	3.0	-18%	2.4	0%	2.5

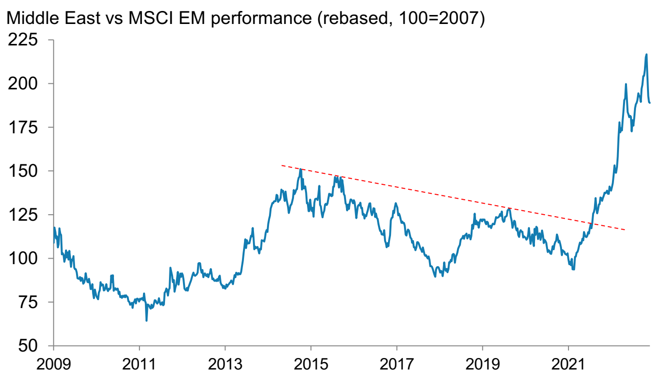
Note: S.D. vs 8-year average; Source: Eikon, IBES, Datastream and Morgan Stanley Research

Saudi Arabia: Time for a Pause; Downgrade to Equal-weight

After a very strong 2022 in which MSCI Saudi Arabia outperformed MSCI EM by 28% (YTD), we expect the recent pause to outperformance to continue into 2023. **The multi-year, structural case for Saudi Arabia remains in place** – sweeping social and economic reforms backed by a higher for longer oil price outlook, coupled with foreign investor positioning still well below benchmark levels – **but for now, both the global and local dynamics have shifted, leading us to downgrade Saudi Arabia equities to a relative Equal-weight**.

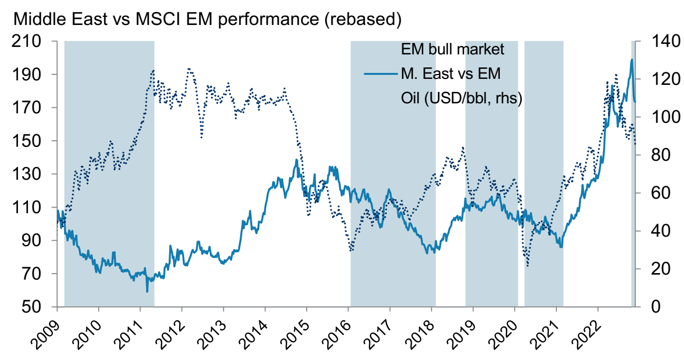
From a global perspective, the following factors have all begun to contribute to Saudi Arabia and Middle East underperformance versus EM: declining US CPI; peaking Fed rates, with investors already looking ahead to the likely start of the rate-cutting cycle from late 2023; and a cyclical rebound in North Asia, which our Asia/EM strategy team expect to continue for Korea and Taiwan in particular (combined 27% weight of MSCI EM vs c. 8% for Middle East). Indeed, Saudi Arabia still trades at a large premium to most of EM, which is likely to close further if more discounted EMs continue to re-rate from lows.

Exhibit 14: Following Saudi / the M. East's sharp outperformance vs EM this year, we expect a number of factors to drive more subdued relative performance in 2023...



Source: Bloomberg and Morgan Stanley Research

Exhibit 15: ...Such as broadly the fact that more defensive Middle East markets tend to underperform during EM recoveries



Source: Bloomberg and Morgan Stanley Research

Locally, pressure on funding costs for Saudi banks (c. 50% of the MSCI Saudi Arabia index) means that even should 2023 corporate loan growth surprise to the upside on the back of economic reforms, **higher costs to fund this growth and resulting pressure on NIMs mean that incremental corporate loan growth would only lead to mild positive revisions to earnings**, on our banks team's estimates. Further, we note the growth in local bond issuance this year (5x the size of this year's Saudi equities issuance) along with rising yields for these new issues (well above Saudi equities' dividend yields). **Our analysis of local equities flows around recent local bond issues suggests local investors are likely shifting from equities into bond markets**, removing some of the support from local equities markets. Given that deepening of local bond capital markets is one of the aims of Vision 2030 reforms, Fed rates and therefore Saudi local bond yields are likely to stay high through most of next year, and Saudi banks in their 'funding conundrum' are increasing wholesale issuance, we anticipate this shift in local market support to equities is likely to remain through most of 2023. Lastly, **local Saudi Arabia equities volumes are falling** largely on the back of reduced retail trading. There are now only 15 Saudi Arabian stocks trading above $20mn ADV in the market (vs 65+ in Brazil, 70+ in MSCI India IMI, and 23 in South Africa – similarly sized markets in MSCI EM but substantially more liquid. This is something the Tadawul exchange is likely to address through 2023, but, for now, it may limit the extent of foreign investment.

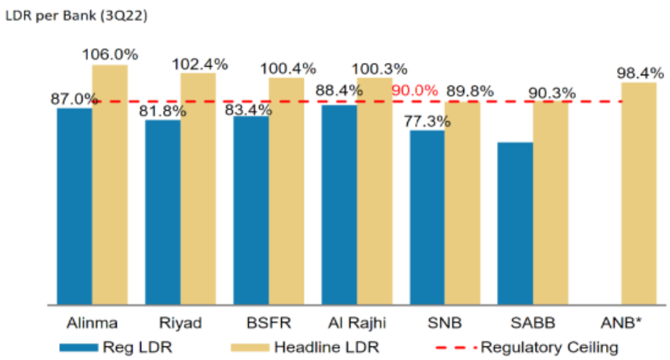
As far as upside drivers keeping us Equal-weight, we anticipate that 2023 may be the year that Saudi Arabia eases foreign ownership limits, given most other GCC countries have already done so and this theme has been ongoing for years. This seems like a straightforward way to boost performance and raise Saudi Arabia's weight in MSCI EM further. We analyze not only the simple passive flows, weight impacts, and stock exposures from this move, but also the likely share price and index level reaction based on prior cases with comparable days to cover. There are also **a number of key dates for oil markets** (December 4 OPEC+ meeting, December 5 EU Russia crude oil embargo and G7 Russia oil price caps introduction, February 5 Russia refined product oil embargo, etc.) with risks tilted to the upside on our oil strategists estimates in the coming year. Despite the Saudi market's largely indirect exposure to oil (Aramco is only an 8% weight of MSCI Saudi Arabia) and our analysis of Saudi banks' reduced earnings sensitivity to incremental loan growth, Saudi equities are still one of the most correlated markets to oil in both EM and globally.

We dive into these and other key Saudi Arabia drivers in the remainder of this section.

Saudi Arabia Banks' 'Funding Conundrum'

As highlighted by our EEMEA banks analyst, Nida Iqbal, Saudi banks are in the midst of a 'Funding Conundrum' - with loan growth having run ahead of deposit growth in recent years and banks' loan to deposit ratios approaching regulatory peaks, banks are increasingly shifting to more expensive wholesale funding markets, leading to declining margins. While this debate has been ongoing in recent months, **what surprises us most from our new analysis is that incremental corporate loan growth would only lead to mild positive revisions to earnings** due to these funding constraints and resulting pressure on net interest margins. This means that even should economic reforms such as the Shareek investment program surprise to the upside in the next year, driving a sharper increase to corporate loan growth, the net result on earnings is likely to be mild.

Exhibit 16: Saudi banks' LDR ratios are nearing regulatory limits ...



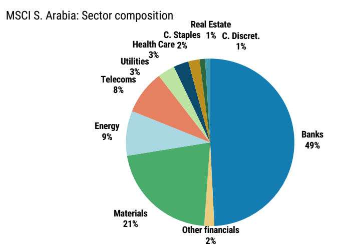
Source: Company data, Morgan Stanley Research. Regulatory LDR assigns higher weights to longer term deposits and also includes capital instruments in the denominator. According to SAMA rules, it cannot exceed 90%. SABB doesn't report regulatory LDR, During the 3Q22 results call CFO mentioned it to be in "low to mid 70s" *ANB does not report Regulatory LDR

Exhibit 17: ...which means any upside surprises to 2023 loan growth on the back of reforms would drive relatively muted sector earnings upside

Impact on 2023 Earnings		2023 YoY Loan Growth				
		15.0%	17.5%	20.0%	22.5%	25.0%
% of wholesale funding on incremental loan growth	100%	0.0%	-0.1%	-0.1%	-0.2%	-0.2%
	80%	0.2%	0.3%	0.5%	0.6%	0.8%
	60%	0.4%	0.7%	1.1%	1.5%	1.8%
	40%	0.6%	1.2%	1.7%	2.3%	2.8%
	20%	0.8%	1.6%	2.3%	3.1%	3.9%
	0%	1.0%	2.0%	3.0%	3.9%	4.9%

Source: Company data and Morgan Stanley Research estimates

Exhibit 18: Banks make up c.50% of the MSCI Saudi Arabia index

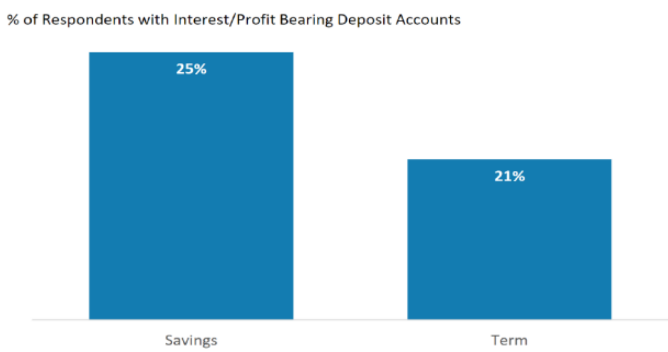


Source: MSCI, Datastream and Morgan Stanley Research

This conundrum is particularly important in light of the fact that banks make up c.50% of the MSCI Saudi Arabia index. Thus a country call on Saudi Arabia equities is closely tied to our view on the Saudi Arabia banks.

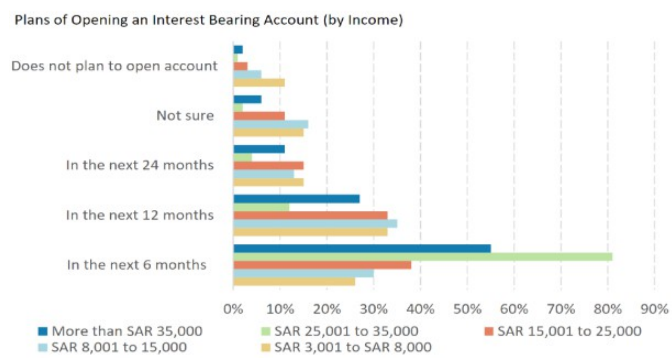
Further, in the current higher rates environment, **Saudi banks are seeing retail deposits shifting from interest-free deposits to interest-bearing** putting further pressure on margins and earnings. Our Saudi banks analysts' recent AlphaWise survey of 1,000 Saudi bank customers showed that c. 52% of respondents are 'very likely' to open a profit/interest bearing account in the next 6 months.

Exhibit 19: Our AlphaWise survey results indicate that ownership of interest bearing accounts remains low ...



See Saudi Banks: The Funding Conundrum for details; Source: AlphaWise, Morgan Stanley Research

Exhibit 20: ... but given the higher interest rate environment, intent to open interest bearing/profit accounts is high



See Saudi Banks: The Funding Conundrum for details; Source: AlphaWise, Morgan Stanley Research

Exhibit 21: A shift out of retail zero-interest demand deposits into either interest-bearing deposits, government savings products or investment products could drive further downside to banks' earnings

Impact on net income	SABB	Riyad	BSFR	SNB	Al Rajhi	Alinma
Scenario #1: Demand deposits shifted into interest-bearing deposits						
Withdrawal of 10% of retail demand deposits	-2.3%	-2.5%	-3.4%	-3.4%	-3.6%	-4.0%
Withdrawal of 20% of retail demand deposits	-4.7%	-4.9%	-6.7%	-6.7%	-7.1%	-7.9%
Withdrawal of 30% of retail demand deposits	-7.0%	-7.4%	-10.1%	-10.1%	-10.7%	-11.9%
Scenario #2: Demand deposits shifted into government savings products, funding replaced by bond issuance						
Withdrawal of 10% of retail demand deposits	-5.2%	-5.5%	-7.5%	-7.5%	-7.9%	-8.8%
Withdrawal of 20% of retail demand deposits	-10.4%	-11.0%	-14.9%	-14.9%	-15.9%	-17.6%
Withdrawal of 30% of retail demand deposits	-15.6%	-16.4%	-22.4%	-22.4%	-23.8%	-26.4%
Scenario #3: Demand deposits shifted into fee-generating, bank managed investment products, funding replaced by bond issuance						
Withdrawal of 10% of retail demand deposits	-4.2%	-4.4%	-6.0%	-6.0%	-6.4%	-7.1%
Withdrawal of 20% of retail demand deposits	-8.3%	-8.8%	-11.9%	-11.9%	-12.7%	-14.1%
Withdrawal of 30% of retail demand deposits	-12.5%	-13.2%	-17.9%	-17.9%	-19.1%	-21.2%

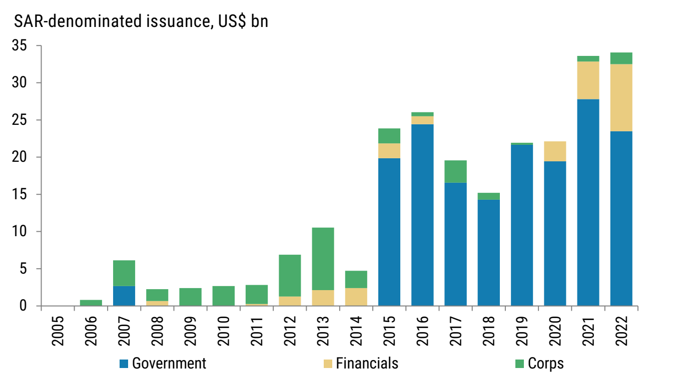
Source: Morgan Stanley Research estimates

Local Bond Issuance Detracting from Equities?

In addition to the conundrum for Saudi banks, there is a conundrum in the local equities versus fixed income debate amid reform momentum. One of the elements of Saudi Arabia's large-scale reforms is the aim to deepen local bond capital markets (see here). Hence, **both local and foreign Saudi bond issuance has been on the rise in recent years, reaching c. $30bn in local issuance this year, c. 5x the level of Saudi's equity issuance**. While this is positive in terms of funding Saudi Arabia's strong economic growth trajectory, it also presents **a second conundrum: with rising Fed rates and largely stable dividend yield levels, the relative appeal of Saudi Arabian bonds has greatly increased versus equities**.

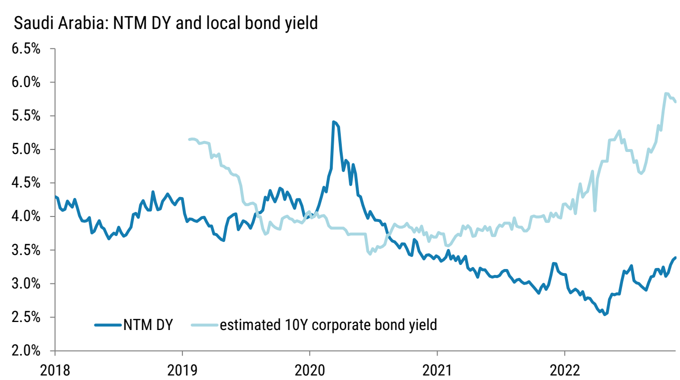
6%+ versus 3%? For example, a recent Al Rajhi sukuk from late October was issued at a 5.5% yield. Should Al Rajhi or other major Saudi Arabia corporates issue near-term, the likely yield at current Fed rate levels would be 5-6%, and our Middle East credit strategists expects these levels to remain in place for most of 2023. In comparison, Saudi Arabia's dividend yield sits at 3.4%. In recent years, many Saudi companies have committed to boost capex to support the economy's growth and/or may be pursuing M&A, both of which leave limited room to grow dividends. Hence, until Fed rates begin to fall over late 2023 to 2024, this dynamic is unlikely to shift.

Exhibit 22: Saudi's domestic bond issuance is on the rise, with a higher proportion of financials and corporate issuance, in line with the reform agenda ...



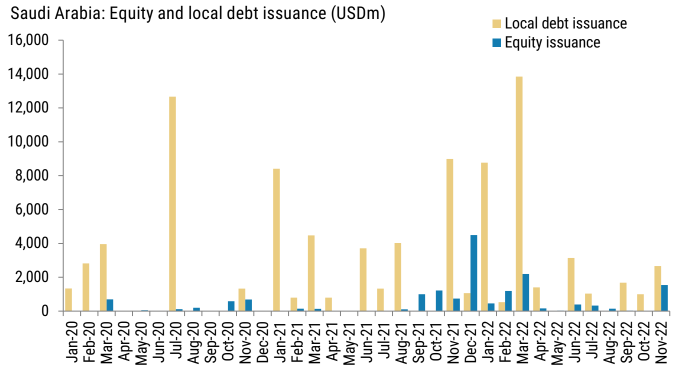
Source: Bloomberg, Morgan Stanley Research; Note: Only includes issuances above US$200 million equivalent.

Exhibit 23: ... but this increased issuance is also coming at an increasingly attractive spread to the local equities yield



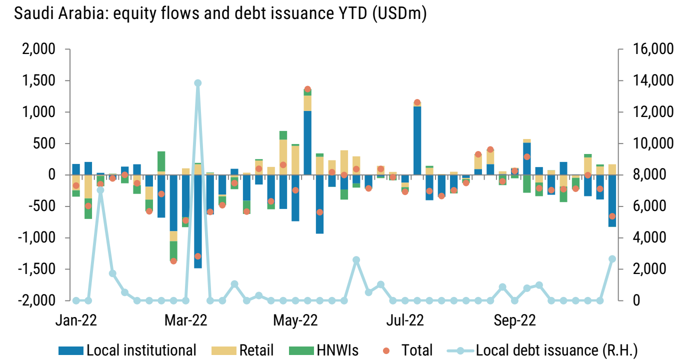
*estimated 10Y corporate bond yield = 10Y gov't local bond yield + 125bp spread; Source: Bloomberg, Eikon and Morgan Stanley Research

Exhibit 24: To put Saudi bond issuance into an equities context, the magnitude of local debt issuance this year has been $30bn, 5x the size of equities issuance



Total local debt issuance including Government and Corporates; Source: Bloomberg, Eikon and Morgan Stanley Research

Exhibit 25: In the weeks leading up to and during a new local debt issuance, Saudi equities tend to see increased outflows from Saudi institutions



Total local debt issuance including Government and Corporates; Source: Bloomberg, Eikon and Morgan Stanley Research

Decelerating US CPI, Peak Fed, Peak USD and Saudi Equities

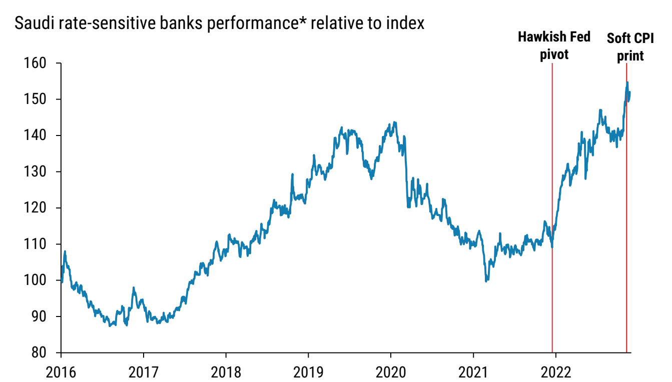
Consensus forecasts Saudi banks' earnings growth at 51% over 2021 to 2023. About half of this growth (ex-Al Rajhi) has been accounted for by rising Fed interest rates, on our banks team's estimates. Hence, with signs of decelerating US CPI and our US economist's expectation that peak Fed rates are reached by January 2023, the market focus is quickly moving on to the prospect of falling rates starting from 4Q23. We thus show sensitivities to 2024 Saudi earnings numbers not to continued Fed hikes in 2023 (well known by now), but to Fed cuts - something that investors will increasingly look ahead to as valuation models shift forward one year, and NTM multiples begin to incorporate 2024 numbers.

Exhibit 26: Investor focus is shifting to Saudi banks' sensitivity to rate cuts rather than hikes ...

Sensitivity to 25bps rate hike/cut			
KSA	Latest Guidance for NIM impact		2024 MSe
	Range	Mid Point	Impact on EPS
SABB	8-10bp	9bp	-3.8%
BSFR	8bp	8bp	-3.1%
Alinma*	3-5bp	4bp	-1.6%
Riyad	2-3bp	3bp	-1.0%
SNB	1-3bp	2bp	-0.9%
Al Rajhi	0bp	0bp	0.0%

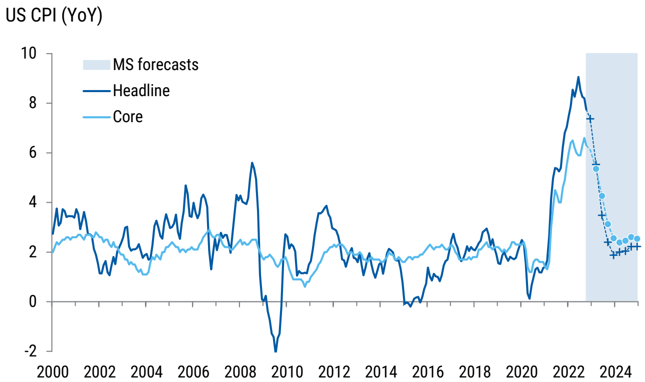
*Alinma at its 3Q22 call mentioned that its NIM sensitivity is now lower than the 4-6bps it had guided to earlier, but did not quantify. We have therefore assumed ~ 3-5bp; Source: Company data and Morgan Stanley Research

Exhibit 27: ... and rate sensitive Saudi banks have just started to underperform the Saudi index after the soft US CPI print



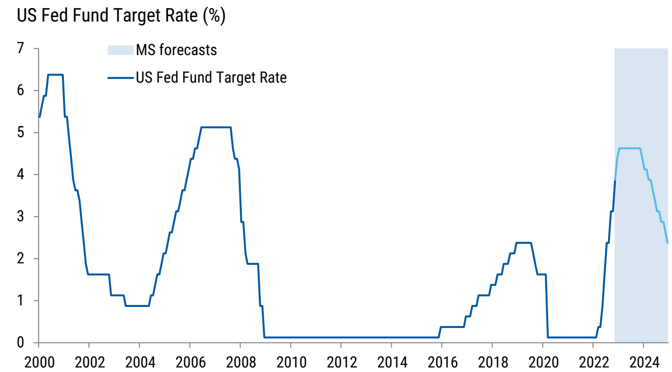
*Equal-weighted performance of SABB, BSFR, Alinma, Riyad Bank, and ANB; Source: Datastream and Morgan Stanley Research

Exhibit 28: Our economist expects US CPI to continue to decelerate sharply over 2023...



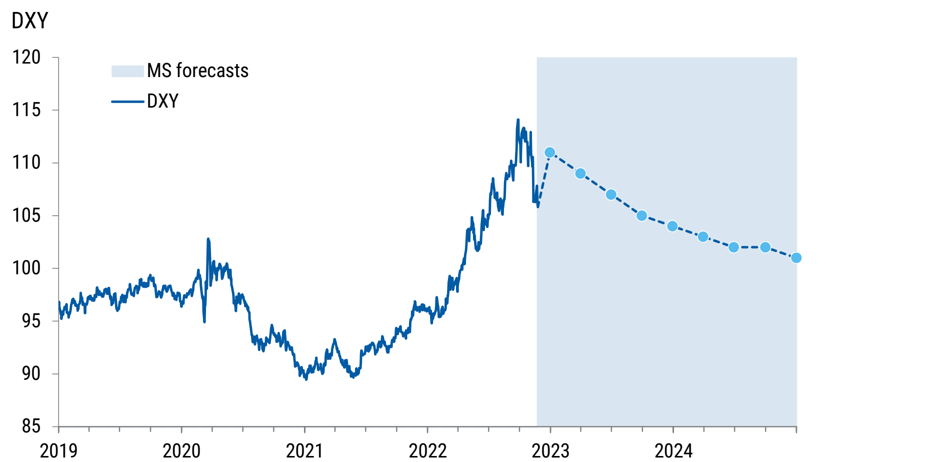
For more details see 2023 US Economics Outlook: By a Whisker (13 Nov); Source: Datastream and Morgan Stanley Research estimates

Exhibit 29: ...And the Fed to deliver two final rate hikes of 50bp in Dec and 25bp in Jan, then keeping the policy rate on hold until YE23 at a range of 4.5-4.75



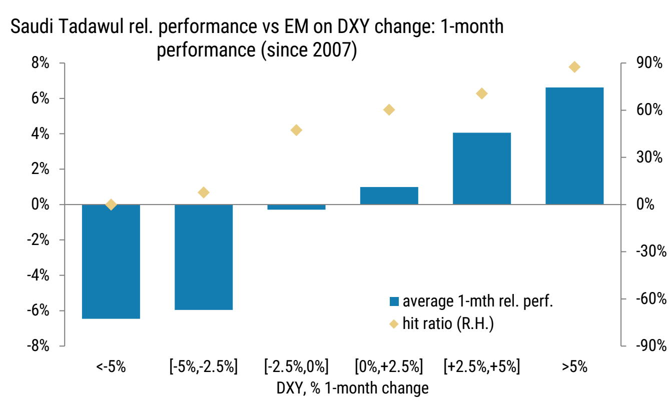
Source: Datastream and Morgan Stanley Research estimates

Exhibit 30: Our FX strategist has called the peak in the USD and expects DXY to gradually decline in the coming years



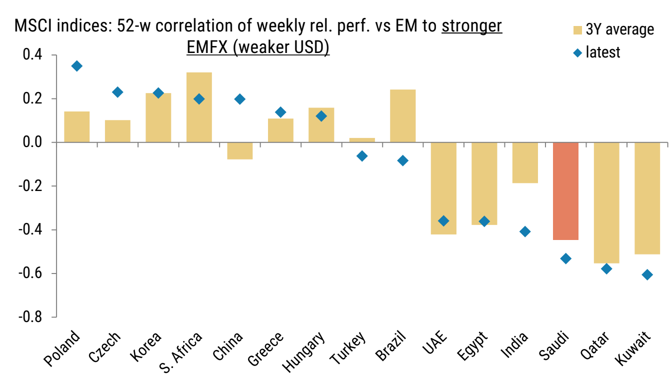
For more details see 2023 Global Macro Strategy Outlook: Sticking the Soft Landing (13 Nov); Source: Datastream and Morgan Stanley Research estimates

Exhibit 31: Should DXY fall sharply (<-2.5% a month, not our FX team's base case), hit ratio for Saudi equities outperformance vs EM falls to <10%



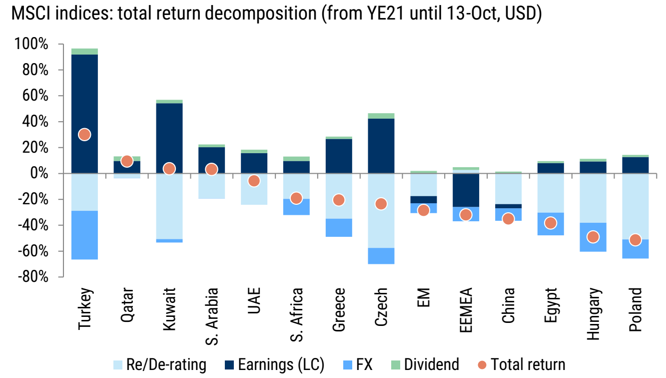
Source: Datastream and Morgan Stanley Research

Exhibit 32: Middle East equities, including Saudi Arabia are unsurprisingly strongly negatively correlated to strengthening EM FX vs USD



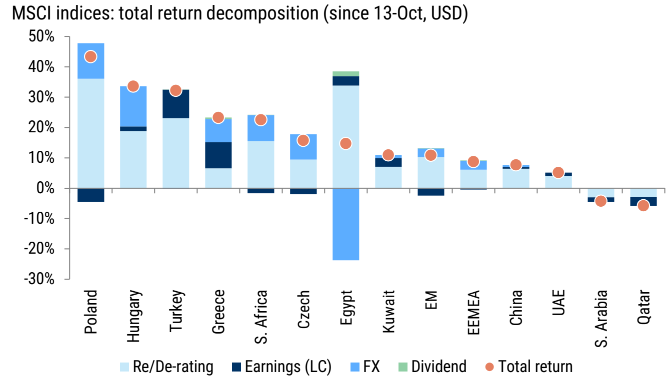
EMFX = MSCI EM currencies index; Source: Datastream and Morgan Stanley Research

Exhibit 33: While FX contributed negatively to EM equities USD returns for most of this year ...



Source: IBES, Datastream and Morgan Stanley Research

Exhibit 34: ... the trend has shifted to EM FX fueling outperformance whilst USD-exposure lags behind



Source: IBES, Datastream and Morgan Stanley Research

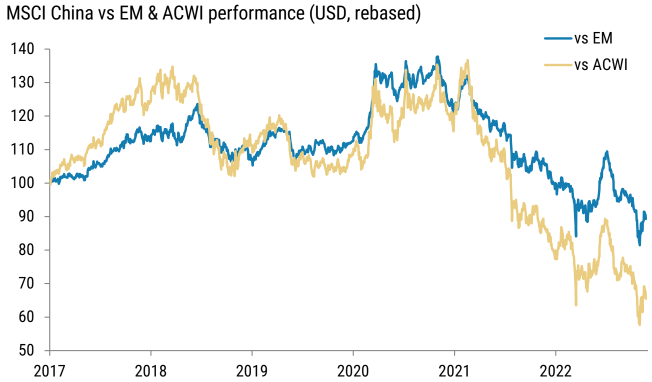
North Asia Recovery Diverting Foreign Flows

Our GEM strategy team published a timely upgrade of Asia/EM equities to Overweight in October and continue to prefer early cycle beneficiaries Korea and Taiwan. China remains an Equal-weight in the team's latest Country Allocation update due to a still wide range of bull/bear targets. They note that "there has been marginal improvement since our last update on geopolitics and property developer support, but Covid cases are rising significantly as the winter approaches. This is challenging the central government's attempts at a more nuanced approach to lockdown measures, in turn leading to public concerns on social media and further weakening of high-frequency data (such as express parcel volumes or mobility indicators)."

Our analysis indicates that a rebound in China (however tactical) and wider North Asia does not bode well for near-term Middle East equities performance, flows, and weights in MSCI EM. The Middle East was a key beneficiary of China/North Asia's declining weight in MSCI EM this year, but with the recent China/North Asia equities rebound, the Middle East's weight in EM has fallen from a peak of 9.1% directly following October's China Party Congress, to 7.7% currently. We still anticipate the Middle East's weight to rise medium-term on easing foreign ownership limits and IPOs/SPOs, but amid a cyclical rebound in large parts of EM, the increased competition for capital may slow this trend.

Exhibit 35: Should North Asia/China's recent rebound continue tactically...

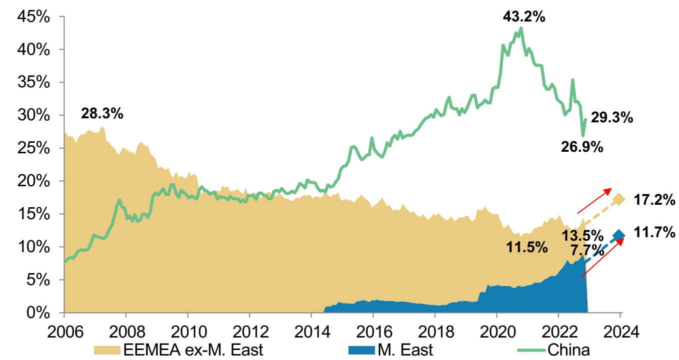
MSCI China vs EM & ACWI performance (USD, rebased)



Source: Datastream and Morgan Stanley Research and Morgan Stanley Research

Exhibit 36: ... the Middle East's weight in MSCI EM will likely continue to reduce, putting less pressure on foreign investors to cover large underweights

Middle East, EEMEA ex-ME & China: weight in MSCI EM

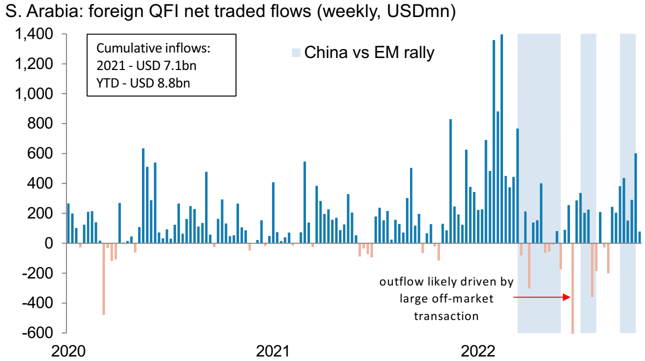


Source: Datastream and Morgan Stanley Research and Morgan Stanley Research estimates

In prior China/North Asia rallies this year, Saudi equities have tended to see increased foreign outflows, and most other major equities markets, including Middle East, tended to see absolute declines. This time appears different with broader, largely passive EM inflows lifting almost all EM boats. For instance, for the week ended November 23, 2022, dedicated EM equity funds (ex-China A) reported net inflows of US$1.2bn, driven by ETF funds, which reported total inflows of U$2bn. This marked the 5th week out of 10 with inflows. That said, Middle East equities, and particularly Saudi Arabia are lagging behind other EMs in the recent rebound (Exhibit 38).

