Boubyan Multi Asset Holding Fund

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Boubyan Capital

SUB-MANAGER'S COMMENTARY

Market Overview

Global equities fell in December in US dollar terms, as US stocks pulled back from highs reached early in the month amid concerns about persistent inflation and uncertainty over forthcoming fiscal and monetary policy. Emerging markets (EM) outperformed their developed market counterparts, notably Chinese stocks, which rose on the promise of broader stimulus measures in the event of US tariffs.

The US Federal Reserve's (Fed) decision to lower interest rates in December did little to stimulate equity markets, given it was accompanied by hawkish rhetoric designed to manage investor expectations. Economic projections from the Federal Open Market Committee (FOMC), released in conjunction with the rate-cut announcement, raised the 2025 forecast for annual US core inflation to 2.5%, as measured by the personal consumption expenditures (PCE) index. The implication was that persistent inflation could be a long-term issue, leading the FOMC to forecast a higher federal funds rate. The Fed's tone was further supported by a healthy US economy, which is growing at 2.4% year-on-year, according to an early January estimate from the Atlanta Federal Reserve's GDP Now model. Uncertainty around the impact of US fiscal policy on growth and inflation also subdued markets in December, despite growing evidence of US economic exceptionalism. Against this background, US 10-year Treasury yields rose by 40 basis points (bps), as the yield curve steepened. Corporate bonds also fell, led by investment-grade issues.

European equity markets also lost ground in December amid a weak macroeconomic environment. The European Central Bank (ECB) cut interest rates during the month amid falling inflation and easing financial conditions, but growth remained weak. ECB projections released in December forecast growth will average 1.1% year-on-year in 2025, with core inflation also projected to fall to 2.3% year-on-year but remain above the central bank's target. Elsewhere, leading indicators of economic activity show an increasing divergence between the United States and Europe. Purchasing Managers' Index (PMI) data from S&P Global showed an overall reduction in euro area business activity, influenced by a deepening downturn in manufacturing production. This contrasted with a further acceleration of US economic growth, led by the services sector. Ten-year German Bund yields rose by 27 bps across the month, as the yield curve steepened in response to an uncertain economic environment.

Elsewhere, the Bank of Japan held interest rates steady despite rising inflation expectations, holding open the possibility of further policy tightening should the economy strengthen. Against this background, Japanese equities rose but were broadly flat in US dollar terms. EMs were broadly flat in US-dollar terms, as gains in Asia and Europe offset losses in Latin America. Markets in Taiwan and China rose, boosted by PMI data showing an acceleration of growth in the manufacturing sectors of both countries. Brazilian stocks fell, hurt by fiscal spending concerns, while Mexican markets were impacted by trade uncertainties.

The MSCI ACWI Islamic Index returned -3.30% (in US dollar terms) during December, while the Dow Jones Sukuk Index returned -0.59%.

Performance and Positioning

The portfolio posted a net return of -0.92% (in US dollars) during December, faring better than its custom benchmark, which returned -1.55% (also in US dollars).

The fund held a high cash component during the month, as it sold out of certain underlying holdings to fund a new position in Franklin Shariah Global Multi-Asset Income Fund.

The cash position and a corresponding underweight to equities contributed to relative returns in December, during a period of market uncertainty.

In addition, equity fund selection benefited relative performance, notably Templeton Shariah Global Equity Fund, where active positioning proved beneficial, specifically selection within the industrials, energy and communication services sectors. Our global equity allocation also outperformed the broad benchmark.

In contrast, our defensive holdings detracted from relative performance slightly. The Franklin Global Sukuk Fund underperformed the benchmark Dow Jones Sukuk Index, due to overweight duration positioning during a period of rising yields.

Outlook

US exceptionalism remains our dominant global investment theme moving into 2025, driven by the promise of pro-growth policies from the new Trump administration. A divergence in economic strength was already evident prior to the election results, but it will become more apparent, in our view, as the new US government adopts protectionist rhetoric and implements policies designed to bolster the US economy at the expense of trading partners.

The US economy is growing, and potential tax cuts and deregulation could give it an additional boost. However, there are unanswered questions around how Donald Trump's fixation with an "America First" perspective will impact other fundamental pillars of economic health, such as inflation and monetary policy. The US disinflation trend remains in place, but we have seen a recent firming of data that demonstrates how difficult it may be to fully normalise inflation in a healthy growth environment. Strong growth, a robust labour market and the potential inflationary impact of fiscal policy appear to confirm our assessment that US interest rates will diverge from the rest of the world during the next 12 months.

These uncertainties curtail our risk appetite and prevent us from taking an outright bullish approach to equities on a cross-asset level, particularly given elevated valuations. However, we have increased our overweight allocation to US stocks, heavily influenced by growth and strengthening corporate fundamentals.

Within our Sukuk portfolio, the uncertain economic and geopolitical environment we are trying to navigate continues to support an increase in defensive allocations to higher-quality issues.

Our rationale for a defensive strategy is based on several interrelated themes that we believe are likely to play out during the next year. In our assessment, stretched valuations for risk assets and higher-for-longer interest rates will eventually weigh on credit spreads, with a greater impact on high yield relative to investment-grade issues. We also think stable oil prices could exacerbate widening budget deficits in Saudi Arabia and other oil producers in the Gulf Cooperation Council (GCC) as well as Asia.

Mitigating these risks to some extent is the relative economic strength of GCC issuers that have been accumulating reserves and improving debt metrics over the past three years, along with an ongoing market development and structural reform story that continues to attract incremental demand to global Sukuk markets.

Past performance is not an indicator or a guarantee of future performance.