



# *Investing in the Stock Market*





## *Background*

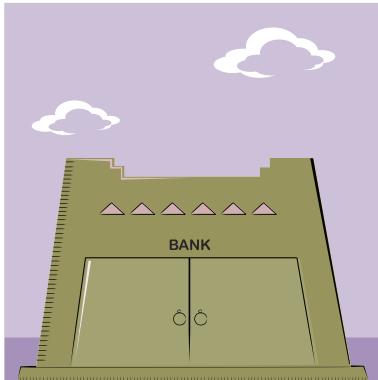
Saudi joint-stock companies started their business in the mid 1930s when the “Arab Automobile Company” was established as the first joint stock company in the Kingdom of Saudi Arabia. By 1975, there were 14 joint-stock companies. The market remained unofficial until 1984 when the Saudi Arabian Monetary Agency (SAMA) was entrusted with the task of regulating the market on a daily basis. . Brokerage was limited to stock trading through commercial banks in order to improve the regulatory framework of trading.

In 1984, the Saudi Share Registration Company (SSRC) was founded by commercial banks. This company helps joint-stock companies in central registration. It also settles and clears all stock operations. The electronic settlement and clearing system was introduced in 1989. In 1990, the Electronic Securities Information System (ESIS) was developed and operated by SAMA. Tadawul, which is the new system for trading, clearing and settling securities, went into operation as of October 2001.

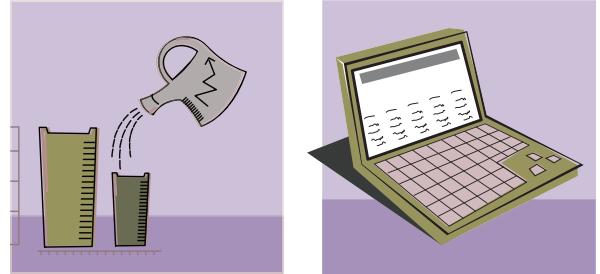
On 2/6/1424H (31/7/2003), the Capital Market Authority (CMA) was established under the Capital Market Law (CML) pursuant to Royal Decree No. (M/30) dated 2/6/1424H. The CMA serves as a government organization responsible for running and regulating the Saudi capital market, and it reports directly to the Prime Minister. The CMA has a legal personality and enjoys financial and administrative autonomy. It aims at regulating and developing the capital market in the Kingdom, and has the power to set up and impose regulations and rules to protect investors and secure fairness and efficiency in the securities market.

## Preface

The historic beginnings of the Saudi Stock Market dates back to 1932 when the first joint-stock company in the Kingdom “Arab Automobile Company” was established. Several other companies followed after that especially in the 1970s when the numbers multiplied. In early 1980s, an unofficial stock market emerged due to the growing number of joint-stock companies. In 1984, Royal Order No. 8/1230 was issued to regulate the stock exchange and trading. The task of overseeing the market activity and implementing the rules governing securities trading was assigned to the Saudi Arabian Monetary Agency (SAMA).



In 1990, the market had a new beginning when the (ESIE) electronic system was employed. It is a system for trading, settling and clearing securities. It was used until 2001 when the “Tadawul” system was first introduced. Tadawul is an advanced system in terms of trading, settlement and clearing mechanisms. It provides a market based on the



continuity of giving sell and purchase orders to the latest price by matching these two prices and giving other information on the volume of trading and the nature of the establishment.

Commercial banks acted as brokers between existing investors or those wishing to enter the market and the stock market by placing orders received from investors to “Tadawul” system, which are classified and arranged according to price priority and time. When purchase and sell orders are matched and executed together, stocks are immediately transferred from the seller’s portfolio to the buyer’s.

The Saudi market has recently witnessed a quantum leap with the issuance of the Capital Market Law in accordance with Royal Decree No. (M/30) dated 31/7/2003. It stated the restructuring of the financial market in terms of regulatory and supervisory aspects and creating the Capital Market Authority that enjoys financial and administrative autonomy. It reports directly to the prime minister and aims to organize and develop the financial market in the Kingdom. It has the power to establish the rules, regulations and instructions neces-

sary to implement the provisions of the Capital Market Law to protect investors and ensure fairness and efficiency in the capital market.

The Board of the Capital Market Authority powers the authorities related to CMA according to the Capital Market Law. The Board shall determine how to regulate the functions of the CMA and its responsibilities and their distribution among its departments. The board is composed of five full-time members: Chairman, Vice-Chairman and three other members which all were appointed under a Royal Order for a five year term, subject to only one renewal as of 1/7/2004.