Exhibit 37: Saudi's foreign inflows have tended to slow in past China/North Asia equities rallies as GEM fund flows get diverted

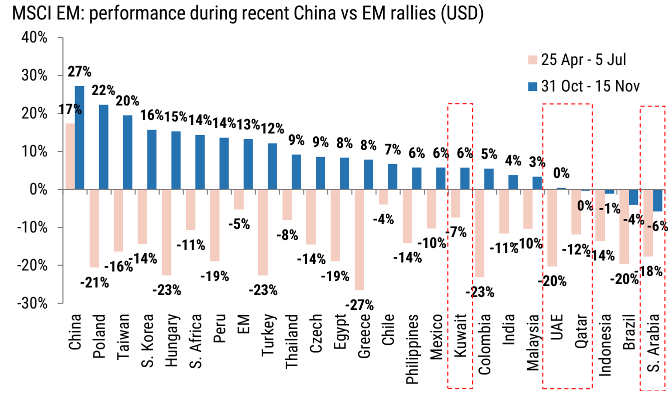
S. Arabia: foreign QFI net traded flows (weekly, USDmn)



Data as of Nov 24, 2022; Source: Tadawul, Bloomberg and Morgan Stanley Research

Exhibit 38: This China/N Asia rally appears different to April-July, as it is lifting most EM boats - though M. East and particularly Saudi are notable laggards

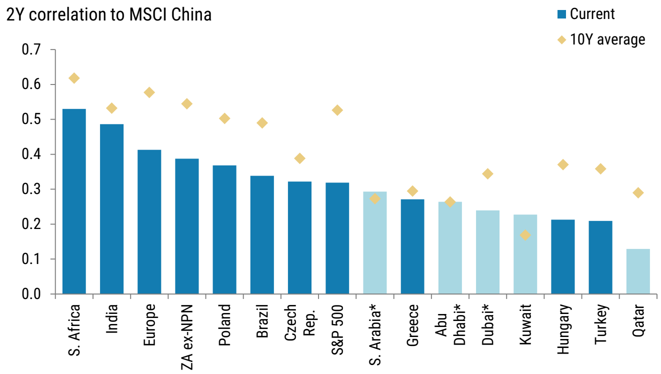
MSCI EM: performance during recent China vs EM rallies (USD)



Source: Datastream and Morgan Stanley Research and Morgan Stanley Research

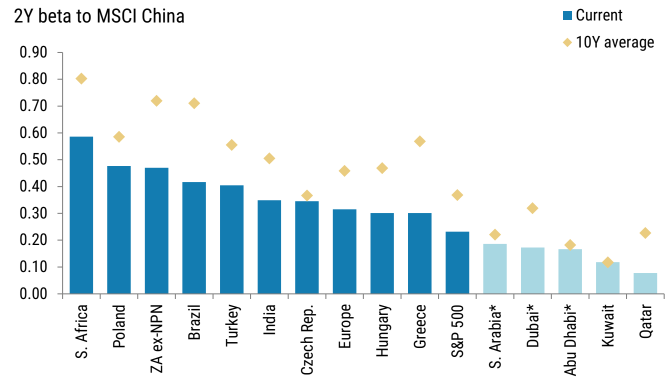
Middle East equities have amongst the lowest beta and correlation to EM and China globally, which is likely contributing to the recent underperformance in these markets. In fact, looking at the performance ratio of highly correlated/beta EEMEA stocks to MSCI China versus low correlation/beta stocks to China, the breakout to the upside for high correlated appears even more sharp than the relative performance of China versus EM (Exhibit 42). Notably, the least correlated/beta list is dominated by Middle East stocks, many of them with negative correlations to MSCI China (Exhibit 41). The same dynamic is true for correlations and beta to broader MSCI EM (see Exhibit 121).

Exhibit 39: Middle East equities have among the lowest correlations to China equities globally ...



*local indices used instead of MSCI; Source: Bloomberg and Morgan Stanley Research

Exhibit 40: ... as well as low beta to MSCI China



*local indices used instead of MSCI; Source: Bloomberg and Morgan Stanley Research

Exhibit 41: Indeed, the stocks least (or even negatively) correlated/beta to China within EEMEA are predominantly in the Middle East ...

	Ticker	Name	Country	Sector	beta vs MSCI China	correl. vs MSCI China
1	ADIB UH	Abu Dhabi Islamic Bank	UAE	Financials	-0.12	-0.12
2	FERTIGLB DH	Fertiglobe	UAE	Materials	-0.10	-0.07
3	MULTIPLY DH	Multiply Group	UAE	Industrials	-0.03	-0.02
4	DEWA DB	DEWA	UAE	Utilities	-0.02	-0.05
5	BINDAWOO AB	BinDawood	Saudi Arabia	C. Staples	-0.02	-0.03
6	ADPORTS DH	Abu Dhabi Ports	UAE	Industrials	-0.02	-0.02
7	EMIRATES DB	Emirates NBD Bank	UAE	Financials	-0.01	-0.01
8	ACWA AB	ACWA Power	Saudi Arabia	Utilities	-0.01	-0.01
9	DALLAH AB	Dallah Healthcare	Saudi Arabia	Health Care	0.00	0.00
10	ETISALAT DH	Etisalat	UAE	Telecom	0.00	0.00
11	TADAWULG AB	Saudi Tadawul Group	Saudi Arabia	Financials	0.00	0.00
12	CARE AB	National Medical Care Co	Saudi Arabia	Health Care	0.01	0.01
13	TAWUNIYA AB	Cooperative Insurance	Saudi Arabia	Insurance	0.01	0.01
14	QNBK QD	Qatar National Bank	Qatar	Financials	0.01	0.01
15	MARK QD	Masraf Al Rayan	Qatar	Financials	0.02	0.02
16	QEWS QD	Qatar Electricity & Water	Qatar	Utilities	0.02	0.03
17	ALDAWAA AB	AL-Dawaa Medical Services Cc	Saudi Arabia	Health Care	0.05	0.05
18	JMT PL	Jeronimo Martins SGPS SA	DM Listed	C. Staples	0.05	0.06
19	ADNOCDIS DH	Abu Dhabi National Oil	UAE	C. Discret.	0.05	0.07
20	SEERA AB	Al Tayyar	Saudi Arabia	C. Discret.	0.06	0.07
21	ALARKAN AB	Dar Al Arkan	Saudi Arabia	Real Estate	0.07	0.06
22	LEEJAM AB	Leejam Sports	Saudi Arabia	C. Discret.	0.08	0.07
23	QGTS QD	Qatar Gas Transport	Qatar	Energy	0.06	0.08
24	SECO AB	Saudi Electricity	Saudi Arabia	Utilities	0.07	0.08
25	ARAMCO AB	Saudi Aramco	Saudi Arabia	Energy	0.06	0.10

Source: Eikon and Morgan Stanley Research

Exhibit 42: ... and EEMEA stocks with low correlation/beta to China are now sharply underperforming those with high correlation/beta (see later section)

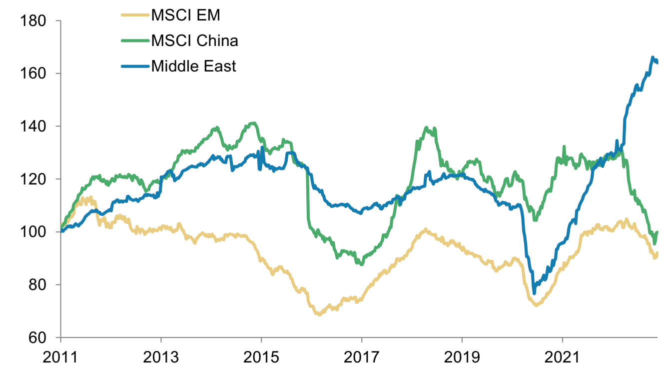
Note: performance of High vs Low China correlation/beta baskets is equal-weighted; Source: Eikon and Morgan Stanley Research

Middle East / Saudi Arabia Earnings Revisions Have Begun to Turn

After an extraordinary year for Middle East earnings growth, momentum has turned in recent months. **Interestingly, just as Saudi's NTM earnings appear to be peaking, Asia and EM earnings are showing some signs of stabilization, suggesting a possible reversal of this year's trend.** Our Asia EM strategy team continue to highlight that the overall earnings outlook for China remains highly uncertain, albeit our house base case of a 2023 economic recovery should ultimately prove supportive. Further, we note that with financials having made up the bulk of Saudi Arabia's country earnings growth in recent years, the fact that our banks analyst has downside to consensus earnings in 2024 where she has factored in Fed rate cuts but consensus estimates likely have not, does not bode well for the trajectory of NTM EPS / earnings revisions relative to MSCI EM. With still high valuations, addressed in the next section, slowing / turning earnings momentum, and a cyclical North Asia rebound, continued Saudi Arabia outperformance versus EM has become less likely for now.

Exhibit 43: After an extraordinary year, Middle East earnings revisions have begun to turn down slightly, while China and EM earnings may be stabilizing

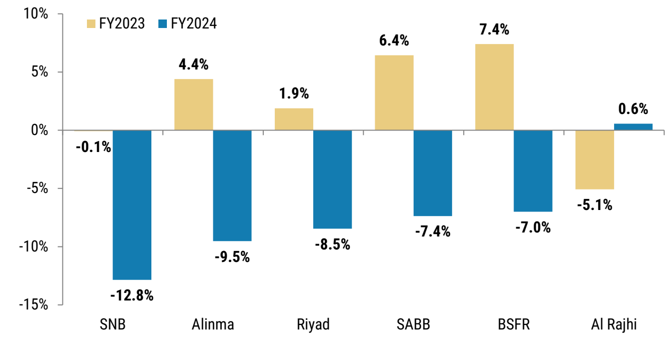
Middle East, China and EM indices: NTM EPS (rebased)



Source: Datastream, Bloomberg and Morgan Stanley Research

Exhibit 44: As NTM EPS rolls forward, Saudi is likely to see downside as rate cuts are incorporated - Our banks analyst's 2024 estimates are well below consensus due to rates

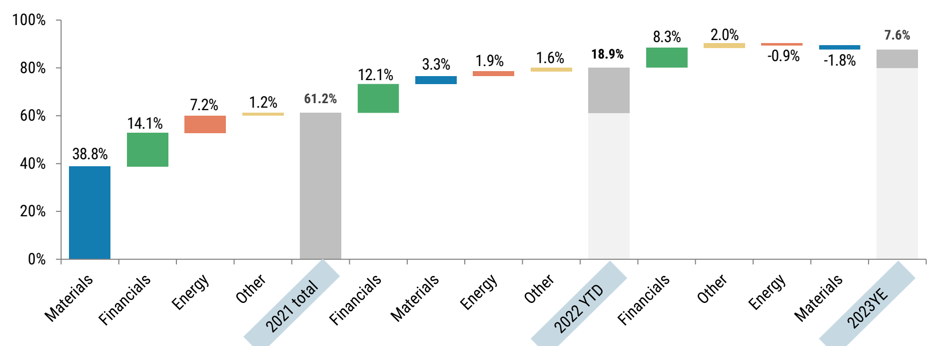
Saudi Banks net income: MSe vs Consensus



Source: Eikon and Morgan Stanley Research estimates (e)

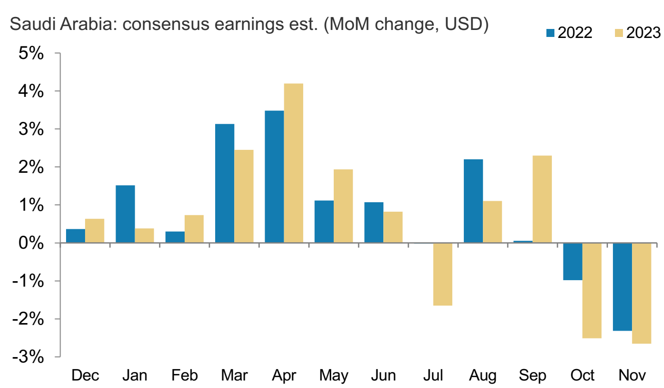
Exhibit 45: With financials having made up for the bulk of Saudi Arabia's earnings growth in recent years, the more mixed outlook for 2023 likely means limited country-level earnings growth

Saudi Arabia: NTM earnings growth breakdown



2023 YE NTM Earnings estimated considering current consensus estimates for 2024FY. Source: Bloomberg, MSCI, Datastream, Eikon, Morgan Stanley Research

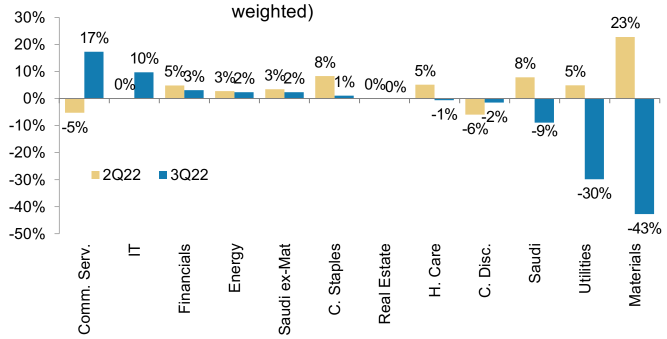
Exhibit 46: Saudi consensus earnings have already begun to turn down in recent months ...



Source: Eikon, Bloomberg and Morgan Stanley Research

Exhibit 47: ... with the 3Q earnings season showing signs of weakness versus a much stronger 2Q

Saudi Arabia: Net Income % surprise vs consensus (Avg Mcap weighted)



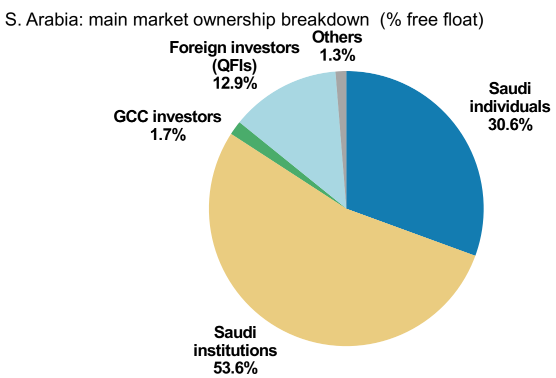
Source: Eikon, Visible Alpha, Bloomberg and Morgan Stanley Research

Declining Market Liquidity a Challenge for Foreign Investors

The Saudi equities market is still predominantly owned by local investors, and retail investors continue to make up the largest though declining share of local trading volumes. One of the challenges for foreign investors beginning to invest in the Saudi equities market is declining liquidity and substantially lower liquidity versus markets of similar weight in MSCI EM (Brazil, South Africa, India, etc.). Currently only 15 Saudi stocks trade above $20mn ADV versus 65+ in Brazil, 70+ in MSCI India IMI, and 23 in South Africa. We believe the substantial decline in retail volumes may be driven by a few factors: a normal dynamic coming out of peak COVID trading volumes, accelerated by substantially increased leisure and entertainment activities, given rapid social reforms and major events such as Riyadh, Jeddah, and 9 other 'Season' festivals around the country.

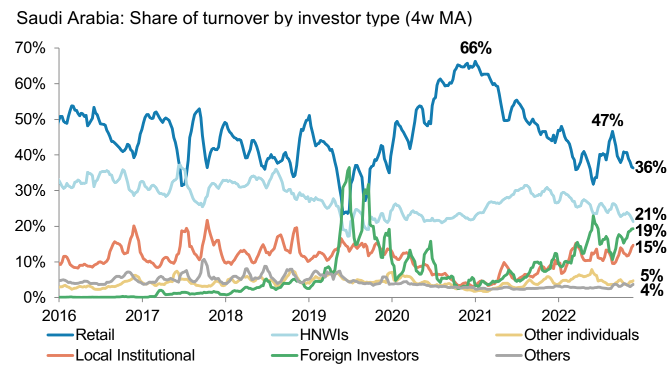
Liquidity dynamics could shift over the course in 2023 on the back of developments to the Tadawul exchange, such as increased shorting volumes and enhanced futures and options trading.

Exhibit 48: Despite foreign inflows, local Saudi investors still hold almost 85% of the country's free float



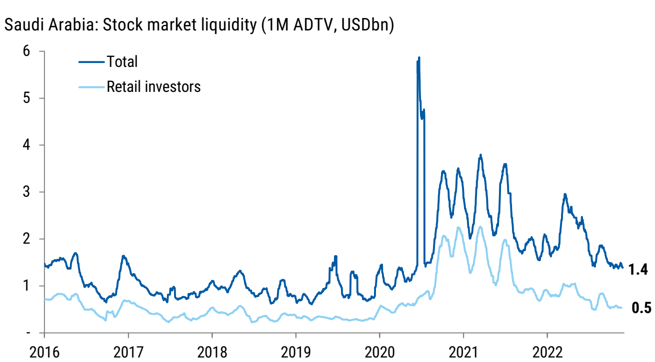
Data as of November 24, 2022; Source: Tadawul and Morgan Stanley Research

Exhibit 49: Saudi retail's share of local equities trading has declined since early September and more broadly has been trending down since early 2021



Data as of November 24, 2022; Source: Tadawul, Bloomberg and Morgan Stanley Research

Exhibit 50: With ebbing retail and total Saudi market trading volumes...



Source: Tadawul, Bloomberg and Morgan Stanley Research

Exhibit 51: ...there are now only 15 stocks in Saudi Arabia which trade with 3M ADTV ≥ USD 20mn

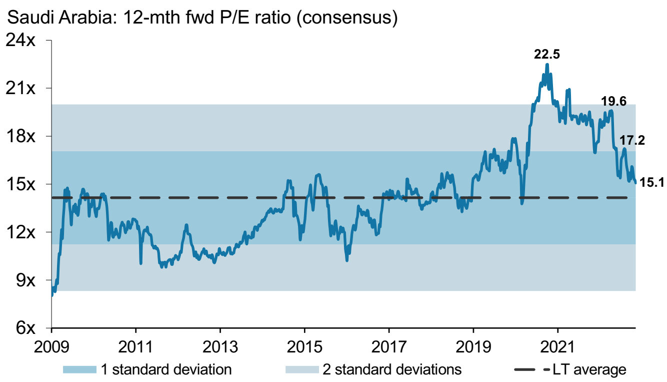
#	Ticker	Company Name	Sector	USD perf. 1M	USD perf. 3M	3M ADTV (USDmn)
1	RJHI AB	Al Rajhi Bank	Financials	-5%	-9%	**102**
2	MAADEN AB	Saudi Arabian Mining	Materials	-15%	-7%	**73**
3	SNB AB	Saudi National Bank	Financials	-20%	-27%	**65**
4	SABIC AB	SABIC	Materials	-11%	-21%	**61**
5	SAFCO AB	Saudi Arabian Fertilizer	Materials	-19%	-14%	**55**
6	ALINMA AB	Alinma Bank	Financials	-6%	-12%	**51**
7	ARAMCO AB	Saudi Aramco	Energy	-8%	-16%	**50**
8	ALARKAN AB	Dar Al Arkan	Real Estate	-19%	-7%	**48**
9	STC AB	Saudi Telecom	Telecom	-3%	-11%	**46**
10	TADAWULG AB	Saudi Tadawul Group	Financials	-28%	-29%	**33**
11	PETROR AB	Rabigh Refining	Energy	-23%	-39%	**31**
12	SIPCHEM AB	Sahara International	Materials	-14%	-25%	**25**
13	ACWA AB	ACWA Power	Utilities	-20%	-21%	**25**
14	BJAZ AB	Bank Aljazira	Financials	-8%	-9%	**21**
15	ELM AB	ELM	IT	-8%	-9%	**21**

Source: Bloomberg and Morgan Stanley Research

Relatively High Valuations

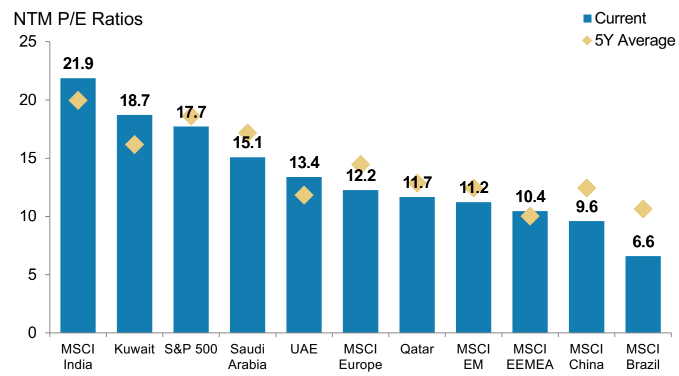
Saudi Arabia trades on 15x NTM P/E, slightly above its long-term average, and well above MSCI EM on 11x and China on 10x. Amid a more subdued earnings outlook from next year and a potential cyclical recovery in North Asia, it is hard to argue that Saudi equities are likely to re-rate substantially in the coming months, especially relative to the MSCI EM index.

Exhibit 52: Saudi trades at 15x NTM P/E, close to its LT average ...



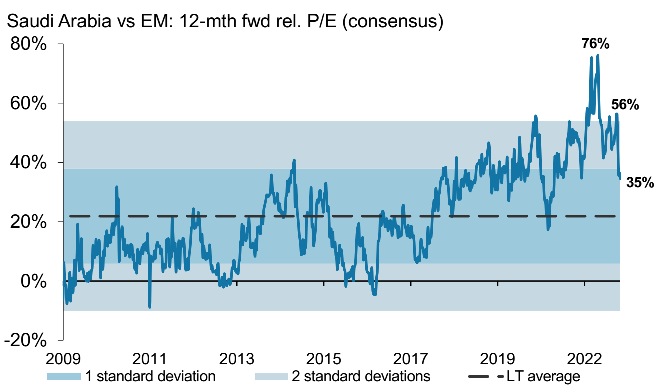
Source: Eikon and Morgan Stanley Research

Exhibit 53: ... but well above MSCI EM and China



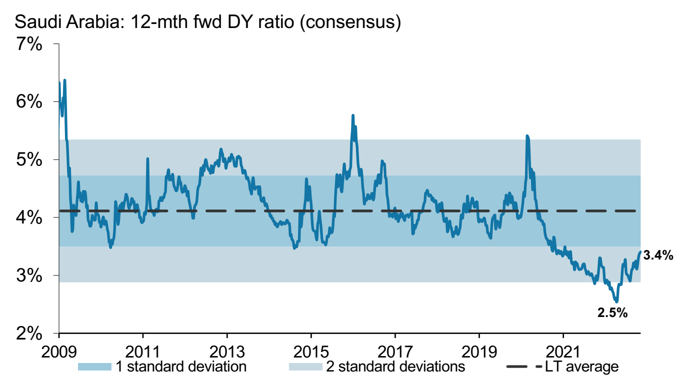
EEMEA country valuation levels are based on Morgan Stanley database estimates; Source: Eikon, Datastream and Morgan Stanley Research

Exhibit 54: Saudi trades at a 35% premium vs EM on NTM P/E, which is 0.8 S.D.'s above its LT average



Source: Eikon and Morgan Stanley Research

Exhibit 55: Saudi's NTM dividend yield is low vs history as companies have committed to capex investment over more meaningful dividend growth



Source: Eikon and Morgan Stanley Research

2023 Upside Risks (Spotlight on FOLs) and Drivers of the Longer-term Structural Story

Despite the 2023 focus of this report, we remind that Saudi Arabia's longer-term, multi-year structural 'Vision 2030' reform story remains intact. We have written about this extensively in a number of pieces this year. Among key themes that are likely to continue to work in 2023 is Saudi Arabia's sharply accelerating growth in expat workers, rapidly growing female labour force participation, broadly increasing wages amid 99th percentile consumer confidence levels, and a very real renewables transition, particularly for domestic energy consumption. As far as the 'funding conundrum', we note that **one significant factor that could resolve this challenge for banks' margins**

more structurally is a liquidity injection from the Saudi Central Bank (SAMA), as per the small injection seen in June this year (see here). While there are no indications that such a move is likely, this would be a key signpost to unlock banks' equities upside potential, in our view.

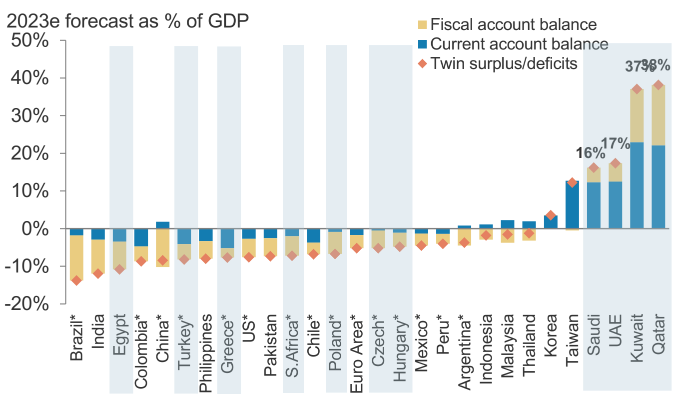
Middle East Equity Strategy: Structural Entry Point (20 Jul 2022)

Saudi Banks: Looking past volatility: Vision 2030 credit playbook (27 Sep 2022)

Middle East Equity Strategy: The Middle East's Renewables/ Energy Transition Opportunity (17 Aug 2022)

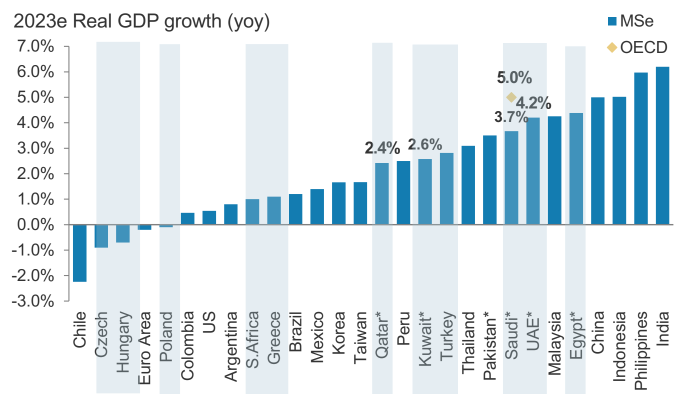
EEMEA Equity Mid-Year Outlook: Structural Winner (16 May 2022)

Exhibit 56: Should the global/EM bear market resume, the Middle East's defensive macro dynamics should come back into focus...



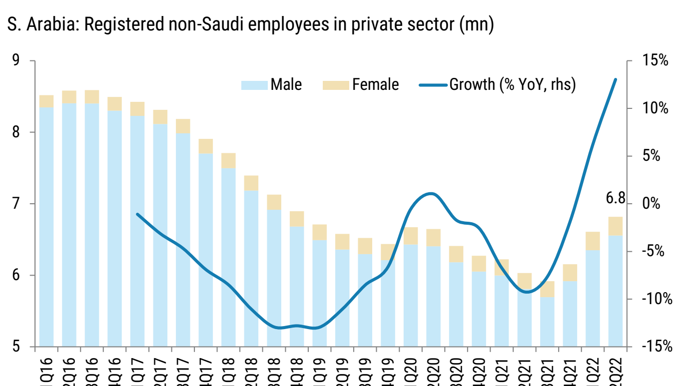
Note: IMF assumes 2023 Brent price at $89/bbl; Blue shading denotes EEMEA countries; *MS Research estimates; Source: IMF and Morgan Stanley

Exhibit 57: ...With resilient growth more likely to remain intact due to idiosyncratic reform drivers, even if global conditions deteriorate



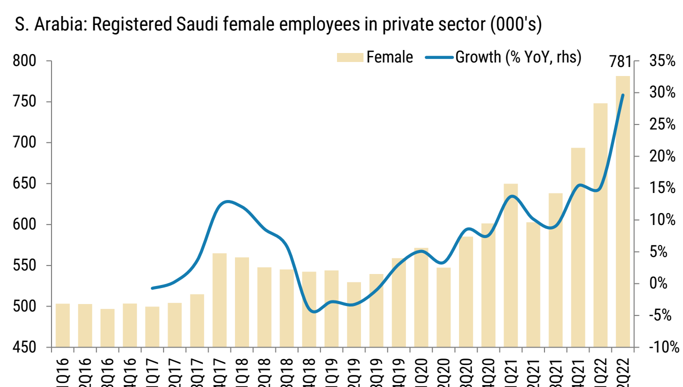
Note: Blue shading denotes EEMEA countries; OECD forecasts Saudi 2023 GDP growth rate to be the second highest in G20 after India; *IMF estimates; Source: OECD, IMF, World Bank and Morgan Stanley Research

Exhibit 58: Among key themes that are likely to continue to work in 2023 is Saudi Arabia's sharply accelerating growth in expat workers...



Source: GOSI and Morgan Stanley Research

Exhibit 59: ...As well as sharply rising female labour force participation



General Authority for Statistics, GOSI and Morgan Stanley Research

For 2023, we also flag a number of upside risks. First, we believe that 2023 may be the year that Saudi Arabia relaxes its foreign ownership limits, given this theme has been ongoing across the GCC region for years and Saudi Arabia is the last major regional market with significant room to relax FOLs. **We take a more in depth look at this upside risk, analyzing the likely share price reaction, resulting weight increase, and ultimate passive flows (post FOL announcement rally) should this catalyst materialize**. We find that within Saudi Arabia, **Al Rajhi, Riyad Bank, Banque Saudi Fransi, Yanbu Cement, Jarir Marketing, Mobily, Advanced Petrochemical and SIBC** would have 20 or higher days to cover on full FOL removal – based on prior cases, **we estimate this could drive absolute share price upside of 25-55%**. At today's price levels, this would also mean $8.3bn in foreign passive inflows, but at higher share prices, following any such announcement and on actual implementation, this figure could rise to $11bn, on our estimates. This compares to $9bn in YTD foreign investor flows into Saudi equities.

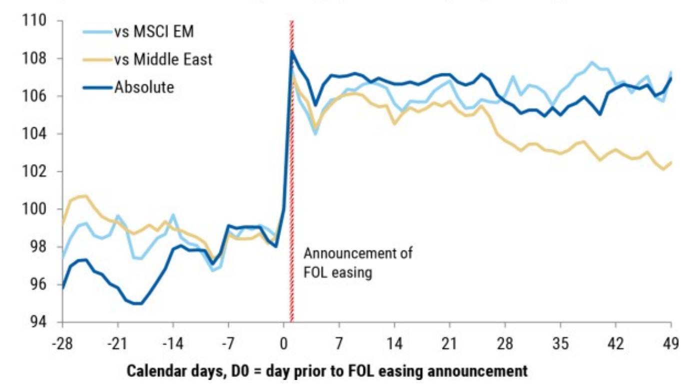
Exhibit 60: On average, UAE/Qatari stocks tended to go up 25% and 54% in absolute and vs EM terms respectively from FOL easing announcement until MSCI implementation

			1D performance on announcement day (USD)				-1W to +1W perf. around implementation day (USD)				Perf. from announcement until MSCI implementation day (USD)**			Est. impact of passive flows (days to cover)	
Ticker	Name	Announcement date	Abs.	vs M. East	vs EM	Exchange implementation	Abs.	vs M. East	vs EM	MSCI implementation	Abs.	vs M. East	vs EM	announc.	implement.
MARK QD	Masraf Al Rayan	Apr'21	5.5%	3.8%	5.1%	Apr'22	9.3%	5.5%	11.9%	May'22	9.4%	-19.6%	35.7%	15	14
QIBK QD	QIB	Apr'21	8.3%	6.5%	7.9%	Apr'22	3.9%	0.6%	6.2%	May'22	37.8%	1.2%	70.9%	35	21
CBQK QD	CBQ	Apr'21	10.0%	8.2%	9.6%	Apr'22	0.4%	0.1%	3.8%	Aug'22	46.9%	11.2%	97.5%	39	32
QIIK QD	QIIB	Apr'21	5.6%	3.8%	5.2%	Aug'22	5.2%	2.2%	3.6%	Nov'22	29.4%	5.7%	86.5%	26	21
QFLS QD	Qatar Fuel Co	Apr'21	4.3%	2.6%	3.9%	Aug'22	6.0%	6.2%	7.1%	Nov'22	9.1%	-10.9%	57.2%	18	23
DIB DB	DIB	Feb'20	0.7%	1.3%	1.0%	Aug'21	3.9%	1.2%	4.3%	Nov'21	-8.7%	-33.4%	-16.4%	17	17
EAND DH	e&	Jan'21	14.9%	14.8%	13.1%	Sep'21	3.4%	6.8%	4.4%	Nov'21	76.5%	43.7%	97.8%	80	55
DU DB	DU	Jan'21	14.6%	14.5%	12.7%	Feb'21	9.6%	2.0%	16.3%	-	-	-	-		
EMAAR DB	Emaar Properties	Aug'22	4.0%	3.0%	2.1%	Oct'22	-3.2%	1.1%	-2.0%	Feb'23*	2.5%	12.1%	8.5%	15	14
Average			**7.5%**	**6.5%**	**6.7%**		**4.3%**	**2.8%**	**6.2%**		**25.4%**	**1.2%**	**54.7%**		

Note: MSCI implementation day is when MSCI puts into effect the FOL changes done by local exchanges; *Expected MSCI implementation date, for more detail see EEMEA Equity Strategy: MSCI index review: EEMEA highlights (Nov'22); **In case of QIIB, QFLS and EMAAR, whose MSCI implementation day is yet to happen, we use prices as of 22nd November 2022 close to calculate their performance; estimated impact of passive inflows based on stock weights and liquidity 1M before the announcement and 1M before the implementation; Source: Eikon and Morgan Stanley Research

Exhibit 61: On the actual FOL easing announcement date, on average, UAE/Qatari stocks rallied 7-8% in absolute and vs EM/M. East terms...

