Boubyan Multi Asset Holding Fund

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Boubyan Capital

SUB-MANAGER'S COMMENTARY

Market Overview

Global equities rose in September, benefitting from interest-rate cuts in the United States (US) and Europe and a broad package of fiscal and monetary stimulus measures in China. US stocks led developed market gains, amid relatively robust macro fundamentals, although they were outperformed by their emerging market (EM) counterparts.

The US Federal Reserve (Fed) reduced interest rates in September by 50 basis points, marking the end of a two-and-a-half year tightening cycle. The policy committee said a positive shift in the balance of risks between employment and inflation had made it possible to cut rates in support of the economy. Headline consumer price index inflation fell to 2.5% (year-on-year) in August, while core inflation (less food and energy) remained slightly higher at 3.2% (year-on-year). Non-farm payroll employment increased by 142,000 in August, with unemployment relatively stable at 4.2%. The Fed's third-quarter economic projections revised unemployment levels up to 4.4% for 2024, but revised core personal consumption expenditures (PCE) inflation down to 2.6% for the year and 2.2% in 2025. Projections for the federal funds rate were also revised down across the next two years, to 3.4% in 2025 and 2.9% in 2026.

Leading indicators of US business activity in September, suggested a growing divergence between the manufacturing and services sectors. Purchasing managers' index (PMI) data from S&P Global showed a deterioration in business conditions within the goods-producing sector for a third successive month, as new orders fell at the fastest rate since December 2022. Against this background, the US Treasury yield curve disinverted amid falling yields at the short end of the curve. Corporate bonds rose, alongside US equities, as the S&P 500 Index was led by the consumer discretionary and utilities sectors.

The European Central Bank (ECB) also cut interest rates in September, referencing the dynamics of underlying inflation and the strength of monetary policy transmission. Annual inflation moved below target in September, reaching 1.8% with the deflationary effect of falling energy prices. However, core inflation remained elevated at 2.7%, impacted by higher prices for services. The ECB's stance was further supported by weak sentiment and manufacturing activity in the region. PMI data for September, from S&P Global, showed that key barometers of factory strength such as production, new orders, employment and procurement activity all declined at quicker rates. Against this background, German Bund yields fell across the curve, which bull steepened.

EM stocks rose across the period, driven by Asia. Stocks in China saw significant gains, benefiting from fiscal and monetary policy stimulus measures designed to bolster the property sector and stock market liquidity. Despite this, operating conditions in China's manufacturing sector deteriorated, according to PMI data from Caixin, impacted by a downturn in new export orders. Indian stocks rose, but markets in South Korea contracted. Elsewhere, Polish markets dipped amid an acceleration in inflation, while Brazilian stocks were impacted by fiscal spending concerns.

The MSCI ACWI Islamic Index returned 1.90% (in US dollar terms) during September, while the Dow Jones Sukuk Index returned 1.22%.

Performance and Positioning

The portfolio posted a net return of 1.66% (in US dollars) during September, outperforming its custom benchmark, which returned 1.45% (also in US dollars).

Our defensive holdings contributed to relative performance, in aggregate. An allocation to gold shares was a strong positive, as gold prices rose throughout the month, responding to rising geopolitical tensions and falling US yields. Elsewhere, our Sukuk holdings also posted positive relative returns, in aggregate. Franklin Global Sukuk Fund outperformed the Dow Jones Sukuk Index, benefiting from its longer duration profile during a period of falling yields.

In contrast, equity fund selection detracted, in aggregate, held back by exposure to European and EM equities, which underperformed the broad global equity benchmark. Templeton Shariah Global Equity Fund also detracted, impacted by an underweight to the US and overweight allocations to the United Kingdom and Japan. Elsewhere, our allocation to an underlying US fund contributed to returns.

Outlook

Interest-rate cuts from the US Federal Reserve (Fed) are supporting risk assets, alongside constructive macro fundamentals, but high equity valuations and near-term uncertainty has led us to retain a neutral approach to asset allocation into October.

Separately from Fed intervention, the macro environment has improved somewhat during the last month, as leading indicators of growth remain supportive even as global growth slows toward trend. Major economies have also made significant progress on disinflation, to the extent that most other large central banks have already begun to ease monetary policy to support economic growth. Additionally, policy support should allay concerns around labour market weakness and cyclicality, notably in the manufacturing sector, which continues to lag services.

Against this background, we hold a broadly optimistic view of risk assets, but a few considerations dampen our enthusiasm. US equity markets have already experienced a strong rally during the past year, reducing the possibility of continued upside, while events such as the dis-inversion of the US Treasury yield curve add further uncertainty. Additionally, we are concerned about the likelihood of increased volatility as we draw closer to the presidential election in early November. As a result, our preference is to hold portfolios in "safe harbour" as we wait for compelling opportunities to add risk.

The diversified approach we are taking to regional allocations amid a changing equity landscape is evidence of our caution. We are reducing our optimism toward US equities, moving to a neutral position amid weaker corporate earnings growth expectations. We have also moderated our positive outlook on emerging market (EM) equities, despite positive corporate fundamentals in the region. This is largely due to a more uncertain macro environment where leading indicators for both manufacturing and growth are weakening. Elsewhere, we downgraded our view on Japanese equities, as the country is dealing with weak growth alongside inflationary pressures that may result in tighter monetary policy and a stronger yen, in our view. Reducing our allocation to equities in these regions, particularly the United States, has allowed us to increase exposure to certain developed economies that we believe have brighter growth prospects, notably the United Kingdom and Canada. Elsewhere, we have decided to retain a neutral view on China, despite weakening domestic consumer demand and a precarious property sector. The market-friendly range of fiscal and monetary stimulus measures unveiled by the Politburo and the People's Bank of China in late September should stabilise Chinese equities, in our view.

Our Sukuk portfolio has increased credit quality recently. Where we do take on higher-risk positions, they are increasingly selective and idiosyncratic and, in our view, compensate us for the elevated risks involved.

Interest-rate volatility is likely to remain elevated as incoming economic data support conflicting growth and inflation narratives, along with a US presidential election cycle exacerbating policy uncertainty. Our outlook continues to support an increase in defensive allocations to higher-quality fixed income sectors as rate cuts continue unfolding in 2024.

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