## *Prevalent Investment Instruments in the Saudi Market*

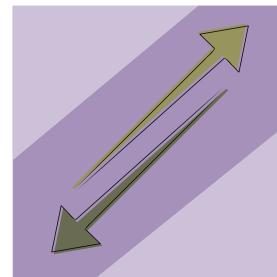
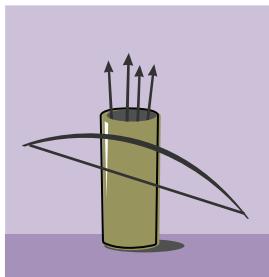
Securities market is the market that draws together all the securities offered to the public, whether they were shares (certificates of ownership) or debt instruments. Trading in the Saudi Stock Exchange is limited to ordinary shares only. Other securities such as debt instruments, whether governmental or private (issued by companies) and others are still not traded in the capital market, but are expected to be traded in the near future.

Ordinary shares represent a certificate of ownership in a company where the holder gets capital gains from cash dividends which represent earnings per share of the profits realized by the com-

pany during a given period (annual, semi-annual or other). This comes after the general assembly's approval on distributing a percentage of the realized profits to shareholders, or profits in the form of granting shares from the company itself, or from price differentials when sold.

The Saudi Stock Market is the largest Arab market in terms of market value or what is known as "Market Capitalization or Market Cap" and the daily traded volumes and rates. It also holds a very advanced place in the ranking of emerging markets.

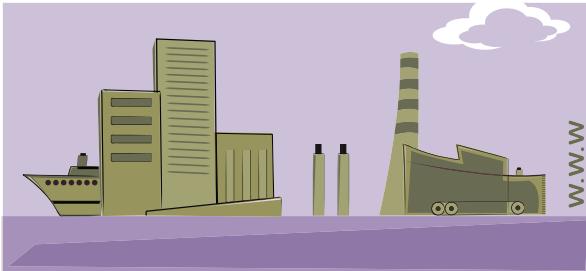
Although the number of listed companies in the Saudi Stock Market is limited, it is the most active Arab market. The number of listed companies is expected to rise in the future.



The listed companies are distributed among fifteen sectors: Banks & Financial Services, Petrochemical Industries, Cement, Retail, Energy & Utilities, Agriculture & Food Industries, Telecommunication & Information Technology, Insurance, Multi-Investment, Industrial Investment, Building

& Construction, Real Estate Development, Transport, Media and Publishing, and Hotel & Tourism.

GCC citizens are allowed to invest directly in the listed companies in the Saudi Market. Note that it is possible to invest indirectly through mutual funds.



Mutual Funds which are expected to list their units in the Saudi Market in the future are a portfolio of diversified or specialized investments in one or several types (stocks, bonds, cash). Their level of risk and return differs according to the mechanisms of investment. These mutual funds have been established in licensed brokerage firms to sustain and maintain investors' money.

Portfolios or mutual funds in general have the following features:

1. Good Diversity: Funds choose the investment mechanisms that suit their goals, and benefit from the diversity principle to reduce risk.
2. Specialized Management: Funds are usually managed by specialized teams that take over monitoring and following up the investment

instruments listed and make sure that they are efficient and in line with the funds' goals.

3. Liquidity: Invested units can be converted into cash quickly.
4. Diversification at Low Cost: The unit in the fund means ownership in more than one investment product listed in the fund.

Investment Funds are classified according to the investment products listed in them and what is consistent with their objectives. For example, there are special funds for domestic equity, special funds for short-term investment products "Money market funds", global equity funds and so on. Investment funds in the Saudi market are managed by local commercial banks which takes over all its related operations.



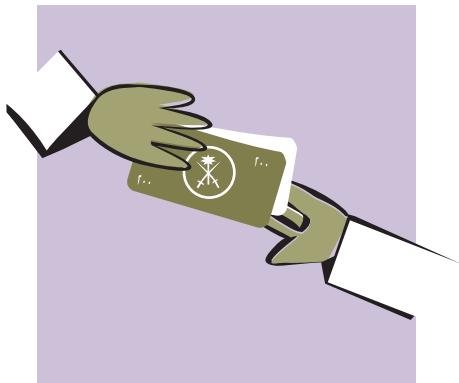
## *Brokers & Lenders*

Licensed brokerage firms play the role of an intermediary in the Saudi market. They are the sole en-

tities performing that role. Brokers are in charge of buying and selling on behalf of the investor in the stock market. The most important operations they do are:

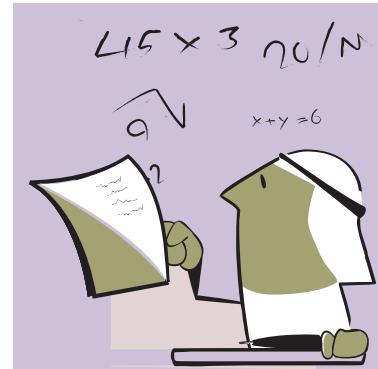
- Opening an investment portfolio through which the investor or the client can deal in the market.
- Possessing securities or offering them for the issuer.
- Providing necessary funding and facilities for clients to trade stocks.