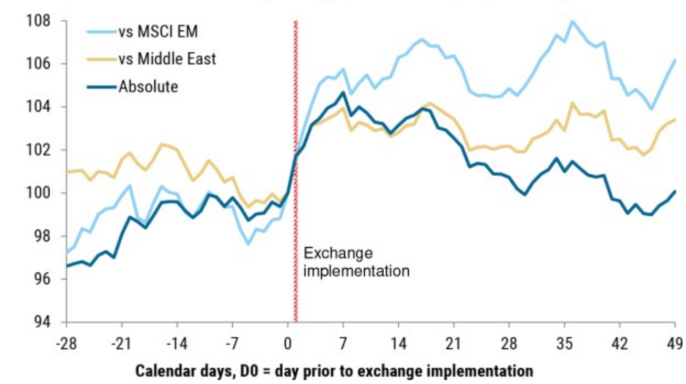
UAE & Qatar cases of FOL easing: Average performance (USD, rebased)



Note: FOL easing announcement date in case of Qatari stocks is when the Qatari cabinet approved a draft law allowing 100% foreign ownership of listed companies on 15th April 2021, and in case of UAE stocks is when a company's management or BoD puts forward a recommendation to increase their FOL; Source: Eikon and Morgan Stanley Research

Exhibit 62: ...and continue to go up in absolute and relative terms until the final rally around the implementation date

UAE & Qatar cases of FOL easing: Average performance (USD, rebased)



Note: Exchange implementation day is when local exchanges put into effect FOL changes following regulatory and shareholder approvals; Source: Eikon and Morgan Stanley Research

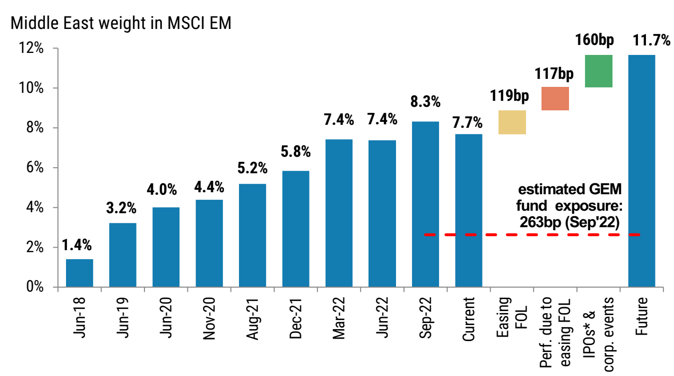
Exhibit 63: Within Saudi, Al Rajhi, Riyad Bank, Banque Saudi Fransi, Yanbu Cement, Jarir Marketing, Mobily, Advanced Petrochemical and SIBC would have 20 or higher days to cover on full FOL removal - based on prior cases, we estimate this could drive absolute upside of 25-55%

		at current prices						Estimated abs. upside		at prices after easing FOL*	
Ticker	Name	MSCI EM weight	MSCI Flows USDm	FTSE flows USDm	Total flows USDm	ADTV USDm	FTSE + MSCI DTC	1D after announc.	from announc. to implem.	Total flows USDm	FTSE + MSCI DTC
1 RJHI AB	Al Rajhi Bank	0.70%	2,843	1,506	4,349	102	43	**9%**	**55%**	6,530	64
2 QACCO AB	Qassim Cement Co/The	0.00%	0	36	36	1	39	**8%**	**50%**	54	59
3 RIBL AB	Riyad Bank	0.21%	0	346	346	11	32	**7%**	**42%**	490	46
4 BSFR AB	Banque Saudi Fransi	0.11%	46	89	135	6	24	**5%**	**31%**	116	21
5 YNCCO AB	Yanbu Cement Co	0.00%	0	31	31	1	22	**5%**	**29%**	40	29
6 JARIR AB	Jarir Marketing Co	0.04%	54	84	138	6	22	**5%**	**28%**	169	27
7 EEC AB	Etihad Etisalat Co	0.06%	103	66	169	8	20	**5%**	**26%**	202	24
8 APPC AB	Advanced Petrochemical Co	0.02%	82	48	130	6	20	**5%**	**26%**	158	24
9 SIBC AB	Saudi Investment Bank/The	0.04%	17	39	56	3	20	**5%**	**25%**	49	17
10 ALMARAI AB	Almarai Co JSC	0.06%	0	93	93	5	19	**5%**	**25%**	116	24
11 ALINMA AB	Alinma Bank	0.14%	512	395	907	51	18	**4%**	**23%**	1,079	21
12 SACCO AB	Saudi Cement Co	0.00%	0	37	37	2	16	**4%**	**21%**	45	20
13 SAVOLA AB	Savola Group/The	0.03%	29	29	57	4	15	**4%**	**20%**	63	17
14 SIPCHEM AB	Sahara International Petrochem	0.06%	203	129	332	25	14	**4%**	**17%**	376	15
15 SIIG AB	Saudi Industrial Investment Gr	0.03%	85	59	145	11	13	**3%**	**17%**	162	15
16 YACCO AB	Yamama Cement Co	0.00%	0	25	25	2	13	**3%**	**17%**	30	15
17 BJAZ AB	Bank Al-Jazira	0.04%	139	86	225	21	11	**3%**	**14%**	247	12
18 KAYAN AB	Saudi Kayan Petrochemical Co	0.03%	47	35	82	9	9	**3%**	**12%**	86	10
19 SOCCO AB	Southern Province Cement Co	0.00%	0	7	7	1	8	**2%**	**10%**	8	8
20 TAWUNIYA AB	Co for Cooperative Insurance/T	0.00%	0	27	27	4	6	**2%**	**8%**	30	7
21 SNB AB	Saudi National Bank/The	0.50%	0	413	413	65	6	**2%**	**8%**	446	7
22 EMAAR AB	Emaar Economic City	0.01%	0	29	29	5	6	**2%**	**8%**	32	7
23 AOTHAIM AB	Abdullah Al Othaim Markets Co	0.00%	0	20	20	3	6	**2%**	**8%**	22	7
24 NIC AB	National Industrialization Co	0.02%	43	33	76	13	6	**2%**	**8%**	79	6
25 ALARKAN AB	Dar Al Arkan Real Estate Devel	0.03%	134	97	231	47	5	**2%**	**6%**	238	5

*We assume weight increase before the FOL implementation driving additional inflows from passive funds, assuming all else equal. The estimated upside is based on prior cases of easing FOL as shown on Exhibit 60. Source: Datastream, Bloomberg, MSCI, FTSE, Morgan Stanley Research

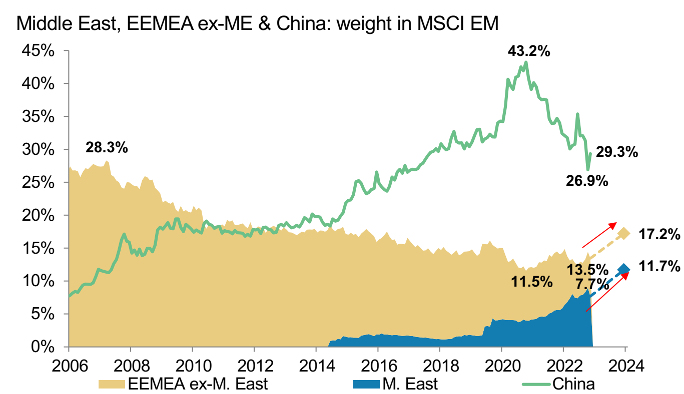
Still Low Foreign Positioning: We remind that GEM fund positioning in the Middle East continues to sit well below benchmark weights, at 2.63% as of September 30, 2022, versus a current MSCI EM benchmark weight for the region of 7.7%. Should upside catalysts such as FOL easing come through, as well as already announced SPOs and listed IPOs joining the index, we estimate the weight of the Middle East is likely to rise medium-term to at least 11.7%. That said, recent China and North Asia outperformance, which our GEM strategy team expects to continue, is driving Middle East underperformance for now and a falling Middle East weight in MSCI EM. This likely reduces pressure on GEM investors to cover significant underweights.

Exhibit 64: GEM funds remain significantly underweight M. East equities - FOLs, as well as equity issuance, should continue to drive this weight up structurally...



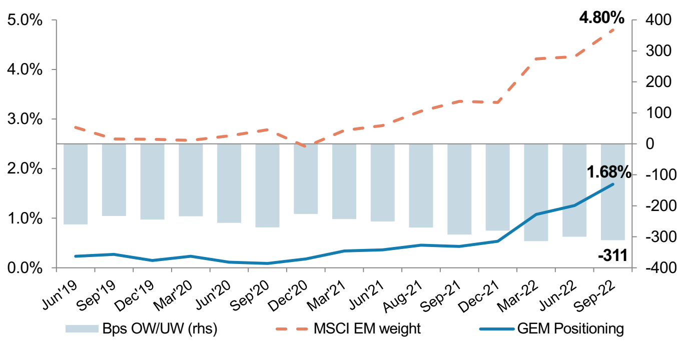
Source: Datastream MSCI, FTSE, Morgan Stanley Research

Exhibit 65: ...Though the recent China/North Asia rebound has led to a somewhat falling Middle East weight in MSCI EM due to recent underperformance



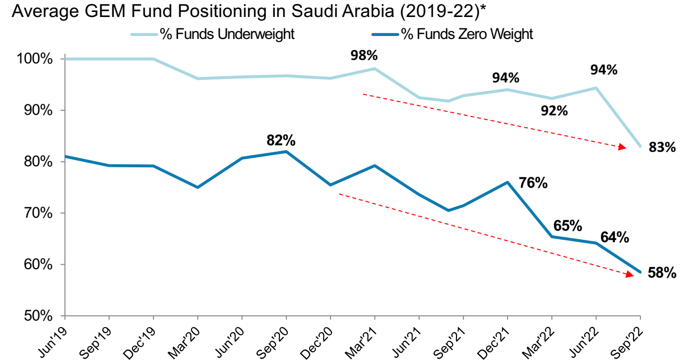
Source: Datastream and Morgan Stanley Research

Exhibit 66: S. Arabia: GEM funds' absolute positioning increased this year, but below the pace of the rise in the benchmark weight



*Our sample group of GEM funds varies month-to-month so is not directly comparable though can serve as a rough guide of changing positioning over time; Source: FactSet, Morgan Stanley Research

Exhibit 67: As of September, 58% of GEM funds still had zero exposure to Saudi equities and 83% of funds were UW

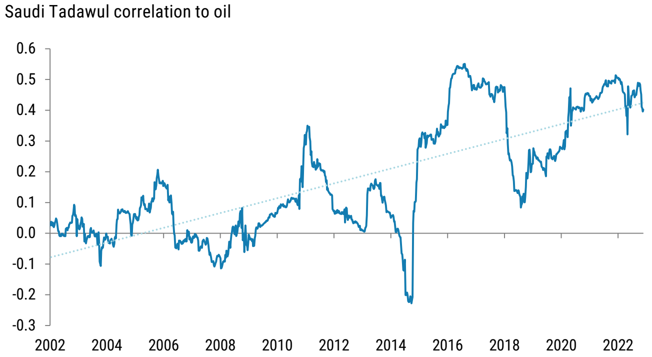


*Our sample group of GEM funds varies month-to-month so is not directly comparable though can serve as a rough guide of changing positioning over time; Source: FactSet, Morgan Stanley Research

Oil price upside: While we see reduced Saudi banks equities' earnings sensitivity to any pick-up in reform-related loan growth, the fact remains that Saudi equities correlation to oil prices is among the highest in MSCI EM. We provide a list of stocks with the highest correlations and beta to oil prices in the event of a rebound. It's worth noting that at this time, the Middle East's most correlated / high beta stocks to oil are 2.4 S.D.'s oversold relative to low correlation / beta stocks. There are a number of important dates on the horizon for oil prices, which could drive upside: December 4 OPEC+ meeting; December 5 EU embargo on Russian crude comes into effect, as well as possible price caps; February 5 EU embargo on Russian refined products. Our oil strategist, Martijn Rats, notes other factors to consider into 2023: the recovery in aviation, signs of China re-opening, diesel tightness, capital discipline in Shale, and the end of SPR releases. Overall, Martijn expects Brent oil prices to rebound to $110/bbl by 2H23. This should be broadly supportive for Saudi equities. See: The Oil Manual: Seven Uncertainties for 2023 (24 November).

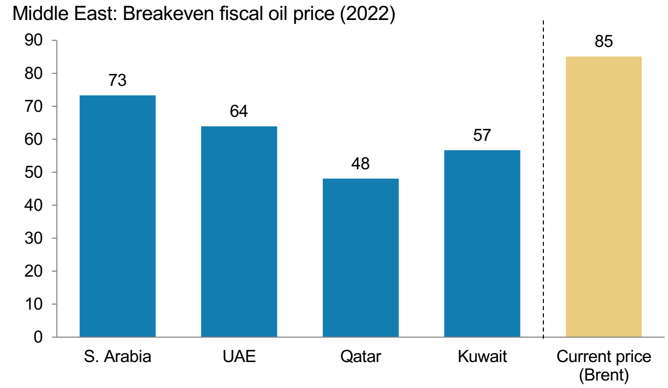
Defensive attributes: Of course the global backdrop will also be important to determining Saudi Arabia's relative performance in 2023. Any deterioration, be it geopolitics or earnings dynamics, would drive increased demand for 'safe haven' / defensive exposure in the USD and likely in the Middle East. As we have written about, Middle East equities tend to outperform EM in bear markets and underperform in bull markets. An exceptionally strong relative macro drop supports this dynamic more than usual.

Exhibit 68: Saudi equities performance correlation to oil has been rising structurally



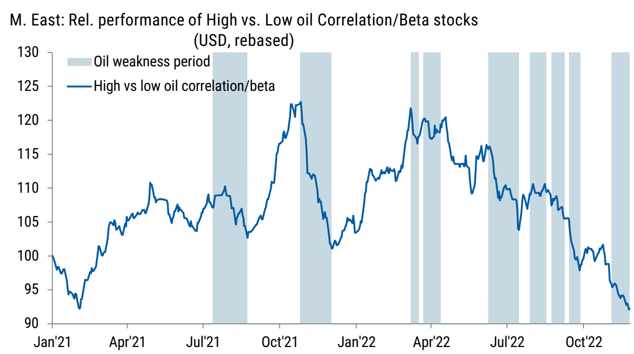
2Y correlation of weekly returns; We adjust the correlation from the temporary drop in oil prices and global equity markets in March'20 as it inflates the correlation between the series; Source: Bloomberg and Morgan Stanley Research

Exhibit 69: Local investors cite $90/bbl as a key level supporting their conviction in reform momentum, still comfortably above fiscal breakevens



Source: IMF, Eikon and Morgan Stanley Research

Exhibit 70: Amid the recent oil price pullback, the Middle East's high oil correlation/beta stocks have been underperforming low oil correlation/beta stocks...



Source: Eikon and Morgan Stanley Research

Exhibit 71: Should oil prices begin to rebound, we would expect Middle East stocks with high oil correlation/beta to begin to outperform

	Ticker	Name	Country	Sector	vs 12M fwd oil	
1	SIPCHEM AB	Sahara International	Saudi Arabia	Materials	0.73	0.48
2	NIC AB	National Industrialization	Saudi Arabia	Materials	0.65	0.51
3	BOROUGE DH	Borouge	UAE	Materials	0.63	0.42
4	IQCD QD	Industries Qatar	Qatar	Industrials	0.53	0.47
5	ALBI AB	Bank AlBilad	Saudi Arabia	Financials	0.53	0.40
6	SIIG AB	Saudi Industrial Investment	Saudi Arabia	Materials	0.50	0.40
7	MAADEN AB	Saudi Arabian Mining	Saudi Arabia	Materials	0.58	0.33
8	AMAK AB	Al Masane Al Kobra Mining	Saudi Arabia	Materials	0.65	0.32
9	SABIC AB	SABIC	Saudi Arabia	Materials	0.41	0.43
10	YANSAB AB	Yanbu	Saudi Arabia	Materials	0.44	0.38
11	BJAZ AB	Bank Aljazira	Saudi Arabia	Financials	0.45	0.36
12	PETROR AB	Rabigh Refining	Saudi Arabia	Energy	0.52	0.33
13	TADAWULG AB	Saudi Tadawul Group	Saudi Arabia	Financials	0.56	0.31
14	ADNOCDRI DH	Adnoc Drilling	UAE	Energy	0.47	0.33
15	KAYAN AB	Saudi Kayan	Saudi Arabia	Materials	0.43	0.35
16	ALINMA AB	Alinma Bank	Saudi Arabia	Financials	0.40	0.38
17	RJHI AB	Al Rajhi Bank	Saudi Arabia	Financials	0.36	0.36
18	SAFCO AB	Saudi Arabian Fertilizer	Saudi Arabia	Materials	0.43	0.31
19	APPC AB	Advanced Petrochemical Co	Saudi Arabia	Materials	0.35	0.32
20	ZAINKSA AB	Mobile Telecommunications Co Sauc	Saudi Arabia	Comm. Serv.	0.29	0.35
21	AGLTY KK	Agility Public Warehousing	Kuwait	Industrials	0.41	0.30
22	ARAMCO AB	Saudi Aramco	Saudi Arabia	Energy	0.26	0.40
23	RIBL AB	Riyad Bank	Saudi Arabia	Financials	0.36	0.31
24	FERTIGLB DH	Fertiglobe	UAE	Materials	0.43	0.27
25	ADPORTS DH	Abu Dhabi Ports	UAE	Industrials	0.47	0.25

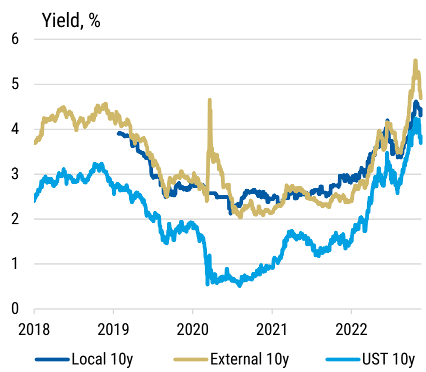
Note: 2Y beta and correlation of weekly returns vs 12-mth fwd oil contract; when stock had less than 2Y period of price history, we considered the longest historical data available and only stocks with ADTV ≥ 3 USDmn; Source: Bloomberg and Morgan Stanley Research

Saudi Fixed Income: Increasing Appeal for Local Investors

Pascal Bode

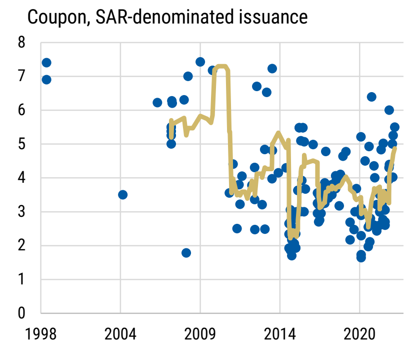
One of the key debates in the Saudi onshore investment space is the potential for rotation from equities into the domestic fixed income space, where yields have risen substantially. Local and external markets now offer around 4.5%+ at the 10-year point of the curve, with more spread pick-up to be had further along the credit spectrum in the corporate and financial markets, where yields run up to 6%. However, the majority of capital should continue to be allocated to the Saudi government local sukuk curve principally, which constitutes around 80% of the SAR-denominated outstanding bond universe.

Exhibit 72: 10-year yields peaked in late October and have fallen slightly since the latest US CPI print



Source: Bloomberg, Morgan Stanley Research

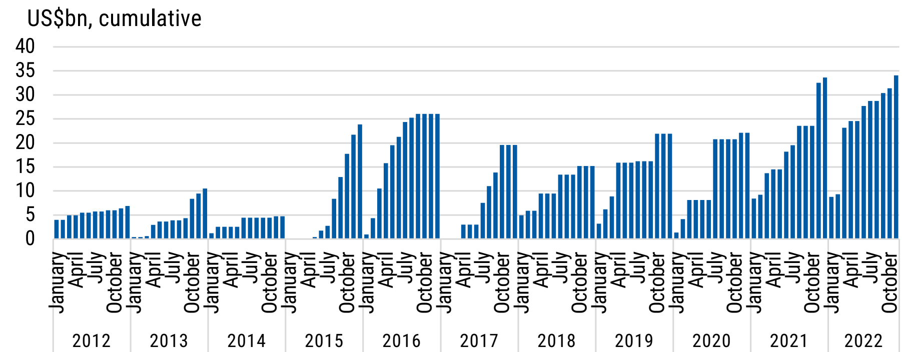
Exhibit 73: Issuance costs as proxied by coupons have risen over the past few months



Source: Bloomberg, Morgan Stanley Research

Given the dollar peg, the Saudi Arabian Monetary Authority (SAMA) has for the most part matched the Fed's hiking path, bringing the repo rate to 4.5%. If SAMA continues to match Morgan Stanley's expectations for Fed hikes, the rate would end up just 75bp higher in March, at 5.25%, though the belly and long end of the curve are unlikely to match further rises in yield, especially as end-2023 cuts come into focus. In fact, local 10-year yields are already more than 100bp below SAIBOR, while the external 10-year now trades in line with 3M USD LIBOR. These considerations may foster increased demand for bonds as investors increasingly look to add fixed income exposure towards the end of the hiking cycle, especially where carry is attractive too.

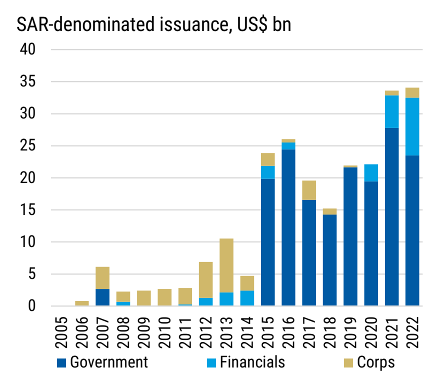
Exhibit 74: Nominal SAR-denominated issuance year to date now exceeds 2021 full-year levels



Source: Bloomberg, Morgan Stanley Research; Note: Only includes issuances above US$200 million equivalent.

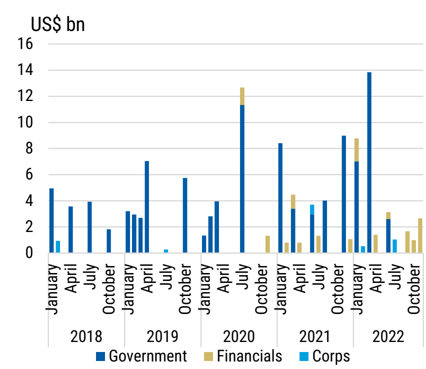
On issuance, nominal volumes now exceed last year's record, but the structure of issuance is changing. For one, bank issuance has risen noticeably further both in dollar terms and as a percentage of total issuance. This largely relates to greater demand for wholesale funding as loan growth remains substantially above deposit growth (see Saudi Banks: The Funding Conundrum, November 18, 2022). Bank issuance in 2022 started strong in January and resurged in September-November following a period of more muted volumes as the primary market softened due to the Russia/Ukraine conflict.

Exhibit 75: The structure of the Saudi domestic market is changing, with financials in particular playing a more important role



Source: Bloomberg, Morgan Stanley Research; Note: Only includes issuances above US$200 million equivalent.

Exhibit 76: Bank issuance spiked in January and September-November, while initially strong government issuance has been muted since April



Source: Bloomberg, Morgan Stanley Research; Note: Only includes issuances above US$200 million equivalent.

Second, while government issuance spiked around the absorption of the KSA US$4.5 billion sukuk in March 2022, issuance from this source has remained comparatively muted since then, despite slightly lower funding costs locally than externally. This likely is a product both of central government fiscal surpluses and greater issuance restraint due to rising borrowing costs and deteriorating onshore liquidity.

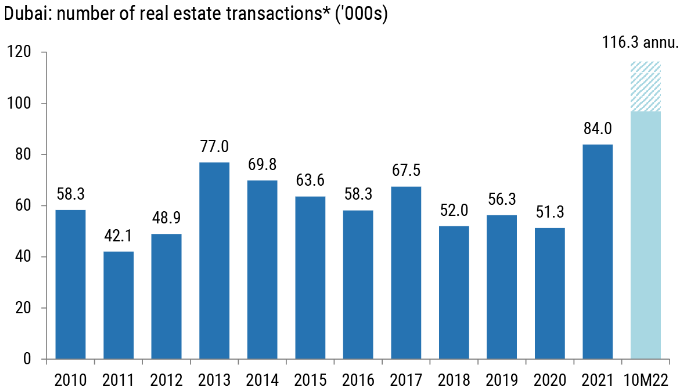
UAE: Our Preferred Middle East Market

We remain Overweight The UAE and increase our relative allocation. In Dubai, the property market is booming, while in Abu Dhabi, structural economic reforms coupled with higher-for-longer energy prices support a multi-year economic growth story. In addition, positive earnings momentum and relatively cheap valuations compared to other main Middle East markets support our constructive view. We note that our GEM strategy team upgraded UAE to overweight in an Emerging Market context along with this note, see here.

Dubai's structural property boom. Real estate transactions have risen to historical highs, prices continue to increase but still remain far from historical peaks in 2008 and 2014 (Exhibit 80) and, importantly, significantly below other global cities (Exhibit 81). We continue to see many tailwinds for the property sector on the back of an increasingly multipolar world, reform momentum (golden visas, shift to Monday-Friday work week), attractive prices on a square meter basis in a global context, education availability, high safety levels, and more, all suggesting to us that these trends are here to stay, and may be fuelled further as and when China relaxes restrictions around foreign travel. Meanwhile, supply is not keeping up with the pace of demand, and geopolitics coupled with this year's golden visa reforms have opened the door to waves upon waves of increased demand.

Exhibit 77: This year Dubai real estate sales have already broken recent years' historical records in terms of number of transactions ...

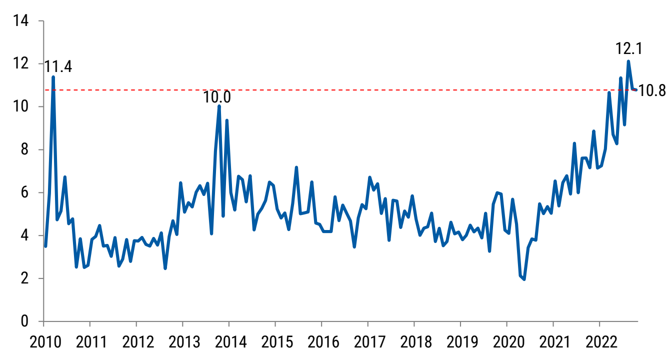
Dubai: number of real estate transactions* ('000s)



*Includes primary and secondary sales, mortgages and gifts; Source: Dubai Land Department and Morgan Stanley Research

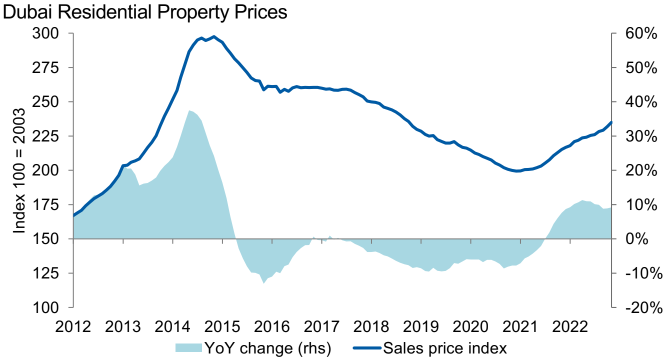
Exhibit 78: ... with the monthly number of transactions also around historical highs on the back of local reforms and geopolitics

Dubai: Monthly number of real estate transactions* ('000s)



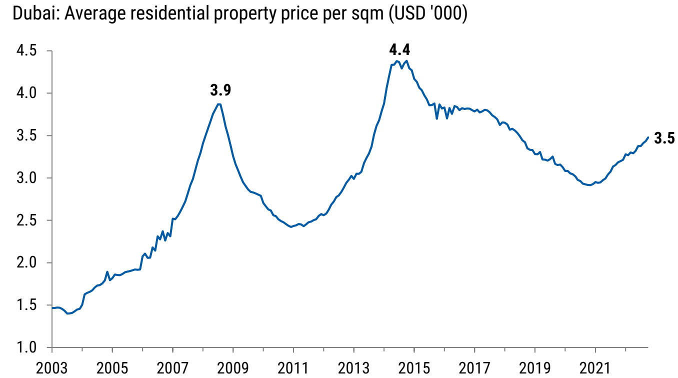
*Includes primary and secondary sales, mortgages and gifts; Source: Dubai Land Department and Morgan Stanley Research

Exhibit 79: Dubai residential property prices continue to rise and are up +17.8% since bottoming in Nov '20...



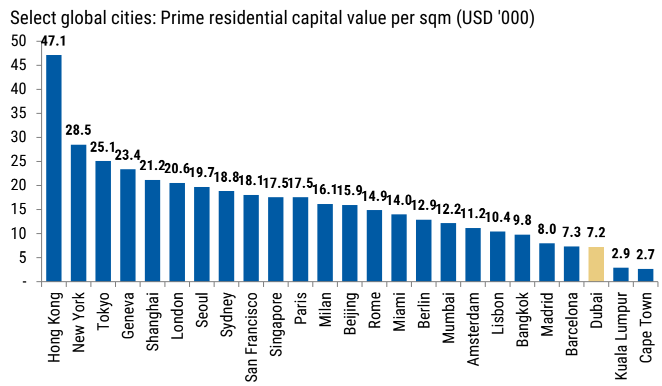
Note: data as of October 2022; Source: REIDIN and Morgan Stanley Research

Exhibit 80: ...but are still below peaks of 2008 and 2014



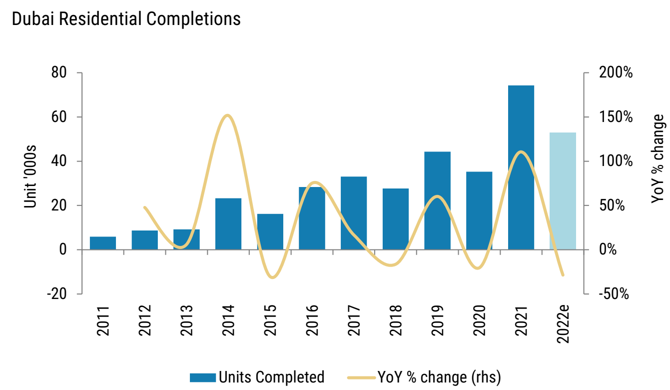
Note: data as of October 2022; Source: BIS, REIDIN and Morgan Stanley Research

Exhibit 81: Dubai's average price of prime residential properties is among the lowest among major global cities



Note: data as of June 2022; Source: Savills and Morgan Stanley Research

Exhibit 82: Dubai's supply remains relatively contained



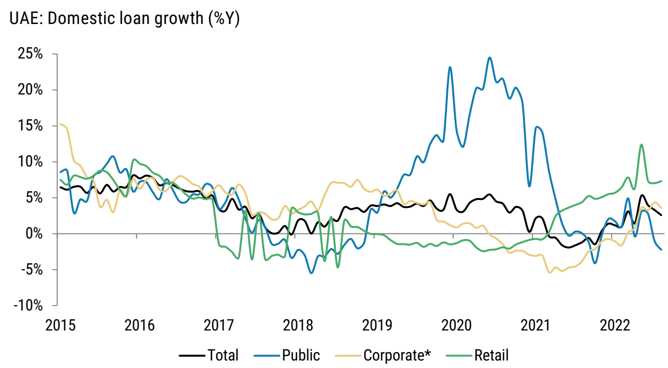
Source: JLL MENA, REIDIN and Morgan Stanley Researche; = JLL MENA estimates

In Abu Dhabi, structural economic reforms coupled with higher oil prices support multi-year economic growth. As an example, more recently, it was announced the newly formed KEZAD group, which comprises 12 economic zones, including part of Free Zones, and "will strengthen Abu Dhabi's position as the region's leading industrial and manufacturing destination", according to Abu Dhabi Ports. "The forward-looking strategy looks to drive the enhancement and development of the industrial and overall business ecosystem in Abu Dhabi in line with AD Ports Group's integrated model for one-stop economic hubs...". In our view, this could be potentially positive for: 1) in the short term, boosting investments and consequently, loan growth for the banks, and 2) in the medium to long-term, diversifying the economy away from fossil fuel.

