Middle East Funds Face Rough Going
By Daniel Pearl

CAIRO, Egypt -- A wave of funds that invest in the Middle East are hitting the market -- and the going looks rough.

That isn't because of the chronic instability that troubles this region. It's because there isn't nearly enough supply -- shares -- to meet growing demand.

In Arab countries like this one, the pace of privatization hasn't kept up with investor demand and only a handful of shares can be traded internationally. Investors crowding the hallways here at the third annual Middle East Economic Conference say they're focusing on nations such as Egypt, Morocco and Tunisia that are relatively stable, are liberalizing their economies and have less at stake in the Middle East peace talks than some of the participants.

Still, while there are officially 605 share-issuing public companies in Egypt, only 60 or so are actively traded. (Three Egyptian mutual funds have been launched this year. Prices are up 15 percent.)

In Lebanon, the stock market is dominated by Solidere, Beirut's downtown-redevelopment company. In the Persian Gulf, stock markets in every country except Oman are off limits to non-Arab investors. And some of the most dynamic companies in Arab countries are family-owned, not publicly traded.

"We don't have a major tourism play, not one of any size in any state," notes Angus Blair, head of Middle East research for ING Barings.

In the past, Middle East investment funds compensated for the lack of supply by including Turkish and Israeli companies. Foreign & Colonial Emerging Markets Ltd. has 26 percent of its two-year-old Middle East fund invested in those two countries.

Now, hopeful fund managers are employing other strategies. Merrill Lynch & Co. is trying to persuade the Kuwaiti government to allow it to set up a Kuwait fund. Philippe Cahen, a Luxembourg fund manager preparing to launch the open-end Middle East and North Africa Fund, is avoiding both Egypt and Israel, looking for debt as well as equity and counting on Tunisia to triple its supply of publicly traded companies. Basil Al-Rahim, a London investment banker, is launching the Saudi-backed Safron Fund with the hopes of controlling private companies that will be in a position to go public and to buy out competitors.

"There is a tremendous amount of fragmented industries," says Mr. Al-Rahim. "In Lebanon, there are 70 banks." Buying private companies is tricky in Arab countries. Investment bankers have found it difficult to persuade family businesses to offer shares to the public. And restrictions on buyouts remain. Even though Egypt allows mergers, for instance, it has labor laws that make it almost impossible to lay off workers.
Still, private-equity funds are proliferating. SBC Warburg, which had tried to launch a $50 million private-equity fund for Lebanon last year, plans to try again next month. Two venture-capital funds are being launched in Egypt. "Probably in a year's time, there will be so many private-sector funds that people will be looking for different twists, like derivatives," says Aladdin Saba, managing director of EFG-Hermes, Egypt's largest asset-management company, which has two Egypt funds and is about to start buying shares of companies before public offerings.

Indeed, Kuwait is already considering allowing futures trading. Of course, the recent fighting in Iraq and the derailing of Middle East peace talks haven't helped Middle East fund managers. New York investment boutique Siguler Guff & Co. has spent two years trying to raise $250 million from pension funds and other institutions for a regional fund making long-term investments in closely held companies in Jordan, the Palestinian autonomous areas, Egypt and North Africa. An October trip for potential investors had to be postponed because of the renewed bloodshed in Jerusalem. Less than half the money has been raised.

Still, Mona Aboelnaga, portfolio manager for the fund, which is backed by the Overseas Private Investment Corp., the U.S. government agency that insures investments abroad, says the fund is almost fully committed. One sector where she sees potential is housing for Palestinians because little has been built since 1967.

The Israeli stock market has suffered much more than Arab stock markets this year, losing a fifth of its value, largely because of Israeli budget woes, a fact not lost on Israeli investors. At the Cairo conference yesterday, Tel Aviv investment banker Zeev Holtzman says he was trying in vain to get Egyptian bankers interested in setting up cross-border funds. "The Egyptians are very focused on what's going on internally now," he says.