Boubyan Multi Asset Holding Fund

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31 August 2023

Sub-Manager's Commentary

Market Overview

Global equities fell in August, as investors worried about slowing global growth amidst persistent inflationary pressures. Emerging markets (EMs) led losses, affected by a weak Chinese economy, while Europe posted the largest declines amongst developed markets.

The US Federal Reserve's (Fed's) monetary policy committee did not meet in August, although Fed Chair Jay Powell struck a hawkish tone during his Jackson Hole speech, suggesting a continuation of restrictive policy to achieve inflation targets. Headline inflation increased slightly to 3.2% (year-on-year) in July, while core inflation (less food and energy) remained elevated at 4.7%. Inflation remained sticky, despite evidence of a cooling economy, as nonfarm payroll employment increased by just 187,000 in August and unemployment rose to 3.8%. The most compelling evidence of an impending slowdown came from US Purchasing Managers' Index (PMI) data released by S&P Global. It showed the US manufacturing sector contracted amidst subdued client demand, while service sector growth slowed to its weakest level since February. The possibility of higher rates, alongside economic weakness, concerned investors early in the month, although US equity markets were relatively resilient during August, buoyed by the energy sector. Against this background, benchmark 10-year US Treasury yields rose above 4% by month-end, while the yield curve remained inverted. US credit lost ground, led by investment-grade issues.

The European Central Bank (ECB) raised rates at its last meeting in July, although anuncertain economic outlook for the region challenged the case for further rate rises. Annual inflation in the euro area remained high at 5.3% in August, bolstering the case for more policy tightening, but growth remained weak. Third-quarter projections from the ECB's survey of professional forecasters suggested the eurozone economy would grow by 0.6% in 2023, and 1.1% in 2024. Elsewhere, PMI data from Hamburg Commercial Bank showed output in the eurozone economy declined at the fastest rate in nearly three years during August. Against this backdrop, German, French, Italian and UK equities all lost ground, while German Bund yields fell across the curve.

EM equities also fell in August, amid weakness in Chinese markets. Private sector activity inChina grew at the slowest pace since January, as a slowdown in services activity was only partly offset by a slight increase in factory production, according to PMI data from Caixin. Elsewhere, Latin American markets also declined, led by Brazil, which suffered from soft economic data and a weak Brazilian real. Oil prices rose slightly during August, influenced by supply cuts from the Organization for Petroleum Exporting Countries and its allies, notably Russia (OPEC+).

Performance and Positioning

The portfolio posted a net return of -1.11% (in US dollars) during August, slightly behind itscustom benchmark, which returned -1.03% (also in US dollars).

An underweight to equities proved positive for relative results as markets fell during the month, while an allocation to cash also contributed. This was offset slightly by an underweight to fixed income.

Our defensive holdings within fixed income and precious metals detracted, in aggregate, as the two underlying Sukuk funds underperformed the benchmark Dow Jones Sukuk Index. Both funds suffered from a slight overweight to duration, relative to the benchmark, during a period of rising US rates. Exposure to a gold ETF (exchange-traded fund) had no significant effect on returns. Elsewhere, equity fund selection detracted, in aggregate, as the positive performance of our US holdings was offset by EM and European stocks.

Outlook

We retain our cautious view of equities into September, given inflation remains high and growth continues to weaken in developed economies. Short-term measures of economic health remain relatively resilient, alongside corporate earnings, but we believe the lagged effect of tightening measures has not yet been fully felt. As a result, we retain a preference for bonds, given our view that equity valuations remain stretched, despite the market downturn in August.

We expect central banks in the United States and Europe to maintain tight monetary policy, prioritising persistent core inflation, although any further policy decisions will be increasingly data dependent as peak levels of interest rates are reached. We still expect a combination of tight monetary policy and deteriorating economic data to create recessionary conditions across developed markets, although the timing and length of any recession could vary between countries.

Against this background, we maintain a neutral view on most equity regions, as we expect earnings to weaken amidst tighter financial conditions. We remain pessimistic on Europe, due to sluggish consumer and business activity, influenced by interest-rate rises from the ECB.

Elsewhere, our outlook on EMs is becoming more positive moving into September, amidst a lessening of local inflation pressures. Any stabilisation in developed market demand should also boost earnings for these highly cyclical markets. We have reduced our optimism towards China, taking a neutral view, as residual risks offset attractive valuations, despite the prospect of further stimulus measures from the Chinese government.

Our Sukuk positioning shows a preference for higher-quality credits that have financial buffers to manage slowing economic activity. This is not to say we are not taking any risk, as there are opportunities in EMs that reflect dire outcomes that we think may not materialise, or at least compensate us for the risks involved. On average, however, our portfolios do have higher credit quality than their historical average. Oil may be vulnerable to slowing demand, but we think OPEC+, through production cuts, should manage to keep oil prices around US$70 a barrel, a supportive level for Gulf Cooperation Council (GCC) sovereign credit profiles. After every sharp drawdown in fixed income, there have been strong recoveries. The outlook still supports an increase in allocations to higher-quality fixed income sectors, including global Sukuk, which look poised to better defend portfolios and provide attractive levels of income.

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