Exhibit 83: Abu Dhabi launched a group of Economic cities and Free zones to boost investments

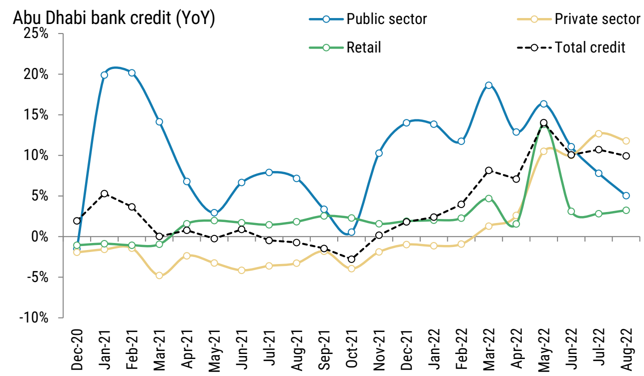
Source: AD Ports

Exhibit 84: Domestic loan growth for corporates in the UAE has been positive but in single digit levels ...



*excludes non-banking financial institutions; Source: CBUAE, Haver Analytics and Morgan Stanley Research

Exhibit 85: ... and in Abu Dhabi, the private sector loan growth has been leading on a yoy basis relative to public and retail loans

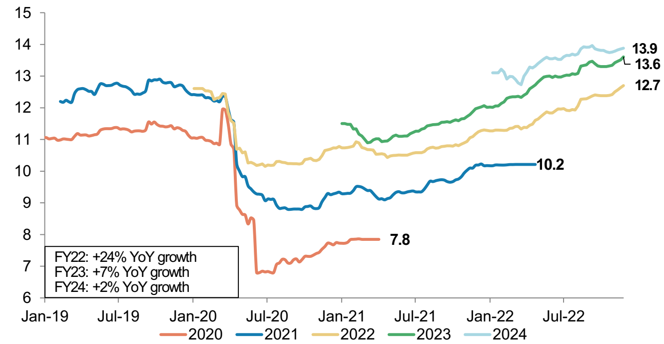


Source: CBUAE and Morgan Stanley Research

Positive earnings momentum, valuations remain attractive on a relative basis. Earnings revisions have been positive almost every month this year, with most sectors, including Materials/Fertilizers, Real Estate, Industrials and Financials recording positive trends. Meanwhile, valuations have de-rated from peak levels, but are marginally rich (c. 1 standard deviation above the historical average) on a NTM PE and PBV basis, but in line on NTM dividend yield. However, relative to other Middle East markets, Saudi Arabia and Kuwait for instance, the UAE does look more attractive on a valuation perspective.

Exhibit 86: Earnings revisions have been positive for 2022 and 2023 ...

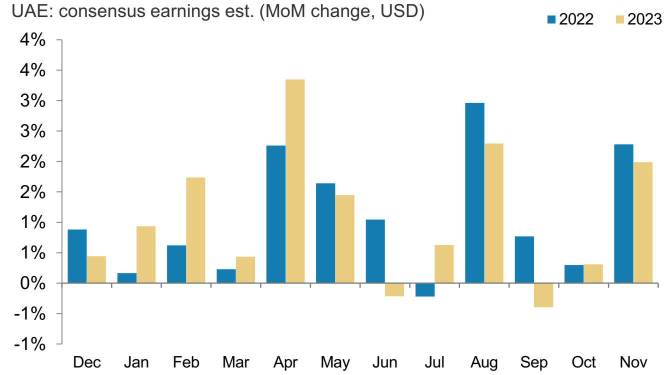
UAE: consensus net income estimates (USDbn)



Source: Eikon, Bloomberg and Morgan Stanley Research

Exhibit 87: ... in almost every month during this year

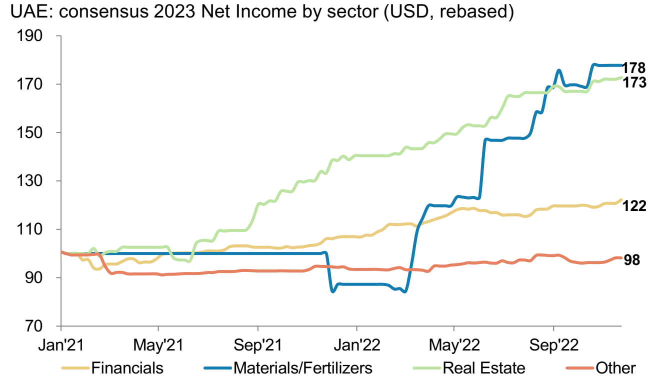
UAE: consensus earnings est. (MoM change, USD)



Source: Eikon, Bloomberg and Morgan Stanley Research

Exhibit 88: For 2023, this positive trend has been seen in almost every major sector ...

UAE: consensus 2023 Net Income by sector (USD, rebased)



Source: Eikon, Bloomberg and Morgan Stanley Research

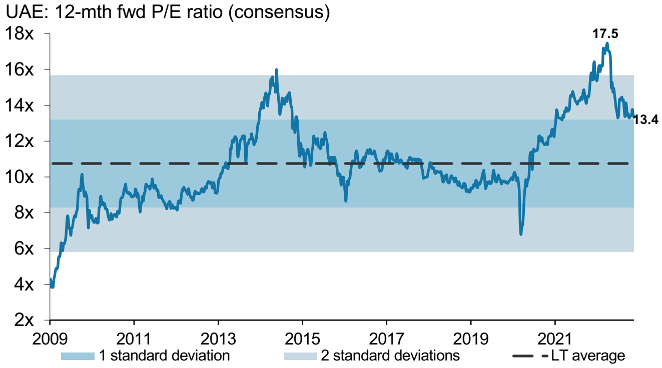
Exhibit 89: ... including Real Estate and Industrials

	2022			2023		
	1M Change	3M Change	YTD	1M Change	3M Change	YTD
UAE						
Real Estate	-1.6%	**8.5%**	21.1%	1.0%	3.7%	23.0%
Consumer Discretionary	4.7%	**4.5%**	20.0%	0.4%	0.4%	6.6%
Industrials	10.9%	**4.1%**	11.7%	9.8%	-0.6%	27.6%
Financials	3.0%	**3.7%**	13.0%	2.3%	3.2%	14.3%
Energy	2.2%	**2.8%**	21.4%	-1.6%	-2.1%	14.3%
Communication Services	0.9%	**0.0%**	-1.1%	1.3%	-1.0%	0.4%
Materials	3.0%	**-0.6%**	97.7%	0.0%	5.4%	103.7%
Consumer Staples	0.0%	**-10.5%**	-8.3%	0.0%	-12.2%	-5.2%

Source: Eikon, Bloomberg and Morgan Stanley Research

Exhibit 90: On a NTM P/E basis, multiples have de-rated along the year, and are now 1.1 S.D.

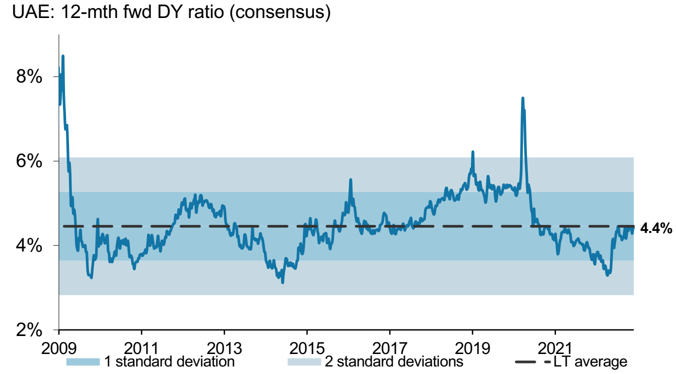
UAE: 12-mth fwd P/E ratio (consensus)



Source: Eikon and Morgan Stanley Research

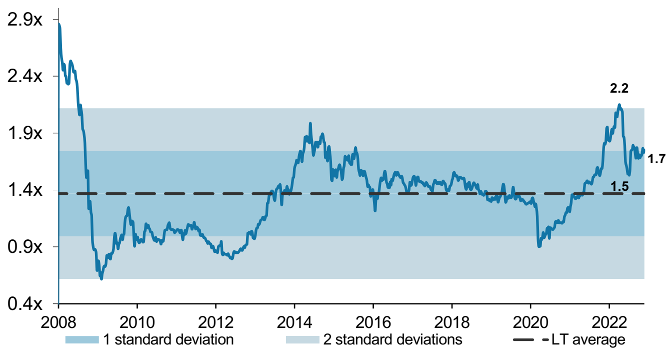
Exhibit 91: NTM DY for UAE stocks are at 4.4%, or roughly in line with LT historical average

UAE: 12-mth fwd DY ratio (consensus)



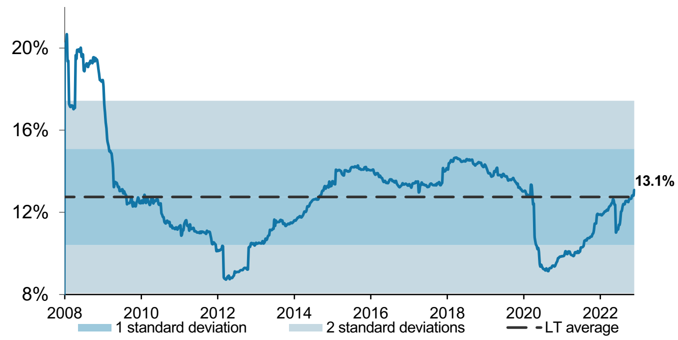
Source: Eikon and Morgan Stanley Research

Exhibit 92: UAE stocks are trading at 1.7x on a NTM PBV ratio, or +1.0 S.D. vs historical mean



Source: Eikon and Morgan Stanley Research

Exhibit 93: NTM ROE levels have been recovering since COVID trough and are now in line with LT average



Source: Eikon and Morgan Stanley Research

Exhibit 94: Valuations – UAE trades at a discount to other Middle East markets such as Saudi Arabia and Kuwait

	Level							Percentile of LT average					Z-score (st. deviation vs own history)				
	P/E	P/BV	EV/E	DY	ROE	EPS Growth 2022	EPS Growth 2023	P/E	P/BV	EV/E	DY	ROE	P/E	P/BV	EV/E	DY	ROE
CZECH	10.1	2.0	4.0	8.8%	19.7%	100%	-8%	20%	80%	0%	98%	84%	-1.0	0.7	-2.5	2.4	1.3
HUNGARY	5.5	0.8	3.0	5.0%	14.7%	6%	-17%	4%	20%	2%	93%	87%	-2.6	-0.9	-2.3	2.2	1.0
POLAND	7.6	0.8	4.5	4.3%	10.2%	54%	-29%	4%	3%	8%	70%	52%	-2.6	-1.7	-1.9	0.2	-0.3
GREECE	7.5	0.9	5.2	4.8%	11.6%	65%	-13%	14%	72%	36%	72%	81%	-0.3	0.1	-0.4	0.4	0.8
EGYPT	5.0	1.0	1.6	5.3%	19.2%	-3%	-18%	4%	27%	1%	62%	81%	-2.0	-0.6	-2.1	0.4	1.0
KUWAIT	18.7	2.0	8.3	2.7%	10.9%	35%	17%	89%	94%	96%	3%	38%	2.1	1.8	2.6	-2.0	-0.5
QATAR	11.7	1.5	10.7	4.3%	12.7%	14%	8%	53%	32%	50%	31%	47%	0.2	-0.6	0.2	-0.7	-0.6
SAUDI	15.1	2.1	8.7	3.4%	14.1%	17%	7%	69%	87%	44%	13%	54%	0.4	1.6	0.0	-1.5	0.4
UAE	13.4	1.7	8.8	4.4%	13.1%	24%	7%	82%	87%	86%	55%	55%	1.3	1.1	1.4	-0.1	0.1
S. AFRICA	9.9	1.4	7.1	4.9%	14.5%	-11%	3%	13%	11%	39%	74%	47%	-1.3	-1.3	-0.5	0.5	-0.1
S. AFRICA EX-TECH	9.1	1.5	5.3	5.8%	16.1%	-9%	2%	12%	21%	10%	83%	63%	-1.5	-0.8	-1.7	1.0	0.4
TURKEY	5.9	1.4	5.8	3.7%	23.5%	70%	-31%	16%	77%	26%	27%	100%	-1.4	0.7	-1.0	-0.7	5.0

Source: Eikon and Morgan Stanley Research

Cutting Middle East Exposure: Double Downgrade Qatar & Kuwait

1) Downgrade Qatar to Underweight

We reduce our exposure to Middle East and downgrade Qatar to Underweight. Despite the strong macro fundamentals, we continue to see weak transmission mechanism of high energy prices into company earnings, in particular for the banks. In addition, differently from Saudi Arabia and the UAE, our relative preferences in the Middle East, both Qatar and Kuwait lack of catalysts related to structural economic and social reforms. From a tactical point of view, the passive inflows tailwinds from foreign ownership limit removals were already catalysts in the past year, and we do not expect any major impact from here. Lastly, our global EM strategy team expects a broader EM recovery lead by Asia EM, which should be headwinds for the Middle East, in particular in the early stages of a rebound. In this case, given the low beta and low correlation to EM, we downgrade Qatar from Overweight to Underweight in an EEMEA context.

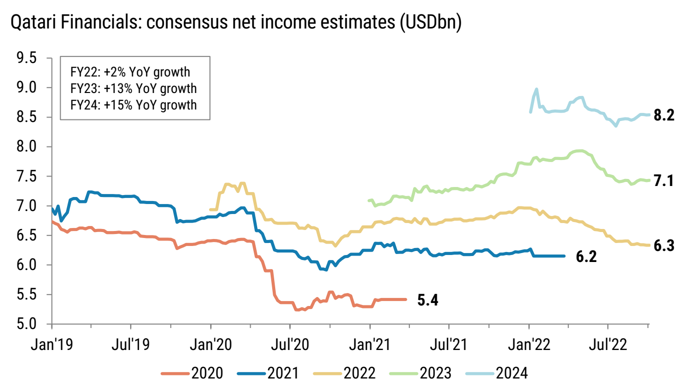
Weak earnings trends, in particular for the banks. Qatari banks, which are 71% of the country index, have disappointed on weak loan and earnings growth this year. Indeed, despite very strong fundamentals (fiscal surplus of 12.5% of GDP and current account balance of 21.2%), consensus has only 2% yoy growth for 2022. This is because high energy prices, and consequently strong fiscal position, drove government loan repayments to the banks and had a negative impact on loan growth. Thus, earnings revisions for 2022 have been negative for the banks the entire year (Exhibit 96). For 2023, although private loan is expected to accelerate, according the QNB 3Q22 earnings call, the pace of government repayments is highly depend on energy prices and, consequently, a risk for loan growth. Consensus earnings is currently at +13% yoy which seems optimistic in this scenario.

Exhibit 95: Earnings revisions for 2022 and 2023 have been negative for the banks the entire year

	2022			2023		
	1M Change	3M Change	YTD	1M Change	3M Change	YTD
Qatar						
Materials	0.0%	11.6%	11.6%	0.5%	13.5%	12.6%
Energy	5.1%	5.5%	9.1%	4.1%	3.5%	6.1%
Communication Services	1.7%	4.3%	10.1%	0.7%	3.3%	1.8%
Utilities	0.0%	0.0%	10.3%	0.0%	0.2%	11.9%
Financials	-2.0%	-1.4%	-10.1%	-2.9%	-3.5%	-7.8%
Industrials	-1.6%	-10.0%	31.0%	0.0%	0.7%	67.4%

Source: Eikon, Bloomberg and Morgan Stanley Research

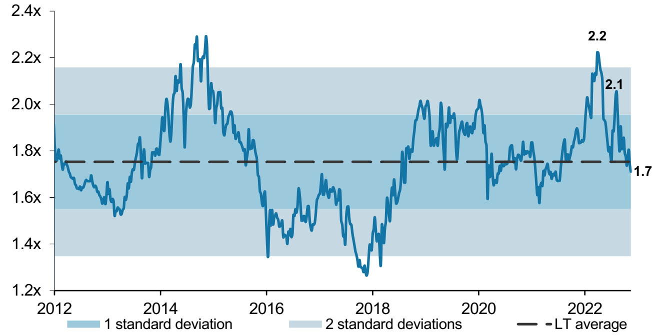
Exhibit 96: However, we see downside risks for the +14% earnings growth for 2023 if energy prices remain high



Source: Eikon, Bloomberg and Morgan Stanley Research

Exhibit 97: Meanwhile, on a NTM PBV basis, Qatari banks are trading in line with their LT historical average ...

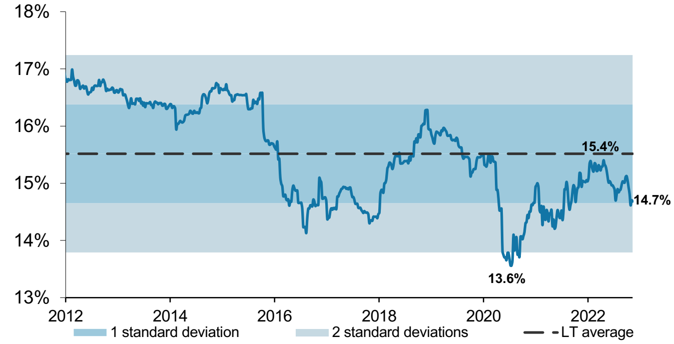
Qatar Banks: 12-mth fwd PBV ratio (consensus)



Source: Eikon and Morgan Stanley Research

Exhibit 98: ... but on a declining ROE trend (-1.0 S.D. vs LT mean)

Qatar Banks: 12-mth fwd ROE (consensus)

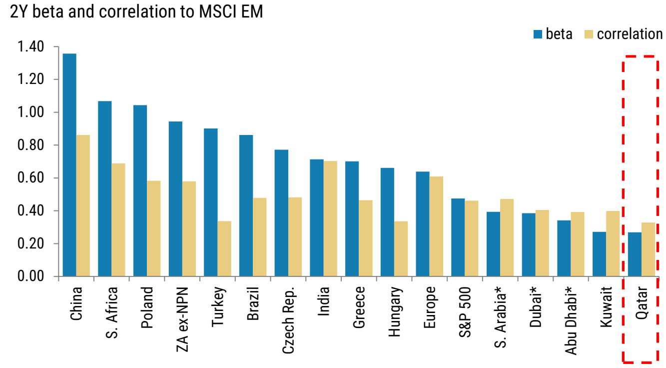


Source: Eikon and Morgan Stanley Research

A broader recovery in EM led by Asia EM should pause Middle East outperformance; we reduce our Middle East exposure. Our Global EM team recently reiterated its positive view on Asia/EM equities indicating that EM equities might have passed the trough. Given the low beta nature and defensive characteristics of Middle East equities, a broader EM recovery led by Asia EM could signify Middle East underperformance, in particular in the early stages of such a rebound. Therefore, we reduce our exposure to the Middle East, but prefer markets with structural economic and social reforms, such as the UAE and Saudi Arabia.

Exhibit 99: Qatar has one of the lowest beta and correlation to EM ...

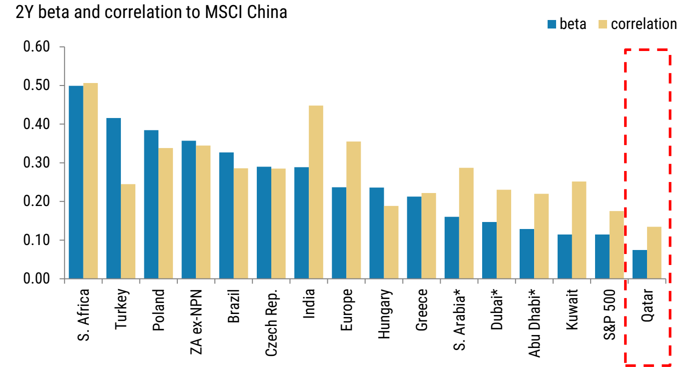
2Y beta and correlation to MSCI EM



*local indices, otherwise we used MSCI; Source: Datastream and Morgan Stanley Research

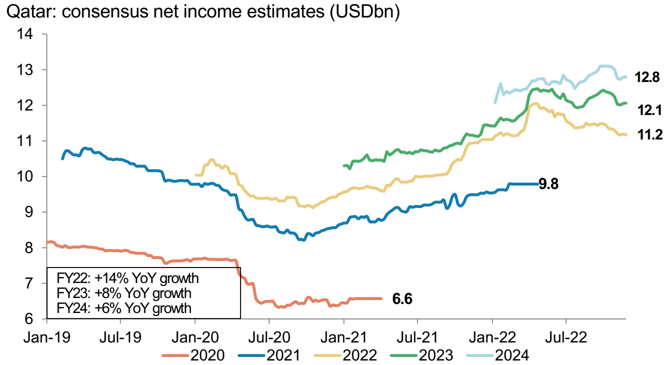
Exhibit 100: ... as well as to China

2Y beta and correlation to MSCI China



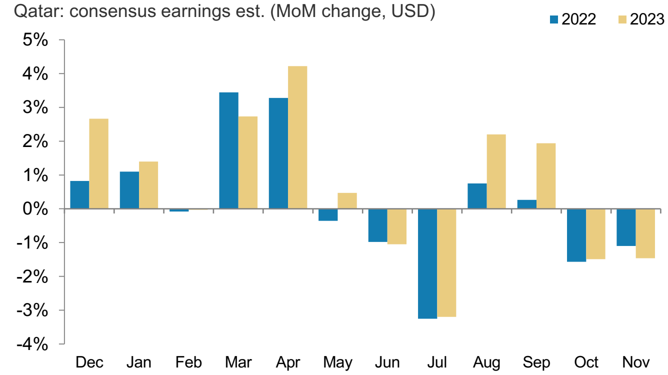
*local indices, otherwise we used MSCI; Source: Datastream and Morgan Stanley Research

Exhibit 101: For the overall market, earnings revisions have also been negative recently ...



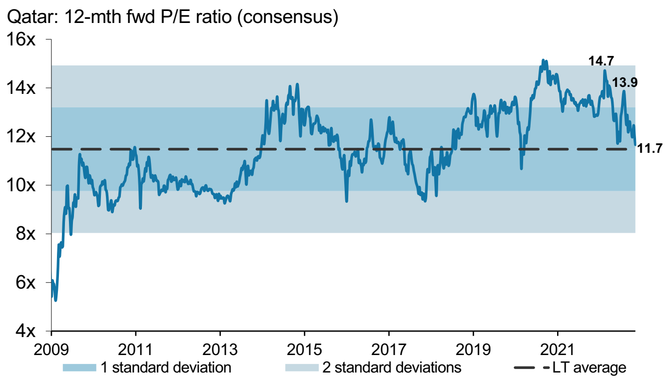
Source: Eikon, Bloomberg and Morgan Stanley Research

Exhibit 102: ... but mixed during the last 12 months



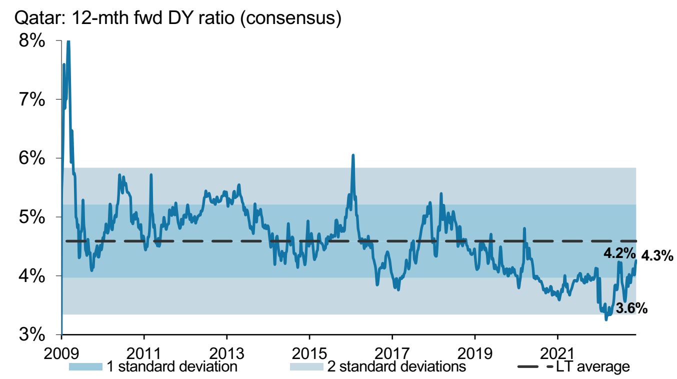
Source: Eikon, Bloomberg and Morgan Stanley Research

Exhibit 103: Meanwhile, valuations remain slightly above the LT historical average, on a NTM PE and ...



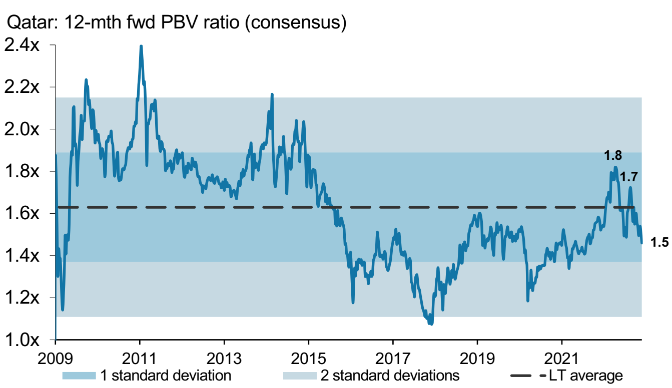
Source: Eikon and Morgan Stanley Research

Exhibit 104: ... on a dividend yield basis



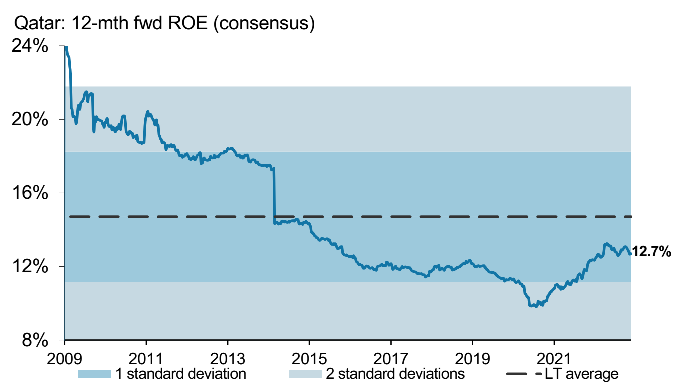
Source: Eikon and Morgan Stanley Research

Exhibit 105: On a NTM P/BV ratio basis, we find the overall market trading at a -0.7 S.D. discount to LT average ...



Source: Eikon and Morgan Stanley Research

Exhibit 106: ... but justified by a lower return-on-equity

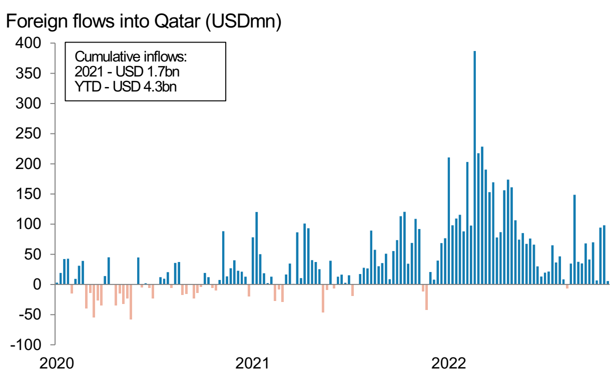


Source: Eikon and Morgan Stanley Research

Risks to our Underweight: 1) light active foreign positioning; foreign inflows: We estimate GEM funds have only 28bp of exposure to Qatar, which compares to a benchmark weight of 1.25%. In addition, 68% of GEM funds in our database have no exposure to Qatari stocks. However, we note that this year, despite weak earnings trends, foreign inflows into Qatari stocks have been consistently positive, totalling more than 2x the inflows from 2021; **2) cheaper valuations compared to other Middle East**

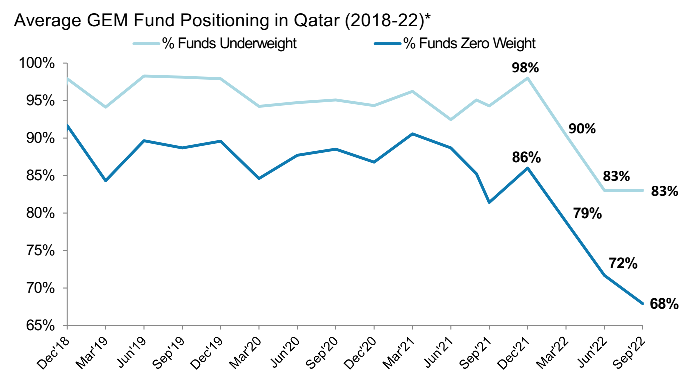
markets: at 11.7x NTM PE, 1.5x NTM PBV and 4.3% DY, Qatari stocks look, on average, marginally expensive relative to their own long-term history, but they do trade at a discount to Middle East peers. With foreign investors focus on relative valuations, Qatari stocks might continue to be a preference for international investors willing to add exposure to the Middle East; and **3) private loan growth surprise to the upside**: as we mention in our feedback note in October, one theory we came across in some of our meetings is that projects and, consequently, loan growth could resume next year. The argument is that the focus from officials this year in Qatar has been mainly on the 2022 FIFA World Cup and that once the event takes place, the efforts will revert to other parts of the economy and other infrastructure projects. If that happens, there is a potential for loan growth to pick up. QNB did mention this expectation in its 3Q22 earnings call, but it remains uncertain at what pace this would happen. As we mentioned before in this section, consensus currently has 13% earnings growth for the banks for next year, which compares to 2% this year. If private loan growth pick up significantly, there could be upside risks to earnings.

Exhibit 107: Qatar equities have seen consistently positive inflows YTD, already accounting for 2.5x+ 2021 flows and with the pace rising recently



Data as of 17th Nov, 2022; Source: QSE, Datastream and Morgan Stanley Research

Exhibit 108: The share of GEM funds with underweight remained steady at 83% over 3Q while those with zero exposure reduced slightly



*Our sample group of GEM funds varies month-to-month so is not directly comparable though can serve as a rough guide of changing positioning over time; Source: FactSet, Morgan Stanley Research

Exhibit 109: Valuations – Qatar trades at a discount to other Middle East markets

	Level							Percentile of LT average					Z-score (st. deviation vs own history)				
	P/E	P/BV	EV/E	DY	ROE	EPS Growth 2022	EPS Growth 2023	P/E	P/BV	EV/E	DY	ROE	P/E	P/BV	EV/E	DY	ROE
CZECH	8.5	2.0	3.7	8.9%	23.2%	100%	-8%	4%	78%	0%	99%	96%	-1.6	0.7	-2.9	2.4	2.0
HUNGARY	5.5	0.8	3.0	5.0%	14.8%	6%	-17%	4%	20%	2%	94%	87%	-2.6	-0.9	-2.3	2.2	1.1
POLAND	7.4	0.8	4.4	4.4%	10.5%	54%	-29%	3%	4%	8%	74%	62%	-2.7	-1.6	-1.9	0.4	-0.1
GREECE	7.3	0.8	5.1	5.0%	11.5%	65%	-13%	12%	69%	28%	76%	81%	-0.3	0.0	-0.6	0.5	0.7
EGYPT	5.0	1.0	1.5	5.3%	19.2%	-3%	-18%	4%	27%	1%	63%	81%	-2.0	-0.7	-2.1	0.4	1.0
KUWAIT	18.6	2.0	8.3	2.8%	10.9%	35%	17%	88%	94%	96%	4%	39%	2.1	1.8	2.5	-2.0	-0.5
QATAR	11.7	1.5	10.7	4.3%	12.7%	14%	8%	53%	31%	51%	31%	46%	0.2	-0.6	0.2	-0.7	-0.6
SAUDI	15.1	2.1	8.7	3.4%	14.1%	17%	7%	69%	87%	44%	13%	54%	0.4	1.6	0.0	-1.5	0.4
UAE	13.3	1.7	8.8	4.5%	13.1%	24%	7%	81%	87%	86%	58%	55%	1.3	1.1	1.4	-0.1	0.1
S. AFRICA	9.7	1.4	6.9	5.0%	14.5%	-11%	3%	11%	10%	34%	78%	47%	-1.4	-1.4	-0.6	0.7	-0.1
S. AFRICA EX-TECH	8.9	1.4	5.1	5.9%	16.1%	-9%	2%	10%	17%	8%	86%	63%	-1.6	-0.9	-1.8	1.1	0.4
TURKEY	5.9	1.4	5.7	3.7%	23.4%	70%	-31%	14%	75%	25%	30%	100%	-1.5	0.6	-1.1	-0.6	5.0

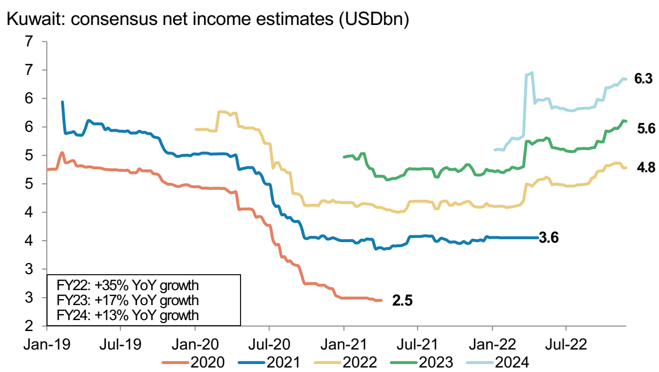
Source: Eikon and Morgan Stanley Research

2) Downgrade Kuwait to Underweight

As part of trimming our positioning in the Middle East, we also downgrade Kuwait to Underweight. Similar to Qatar: 1) Kuwait lack of catalysts related to structural economic and social reforms, despite its strong macro fundamentals on the back of high energy prices, and 2) given the low beta and low correlation to EM, Kuwait should underperform EM in the early stages of an EM rebound lead by EM Asia.