Lenders are the financial institutions that extend loans to investors for one goal only, and that is investing in the stock market. Currently, this role is played by commercial banks. This is what is called finding and facilitating. It means that the investor borrows a part of the investment value in the stock market from the bank after determining the stocks he wants to invest in.



## Borrowing to Trade on the Market (Cost & How)

A lot of people want to enter the stock market, however, due to their lack of liquidity, they can be financed by lenders (funding institutions like banks for instance). In such cases, the investor should:



- Look for funding institutions that extend loans at the lowest prices (borrowing cost)
- Conduct a thorough study to determine the investment channels that he/she wishes to engage in, and make sure that they bring in a return higher than the borrowing cost.
- Bear in mind that the returns of this investment will be the difference between his received return and the cost of borrowing
- Know that investing in areas with high return

means also high risk at the same time (direct correlation)

- The borrower should keep in mind that he/she should pay the loan in case of loss. As a result, borrowing might multiply the return and loss ratio.
- Determine the cost of borrowing for the first year with the following equation:

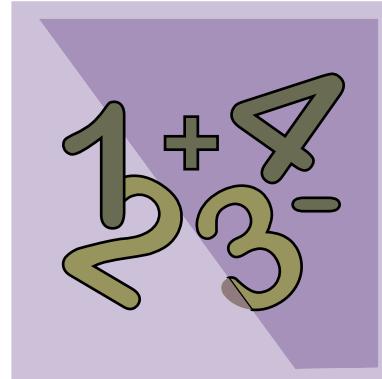
$$\text{Annual Cost of Borrowing} = \text{Amount Borrowed} \times \text{Annual Interest Rate}$$

- Determine the borrowing cost for more than one year with the following equation:

$$\text{Total Cost of Borrowing} = \text{Annual Cost of Borrowing} \times \text{Number of Borrowing Years}$$

- Calculation of net return from borrowing as in the following equation:

$$\frac{\text{Total annual return from the amount borrowed after investing} - \text{annual cost of borrowing}}{\text{Total Loan Value}}$$



## Market Index

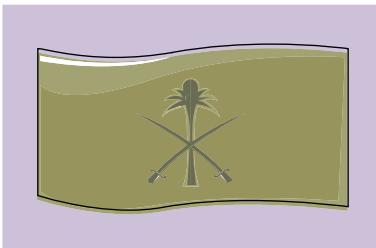
The market index gives a general idea on the trend of market performance. It represents the measure through which the investor can know the market, the trend of the buying and selling forces as well as the general level of increase or decrease in the prices of companies listed on the market. The manner in which the index is calculated differs accordingly. It is either calculated by the prices of all the listed shares or part of them as a sample that hopefully reflects the reality of the whole market.

Mathematically, the index is calculated by dividing the total market capitalization of shares listed on the market on that day by the total market capitalization of the shares previously listed on the index. This is known as the market capitalization weighted index. The index can be calculated in other ways such as the average prices by calculating the total prices of selected stocks divided by the number of the selected stocks.

In Financial markets, the indexes differ according to the informative goals put into it. There are specialized indexes for the overall market and indexes for particular sectors of the market, or a specific type of companies such as small and large companies.

TASI (Tadawul All Share Index) measures the general level of company prices based on the market value of free float stocks of all companies listed on the market. As for the retail sector's index (for example), it calculates the general level of prices of retail companies traded on the market. The same concept applies to the index of the insurance sector for insurance companies and as such in the remaining sectors.

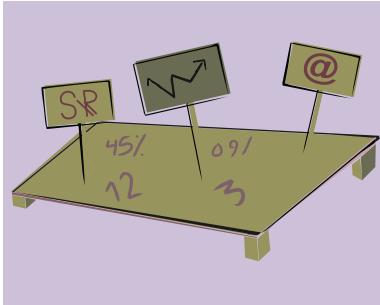
In addition to reflecting the pulse of the market, the index can represent the predictability of the market's future more precisely, especially when determining the nature of the relationship of some of the economic variables within the index.



