Boubyan Multi Asset Holding Fund

Fund Licensed by the Kuwaiti CMA (F/2016/0003)

31 October 2017

بـوبـيـان كـابـيـتـال
Boubyan Capital

Sub-Manager's Commentary:

Market Overview

During October, stock markets continued to make solid gains as optimism about corporate earnings growth and renewed hope of tax reform in the US boosted sentiment. The European Central Bank (ECB) moved to recalibrate its asset purchase programme, as part of a global trend to normalise monetary policy, reducing the amount of bonds purchased but extending the programme for a further nine months. This helped to support a continued recovery in the value of the US dollar, which gained 1.48% against the euro and more than that against certain emerging-market currencies. Bond yields in developed markets remained in established ranges as modest inflation pressures coupled with expectations of tighter monetary policy supported flatter yield curves. As equities continued to advance, market volatility remained low. US stocks made further new highs and ended the month 2.29% higher. European stocks lagged this move, gaining 0.48%, as the MSCI World Index returned 1.92%, in US-dollar terms.

The European economy has continued to benefit from strong confidence indicators, particularly in manufacturing, and from consistent employment gains. However, wage increases and consumer price index (CPI) inflation have remained subdued – increasingly a global phenomenon. Core CPI inflation eased to 0.9% in the year-to-October, still further below the ECB's target of close to 2.0%. As a result, the ECB felt the need to develop a compromise solution to maintain very accommodative monetary policy overall. By reducing the volume of assets purchased, but continuing this over a longer – potentially open ended – time horizon, they have delayed the point where the first rise in interest rates is anticipated to occur. This combination of sustained growth and easy monetary policy supported asset markets generally and saw 10-year German Bund yields fall by 10 basis points (bps), to 0.36% by October-end.

In the United States, stocks remained well supported by stronger-than-anticipated earnings generally and by a return of confidence regarding the delivery of tax cuts or reforms. The US Federal Reserve is expected to continue to normalise monetary policy even with the uncertainty regarding its leadership. The 10-year US Treasury note yield ended the month 5 bps higher at 2.38% - a somewhat larger move than for longer-dated bonds, as the yield curve flattened from one-year and longer. Corporate bonds proved more defensive than Treasuries, as yield spreads compressed. High-yield bonds continued to advance over the month, following equity gains, and performing generally in-line with investment-grade corporate bonds. The Dow Jones Sukuk Index made modest gains, advancing 0.19% in October.

Japanese stocks were amongst the strongest performing markets during the month, gaining 6.16% in euros, as Prime Minister Shinzo Abe was re-elected with a strengthened mandate to pursue his reform agenda. Japanese government bonds ended the period broadly unchanged, with ten-year yields at 0.07%, reflecting the Bank of Japan's commitment to hold yields close to zero.

Emerging-market stocks resumed strong year-to-date gains and returned 3.51% in US-dollar terms. The strongest region as a whole was Asia, where stocks advanced 5.30% in dollars, led by gains in South Korea. However, in line with emerging markets more generally, Asian markets showed an unusually wide dispersion of returns. Amongst the weakest markets in Asia, Pakistan declined sharply and the Philippines lagged noticeably. The Chinese Communist Party Congress cemented the position of President Xi Jinping as paramount leader and may prompt increased global activism, in our view. The EMEA category underperformed emerging markets more generally as Russia declined and the Turkish lira remained under pressure. Latin America saw the weakest performance as both Mexico and Brazil fell, reflecting the resurgence of the US dollar on these markets and their currencies. Emerging-market hard-currency bonds matched developed market equivalents. However, local-currency emerging-market sovereign bond yields rose meaningfully for the first month since November 2016. These investments underperformed hard-currency debt and suffered currency declines against both the US dollar and the euro.

Oil prices continued to rebound reflecting a better balance between production and demand, which itself seems to be growing strongly. Brent crude oil exceeded US$60 per barrel in late October, on optimism that production cuts by the Organization of the Petroleum Exporting Countries (OPEC) might be extended beyond March 2018, to reduce the level of inventories. Overall, the Bloomberg Commodity Index rose more modestly and remained below levels seen earlier in the year.

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Sub-Manager's Commentary:

Outlook

Leading indicators suggest stronger growth over the medium term, and global activity has improved. Reflecting these developments, and also in light of improving corporate fundamentals, we maintain a somewhat less cautious view of growth assets such as global equities and find limited value in developed-market government bonds. With global central banks following divergent monetary policies, we expect to find multi-asset investment opportunities.

The highlights of our analysis include the following:

• The global economy remains in a period of moderate growth overall, but with greater stability evident in key emerging markets.

• Markit's global Purchasing Managers' Indices (PMIs) continue to show signs of a robust expansion, whilst the delivery of US tax cuts and stimulus measures remains uncertain.

• Measures of corporate earnings growth, positive surprises and momentum remain strong. However, equities have appreciated and valuations based on price-to-earnings ratios in developed markets appear demanding and are elevated relative to their historical averages.

• The outlook for inflation is mixed, with persistently below-target core inflation in the developed economies, whilst wage growth has disappointed expectations given the employment growth seen generally.

• Central banks in developed markets appear constrained in their options, as a desire to unwind unconventional policies and normalise interest rates is balanced by a continued need for stimulus measures.

• The prospect of interest rates remaining "lower for longer" continues to see developed-market sovereign bond yields trading at very low levels in many markets, presenting limited investment opportunities in sovereign bonds in our assessment.

• Although emerging market central banks appear to have more flexibility in monetary policy, the threat of protectionist trade policies from the United States could present headwinds to emerging-market investments.

• A period of uncertainty about the pace of monetary policy tightening, fiscal developments and ongoing geopolitical risks suggest that market measures of volatility, which are currently subdued, may increase.

For now, we may continue to see stronger returns from equities, especially where earnings are improving, despite demanding historic valuations. However, we are maintaining the portfolio's balanced positioning, with relatively high levels of cash but a preference for equities over Sukuk. In the longer term, emerging-market equities may offer more attractive valuations.