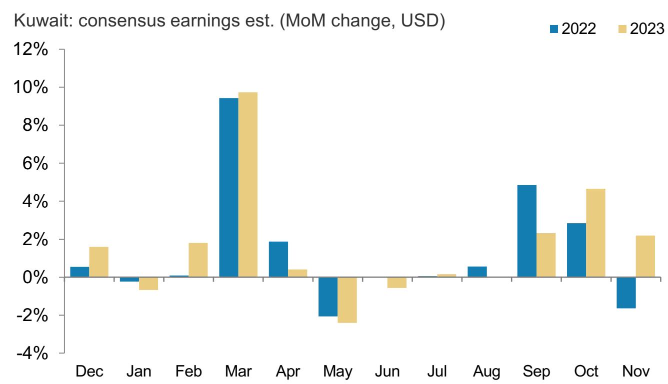
Positive earnings revisions, expensive valuations. Kuwait stocks have seen positive earnings revisions, most likely driven by Fed hikes. With Fed expected to peak in January 2023, we would expect earnings momentum to slow down. In addition, despite positive earnings revisions for 2022 and 2023, valuations for Kuwait stocks have de-rated less than other markets and continue to be significantly expensive. For instance, on a NTM P/E basis, Kuwaiti equities are trading at 18.7x, which is 2.2 standard deviations above their historical average. On a NTM P/BV basis, they are at 2.0x ratio, or 1.8 standard deviations above their long-term mean, while ROE at 10.9% is below their historical average.

Exhibit 110: Kuwait stocks have seen positive earnings revisions this year ...



Source: Eikon, Bloomberg and Morgan Stanley Research

Exhibit 111: ... with an acceleration in September and October



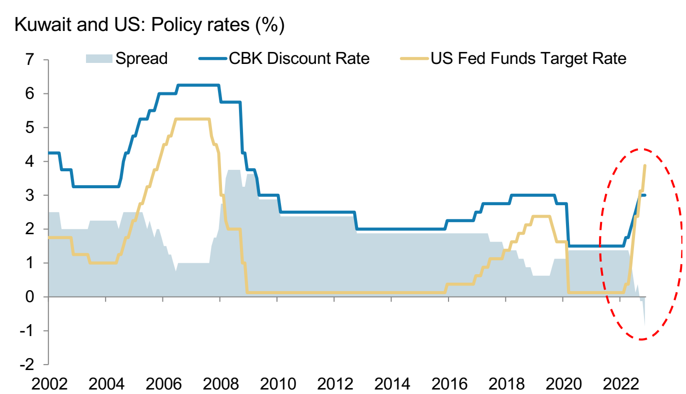
Source: Eikon, Bloomberg and Morgan Stanley Research

Exhibit 112: At the sector level, Financials and Industrials have seen the most positive earnings upgrades this year

	2022			2023		
	1M Change	3M Change	YTD	1M Change	3M Change	YTD
Kuwait						
Industrials	0.0%	45.5%	25.4%	0.5%	121.9%	65.5%
Financials	-2.8%	5.9%	22.5%	1.8%	6.7%	22.0%
Communication Services	1.8%	2.4%	-2.8%	5.8%	5.4%	4.8%
Consumer Discretionary	4.3%	1.4%	16.8%	3.6%	3.0%	6.6%
Materials	0.0%	0.0%	9.7%	0.5%	-0.2%	-5.6%
Real Estate	0.0%	-1.0%	-9.0%	0.5%	3.4%	-9.8%

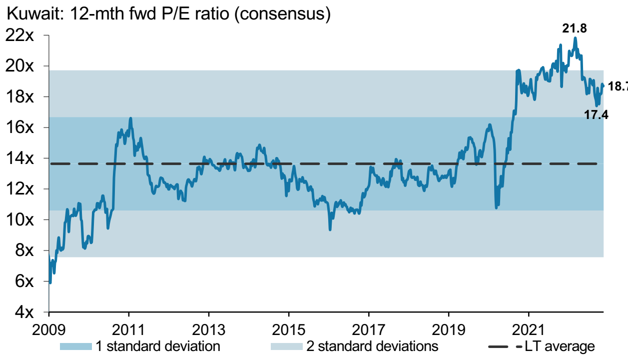
Source: Eikon, Bloomberg and Morgan Stanley Research

Exhibit 113: For Financials, the Fed hikes have been a positive driver for NIMs and earnings surprise



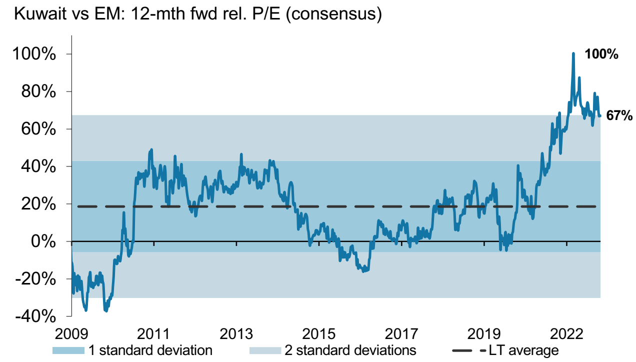
Source: Haver Analytics and Morgan Stanley Research

Exhibit 114: Despite positive earnings revisions, valuations for Kuwait stocks have de-rated less than other markets ...



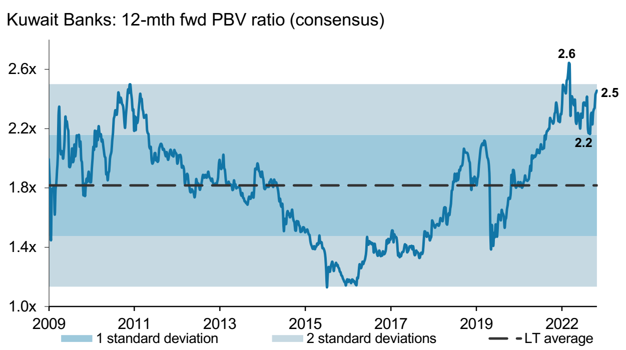
Source: Eikon and Morgan Stanley Research

Exhibit 115: ... and remain significantly expensive on absolute and relative basis to EM



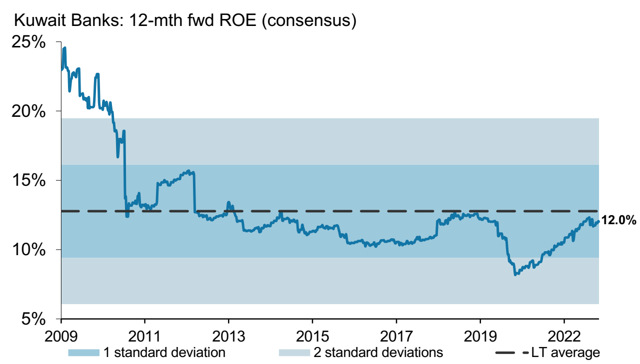
Source: Eikon and Morgan Stanley Research

Exhibit 116: The banks (84% of the index) are trading at 2.5x on a NTM PBV basis, or almost 2 S.D. premium to LT average ...



Source: Eikon and Morgan Stanley Research

Exhibit 117: ... while ROE at 12% is marginally below historical mean



Source: Eikon and Morgan Stanley Research

Exhibit 118: Valuations – Relative to EM vs History

	Premium/discount vs EM					Percentile of LT average					Z-score of prem/disc to EM (SD vs mean)				
	P/E	P/BV	EV/E	DY	ROE	P/E	P/BV	EV/E	DY	ROE	P/E	P/BV	EV/E	DY	ROE
CZECH	-10%	42%	-51%	156%	57%	19%	93%	0%	92%	93%	-1.0	1.7	-1.5	1.3	1.9
HUNGARY	-51%	-42%	-64%	44%	17%	3%	15%	2%	96%	99%	-2.7	-1.1	-1.2	1.9	1.9
POLAND	-33%	-45%	-46%	25%	-19%	3%	6%	4%	38%	64%	-2.1	-1.9	-1.3	-0.3	0.1
GREECE	-33%	-38%	-37%	39%	-8%	12%	75%	21%	52%	82%	-0.3	0.4	-0.5	0.1	1.2
EGYPT	-55%	-32%	-81%	53%	53%	8%	33%	2%	47%	76%	-1.7	-0.5	-1.3	-0.3	0.9
KUWAIT	67%	45%	1%	-20%	-13%	94%	100%	90%	1%	38%	2.0	2.2	1.3	-2.1	-0.3
QATAR	4%	4%	29%	23%	1%	62%	35%	50%	7%	41%	0.3	-0.4	-0.2	-1.5	-0.6
SAUDI	35%	51%	6%	-1%	12%	76%	92%	17%	6%	82%	0.8	1.6	-0.7	-1.9	0.9
UAE	19%	24%	7%	28%	4%	86%	89%	74%	24%	54%	1.2	1.3	0.5	-0.8	0.4
S. AFRICA	-11%	2%	-14%	42%	15%	21%	20%	18%	49%	73%	-1.0	-0.8	-0.8	-0.3	0.6
S. AFRICA EX-TECH	-19%	3%	-36%	68%	28%	16%	32%	15%	66%	97%	-1.1	-0.4	-1.1	0.0	1.6
TURKEY	-47%	-1%	-30%	7%	87%	24%	95%	25%	1%	100%	-1.0	1.5	-0.8	-1.3	5.8

Source: Eikon and Morgan Stanley Research

Key risks to our Underweight: 1) light active foreign positioning; foreign inflows: We estimate GEM funds have only 5bp of exposure to Kuwait, which compares to a benchmark weight of 88bp - this is the lowest exposure among Middle East countries. In addition, 94% of GEM funds in our database have no exposure to Kuwaiti stocks; **2) potential new mortgage law approval:** this has been expected and more discussed in late 2021 (as we discussed in another note), but so far there are no indications regarding timing. However, if approved it could significantly boost growth in mortgage lending for the banks, which are c. 80% of the index weight.

Poland: Window of Opportunity; Double Upgrade to Tactical Overweight

As we wrote in our recent piece Poland Equity Strategy: From Worst to Best Performing? (18 Nov, 2022), **Poland has rapidly shifted from being one of the worst performing markets globally to among the best**. That said, the market is still down 33% YTD and valuations are among the most depressed in MSCI EM. **We see a 'window of opportunity' for returns into the start of next year as global early cycle tailwinds continue to drive momentum.** Why only a 'window'? From mid-February regulatory risks will again be elevated into a CJEU opinion on CHF mortgages - our banks team estimates that in a possible worst case scenario we would see material earnings downside risks to banks as well as financial stability risks in the sector. Further ahead, in the months leading up to October/November parliamentary elections, volatility related to potential additional regulation may increase, but a lot is already priced in for these latter risks, and we think elections themselves are likely to be taken positively by the market. Overall, with geopolitical risks also a factor, we expect a volatile year though with risk-reward skewed to the upside following fall elections. **For now, we double upgrade Poland to a tactical Overweight within an EEMEA context to capture inexpensive optionality to ongoing global rotations**.

In large part, recent performance has been driven by Poland's place at the crossroads of a number of ongoing global rotations - Polish equities have a 1.1-1.3 beta to EM and Europe, one of the highest negative correlations to DXY globally (-0.7), and among the highest correlations and beta to China within EEMEA.

Exhibit 119: Poland has gone from being one of the worst performing markets globally ...

Market	Classif.	USD performance YTD	USD performance Until 13-Oct	Market	Classif.	USD performance YTD	USD performance Until 13-Oct
1 Turkey	EM	65.6%	25.3%	28 Czech	EM	-16.3%	-27.7%
2 Chile	EM	18.4%	6.1%	29 Europe	Region	-16.3%	-30.8%
3 Peru	EM	14.4%	-4.3%	30 Belgium	DM	-16.4%	-30.2%
4 Kuwait	EM	11.9%	0.9%	31 Japan	DM	-16.5%	-28.3%
5 Indonesia	EM	4.0%	1.5%	32 Colombia	EM	-16.6%	-20.8%
6 Latam	Region	3.8%	1.1%	33 Philippines	EM	-17.0%	-28.3%
7 Brazil	EM	3.4%	8.4%	34 Finland	DM	-17.1%	-28.4%
8 Mexico	EM	3.4%	-12.4%	35 ACWI	Region	-17.1%	-26.0%
9 Qatar	EM	-0.1%	6.1%	36 Hong Kong	DM	-17.5%	-23.1%
10 Thailand	EM	-3.3%	-14.1%	37 Switzerland	DM	-18.0%	-29.3%
11 S. Arabia	EM	-3.6%	0.9%	38 New Zealand	DM	-20.3%	-34.5%
12 UAE	EM	-3.6%	-8.4%	39 Israel	DM	-22.1%	-27.5%
13 Greece	EM	-4.4%	-22.2%	40 Germany	DM	-23.1%	-39.0%
14 Portugal	DM	-4.6%	-21.7%	41 EM	Region	-23.2%	-30.6%
15 S. Africa	EM	-5.0%	-22.4%	42 EM Asia	Region	-24.6%	-32.7%
16 India	EM	-5.5%	-12.2%	43 Ireland	DM	-25.6%	-40.2%
17 Australia	DM	-7.3%	-22.0%	44 Netherlands	DM	-25.9%	-43.2%
18 Britain	DM	-7.6%	-21.3%	45 Sweden	DM	-27.5%	-41.7%
19 Canada	DM	-9.3%	-20.4%	46 Korea	EM	-27.7%	-39.9%
20 Norway	DM	-9.5%	-19.9%	47 Austria	DM	-28.0%	-44.8%
21 Spain	DM	-10.2%	-26.5%	48 Taiwan	EM	-28.5%	-40.9%
22 Malaysia	EM	-11.1%	-22.2%	49 EEMEA	Region	-28.5%	-34.2%
23 Denmark	DM	-13.3%	-27.8%	50 China	EM	-31.8%	-36.6%
24 France	DM	-14.4%	-29.8%	51 Egypt	EM	-31.9%	-39.8%
25 Singapore	DM	-14.9%	-24.3%	52 Poland	EM	-32.7%	-53.0%
26 S&P 500	DM	-15.5%	-23.0%	53 Hungary	EM	-34.6%	-51.0%
27 Italy	DM	-16.3%	-34.3%				

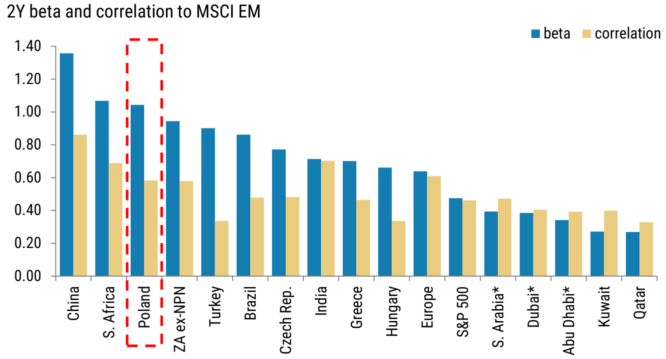
Source: Datastream, Bloomberg and Morgan Stanley Research

Exhibit 120: ... to among the best performing from YTD lows

Market	Classif.	Weight in MSCI World ex-US	Perf. from YTD low USD	Market	Classif.	Weight in MSCI World ex-US	Perf. from YTD low USD
1 Turkey	EM	0.1%	84.3%	28 Australia	DM	5.1%	18.8%
2 Poland	EM	0.2%	43.3%	29 Chile	EM	0.2%	18.7%
3 Hungary	EM	0.1%	36.9%	30 Philippines	EM	0.2%	18.2%
4 Austria	DM	0.1%	34.1%	31 Norway	DM	0.5%	18.0%
5 Peru	EM	0.1%	33.2%	32 Japan	DM	14.2%	16.7%
6 Netherlands	DM	2.8%	31.0%	33 Czech	EM	0.0%	16.4%
7 Italy	DM	1.6%	29.7%	34 Canada	DM	8.2%	16.1%
8 Greece	EM	0.1%	28.7%	35 Switzerland	DM	6.6%	15.9%
9 Germany	DM	5.3%	28.6%	36 Latam	Region	-	15.6%
10 Ireland	DM	0.4%	27.1%	37 Singapore	DM	0.9%	15.5%
11 Sweden	DM	2.3%	26.1%	38 EM Asia	Region	-	15.2%
12 France	DM	7.6%	25.8%	39 Malaysia	EM	0.4%	14.3%
13 Taiwan	EM	4.1%	25.5%	40 India	EM	4.1%	14.2%
14 Spain	DM	1.5%	23.8%	41 ACWI	Region	-	13.7%
15 Denmark	DM	1.7%	23.8%	42 Brazil	EM	1.5%	13.2%
16 S. Africa	EM	1.1%	23.1%	43 Colombia	EM	0.0%	13.2%
17 Portugal	DM	0.1%	22.5%	44 Thailand	EM	0.6%	12.9%
18 Europe	Region	-	22.4%	45 S&P 500	DM	-	12.6%
19 Korea	EM	3.3%	22.3%	46 EM	Region	-	12.2%
20 Egypt	EM	0.0%	22.3%	47 Kuwait	EM	0.3%	12.0%
21 New Zealand	DM	0.1%	21.7%	48 Indonesia	EM	0.6%	11.3%
22 China	EM	8.1%	21.7%	49 EEMEA	Region	-	10.3%
23 Mexico	EM	0.7%	21.6%	50 Israel	DM	0.5%	8.7%
24 Belgium	DM	0.6%	20.5%	51 UAE	EM	0.4%	5.2%
25 Britain	DM	9.9%	20.2%	52 Qatar	EM	0.3%	0.7%
26 Hong Kong	DM	1.7%	20.0%	53 S. Arabia	EM	1.2%	0.4%
27 Finland	DM	0.6%	19.1%				

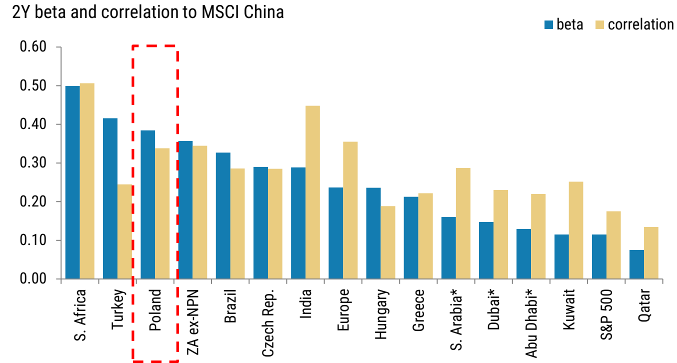
Source: Datastream, Bloomberg and Morgan Stanley Research

Exhibit 121: Poland has the second highest beta to MSCI EM within EEMEA at 1.05, correlation to EM is also among the highest at 0.6



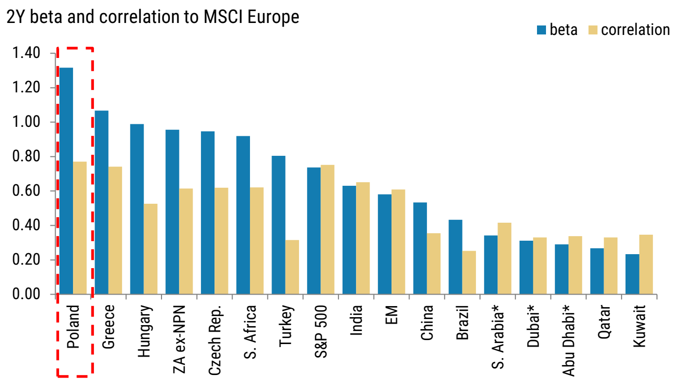
Source: Bloomberg and Morgan Stanley Research

Exhibit 122: Poland also has one of the highest levels of beta and correlation to China within EEMEA



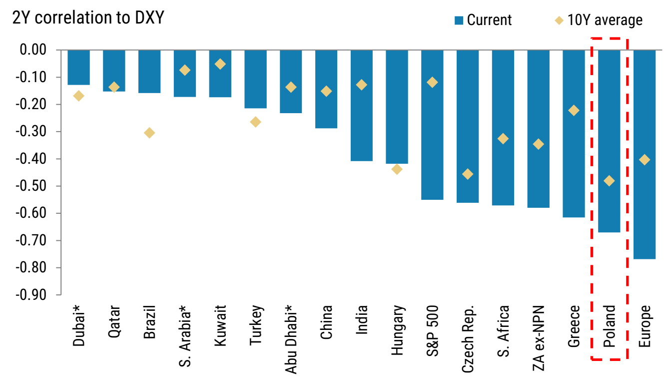
Source: Bloomberg and Morgan Stanley Research

Exhibit 123: Poland's beta to Europe sits at 1.3x ...



Source: Bloomberg and Morgan Stanley Research

Exhibit 124: ... while its negative correlation to the DXY is among the highest globally



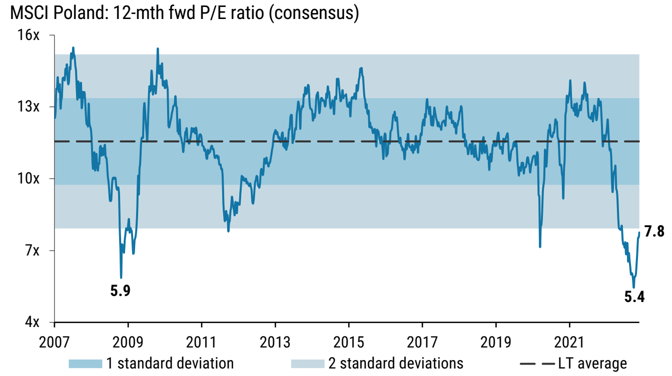
Source: Bloomberg and Morgan Stanley Research

There are also a number of local drivers:

- **Reduced risk of broad-based windfall taxes** as per our recent macro trip feedback and political expert checks ...
- **... which adds to the attractiveness of valuations** - Poland's rebound began off GFC-low NTM P/E levels of 5x , now 7.8x, a 31% discount to EM.

Exhibit 125: Poland has re-rated from near-GFC low NTM P/E levels of 5x to a still fairly depressed 7.8x, 2.1 S.D.'s below its LT avg

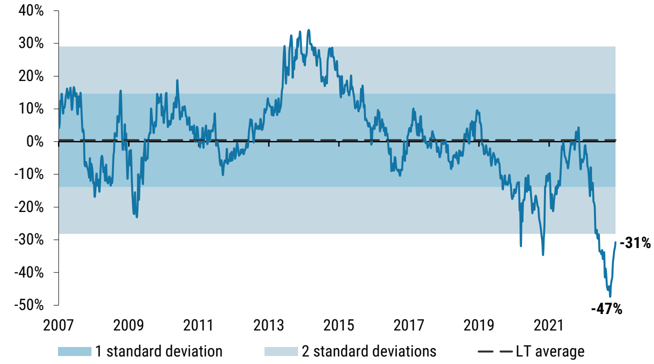
MSCI Poland: 12-mth fwd P/E ratio (consensus)



Source: Eikon and Morgan Stanley Research

Exhibit 126: Relative to EM, Poland's discount on NTM P/E has narrowed to -31%, which is still largely undemanding at 2.2 S.D.'s below LT avg

MSCI Poland vs EM: 12-mth fwd rel. P/E (consensus)

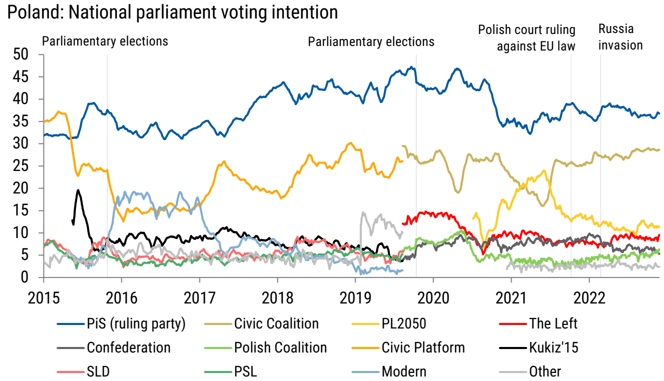


Source: IBES, Datastream and Morgan Stanley Research

- **Fall 2023 parliamentary elections** - while EM election optionality typically starts to be priced 7M ahead, our feedback indicates some equities investors are already anticipating elections may sustain any rebound structurally.

Exhibit 127: Some equities investors are already starting to look ahead to Poland's parliamentary elections, scheduled for Autumn 2023

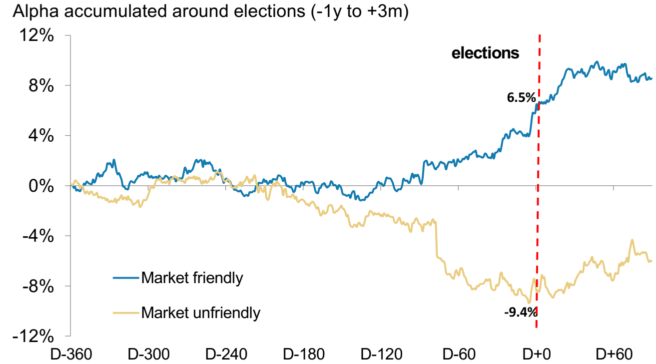
Poland: National parliament voting intention



Source: POLITICO and Morgan Stanley Research

Exhibit 128: EM elections case study suggests that the market typically starts to price in the potential outcome from about 7 months prior to the election date

Alpha accumulated around elections (-1y to +3m)



Source: Bloomberg and Morgan Stanley Research

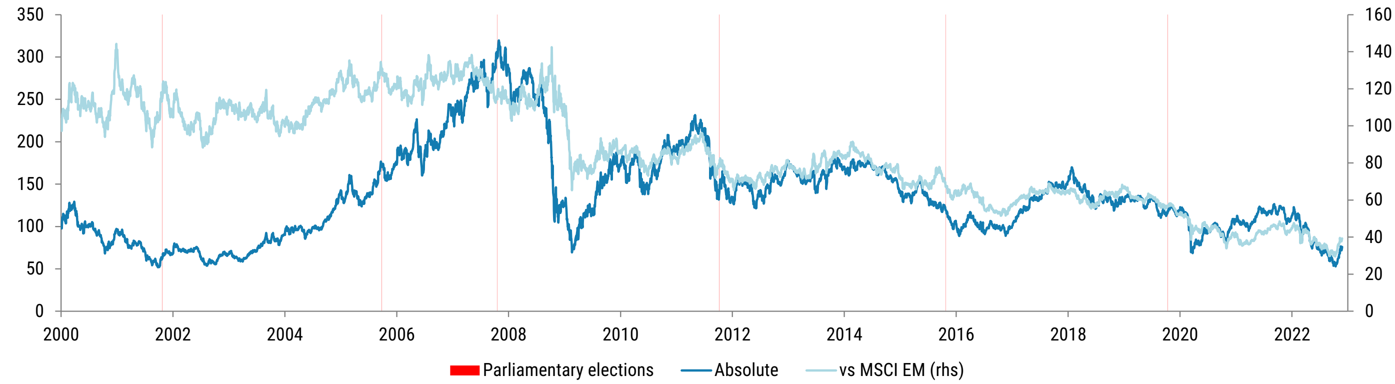
- **Peak NBP rates?** Poland was early in the global hiking cycle and our economist sees high chances that the end of the hiking cycle has been reached.

But Poland still has significant risks as well:

- **Our analysis of prior Polish election cycles shows that buying equities ahead of parliamentary elections has typically not been an alpha generating trade.** For example, in the last two election cycles (2015 and 2019), there were a large number of consumer-friendly measures introduced starting from about 8-9 months prior to the election date (Exhibit 130), which weighed on market performance both in absolute terms and relative to MSCI EM.

Exhibit 129: Over the last decade, MSCI Poland has performed poorly ahead of Parliamentary elections ...

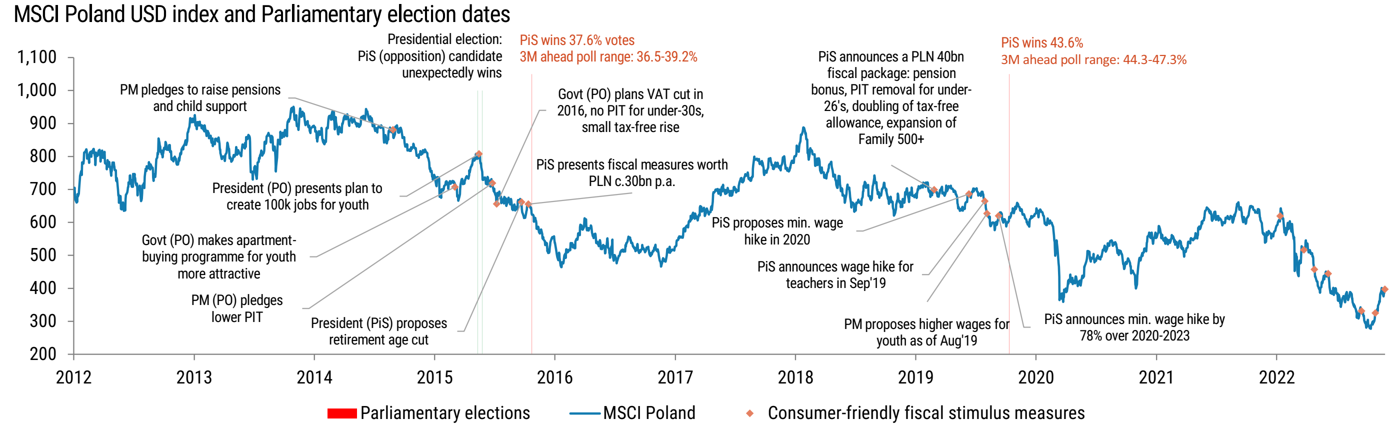
MSCI Poland: USD rebased performance and Parliamentary election dates



Source: Datastream and Morgan Stanley Research

Exhibit 130: ... with a number of 'consumer-friendly' measures weighing on market performance

MSCI Poland USD index and Parliamentary election dates

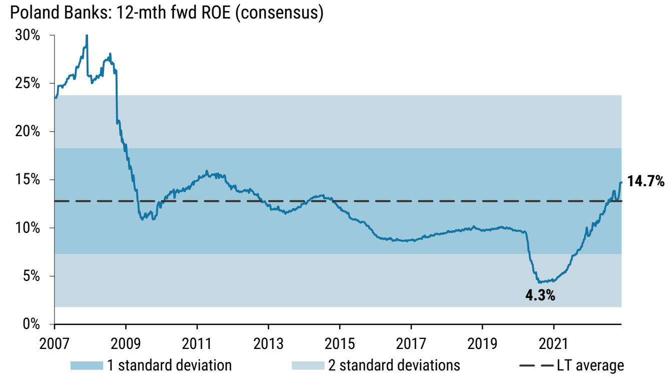


Source: POLITICO, Datastream and Morgan Stanley Research

- Indeed, **if we look at the banks sector, which makes up c. 30% of the MSCI Poland Index, there are a number of regulatory measures which may be introduced or extended next year.** These include but are not limited to Credit Holidays for mortgage borrowers, contributions to the Resilience Fund (IPS), and contributions to the Borrower Support Fund. We provide a sensitivity to these measures in Exhibit 133

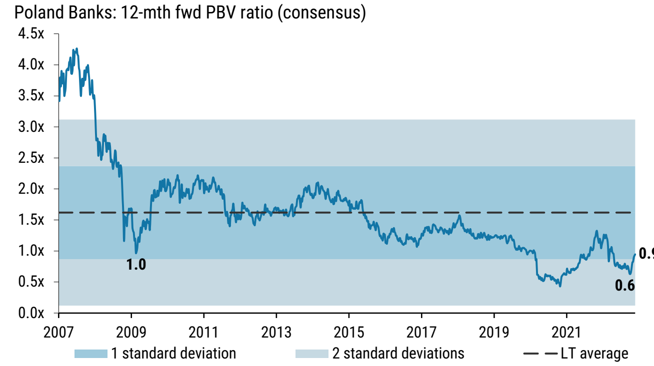
- **A more simplistic approach to assess potential downside to earnings is to assume that the consensus Polish banks 2023 RoE of 15% is reduced to the average in the last 5 years, c. 10%.** For our covered Polish banks, PEO and PKO, a reduction in RoE to 5-year average levels would imply **a 39% and 36% cut to earnings estimates**, respectively.

Exhibit 131: A simple way to assess regulatory risk is to assume any new measures bring the sector RoE of 15% down to the 5Y average of c. 10% ...