## How to Trade and Types of Buying and Selling

When an investor is willing to enter the securities market, he should do the following steps:

1. Open an investment account with one of the brokers authorized to carry out the securities business on the Saudi Capital Market.
2. Fill out the required application to buy or sell a specific stock. Some brokers may offer buying and selling online or via telephone without the need for the investor to be physically present.
3. Determine the type of buy or sell order. When filling out the application, the investor has to choose the correct and appropriate order. Keep in mind that the available orders in the Saudi market are:
  - 3-1 **Hit Order**: an order to sell a certain available quantity at the best price on the market.
  - 3-2 **Take Order**: an order to buy a certain available quantity at the best price on the market.
  - 3-3 **Match Order**: used to match and meet a previously placed order on the market.
  - 3-4 **Market Order**: an order to sell or buy a particular number of stocks according to the prevailing prices in the market. The system calculates the price protection equation (5 ticks) higher or lower only.
  - 3-5 **Limit Order**: an order to sell or buy a specific number of shares at a particular price or at a



better price according to the prevailing price on the market.

**3-6 Un-priced Order:** an un-priced order to sell or buy to trade a stock according to the prevailing price (execution price) on the market. It becomes a specified price order whenever the best price is granted, the system determines the price before adding the order to the list.

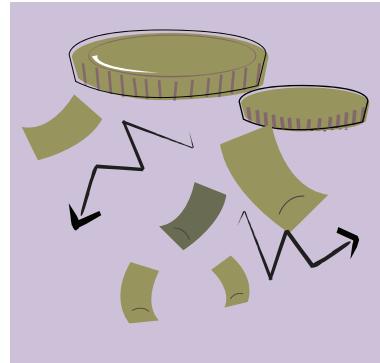
**3-7 Undisclosed Order:** part of the total quantity of the order that appears on the brokers' screens. This is necessary when there are orders for large quantities as concealing the actual quantity of large orders allows the execution of only disclosed quantities according to the prevailing prices without affecting the price levels.

**3-8 All or none Order:** the whole quantity of the order should be all traded once.

**3-9 Minimum block:** the order is traded by the specified minimum quantity and after each

trade, another quantity to trade again.

**3-10 Minimum fill:** it is the least quantity specified to execute the order for the first time only.



4. The investor specifies the duration of the validity of the order. It can be determined as follows:

**4-1 Day Order:** it is an order that is valid until the market closes on the trading day on which the order was entered.

**4-2 Good Till Week Order:** it is an order that is valid up to the end of the current week.

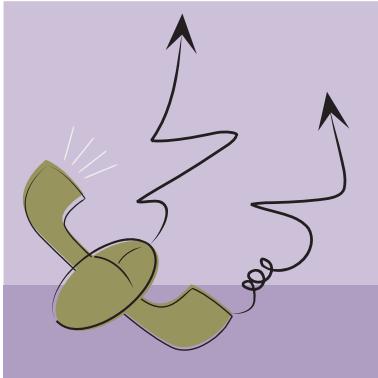
**4-3 Good Till Month Order:** it is an order that is valid up to the end of the current Gregorian month.

**4-4 Good Till Date Order:** it is an order that is valid up to market close on the specified trading date. This order cannot exceed a period of 30 days.

**4-5 Immediate-or-Cancel Order:** it is an order that should be fully or partially executed once it enters the market, but if the transaction was

not executed directly then the order will be cancelled automatically.

The execution mechanism is implemented through the “Tadawul” system where the deals that match buying and selling orders are executed. Then, they are automatically sent to the Securities Depository Center to complete the process of transferring ownership and clearing between brokers from the seller’s portfolio to the buyer’s .



## *Sources of Stock Information:*

An investor’s decision in the stock market should be based on information that is well related with the stock’s future. Therefore, he should search and look for this information and its sources. The information that is vital to investors varies according to their needs and the sources of the information differ depending on the type of information the investor looks for. Generally, there are some sources of information that any investor can get the information from without big costs such as:

- Calling the company itself to get the information from the source.
- Official websites that are authorized to release information on listed companies such as the websites of the Capital Market Authority and “Tadawul”.
- The company’s website on the internet and its annual reports.
- Financial statements and economic news in specialized newspapers and magazines.
- Offices that provide the services of financial consultants and their publications.
- Brokers’ publications.

## Necessary Information on Companies:

This means the news of the invested in companies or the ones to be invested in as well as the general news on the economic conditions. This information differs as the companies do. For example, the companies that work in the industrial sector, the information on the world oil prices and expectations –whether it was high or low- will have a high impact on it more than any other company in another sector.

It is always necessary to look for the appropriate information that goes in line with the investor's vision and his intention to buy, sell or just own. Generally, there are some information that should be considered and looked for due to its direct impact on taking any investing decision. Some of which are:

- The company's previous financial statements.
- Analysis of past financial ratios, including the dates of profits and dividends.
- The company's management and Board of Directors as well as the change in its performance in the past years.
- Global prices of the company's product and compare it with the prices locally.
- Searching for sources of growth and expansion in the company's business in the future.
- General economic conditions (oil prices, inflation, exchange and interest rates)











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