Boubyan Multi Asset Holding Fund

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

31 August 2017

بـوبـيـان كابيتال
Boubyan Capital

Sub-Manager's Commentary:

Market Overview

In August, financial markets experienced short-lived periods of volatility, mainly related to North Korea's missile testing programme. Stocks did not sustain significant or lasting damage despite a notable escalation in geopolitical concerns. This may reflect investor confidence in the underlying global growth story or simply a belief that the monetary policy environment is likely to remain supportive for some time to come. However, other assets showed signs of concerns. Gold rose by more than 4%, to above US$1300 for the first time since the final quarter of 2016. In addition, bond yields fell noticeably, despite continued strong growth expectations. Markets focused on central bankers' policy deliberations, as persistently low inflation may limit the monetary policy normalisation that can be achieved in the near term. As a result, the US dollar remained under pressure and fell by 0.83% against the euro, which reached its highest level since the end of 2014. Firmer commodity prices and a weaker dollar helped emerging market stocks outperform developed market peers in August. US stocks outperformed major peers and made marginal new highs to end the month 0.33% higher. European stocks dipped in local currency terms but reported limited gains in US dollars as the euro appreciated by 0.84%. The MSCI World Index returned 0.19%, in US-dollar terms.

Indicators such as the Markit Purchasing Managers' Indices (PMIs) have moderated but continue to point to stronger growth—especially in the eurozone. However, as the euro appreciated, broad financial conditions have tightened making it harder for the European Central Bank (ECB) to meet its objectives. Companies in the region may already have seen earnings expectations held back by the euro's strength. Although the ECB continued to express optimism about the outlook for economic growth in the eurozone, it downplayed expectations for an imminent end to its asset purchase programme. Such market expectations may have been premature as subdued consumer price index (CPI) inflation remains the major driver of policy. Core CPI rose 1.2% in August, still well below the ECB's target of close to 2%. German Bund yields fell by 18 basis points (bps), reflecting geopolitical risks, whilst peripheral European sovereign bonds lagged this move on concerns about a reduction in official bond purchases.

In the United States, growing concerns about the ability of the administration to carry out President Trump's policy agenda added to market concerns over geopolitical risks as reasons for caution. Stocks remained well supported by generally strong earnings and by the beneficial effect of a weaker dollar, despite fading expectations of economic stimulus from tax cuts or reforms. The US Federal Reserve (Fed) noted some concerns about subdued inflation in recent months but may still raise rates later this year. The Fed is expected to scale-back the size of its balance sheet in the near future, reversing the accumulation of bonds that resulted from its earlier quantitative easing policy. The 10-year US Treasury note yield ended the month 17 bps lower at 2.12%. The level of inflation expectations embedded in yields, the so-called "break-even inflation" rate, fell further, supporting a flatter yield curve. Corporate bonds lagged the gains in Treasuries, reversing the yield spread compression seen in July. High-yield bonds broadly recovered losses seen early in the month but could not match investment-grade bonds, which benefitted from lower yields overall. Following a sell off early last month, the Dow Jones Sukuk Index continued to recover to return 0.80% in August.

Emerging-market stocks posted strong gains and rose 2.27% in dollar terms. The strongest region as a whole was Latin America, where stocks advanced 4.65% in dollars, led by gains in Brazil. The EMEA category also outperformed emerging markets more generally as commodity-dominated markets such as Russia benefitted most sharply. Some of the weakest markets were in Asia, where Pakistan continued to decline sharply. The Chinese renminbi appreciated, reflecting policy tightening measures, supporting sentiment for China stocks. Emerging-market hard-currency bonds fared much better than developed market equivalents, as assets flowed towards these investments. Similarly, local-currency emerging-market sovereign bonds continued to rally, matching the gains seen in hard-currency debt overall. Emerging-market currencies appreciated modestly against the US dollar but lagged the gains seen by the euro.

Brent crude oil remained above US$50 per barrel during August, on optimism that production cuts by the Organization of the Petroleum Exporting Countries (OPEC) might ease the current high level of inventories. US oil prices fell sharply late in the month following storm disruption in Texas. Overall, the Bloomberg Commodity Index rose slightly, but remained below levels seen earlier in the summer.

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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 modest growth overall, but with greater stability evident in key emerging markets.

• Markit's global Purchasing Managers' Indices (PMIs) have moderated, but continue to show signs of a robust expansion, whilst fears over the delivery of US stimulus measures could result in disappointments.

• Measures of corporate earnings growth, positive surprises and momentum have improved. 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.

• Central banks in developed markets appear more constrained in their options, as appetite for unconventional policy has diminished amidst questions about its efficacy.

• The outlook for inflation is mixed, with US reflation moderating somewhat and persistently below-target core inflation in the eurozone and Japan.

• 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 path of monetary policy, fiscal developments and notable 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.

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