Source: Eikon and Morgan Stanley Research

Exhibit 132: ... but Polish banks already appear to price this downside potential in with NTM P/BK at 0.9x



Source: Eikon and Morgan Stanley Research

- **Among the most material downside risks we see for 2023 is a likely resolution to the long-standing CHF mortgage issue for banks. On February 16, the Advocate General of the Court of Justice of the European Union (CJEU) is scheduled to give its opinion on the remuneration for capital deployed for banks,** i.e if a contract is declared null and void, the compensation that banks are entitled to for the use of funds. Polish banks have been arguing that CHF borrowers whose loans have been deemed illegal have improperly benefitted from the use of that capital and subsequently have charged these borrowers remuneration for capital used and/or sued borrowers for the return of this money. Such cases are clogging up Polish courts and despite the court win rate for borrowers being above c. 90%, the strained legal system can mean years to produce a verdict and thus high up front costs for plaintiffs. **Following the CJEU Advocate General opinion, the CJEU full court will use this in its ruling which should take place c. 3-4 months later**. The full court decision is likely to be in line with the opinion. **In March 2021, Poland's Financial Supervision Authority (KNF) estimated that in a scenario in which CHF based loans are cancelled but capital is returned, the sector cost would be PLN 101.5bn in FX provisions,** which could mean a hit of 85-130% to PEO and PKO 2023 earnings and financial stability risks in the sector (FT, 13 November). Banks have already made provisions for c. PLN 30bn and in the NBP's June Financial Stability Report they indicated that provisions could be c. PLN 50bn to remove the legal risk. **The NBP will publish its latest Financial Stability Report sometime in early December**.

- **Of course geopolitical risks and European macro downside risks remain as well into 2023**. Our CEE economist also anticipates that Polish inflation can overshoot to near or above 20% in February (current: 18%Y) on the back of the January minimum wage hike, reversal of electricity and heating VAT cuts, and unfavourable base effects.

Exhibit 133: In our banks team's estimates, a number of regulatory measures can still drive downside to Polish banks earnings in 2023 - most notably the CJEU's ruling on CHF mortgages

	Regulatory costs					
	2022		2023			
	included (PLNm)	% 2022 NI	included (PLNm)	potential add'l costs (PLNm)	add'l costs % 2023 NI	hypothetical scenario for add'l costs
Pekao						
Credit Holiday Costs	2,429	44%	400	487	**14%**	1) credit holidays extend for 4
Resilience fund (IPS)	440	8%	0	134	**4%**	months
Borrower support fund	166	3%	266	0	**0%**	2) FX provisions: worst case of
FX Provisions	403	7%	174	2,881	**85%**	sector costs: PLN101bn
Total	3,438	63%	840	3,502	**104%**	
PKO						
Credit Holiday Costs	3,111	33%	750	1,550	**27%**	1) credit holidays extend for 4
Resilience fund (IPS)	956	10%	0	223	**4%**	months
Borrower support fund	390	4%	467	0	**0%**	2) FX provisions: worst case of
FX Provisions	1,176	13%	846	7,341	**130%**	sector costs: PLN101bn
Total	5,633	60%	2,063	9,114	**161%**	

Source: Morgan Stanley Research estimates

Lastly, in our earlier piece we wrote that recent technical levels suggested that a material pullback was likely for Polish equities, based on four historical precedent cases in the last 25 years. The key difference with these historical precedents was much lower valuations this time around. We thus anticipated a 10-15% correction may be due. Instead, we saw a pause to performance. At this stage, we feel that technical levels such as z-score and RSI have re-set enough for the rebound to resume, though likely at a slower pace versus the initial rally.

Exhibit 134: Revisiting technical signposts to buy: Not yet in-line with historical troughs versus precedent cases but this may be due to much lower valuations this time

date of 200D M.A. breakout	Downside from RSI peak to new trough	Duration of downside (months)	technicals (S.D.) at RSI peak	technicals (S.D.) at new trough	rel. EM technicals (S.D.) at RSI peak	rel. EM technicals (S.D.) at new trough	RSI level RSI peak	RSI level at new trough	RSI of rel. perf. to EM at RSI peak	RSI of rel. perf. to EM at new trough	Multiples at new trough NTM PE	Multiples at new trough S.D. of NTM PE	Multiples at new trough NTM PE vs EM
Dec-00	-23%	2.6	-0.1	-1.5	4.2	-0.2	79	27	91	36	10.4	-0.4	2%
Nov-01	-30%	7.2	0.5	-1.8	0.1	-1.7	80	28	63	42	10.3	-0.7	19%
Mar-16	-19%	3.7	-0.5	-1.6	-0.3	-2.4	77	37	58	31	10.7	-0.7	-8%
Jul-20	-22%	4.9	-0.7	-1.5	-0.8	-2.5	78	19	66	17	9.2	-2.7	-35%
Average	-24%	4.6	-0.2	-1.6	0.8	-1.7	78	28	70	31	10.2	-1.1	-5%
Current pullback	-7%	0.2	-0.4	-0.7	0.1	-0.2	81	63	70	60	7.4	-1.9	-32%

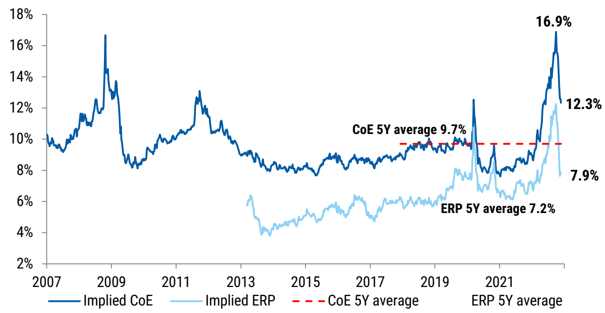
*for current pullback, 'at new trough' number indicates level on November 21, 2022; Source: Datastream, Bloomberg, Morgan Stanley Research

Despite these risks, we see a 'window of opportunity' for tactical Polish equities outperformance into the start of 2023: Our recent Polish macro trip along with our political expert conversations suggest that the next few months are likely to see a pause to new regulatory measures. Indeed those measures already introduced and/or on the horizon - January's minimum wage hike, a likely 14th pension scheme, energy price caps - are well understood and expected by the market. **he key upcoming risk date to watch, as noted, is the CJEU CHF mortgage opinion on February 16.** Beyond this, should new regulatory measures be introduced, they are more likely in the summer, closer to elections which are due to be held in October/November. Thus, in our view this creates a 'window of opportunity' to gain exposure to inexpensive optionality on global reversals - the recovery in EM, China, Europe, and EM FX.

We plan to re-assess our call ahead of the February CJEU decision, but note a potentially attractive risk-reward longer-term: In the event of a broader EM rally, in line with our Asia/EM strategy team's call, no broad-based windfall taxes, no worst case CHF mortgage decision, or other regulatory measures, a market-friendly election outcome, and any longer-term resolution in Ukraine, Polish equities could see substantial upside. To analyze the upside potential from some or all of these fundamental drivers we look at Poland's CoE and ERP levels - a return to 5 year average CoE would imply c. 40% further upside. A move to 5-year low CoE would imply 103% upside.

Exhibit 135: If MSCI Poland's implied CoE normalizes to its 5Y average, the index could see another c. 40% upside and a move to the 5Y low = 103% upside...

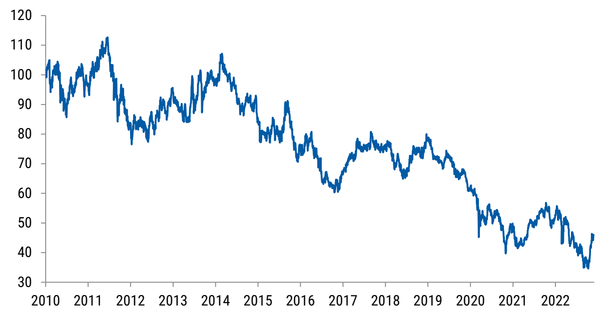
MSCI Poland: Implied CoE and ERP



Note: Implied equity risk premium = Implied Cost of Equity minus UST 10Y bond yield adjusted by country risk, measured by OAS (option-adjusted spread); Source: IBES, Datastream, Bloomberg, Eikon, Morgan Stanley Research

Exhibit 136: ... should Polish equities breakout of their long-term downtrend relative to MSCI EM

MSCI Poland vs EM: Performance (USD, rebased)



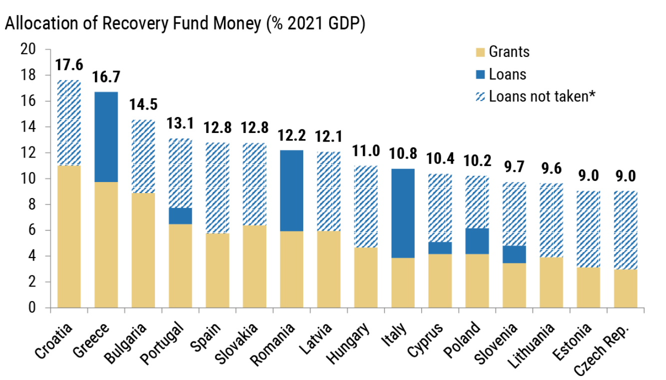
Source: Datastream and Morgan Stanley Research

Greece: Upgrade to Overweight; Our Preferred EM Europe Exposure

We upgrade Greece to Overweight from Equal-weight. The recovery in Greek macro continues, with our economists expecting relative resilience compared to the rest of Europe. They estimate that Greece will ultimately be able to avoid a technical recession (differently from rest of Euro Area), thanks, amongst other factors, to the support stemming from **fairly well-targeted fiscal policy and the implementation of the RRF**. They forecast GDP at 1.1%Y in 2023 and 1.9%Y in 2024. Greece's Recovery Plan is worth a total of €30.5 billion, around 16.7% of 2021 GDP, and includes as many as 106 investment projects in infrastructure, energy efficiency, electricity and digitalisation of SMEs among others, and 67 reforms that address many of the country's structural economic challenges as identified by the EC recommendations. The plan could lift GDP by as much as 6.9% by 2026, based on Bank of Greece estimates. For more details, see our European economists 2023 Year-Ahead Outlook note.

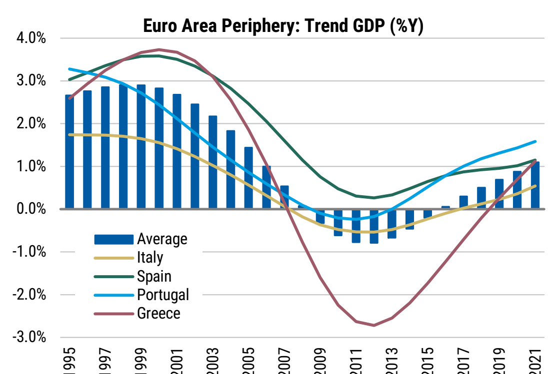
On equities, we favour the banks given the relatively strong macro coupled with their high sensitivity to ECB rate hikes and reduced asset quality risks following balance sheet clean-ups post the last down cycle. Our banks analyst recently published her updated views, with a preference of Greece over both Poland and Hungary in her EM Europe banks coverage. She argues that Greek banks' NIM expansion has just started and is set to grow, driven by ECB rate hikes (assuming 2.5% in 2023), with the benefit outpacing higher provisions due to weaker asset quality risks. Greece offer the best risk reward skew in her coverage at: +29% upside to base case, +61% to bull case and -53% to bear case and her Overweight rated stocks are Piraeus and Eurobank.

Exhibit 137: Greece continues to benefit from relatively high exposure to the EU Recovery Fund in both a European and Emerging European context



Source: *loans not taken yet, but can be requested until August 2023; total loans calculated by MS as 6.8% of 2019 GNI; Source: EC, MS Research

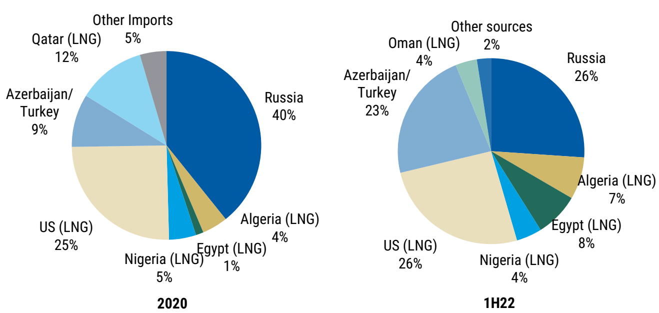
Exhibit 138: This and other factors drive Greece's economic resilience relative to peripheral Europe and CEE



Source: European Commission, Morgan Stanley Research

Exhibit 139: Greece used to satisfy most of its gas consumption via imports from Russia, but recently has started increasing its imports of LNG and of gas via the TAP pipeline

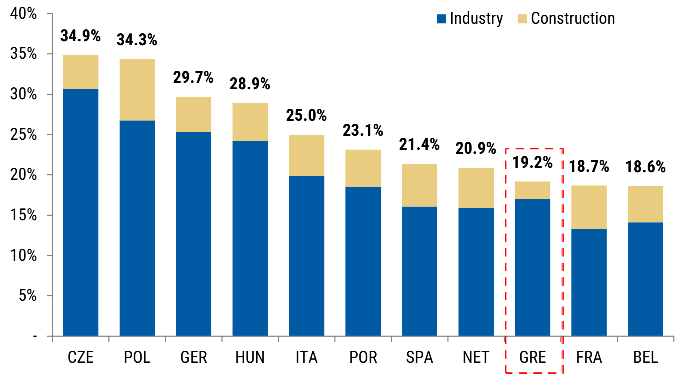
Greece Natural Gas Consumption by Source



Source: Eurostat and Morgan Stanley Research

Exhibit 140: Greece also has relatively low exposure to the energy-intensive manufacturing sector as compared to CEE and Europe

Greece and key EU peers: Industry and Construction, % of GVA 2021

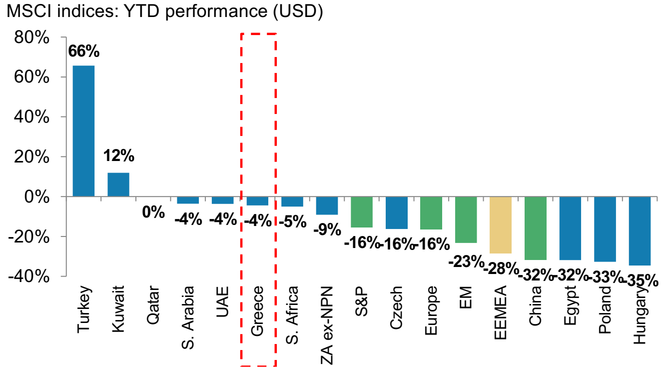


Source: Eurostat and Morgan Stanley Research

Positive earnings momentum, in particular for the banks, should support outperformance. Performance year-to-date of Greek stocks has been better than other Developed and Emerging European peers supported by a very strong 2022FY positive earnings revisions. Going forward, we would expect further upgrades for 2023FY as well. For instance, for the banks, which are 41% of the MSCI index, our analyst has her earnings estimates on average ~11% ahead of consensus on the back of NIM expansion when incorporating further ECB hikes in 2023.

Exhibit 141: Although down 4% YTD (in USD), Greece has outperformed EM, Europe and Emerging Europe YTD

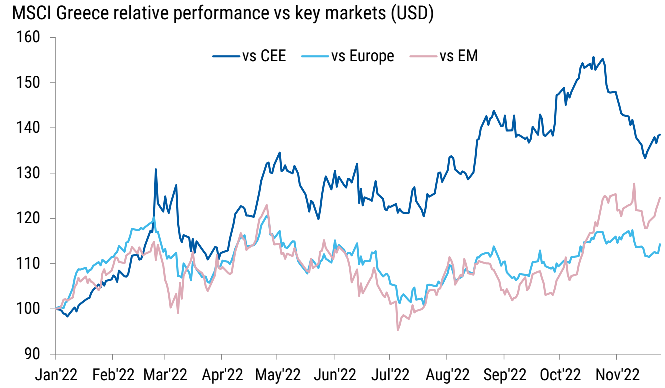
MSCI indices: YTD performance (USD)



Source: Eikon, Datastream and Morgan Stanley Research

Exhibit 142: The momentum vs CEE, as well as EM and European peers, is picking up again after the recent reversal

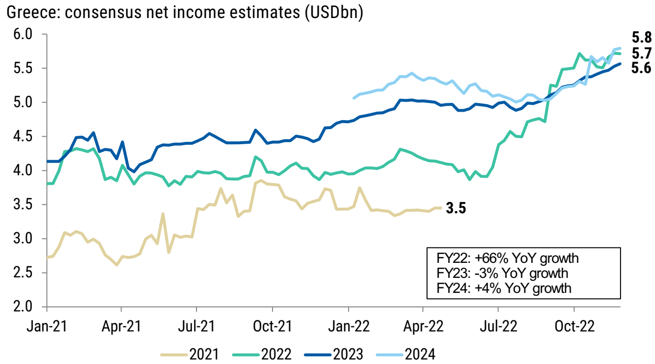
MSCI Greece relative performance vs key markets (USD)



Source: Datastream and Morgan Stanley Research

Exhibit 143: In absolute terms, Greece's aggregate 2022 earnings are on a rising path (driven by banks and energy) ...

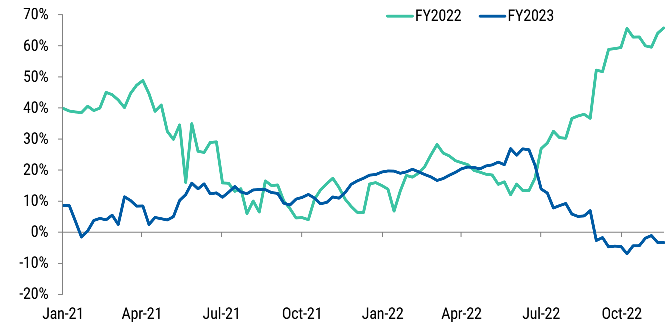
Greece: consensus net income estimates (USDbn)



Source: Bloomberg and Morgan Stanley Research

Exhibit 144: ... which is affecting 2023 YoY growth expectations (as 2022 has re-based higher)

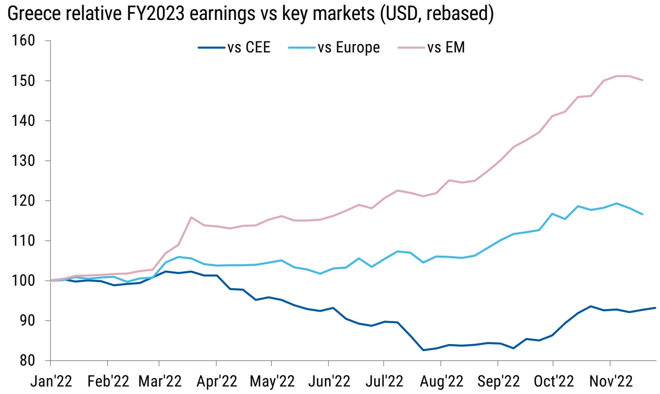
Greece: Consensus net income YoY growth estimates (USD)



Source: Bloomberg and Morgan Stanley Research

Exhibit 145: Greece's FY23 earnings trends are outpacing those of EM, in line with Europe and gained momentum vs CEE in the past 2 months

Greece relative FY2023 earnings vs key markets (USD, rebased)



Source: IBES, Datastream, Eikon and Morgan Stanley Research

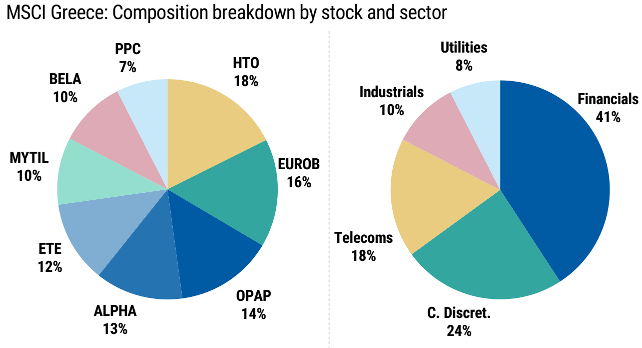
Exhibit 146: Key drivers of Greece's positive earnings revisions in the past 3M have been banks (high sensitivity to ECB rate hikes) and energy (refining)

in USD				2023e Earnings Revisions		
	Ticker	**Name**	**Sector**	**1M**	**3M**	**YTD**
1	TPEIR GA	Piraeus	Financials	-2%	**34%**	11%
2	ELPE GA	Hellenic Petroleum	Energy	9%	**11%**	28%
3	MOH GA	Motor Oil	Energy	14%	**11%**	48%
4	EUROB GA	Eurobank	Financials	-6%	**9%**	-1%
5	ETE GA	NBG	Financials	0%	**8%**	4%
6	MYTIL GA	Mytilineos	Industrials	-1%	**8%**	3%
7	ALPHA GA	Alpha Bank	Financials	-3%	**1%**	-12%
8	HTO GA	OTE	Comm. Services	0%	**0%**	-4%
9	PPC GA	Public Power	Utilities	0%	**-3%**	-29%
10	BELA GA	Jumbo	C. Discretionary	-3%	**-3%**	-7%
11	TENERGY GA	Terna Energy	Utilities	-4%	**-4%**	-11%
12	TITC GA	Titan Cement	Materials	0%	**-7%**	-34%
13	OPAP GA	OPAP	C. Discretionary	-4%	**-10%**	-14%

Source: Bloomberg and Morgan Stanley Research

Exhibit 147: Financials make up 41% of the MSCI Greece index whilst defensive cons. disc. (children's goods & gambling) & telecoms are another 42%

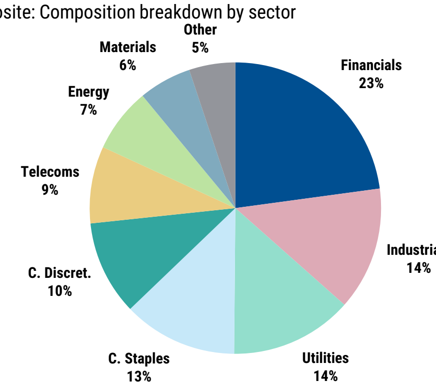
MSCI Greece: Composition breakdown by stock and sector



Source: MSCI, Datastream and Morgan Stanley Research

Exhibit 148: The local Athex index has a broader sector split but still a skew to more defensive sectors

Athex Composite: Composition breakdown by sector

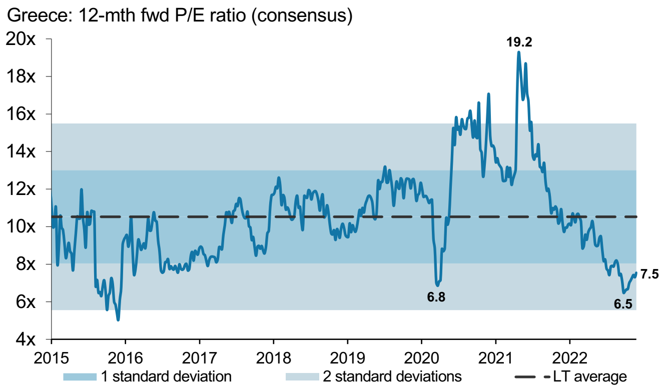


Source: Datastream and Morgan Stanley Research

Cheap valuations on absolute and relative basis. Despite Greece's macro & EPS resilience, wide discounts remain in absolute and relative terms.

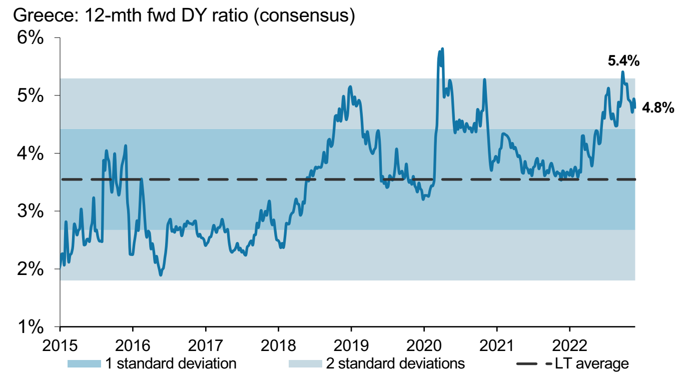
In Absolute Terms Greece is Near Recent Valuation Lows

Exhibit 149: On NTM P/E, Greece has re-rated slightly to 7.5x or -1.2 S.D's below average, but it is still not too far from the Covid trough



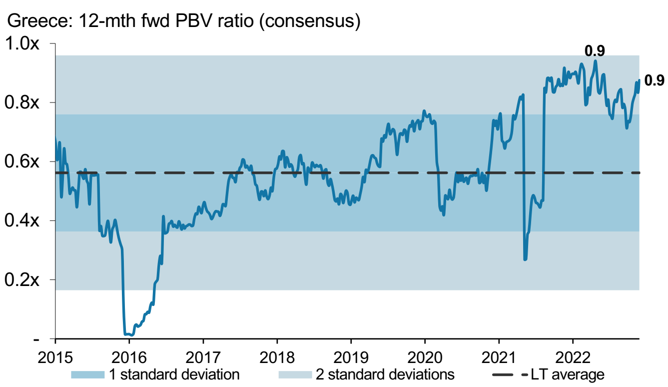
Source: Eikon and Morgan Stanley Research

Exhibit 150: Greece's NTM DY has come off its recent peak and is now at 5.0% or 1.6 S.D.'s above its average



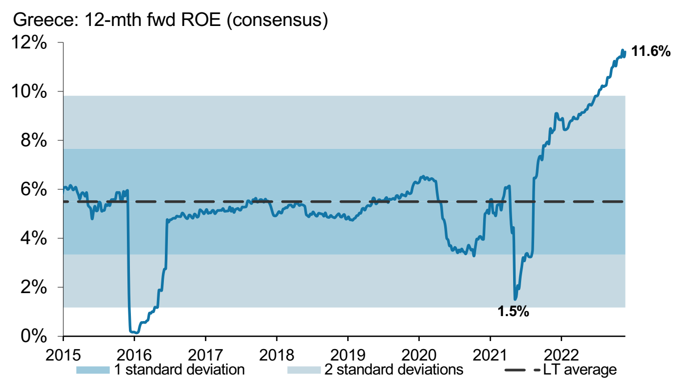
Source: Eikon and Morgan Stanley Research

Exhibit 151: Greece's NTM P/BV is higher versus history at 0.9x...



Source: Eikon and Morgan Stanley Research

Exhibit 152: ...explained by country's RoE rapidly recovering, currently at 11.5%, 2.8 S.D.'s above historical average



Source: Eikon and Morgan Stanley Research

Relative to Europe, the market trades near recent historical high valuation discounts

Exhibit 153: Greece's valuation discounts vs EM and Europe remain high, while vs CEE they are roughly in line, despite lower regulatory risks

	Relative to EM		Relative to Europe		Relative to CEE	
Valuation metric	**Current**	**S.D.**	**Current**	**S.D.**	**Current**	**S.D.**
NTM P/E	-33%	-1.2	-38%	-0.7	-1%	0.4
NTM DY	39%	0.6	34%	1.4	-10%	-0.1
NTM PBV	-38%	2.0	-50%	1.7	-1%	2.3
NTM ROE	-8%	3.0	-18%	2.4	0%	2.5

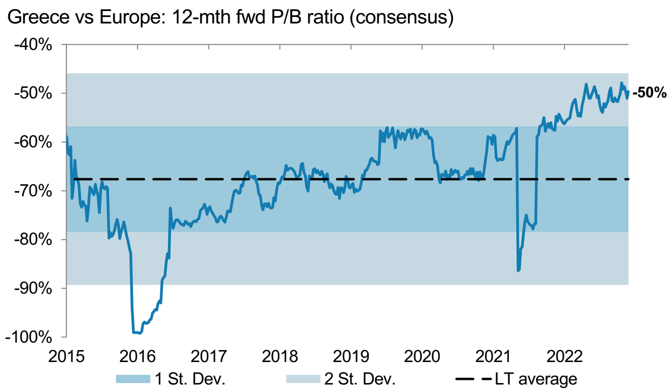
Note: S.D. vs 8-year average; Source: Eikon, IBES, Datastream and Morgan Stanley Research

Despite Greece's relative macro resilience vs Europe, the market trades near recent historical high valuation discounts: -38% on NTM P/E and 34% on DY, which is 0.7 and 1.4 S.D. below the relative 8Y average discount. Meanwhile, on a PBV basis, the 51% discount to Europe is 1.7 S.D. above the 8Y historical mean, justified by an improving relative ROE.

Relative to EM, we find the same trend. Greece valuations are trading at a significant discount (-33% on NTM PE and 39% on NTM DY) for the actual level and also relative to their historical average discount, while on a PBV basis, the discount has been narrowing on the back of improving ROE.

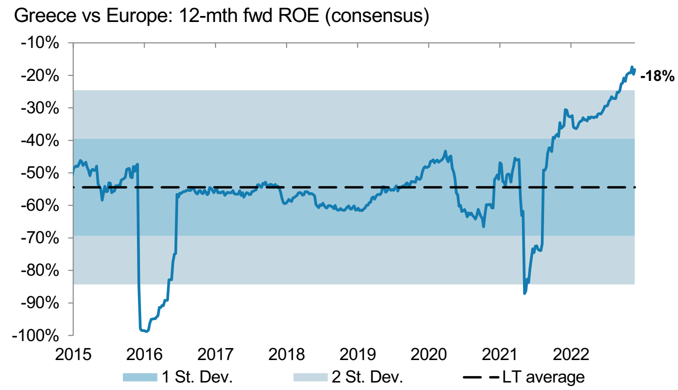
Lastly, relative to CEE peers, Greece's valuation premium has been declining recently and now Greece and CEE stocks are trading in line on a NTM P/E basis, despite lower regulatory risks in Greece. Further, improving relative ROE should continue on the back of positive earnings momentum, in particular for the banks, and consequently NTM PBV discount as well.

Exhibit 154: Greece vs Europe: Greece's structurally high P/BV discount vs Europe (driven by banks) appears to be structurally narrowing ...



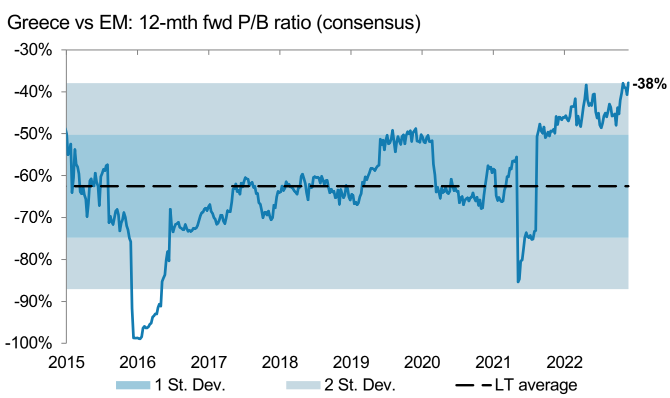
Source: IBES, Eikon, Datastream and Morgan Stanley Research

Exhibit 155: Greece vs Europe: ...whilst its RoE differential is narrowing at an even faster pace on the back of rising earnings



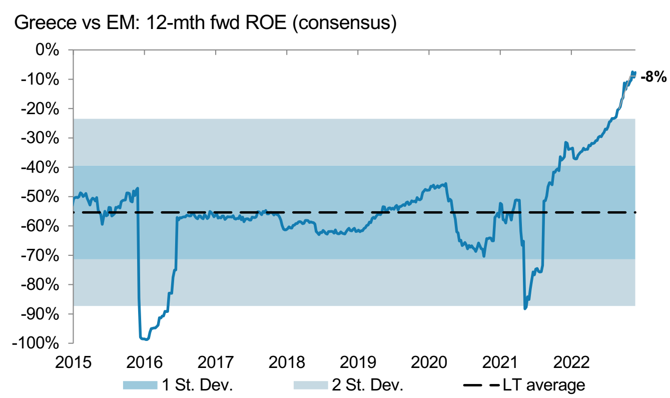
Source: IBES, Eikon, Datastream and Morgan Stanley Research

Exhibit 156: Greece vs EM: Greece trades at a 38% discount to EM on NTM P/BV ...



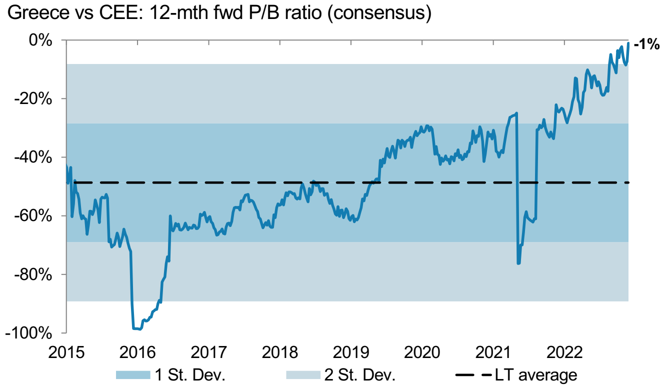
Source: IBES, Eikon, Datastream and Morgan Stanley Research

Exhibit 157: Greece vs EM:... despite a rapidly narrowing RoE discount (currently -8%)



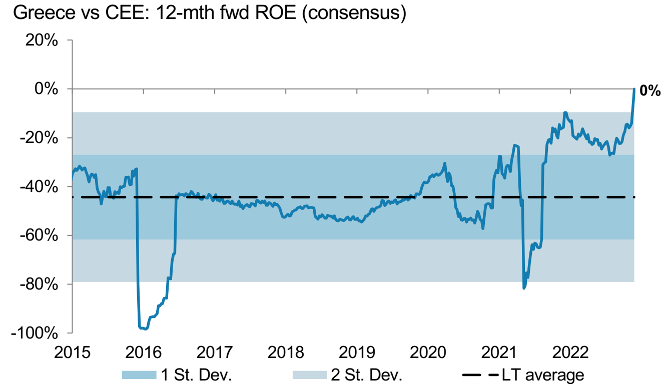
Source: IBES, Eikon, Datastream and Morgan Stanley Research

Exhibit 158: Greece vs CEE: Greece's NTM P/B discount vs CEE is narrowing structurally in our view ...



