Boubyan Multi Asset Holding Fund

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

31 May 2022

بـوبـيـان كابيتال
Boubyan Capital

Sub-Manager's Commentary

Market Overview

Global equity prices experienced significant volatility in May but finished the month broadly flat, as investors speculated that signs of slowing US growth and the possibility that inflation had peaked would result in less aggressive monetary tightening by the US Federal Reserve (Fed).

The Fed raised its base rate by 50 basis points (bps) in early May, amidst an environment of high inflation and low unemployment. The central bank also indicated that ongoing increases in the federal funds rate would likely be necessary, alongside quantitative tightening. Its tough stance came against a backdrop of rising inflation, which reached 8.3% year-on-year in April. Inflationary fears have stoked expectations of aggressive rate tightening by the Fed, and a US unemployment rate of just 3.6% in April bolstered its position. US equities suffered against this backdrop in early May, but recovered later in the month, as weak economic data raised hopes that the Fed might scale back future hikes and avoid a recession.

The S&P Global US Composite Purchasing Managers' Index (PMI) for May signalled softer upturns in output amidst elevated inflationary pressures, a deterioration in supplier delivery times and weaker demand growth. Service providers experienced the slowest increase in new business for almost two years as hikes in selling prices weighed on demand, and the initial boost from economic reopening after COVID-19 showed signs of fading. Consequently, benchmark 10-year US Treasury yields fell 8 bps during the month, after peaking above 3% in early May, while corporate bonds rose.

Europe's energy crisis—resulting from Russia's invasion of Ukraine—drove a further uptick in inflation, increasing pressure on the European Central Bank (ECB) to begin raising interest rates. Eurozone inflation reached 8.1% year-on-year in May, amidst a backdrop of increasingly restrictive sanctions on Russia. The ECB's task continued to be complicated, however, by the need to balance inflationary fears against economic weakness made worse by the conflict in Ukraine. The central bank's most recent forecast revised 2022 growth for the region down to 2.9% from a previous estimate of 4.2%, while the eurozone's May manufacturing PMI fell to its lowest level in 18 months. Business confidence also plummeted in May, according to S&P Global, amidst sustained concerns about the outlook for prices, supply chains and demand. European government bond yields rose, reflecting the increased possibility of policy tightening, while the euro strengthened against the US dollar.

Emerging market (EM) equities were broadly flat in May. Emerging Europe was the weakest region, notably Hungary, while a weak Turkish lira meant Turkish stocks fell, in US dollar terms. Market uncertainty also affected Asian EM equities, particularly India, which suffered from energy security concerns. In contrast, Latin American markets rose, benefitting from high commodity prices. Brent crude prices rose above US$120 per barrel as supply constraints persisted.

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Performance and Positioning

The portfolio posted a net return of -0.21% (in US dollars) during May, behind its custom benchmark, which returned 0.39% (also in US dollars).

An underweight allocation to equities detracted slightly in May, as markets recovered later in the month, while a cash holding also proved negative for relative performance. This was offset slightly by an underweight to Sukuk.

Equity fund selection held back relative results, notably US, European and EM holdings, which underperformed the broad global benchmark. In contrast, Templeton Shariah Global Equity Fund contributed, helped by exposure to energy stocks.

Fixed income selection also detracted, as underlying Sukuk funds underperformed the benchmark Dow Jones Sukuk Index. Our exposure to gold also detracted, held back by rising rates and a relatively strong US dollar.

Outlook

We maintain a cautious approach to risk into June as growth slows to trend amidst high inflation and tighter monetary policy.

Markets remain volatile as major central banks prioritise curtailing inflation over economic support. This uncertainty leads us to retain a balanced view of equities and bonds, allowing managers to add back to risk should the pace of policy tightening ease once inflation passes its peak.

Global consumer sentiment also remains fragile, influenced by energy price increases and a squeeze on living costs. Weakened policy support under these circumstances creates recessionary risk, but we believe central banks should have enough flexibility to avoid this scenario given that real interest rates remain negative.

Within equities, we retain a preference for quality and defensiveness, alongside commodity exposure. As a result, we are more optimistic on stocks in the United States, Canada, Japan and the Pacific ex-Japan region. In contrast, we are bearish on Europe and EMs, influenced by challenging inflationary pressures, geopolitical tensions and tighter monetary policy. We have improved our view on Chinese equities, taking a neutral stance given signs of additional fiscal and monetary stimulus amidst attractive valuations.

Gulf Cooperation Council (GCC) countries are benefitting from higher oil prices in the short term, but risks of economic slowdowns and weaker energy consumption are rising as the combination of higher rates, food inflation and oil prices impact demand.

We hold a defensive posture within our Sukuk portfolio that favours investment-grade credits over high-yield, and longer-duration exposure as a hedge against an escalation of the current geopolitical crisis. The broad-based correction in fixed income markets presents an attractive opportunity for total returns, relative to other riskier assets such as equities, in our view.

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