Source: Eikon and Morgan Stanley Research

Exhibit 159: Greece vs CEE:... and relative RoE should continue to rise supported by NIM expansion for the Greek banks



Source: Eikon and Morgan Stanley Research

Downside risks to our Overweight

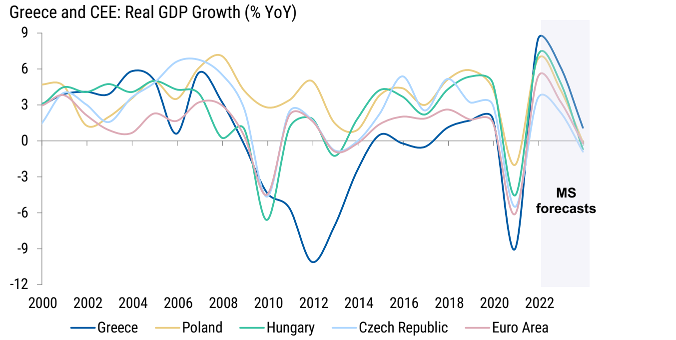
- **Political volatility:** Greece is expected to head to the polls in summer 2023, but ongoing claims of impropriety could lead to early elections. Based on recent polls, current ruling party New Democracy is still the most popular, which means elections are unlikely to result in any substantial change in policy direction. Further, PM Mitsotakis has so far dismissed the possibility of his resignation, and our economists' base case is for a continuation of the current government until the end of its term.

- **Tourism and impact on GDP growth:** One of the major risks to our economists' more constructive view stems from Greece's heavy reliance on tourism – around 15% of its GDP. Higher inflation globally (US & Europe, more in particular) will likely lead to a reduction in consumers' discretionary spending, which would ultimately negatively impact tourism flows and hence Greece's GDP.

- **EU funds absorption is weaker than expected**, driving lower GDP growth.

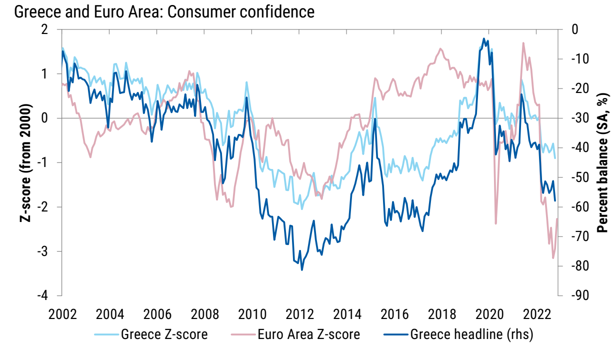
- **Deeper recession risks in euro area:** More disruptions on energy supply would reduce activity further and GDP in the euro area would fall by 1.0%Y in 2023 on our economists' bear case. However, on a relative basis, we think Greece could still outperform CEE peers given their less dependence on gas.

Exhibit 160: Despite Greece's relative economic resilience, the absolute direction is downwards



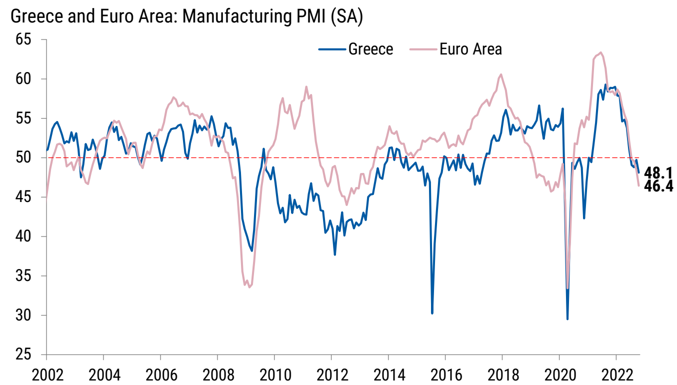
Source: Haver Analytics and Morgan Stanley Research

Exhibit 161: Greece's consumer confidence is negative, though not near all-time lows as in Europe



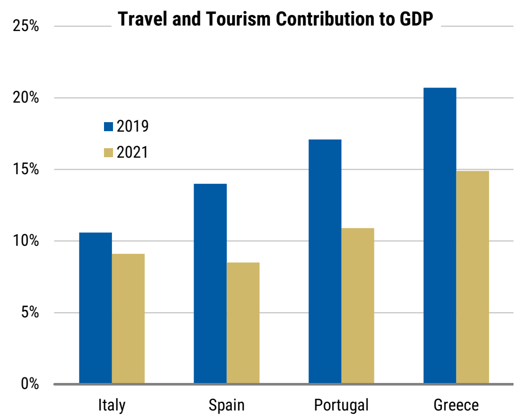
Source: Haver Analytics and Morgan Stanley Research

Exhibit 162: Greece's Manufacturing PMI is still declining (even if relative manufacturing exposure is lower vs European peers) ...



Source: Haver Analytics and Morgan Stanley Research

Exhibit 163: ... and EU/global consumer weakness into 2023 poses risks to next year's tourism season - a key source of budget revenues for Greece



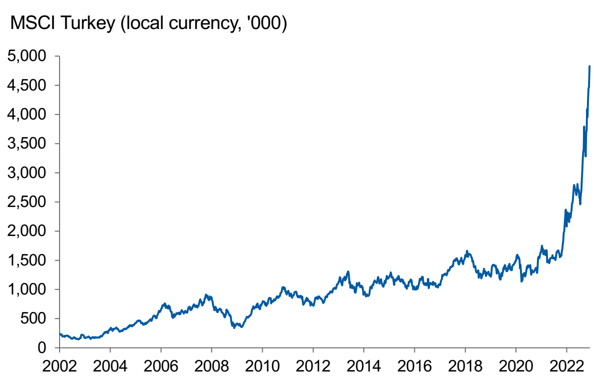
Source: World Travel and Tourism Council, Morgan Stanley Research

Turkey: Focus On Elections; Stay Equal-weight

On our recent macro trip to Ankara and Istanbul, the focus in our meetings with local experts, companies, politicians and political analysts was meaningfully on politics. This fact coupled with rising investor questions on Turkey's ongoing rally and next year's elections, suggests we are transitioning into a period of (pre)election-driven performance. For more details on the macro economic feedback from these meetings, see Macro Trip Notes: At a Crossroads.

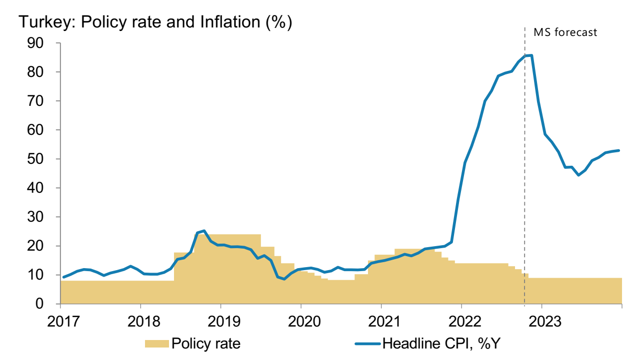
MSCI Turkey continues to make new highs; the best performing market globally, up 66% YTD. In local currency terms, that is explained mainly by local flows. This dynamic is likely driven to a large extent by the relative inflation hedging appeal of the domestic equity market (Turkish headline inflation+85.5% yoy in October, real rates at -76.5%). Meanwhile, in USD terms, the index has broken out to the upside versus its long-term downtrend, supported by a stable TRYUSD since August. The feedback from our conversations during our trip in Turkey suggests a consensus view that at least until elections, which are expected to be held in mid-May, the currency should remain resilient, or only gradually depreciate, despite the country's growing macro imbalances. The recent increase in FX reserves and USD transfers related to international investments, such as the Rosatom NPP (Exhibit 167), were frequently mentioned as important facts supporting the currency. Thus, in this scenario of a stable TRYUSD and high inflation, the index breakout has potentially more room to go, although high volatility should be expected.

Exhibit 164: In local currency, Turkey continues to make new all-time highs ...



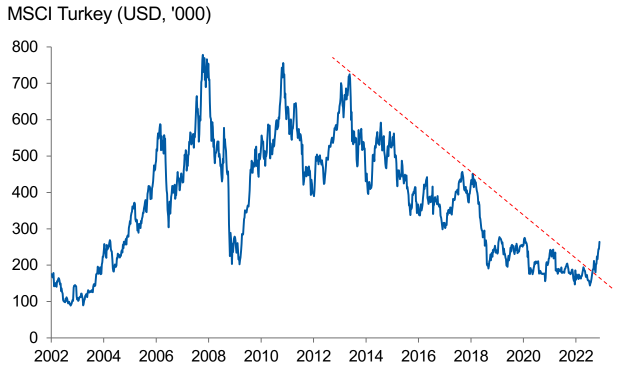
Source: Datastream and Morgan Stanley Research

Exhibit 165: ... driven to a large extent by the relative inflation hedging appeal of the domestic equity market



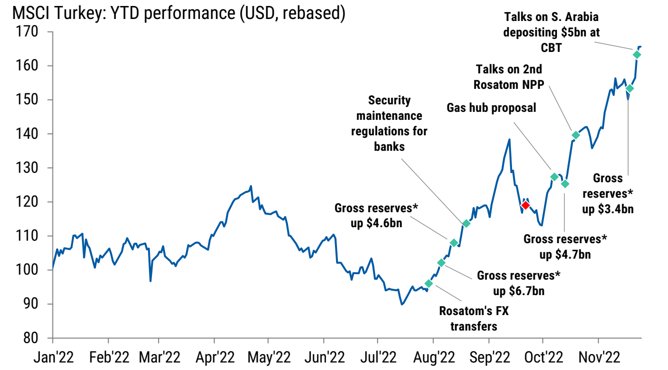
Source: Haver Analytics and Morgan Stanley Research forecasts

Exhibit 166: In USD terms, the index has recently broken out to the upside vs its LT downtrend, supported by a stable TRYUSD ...



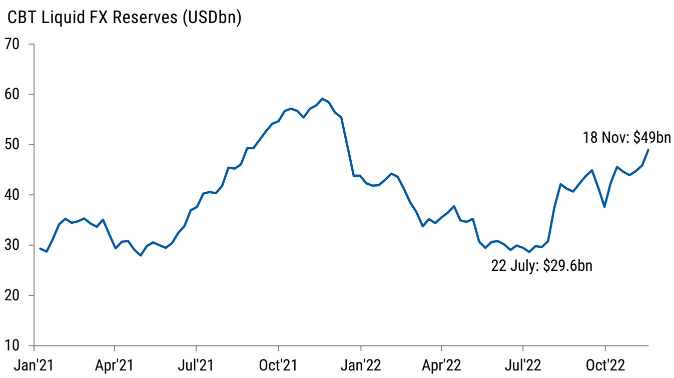
Source: Datastream and Morgan Stanley Research

Exhibit 167: ... on the back of a number of top-down drivers



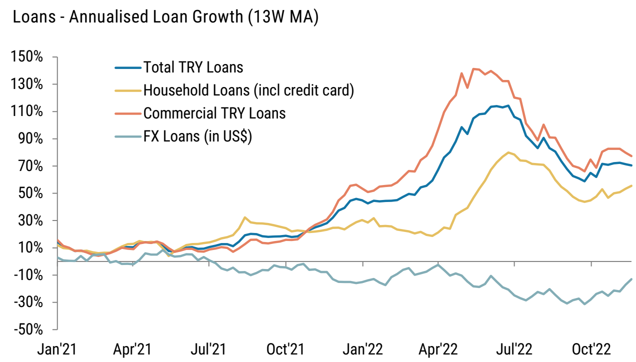
*Release of weekly gross reserves data showing notable increases; Source: Datastream and Morgan Stanley Research

Exhibit 168: Despite their recent volatility, liquid FX reserves stand US$19.3 billion higher relative to end-July



Source: Haver Analytics, Morgan Stanley Research. Note: We calculate liquid FX reserves by subtracting SDR and swaps with other central banks from gross FX reserves

Exhibit 169: Loan growth slowed due to a series of macroprudential measures and regulations in 3Q22



Source: Haver Analytics, Morgan Stanley Research

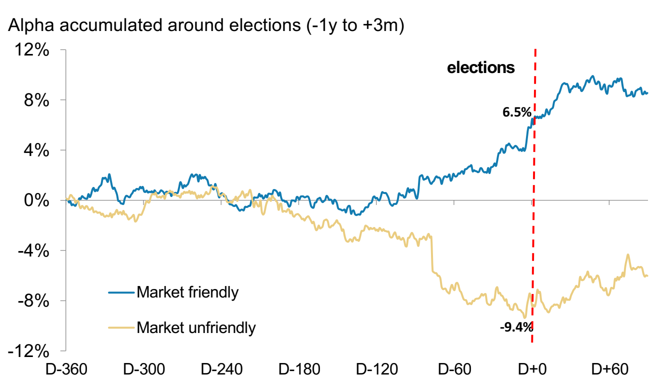
Bottom-up challenges remain in equities. We note that earnings revisions for Turkish stocks, in particular for the banks, have been strong in the first half of this year, benefiting from high inflation and low funding costs. However, hyperinflation accounting has not been introduced. Further, our conversations suggest some headwinds ahead. For the banks, given the new banking sector regulations, lending activity has significantly slowed down (see Exhibit 169). For instance, there are indications from some of the banks and corporates we met with that even credit lines for working capital needs have been impacted and, so far, they don't expect a reacceleration of lending growth – unless part of these regulations were to be reversed. In addition, banks' exposure to long-term fixed rate TRY government bonds was mentioned as a key risk for their balance sheets in the future, in case monetary policy normalizes and interest rates increase. We note that the banks we spoke with are managing this environment and mentioned current low exposure (less than 2% of their balance sheet) to these long-term fixed rate TRY government bonds. Meanwhile, exporters now have to convert 40% of their FX revenue payments to local currency, up from 25% earlier this year. While this has contributed to the stabilization in the currency, it has also been creating working capital challenges such as a mismatch of payables and receivables in hard currency and increasing transaction costs for these companies.

Transitioning to an election-driven rally? Despite the macro and micro challenges, the focus on politics in our meetings during our trip and increasing investor questions we have been receiving on Turkey's rally and next year's elections, suggest to us that we are likely transitioning into a period of election-driven performance. As we have been mentioning in other reports, elections are always important events, especially in Emerging Markets. Our Latam colleagues analysed how equity markets have behaved before and after 100+ Presidential elections in emerging countries over the past 27 years and classified them into three different groups: market-friendly, market-unfriendly and market-neutral. In general, **the market typically starts to price in the potential outcome from about 7 months prior to the election date.** For Turkey, if elections are held in May, we are currently ~6 months away.

Argentina, South Africa, and other prior EM election case studies. Furthermore, looking at one particular case, Argentina's Presidential election in 2015, we note that, during the 21 months leading up to elections, Argentinean banks rallied 300%+ and outperformed MSCI EM by 337% on the prospect of macro adjustment, which our team discussed in a report at that time. At the start of that rally, Argentinean banks' valuation starting point was at similar levels to where Turkish banks are trading today (Exhibit 173).

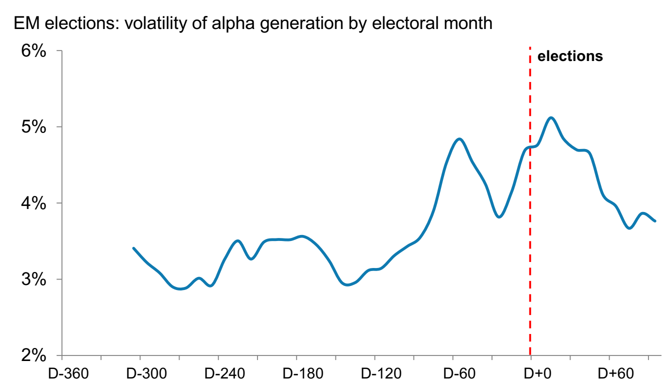
Importantly, in the EM case study, the 2015 Argentina Presidential election and the South Africa ANC race in December 2017, a significant proportion of the rally happened before the election. For instance, in the EM case study of market friendly outcomes, the overall peak of alpha generation happened 1.5 months after the elections and generating an alpha half of the value generated ahead of the elections (+6.5% before vs and additional+3.2% after). In the Argentinean case, as we mentioned before, the banks rallied 300% ahead of the election day. After that, the market declined+20% in the following month and fluctuated around the same level in the following 12 months despite the new orthodox policies implemented. The market made a new peak 2 years after that (Exhibit 172). Lastly, in the case of South Africa, the market peaked in absolute terms by late-January 2018, one month after the ANC election. After that, the index posted negative returns in both absolute and relative terms vs EM in the following 9 months.

Exhibit 170: The EM elections case study suggest that the market typically starts to price in the potential outcome from about 7 months prior to the election date



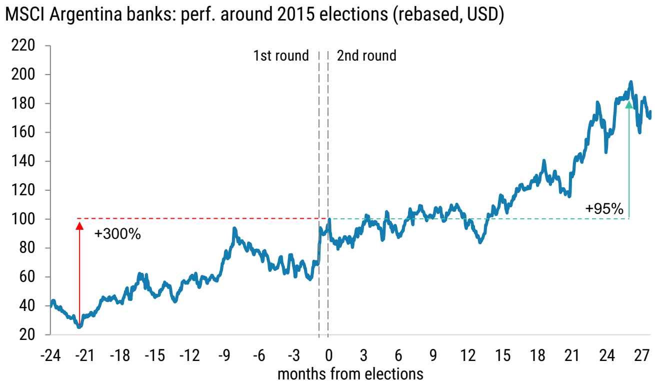
Source: Bloomberg and Morgan Stanley Research

Exhibit 171: In addition, this case study observed an increase in performance volatility near elections



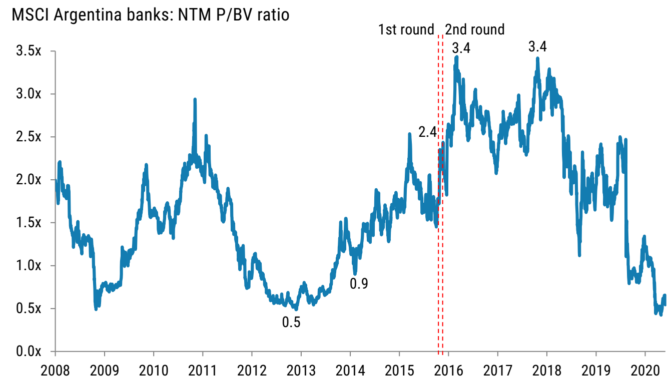
Source: Bloomberg, Morgan Stanley Research

Exhibit 172: In Argentina's case, the banks sector rallied 300% during the 21 months heading to the elections



Source: Datastream and Morgan Stanley Research

Exhibit 173: Argentinian banks were trading at depressed valuations at the start of that process on NTM P/BV



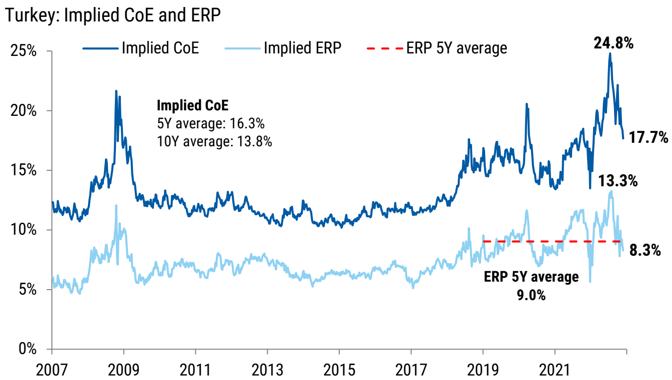
Note: Series stops in May 2020 as there were no longer financial stocks in MSCI Argentina as of June 2020; Source: Bloomberg and Morgan Stanley Research

Pre-election rally likely to be more meaningful than post-elections; long-term case remain binary, keeping us Equal-weight. Over the last decade, we feel that markets have become more aware of the potential challenges to any major policy changes post-EM elections. Therefore, we would expect any election-driven rally to occur pre-elections, making long-term investment challenging. The feedback from our trip suggests that macro and monetary policies are unlikely to change until elections. But there is a debate around whether there will be a shift towards more orthodox policies from 2H23 – which at this point looks binary, in our view. In the short term, high inflation, stable currency and undemanding valuations should continue to support the index rally, while in the medium to long term, uncertainty persists regardless of the election outcome. This fact combined with the earnings risk for 2023 and onwards support our Equal-weight stance on Turkish equities in an EEMEA context.

Implied CoE and implied ERP suggest balanced risks. Implied CoE and ERP have already significantly declined in the recent rally. For instance, Turkey implied ERP at 8.3% is down from 13.3% in its recent peak and is roughly in-line with its 5Y historical average. Looking at the implied cost of equity for Turkish equities, it is currently at 17.7%, down from almost 25% from its peak. If we assume a CoE normalization to its 5Y average of 16.3%, that would mean another 10% upside, all else constant, while a normalization to its long-term average of 13.4% would imply a more significant upside of 41%. On the other hand, a return to recent peak would imply 33% downside from current levels.

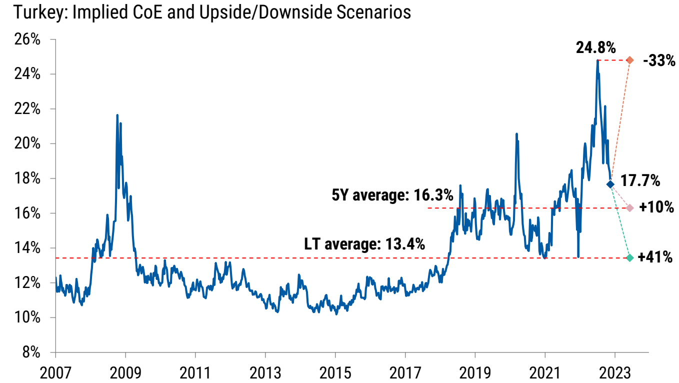
For investors who want to get exposure to potential pre-election optimism, we would recommend the banks sector. For investors who prefer more defensive and resilient Turkish exposure, we would recommend BIM (TRY147.10), Equal-weight rated by our consumer analyst Henrik Herbst (see BIM: Domestic winner).

Exhibit 174: Implied CoE and ERP have already significantly declined in the recent rally



Note: Implied ERP = Implied CoE minus Risk-free Rate; Risk-free Rate = UST 10Y yield adjusted by country risk, measured by 10Y Z-spread; Source: Eikon, Bloomberg and Morgan Stanley Research

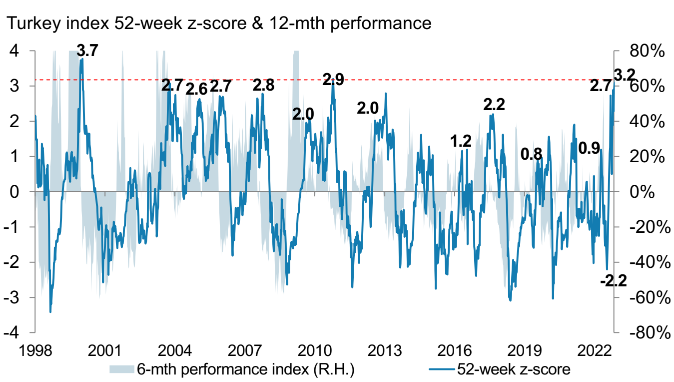
Exhibit 175: Sensitivity on implied CoE suggests balanced risks



Scenarios are calculated holding other parameters constant; Source: Eikon, Bloomberg and Morgan Stanley Research

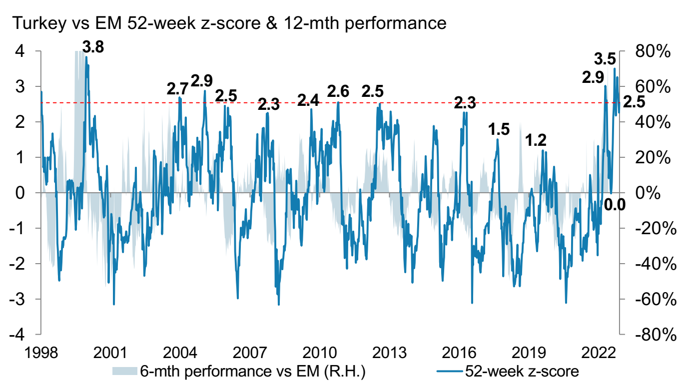
Potential risks for equities: We would expect volatility to increase as we get close to elections. We note, in the case of Argentina which saw a rally comparable in magnitude to Turkey today, there were significant moves ahead of elections (+/-20% in a period of 1-2 weeks). Further, the EM elections case study observed an increase in performance volatility near elections (Exhibit 171). In our view, a volatility increase could be related to: 1) new polls being released, 2) announcement of official candidacies, which should happen between end of the year and early next year, according to our conversations, and/or 3) new policies being implemented ahead of elections. On the tactical side, technicals are downside risks as they continue to screen overbought in both in absolute and relative terms (Exhibit 176 and Exhibit 177). Lastly, given the trade relations with Russia, as mentioned in some articles in the press (FT, Nov 4), potential impact from sanctions are also tail risks we would monitor.

Exhibit 176: On technicals, Turkey is significantly overbought in absolute USD terms at 3.2 S.D.'s ...



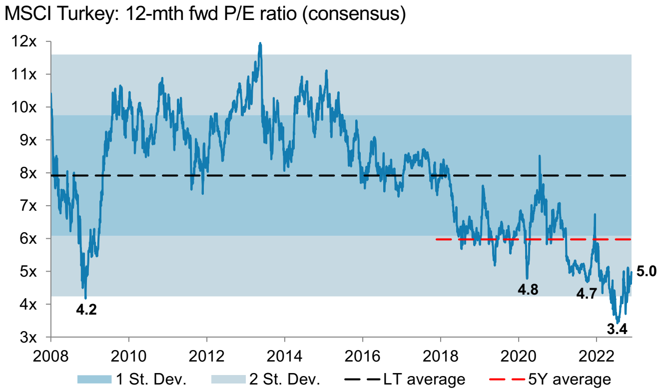
Source: Bloomberg and Morgan Stanley Research

Exhibit 177: ... and slightly less overbought relative to EM at 2.5 S.D.'s, down from 3.5 S.D.'s seen in early September



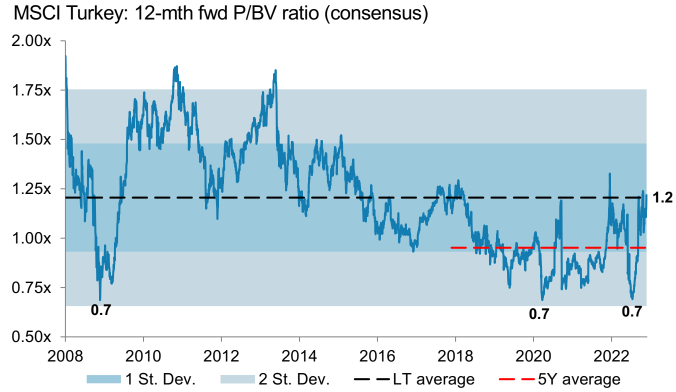
Source: Bloomberg and Morgan Stanley Research

Exhibit 178: Turkish equities' NTM P/E ratio has recovered from historical lows, but is still undemanding at 5.0x or 1.6 S.D.'s below the LT avg



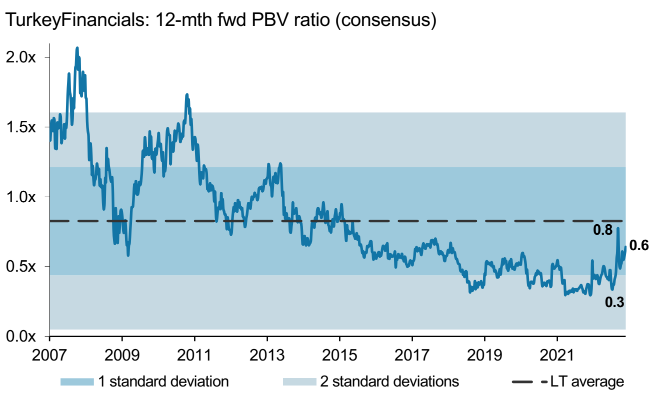
Source: Bloomberg and Morgan Stanley Research

Exhibit 179: On a P/BV basis, Turkey has also re-rated and is now trading at 1.2x, in line with its LT avg



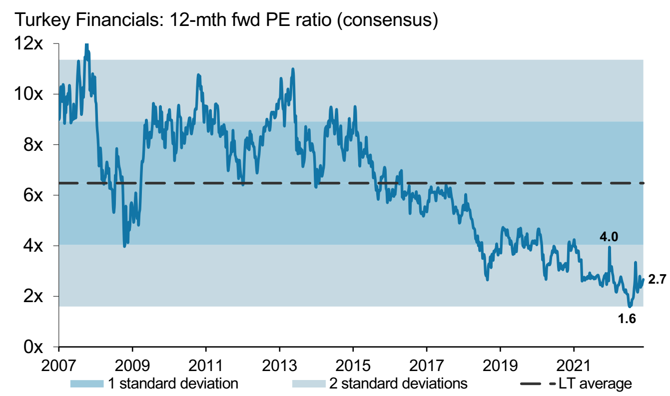
Source: Bloomberg and Morgan Stanley Research

Exhibit 180: On NTM P/BV, Turkish Banks have also come off their lows to trade at 0.6x or 0.5 S.D below the LT average



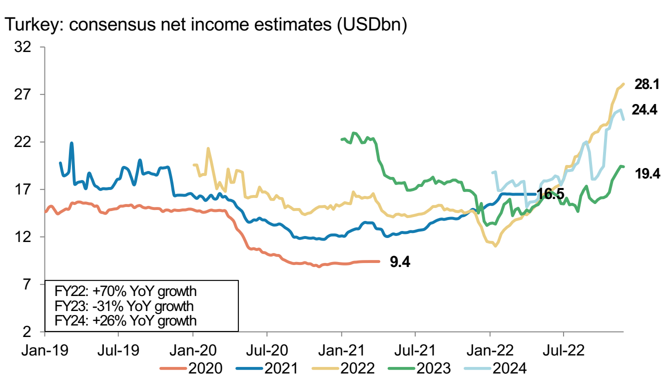
Source: Eikon and Morgan Stanley Research

Exhibit 181: Turkish Banks now trade on 2.7x NTM P/E, 1.6 S.D. below the LT average



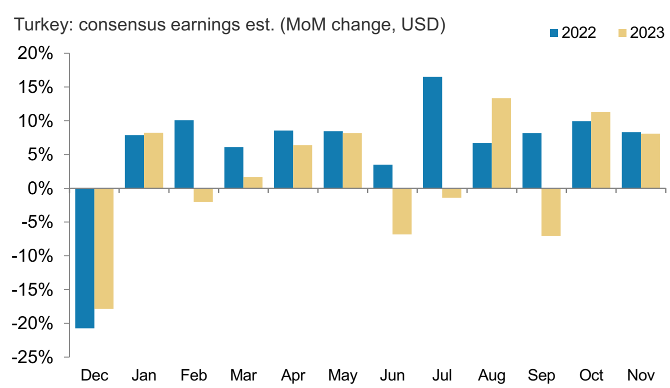
Source: Eikon and Morgan Stanley Research

Exhibit 182: Turkish USD earnings estimates have seen strong upward revisions YTD, especially for FY22 ...



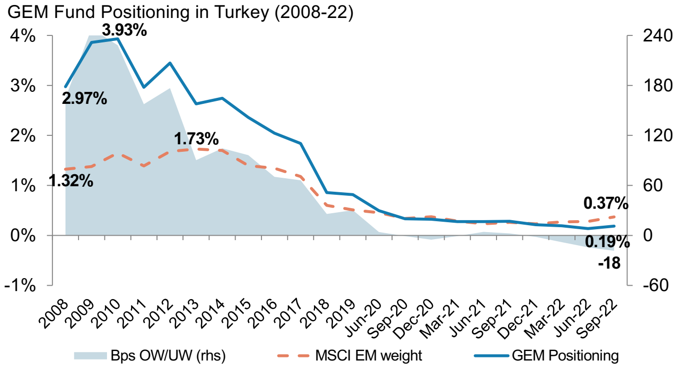
Source: Eikon, Bloomberg and Morgan Stanley Research

Exhibit 183: ... while estimates for FY23 have lagged - maybe driven by macro uncertainties



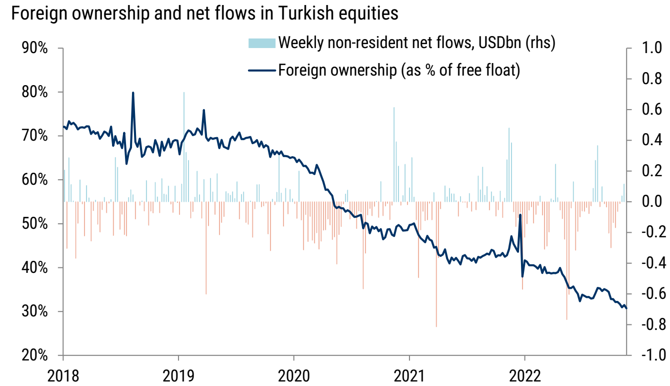
Source: Eikon, Bloomberg and Morgan Stanley Research

Exhibit 184: Foreign exposure to Turkish equities is at all time lows: Turkey's weight in MSCI EM and GEM fund positioning have been in a structural decline



Note: Our sample group of GEM funds varies month-to-month so is not directly comparable though can serve as a rough guide of changing positioning over time; Source: Factset and Morgan Stanley Research

Exhibit 185: Despite recent rally, foreign investors' participation continued to decline



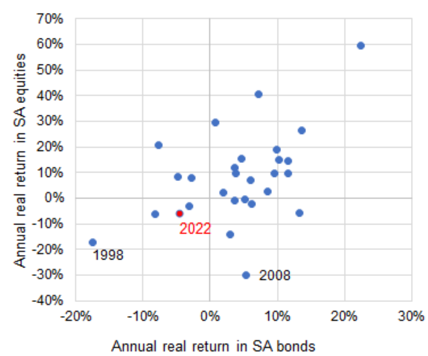
Source: Bloomberg and Morgan Stanley Research

South Africa: 5 Reasons for Positive Absolute Returns in 2023

Mary Curtis, South Africa Strategist

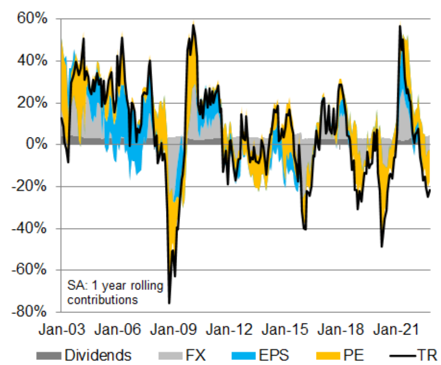
2022 goes down on record as one of the weakest combinations of SA equity and bond returns. At their lowest point (late October), MSCI SA was down 23% and SA 10-year bonds were down 5% in USD terms. There has been a sharp recovery from that low but in absolute terms, MSCI SA is still down 5% YTD. The decomposition shows that 12 month forward earnings expectations have held up well and dividends have been a bigger than usual support to total returns, but these two factors have been insufficient to offset the poor performance of the ZAR against the USD and the SA equity market multiple de-rating.

Exhibit 186: SA real annual equity and bond returns



Source: Thomson Reuters, RMB Morgan Stanley

Exhibit 187: Drivers of MSCI SA 12 month returns: de-rating the biggest drag



Source: Thomson Reuters, RMB Morgan Stanley

There are 5 reasons why we expect positive total returns from SA equities over the next 12 months:

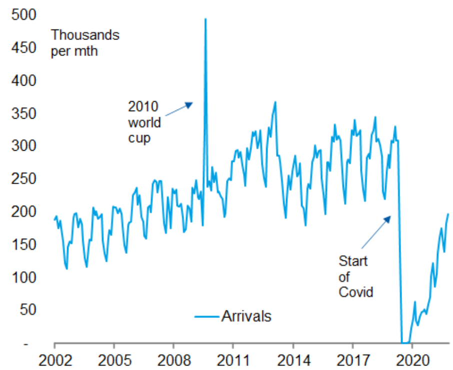
1) **Lower global bond yields.** Higher discount rates have put pressure on equity multiples across the board and SA has been no exception. The 12 month forward PE for SA de-rated from 9.6x at the start of 2022 to 8.5x (latest consensus estimates) as discount rates have risen. Consensus multiples at these levels are only 6% off the lows recorded in March 2020 at the height of the market sell-off in the wake of the covid crisis. Lower global bond yields over 2023 (MS base case is that the US 10 year yield softens to 3.5% end 2023) sets the scene for some re-rating of SA equities. There are many moving parts in the equation but we estimate a 50bps reduction in US yields would support an 5% re-rating of SA equities, all else equal.

2) **Stronger growth from China**. Slow economic activity in China over the last 12 months has been a drag on SA exports. China accounted for 9.5% of SA total exports over the last 12 months down from over 12% of total exports a year ago. MS forecasts a recovery in Chinese GDP growth from 3.2% in 2022 to 5% in 2023 implying stronger demand for SA exports.

3) **Local growth: slowdown, but no recession**. In the recent report detailing our EMEA

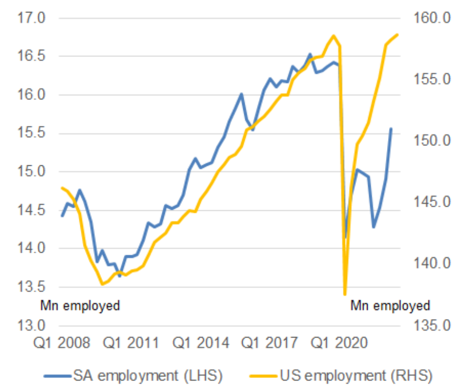
economic outlook (see here), our economist Andrea Masia set out his projections for SA GDP growth into 2023. He forecasts SA growth at 1%, down from 1.6% in 2022. Key to this projection is that South African economic activity is still recovering from the pandemic and that a robust recovery in tourism should drive continued gains in employment, which lends some resilience to household consumption despite the rise in the cost-of-living.

Exhibit 188: Number of foreigners arriving by air into South Africa



Source: Thomson Reuters, STATS SA, RMB Morgan Stanley

Exhibit 189: SA vs US employment: SA has only partially recovered from covid - the return of tourists should help



Source: Thomson Reuters, RMB Morgan Stanley

4) **Flow of funds potential from elevated cash holdings**.

Exhibit 190: Avg allocations of SA balanced funds

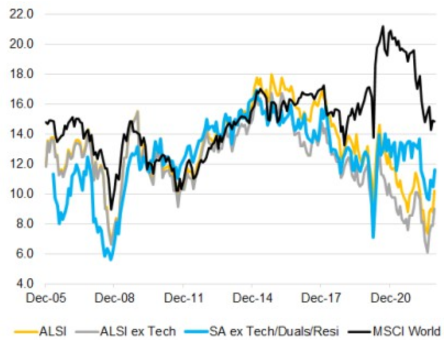
Average	3Q 2022	4Q 2021
SA Equities	41.4%	46.5%
Foreign Equities	24.6%	23.5%
Total Equities	**66.0%**	**70.0%**
SA Bonds	18.7%	18.5%
Foreign Bonds	3.3%	2.1%
Total Bonds	**21.7%**	**20.4%**
SA Property	2.0%	2.6%
Foreign Property	1.4%	1.1%
Total Property	**2.8%**	**3.1%**
SA Cash	5.3%	4.4%
Foreign Cash	4.4%	2.5%
Total Cash	**9.7%**	**6.8%**
Total	**100.0%**	**100.0%**
Foreign Total	**32.9%**	**28.6%**

Source: RMB Morgan Stanley

Our survey of SA balanced funds shows that average SA equity holdings have been reduced YTD in favour of cash (both onshore and offshore) and the offshore allocation. The change (at the end of February this year) in the regulated limit on the offshore allocation (from an effective 30% to 45%) may continue to put pressure on local investments but we expect these shifts to be pragmatic around relative valuation and growth prospects.

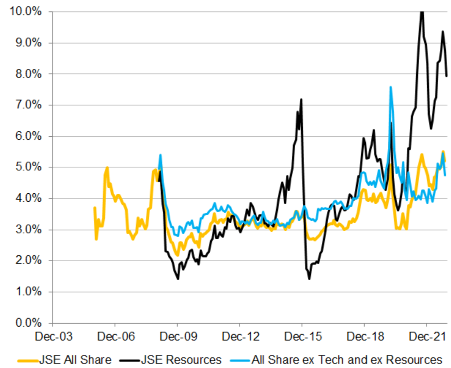
5) **Valuations and dividends**. The main drivers of positive SA equity returns over the next 12 months are most likely to come from a degree of re-rating and the contribution from dividend yields. As we illustrate in Exhibit 191 and Exhibit 192, SA dividend yields are close to 20+year highs on a forward looking basis, PE multiples have bounced off their lows since the end of October but are still only fractionally higher than their Covid trough on consensus expectations.

Exhibit 191: 12 month forward consensus PEs



Source: Thomson Reuters, RMB Morgan Stanley

Exhibit 192: 12 month forward consensus DYs



Source: Thomson Reuters, RMB Morgan Stanley

In Exhibit 193 we combine the bottom-up base case earnings growth forecasts for each of the SA sectors with our ratings outlook and forecast dividend yield to generate the base case total return. Even with relatively pedestrian forecast earnings growth, total returns are reasonably strong thanks to the underpin from dividend yields plus moderate re-rating.

Exhibit 193 also summarises the correlation co-efficients between these SA sectors and Chinese equity performance and US 10 year bond yields. To a large extent, the better macro growth from China in 2023 is already factored into base case earnings projections while the forecast decline in US yields is factored into our target PE multiples, but the data serves to highlight the relative sensitivities.

Exhibit 193: SA sector earnings growth, DYs and target PEs plus correlation co-efficients with MSCI China and US 10 year yields

	MSCI SA Sector wght (%)	Forecast eps gr Next 12 mths	Forecast eps gr Year after	Current 12 mth fwd PE	5 yr avg 12 mth fwd PE	Target 12 mth fwd PE	DY 12 mth fwd	Total Return	Correlation with MSCI China	Correlation with US 10 yr ylds
Diversified Miners	2.9	-15%	-21%	6.2	11.3	8.0	8%	10.4%	0.41	0.17
Gold	8.3	-12%	5%	13.7	12.0	14.0	1%	6.0%	0.16	-0.10
PGMs	11.3	-2%	-16%	6.5	20.0	8.0	10%	13.9%	0.39	0.00
Pulp & paper		-21%	4%	9.5	12.0	10.0	3%	12.5%	0.23	0.04
Chemicals	4.3	79%	-17%	4.0	9.2	5.0	10%	14.0%	0.27	0.22
Beverages		5%	13%	17.0	20.6	17.0	2%	14.9%	0.26	0.09
Tobacco	1.0	11%	8%	7.9	12.4	8.0	8%	17.1%	0.25	0.00
Luxury		24%	6%	19.0	23.7	19.0	2%	8.0%	0.49	0.09
Media	1.1	8%	7%	12.5	13.0	12.5	5%	11.5%	0.28	0.09
Technology	12.7	14%	40%	14.3	30.0	12.0	0%	17.9%	0.77	-0.03
General Retail	4.7	6%	9%	11.8	16.0	12.5	4%	20.0%	0.27	0.17
Industrials	1.6	11%	6%	9.4	10.5	10.0	4%	16.6%	0.30	0.29
Banks	25.5	13%	9%	8.7	10.4	9.5	7%	25.8%	0.21	0.25
Insurance	5.2	12%	9%	8.7	12.2	9.2	4%	18.8%	0.25	0.03
Real Estate	2.3	8%	5%	9.1	10.0	9.5	7%	16.1%	0.32	0.10
Health Care services	1.9	28%	19%	11.4	15.0	12.0	1%	26.3%	0.26	0.11
Pharma	1.4	-1%	11%	9.4	12.3	10.0	3%	21.1%	0.32	0.12
Telecommunications	7.5	10%	8%	9.6	13.3	10.2	3%	17.6%	0.22	0.08
Food & drug retail	8.2	14%	11%	17.3	19.1	18.0	3%	17.7%	0.29	0.12
Food producers		9%	7%	11.6	14.6	12.0	6%	17.1%	0.29	0.14

Source: Thomson Reuters, RMB Morgan Stanley. N.B correlation co-efficients based on 3 years worth of weekly % changes in USD terms

Which sectors/stocks do we expect to deliver the strongest returns? In Exhibit 194, we set out our relative preferences within South African equities. With most sectors offering relatively robust dividend yields and a combination of low multiples and/or positive EPS growth, South African equities have a lot on offer, even if multiples only manage to move sideways from here.

Exhibit 194: RMB MS recommendations for a dedicated South African equity portfolio

OVERWEIGHT

Banks:
Solid earnings, high dividend yields with room for multiple expansion. FSR (OW) offers the greatest upside to target price.

Food Producers:
Margin improvements forecast as input costs moderate. Scope for re-rating + strong dividend support. Tigerbrands and AVI both rated OW.

Tobacco:
High and stable dividend stream, performs well when DM bond yields decline. Expect solid total returns even without any re-rating.

PGMs:
Higher rates of car production supports demand for PGMs, although we are watching closely for any evidence of rapidly building car inventories. Preferred exposure NHM and IMP (OW).

Chemicals:
Cheap against history and sensitive to China re-opening should this catalyse our base case forecast of higher oil prices. SOL (EW)

Healthcare:
Still in recovery mode from covid. Preferred exposure is LHC (OW).

Food and Drug retail:
Strong preference for the food retailers over the drug retailers. SHP (OW) is our preferred pick.

UNDERWEIGHT

Property:
Excess capacity in Office and Retail space likely limits the ability to pass through cost growth leaving the sector with less earnings and dividend growth than elsewhere.

Beverages:
Risk from rising input costs while pricing power is typically not strong.

Pulp & paper:
Sector earnings challenged by slowdown in Europe and competitive pressures.

Gold:
Lower real bond yields and a weaker USD should drive positive performance in gold, but high cost detracts from the earnings outlook. Prefer ANG (EW).

Luxury:
Relatively less earnings growth on offer as global consumption slows off a relatively high base.

Telcos:
Less upside than other SA Inc sectors on our forecast earnings and multiple trajectory. TKG (OW), MTN (EW).

NEUTRAL

Diversified miners:
High yields, cheap multiples. Expect coal prices to stay higher for longer Prefer Thungela (OW), Glencore (OW) and ARM (OW).

Technology:
A relatively small discount to Tencent, but a beneficiary of our base case macro backdrop of lower US bond yields and recovery in China.

Industrials:
Capex rebound in SA should underpin stronger earnings for the sector. Preferred exposure is to BVT (OW) for diversity, cash-generation and high ROE

General retail:
Risk to sales volumes as inflation eats into disposable income. We prefer TFG (OW) and PPH (OW) to MRP and TRU (both UW)

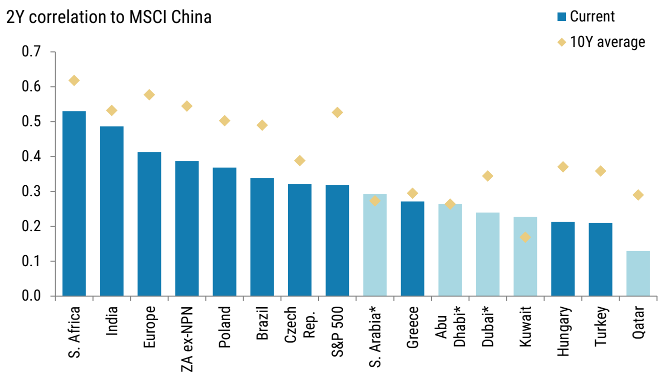
Insurance:
Sector has been historically the most sensitive to better risk asset performance. Growth potential limited by greater competition.

Source: RMB Morgan Stanley Research

Appendix: EEMEA Stocks Correlated to MSCI China

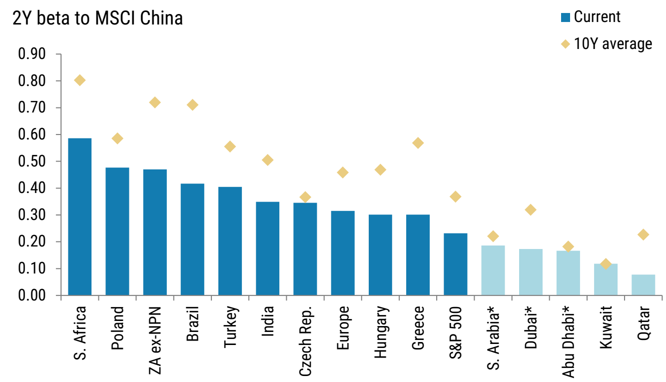
Although our Asia/GEM strategy team remain Equal-weight China equities, the recent broader North Asia rebound has driven a rising number of investor requests for China-correlation levels within EEMEA. Here we show EEMEA countries and stocks most correlated to and high beta versus MSCI China. We caution that with China's shifting growth model towards domestic and especially services-oriented growth, EEMEA country correlations to China equities have been declining and historical correlations may no longer apply. Still, the sentiment impacts of a North Asia/China rebound should continue to drive EEMEA markets tactically.

Exhibit 195: South Africa and Poland have the highest correlations to China within EEMEA, Middle East, Hungary and Turkey the lowest



*local indices used instead of MSCI; Source: Bloomberg and Morgan Stanley Research

Exhibit 196: Middle East equities have amongst the lowest beta to China in the world, South Africa and Poland are highest within EEMEA

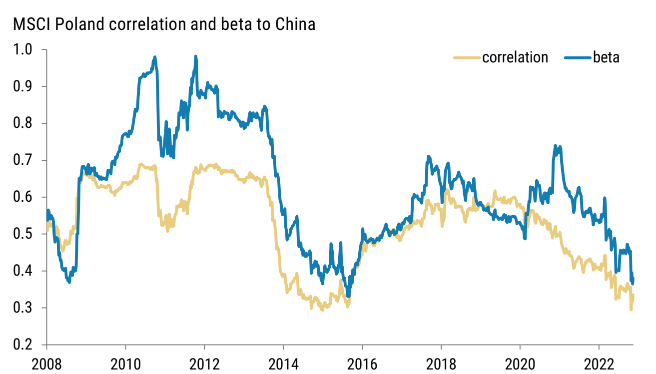


*local indices used instead of MSCI; Source: Bloomberg and Morgan Stanley Research

Exhibit 197: We caution that with China's shifting growth model towards domestic and especially services-oriented growth, correlations have been declining...

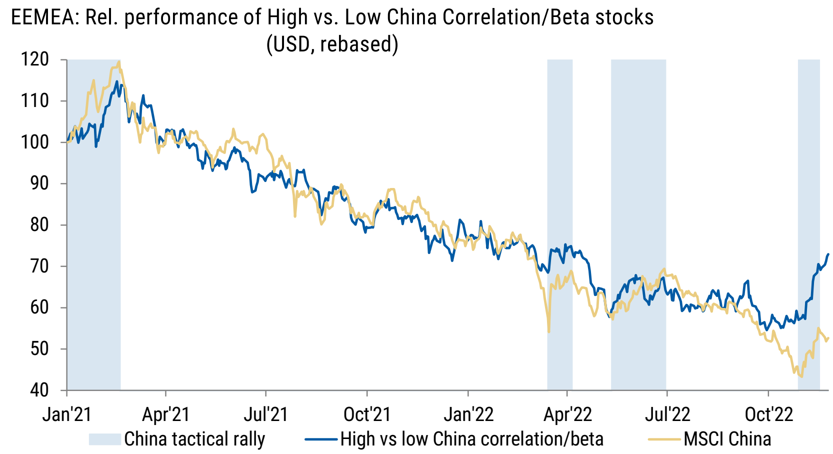
Source: Datastream and Morgan Stanley Research

Exhibit 198: ...And historical correlations may no longer apply - still the sentiment impacts of a China rebound should drive EEMEA markets tactically



Source: Datastream and Morgan Stanley Research

Exhibit 199: Interestingly, EEMEA stocks with high correlation/beta to China are now sharply outperforming those with low correlation/beta



Note: performance of High vs Low China correlation/beta baskets is equal-weighted; Source: Eikon and Morgan Stanley Research

Exhibit 200: S. African and Polish stocks dominate the list of stocks with highest correlation/beta to MSCI China...

Ticker	Name	Country	Sector	beta vs MSCI China	correl. vs MSCI China
1 NPN SJ	Naspers	South Africa	IT	1.28	0.68
2 DHER GY	Delivery Hero	DM Listed	C. Discret.	1.11	0.45
3 KIO SJ	Kumba Iron Ore	South Africa	Materials	1.05	0.50
4 JMIA US	Jumia	DM Listed	C. Discret.	1.17	0.37
5 ARI SJ	African Rainbow Minerals	South Africa	Materials	0.64	0.37
6 EXX SJ	Exxaro Resources	South Africa	Materials	0.59	0.38
7 KGH PW	KGHM	Poland	Materials	0.63	0.35
8 SSW SJ	Sibanye Gold Ltd	South Africa	Materials	0.64	0.35
9 SCATC NO	Scatec Solar	DM Listed	Utilities	0.60	0.31
10 FROTO TI	Ford Otomotiv	Turkey	C. Discret.	0.66	0.30
11 ENJSA TI	Enerjisa Enerji	Turkey	Utilities	0.55	0.31
12 AMS SJ	Anglo American Platinum	South Africa	Materials	0.54	0.30
13 NPH SJ	Northam Platinum	South Africa	Materials	0.54	0.29
14 BID SJ	Bid Corp	South Africa	C. Staples	0.43	0.38
15 IMP SJ	Impala Platinum	South Africa	Materials	0.55	0.28
16 EKGYO TI	Emlak Konut	Turkey	Real Estate	0.59	0.27
17 SOL SJ	Sasol	South Africa	Materials	0.52	0.29
18 NAHDI AB	Nahdi Medical	Saudi Arabia	C. Staples	0.40	0.41
19 OMU LN	Old Mutual Ltd	DM Listed	Insurance	0.42	0.30
20 ANG SJ	AngloGold Ashanti	South Africa	Materials	0.51	0.28
21 KCHOL TI	KOC Holding	Turkey	Industrials	0.51	0.26
22 SPL PW	Santander Bank Polska	Poland	Financials	0.44	0.28
23 DNP PW	Dino Polska	Poland	C. Staples	0.40	0.29
24 YKBNK TI	Yapi Kredi Bank	Turkey	Financials	0.56	0.24
25 SAHOL TI	Sabanci Holdings	Turkey	Financials	0.50	0.26

Source: Eikon and Morgan Stanley Research

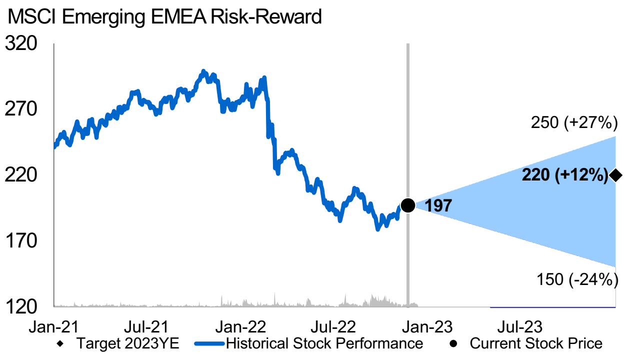
Exhibit 201: ...while the stocks with the lowest correlation/beta to MSCI China are purely made up of Middle East names

Ticker	Name	Country	Sector	beta vs MSCI China	correl. vs MSCI China
1 ADIB UH	Abu Dhabi Islamic Bank	UAE	Financials	-0.12	-0.12
2 FERTIGLB DH	Fertiglobe	UAE	Materials	-0.10	-0.07
3 MULTIPLY DH	Multiply Group	UAE	Industrials	-0.03	-0.02
4 DEWA DB	DEWA	UAE	Utilities	-0.02	-0.05
5 BINDAWOO AB	BinDawood	Saudi Arabia	C. Staples	-0.02	-0.03
6 ADPORTS DH	Abu Dhabi Ports	UAE	Industrials	-0.02	-0.02
7 EMIRATES DB	Emirates NBD Bank	UAE	Financials	-0.01	-0.01
8 ACWA AB	ACWA Power	Saudi Arabia	Utilities	-0.01	-0.01
9 DALLAH AB	Dallah Healthcare	Saudi Arabia	Health Care	0.00	0.00
10 ETISALAT DH	Etisalat	UAE	Telecom	0.00	0.00
11 TADAWULG AB	Saudi Tadawul Group	Saudi Arabia	Financials	0.00	0.00
12 CARE AB	National Medical Care Co	Saudi Arabia	Health Care	0.01	0.01
13 TAWUNIYA AB	Cooperative Insurance	Saudi Arabia	Insurance	0.01	0.01
14 QNBK QD	Qatar National Bank	Qatar	Financials	0.01	0.01
15 MARK QD	Masraf Al Rayan	Qatar	Financials	0.02	0.02
16 QEWS QD	Qatar Electricity & Water	Qatar	Utilities	0.02	0.03
17 ALDAWAA AB	AL-Dawaa Medical Services Cc	Saudi Arabia	Health Care	0.05	0.05
18 JMT PL	Jeronimo Martins SGPS SA	DM Listed	C. Staples	0.05	0.06
19 ADNOCDIS DH	Abu Dhabi National Oil	UAE	C. Discret.	0.05	0.07
20 SEERA AB	Al Tayyar	Saudi Arabia	C. Discret.	0.06	0.07
21 ALARKAN AB	Dar Al Arkan	Saudi Arabia	Real Estate	0.07	0.06
22 LEEJAM AB	Leejam Sports	Saudi Arabia	C. Discret.	0.08	0.07
23 QGTS QD	Qatar Gas Transport	Qatar	Energy	0.06	0.08
24 SECO AB	Saudi Electricity	Saudi Arabia	Utilities	0.07	0.08
25 ARAMCO AB	Saudi Aramco	Saudi Arabia	Energy	0.06	0.10

Source: Eikon and Morgan Stanley Research

MSCI EEMEA Risk-Reward

Exhibit 202: Our base case MSCI EEMEA 2023YE price target implies 12% potential upside



Source: Datastream, Morgan Stanley Research estimates

Our base case MSCI EEMEA 2023YE price target implies 12% potential upside, with our bull to bear skewed positively 1.2:1. Our methodology is based on two components: 1) top-down earnings growth estimates, and 2) target P/E. To derive our top-down earnings growth forecasts, we consider aggregate bottom-up estimates for 200+ EEMEA stocks and make adjustments based on macro inputs and both consensus and MS analysts' estimates. For the second component, we consider the change in the market's 12-month forward P/E ratio and estimate a potential re-rating or de-rating to the overall market based on our view of local and global macro factors.

BASE CASE (220 POINTS, +12% UPSIDE POTENTIAL, 11.3x BASE CASE NTM P/E)

Another year of EEMEA outperformance vs EM. Our expected upside for the next 12-month for MSCI EEMEA of +12% compares to +6% for MSCI EM from our Global EM strategy team. Our global commodity strategist forecasts Brent to remain above $90/bbl during the year and gradually increase to $110/bbl in 3Q23. The transmission mechanism of higher energy prices benefits the continuation of structural reforms in some Middle East countries supporting our positive view on UAE and Saudi Arabia (Overweight UAE and constructive outlook in the medium to long-term in Saudi Arabia). In other parts of MENA, where we see a weak transmission mechanism of high energy prices into company earnings, we assume lower earnings growth for the next two years. In Emerging Europe, we forecast more upside this year relative to EEMEA overall, but a wider bull-to-bear risk-reward. In Greece, the macro recovery continues and we expect more resilience compared to European peers. For the rest of EM Europe, the outlook looks more binary with meaningful events or risks on the horizon, such as elections and/or regulatory risks. Overall, we see EEMEA earnings in USD increasing 3% in 2023 and 8% in 2024 (1p.p. above consensus for both years). For the P/E ratio, in the current global environment of higher interest rates, we forecast multiples to only marginally re-rate to 11.1x from current 11.5x, roughly in line with the LT average of 11.7x.

Exhibit 203: MSCI EEMEA 2023YE target

	MSCI Index			NTM P/E		Multiple	USD earnings growth			Bull to bear
	weight	Target	upside (USD)	Current	Target	LT Avg	2022	2023	2024	ratio
Saudi Arabia	34%	395	14%	15.1	15.6	17.9	16%	7%	7%	1.4
South Africa	27%	100	13%	9.7	10.2	12.3	-6%	9%	7%	1.0
MENA ex-SA	27%		11%	13.1	12.9	11.3	18%	6%	5%	0.9
EM Europe	13%		16%	6.7	7.0	9.7	38%	-24%	15%	1.1
EEMEA	100%	220	12%	11.1	11.5	11.7	13%	3%	8%	1.2

Source: Eikon, Bloomberg and Morgan Stanley Research

Saudi Arabia (34% of the index): We forecast 14% upside in USD to Saudi equities in the next 12 months mainly driven by earnings growth. The transmission mechanism of higher oil prices continues to support the economic reforms in the country. However, we see earnings momentum slowing down, in particular for the banks (50% of the index), as the Fed peaks and market starts to price in cuts by the end of 2023 and margins headwinds driven by funding tightness in the market. Therefore, we assume an increase in earnings of 7% in 2023 and another 7% in 2024. For the P/E ratio, Saudi stocks now trade at 15.1x, well below the peak levels we've seen in late 2020, when they peaked at 22x. For next year, we see a small re-rating from current levels to 15.6x, which is 1.2 S.D. below the 4-year historical mean.

South Africa (27% of the index): Our South Africa strategist, Mary Curtis, sees 13% upside potential in USD to MSCI South Africa for 2023YE. This assumes a 2022 earnings decline of 6% in USD, but growth of +9% in 2023 and another 78% in 2024. For the P/E ratio, Mary expects a re-rating to 10.2x, but still below the LT average of 12.3x.

MENA ex-Saudi Arabia (Qatar, UAE, Kuwait and Egypt, 27% of the index): We see 11% upside in USD to MENA ex-Saudi Arabia equities for 2023YE. We see different patterns for these equity markets next year. In the UAE, our preferred market in the Middle East, we expect Abu Dhabi to continue benefitting from higher energy prices for longer, boosting government spending in infrastructure projects, for example, while in Dubai, we expect the property market to continue booming as we see the bullish property trends being structural this time. For the rest of the region we are less optimistic. In Qatar and Kuwait, there is a lack of catalysts related to structural economic and social reforms, which combined with rich valuations and lower earnings growth, support our relatively cautious view. Overall for MENA ex-Saudi Arabia, we expect earnings to increase by 6% in 2023 and 5% in 2024. The current multiple for the group is 13.1x on a NTM P/E basis, or 1 standard deviation above the LT average. For 2023YE, we estimate a marginal de-rating in earnings multiple to 12.9x, and to remain above long-term average.

EM Europe (Poland, Hungary, Czech Rep, Greece, Turkey, 13% of the index): For CEE and EM European countries, we see 16% upside in USD. We forecast sightly more upside this year relative to the EEMEA index, but a wider bull-to-bear risk-reward (38% upside to bull case and 36% downside to bear case). In Greece, the macro recovery continues and we expect more resilience compared to Developed and Emerging European peers. For the rest of EM Europe, the outlook looks more binary with meaningful events or risks on the horizon, such as elections and/or regulatory risks, although multiples look cheap on absolute and relative basis. We expect earnings to decline 24% in 2023 (driven by commodities and cyclicals, including financials, in Turkey), but to grow 15% in 2024. The region trades at 6.7x on a NTM P/E basis, which is already 1.6 S.D below its LT average. For 2023YE, we expect the earnings multiple to stay close to these levels at 7.0x.

BULL CASE (250 POINTS, +27% UPSIDE POTENTIAL, 12.4x BULL CASE NTM P/E)

Very strong outlook for oil prices. Moderating inflation, in particular in EM Europe, and fewer risks to global growth. In EEMEA, high oil prices for longer driven by demand recovery and supply constraints, and structural reforms in the Middle East accelerating faster than expected in addition to the better economic outlook and declining inflation for other parts of EEMEA (S. Africa and CEE) support a re-rating and better earnings growth. Globally, Fed and ECB simply delever on the tightening that is already expected by the market. In such a scenario, we assume EEMEA earnings in USD to grow 7% in

2023 and another 11% in 2024 – 3-4 p.p. above our base case, as we see earnings tailwinds for the region, from high oil prices and better global growth outlook. Next 12-month (NTM) earnings multiple to trade at 0.5 standard deviations above its 14-year average.

BEAR CASE (150 POINTS, -24% DOWNSIDE POTENTIAL, 9.1x BEAR CASE NTM P/E)

Global recession and oil price decline. In our global strategy team's bear case, the US does fall into recession, Europe's recession is more severe, and China reopens more cautiously. Consequently, brent prices decline during the year to $65/bbl in 2Q23 with demand falling off more quickly than our commodity strategists are assuming. This and other risks related to oversupply could lead to lower oil prices. However, at $65/bbl, and long term prices at $60/bbl, they are still manageable for most of Middle East countries from a fiscal perspective, but it would have a negative impact on sentiment. In EM Europe, escalation on geopolitical risks could drive further downside for growth. Further, regulatory risks and windfall taxes could dovetail in this scenario. In our bear case, we assume NTM earnings de-rate to 9.1x, 1.9 S.D. below the 13-year mean level, which is close to lowest level in the past 13 years, ex-COVID sell-off. We assume negative earnings revisions from current levels and EEMEA USD earnings to decrease by 17% in 2023 and 11% in 2024.

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