Boubyan Multi Asset Holding Fund

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بـوبـيـان كابيتال
Boubyan Capital

Sub-Manager's Commentary

Market Overview

Global equities fell in February, as investors worried that persistent inflation would lead major central banks to keep interest rates higher for longer. Emerging market (EM) equities led losses, although their developed market counterparts were also lower, notably North American stocks. Hawkish rhetoric saw bond prices fall, while the US dollar strengthened given the possibility of higher rates.

Data released during February showed that the US economy remained resilient, despite significant monetary policy tightening, while the unemployment rate was unchanged at 3.4% in January, accompanied by strong job growth. Inflation held steady at 6.4% (year-on-year) during January, influenced by higher energy prices. The favourable data had raised hopes of a soft landing for the US economy, although signs that inflation might be more persistent than projected led investors to reassess when the rate-hiking cycle might end. The US Federal Reserve (Fed) raised the federal funds rate by just 25 basis points (bps) in early February but reiterated its commitment to bring inflation down to its 2% target, increasing the possibility of a larger rate increase at its March meeting. Against this backdrop, benchmark 10-year US Treasury yields rose, moving back close to 4% by month-end, although the yield curve inverted further – historically an indicator of recession. Elsewhere, US equities fell, while corporate bonds also lost ground.

The European Central Bank (ECB) tried to dampen inflation expectations by raising interest rates by 50 bps in early February, while confirming it would do the same in March. Against this background, euro area inflation fell to 8.6% (year-on-year) in January but remained at that level in February according to initial estimates, suggesting a further tightening of monetary policy might be required. Wage growth in the region was partially responsible, according to the ECB's latest Survey of Professional Forecasters, which revised up inflation expectations to 5.9% for 2023 and 2.7% for 2024. Purchasing managers' index (PMI) data from S&P Global, showing business activity growth accelerating to a nine-month high in February, indicated further pricing pressures. European equities were broadly flat, in US dollar terms, as the economy improved, although the euro government yield curve inverted further.

EM equity markets led global losses during February, led by Chinese stocks, which gave back gains made in January. The Chinese market's decline was driven by a downturn in global investor confidence rather than the domestic economy, as the recent removal of pandemic restrictions led to a solid upturn in both production and new orders for the country's manufacturing sector during the month. Elsewhere, Latin American markets lost ground, while European EMs rose, bolstered by improved conditions in the euro area.

Performance and Positioning

The portfolio posted a net return of -1.51% (in US dollars) during February, faring better than its custom benchmark, which returned -1.59% (also in US dollars).

The portfolio benefitted from an underweight allocation to equities as markets fell during the month on waning risk appetite, although an underweight to fixed income detracted. A large allocation to cash was also beneficial for relative performance.

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Equity fund selection had a positive effect on relative performance, in aggregate, as our US and European holdings both did better than the global benchmark. In contrast, our EM holdings detracted, lagging the global market.

In contrast, fixed income fund selection detracted from relative results in aggregate, notably Franklin Global Sukuk Fund. It underperformed the benchmark Dow Jones Sukuk Index, influenced by its longer duration profile during a period of rising yields. Elsewhere, exposure to gold shares proved negative on a strengthening US dollar.

Outlook

We have retained our preference for bonds into March, as major central banks maintain their hawkish stance on monetary policy amidst growth that is below trend but stabilising.

Persistent inflation in the United States (US) and Europe, combined with robust jobs data, has provided impetus for central banks to keep interest rates higher for longer. We believe this dynamic, combined with the lagged effect of previous rate hikes, will prove a drag on developed-market economies into 2023, meaning recession is still a likely outcome at some point this year. Although the risks around inflation appear more balanced than they did towards the end of 2022, a sustained policy response may be required to bring it back to target levels. An emphasis on managing inflation expectations is likely to see central banks prioritise this over economic growth, suggesting policy will remain restrictive for some time.

Against this background, we expect equity valuations to moderate, but see select opportunities for investment. We have moderated our preference for the US, as profit margins remain under pressure, although we still believe this market should weather a global slowdown relatively well. The recent sharp drop in natural gas prices has improved the outlook for Europe, leading us to become less bearish on European equities, while we have moderated our constructive view on Japanese equities to pursue other opportunities. We have also improved our outlook for Chinese equities into March, influenced by the removal of zero-COVID restrictions and fading regulatory concerns. Elsewhere, we remain cautious on EM equities, but have warmed slightly to their longer-term prospects, due to fading inflation pressures and attractive valuations.

Within Sukuk markets, we continue to have a pronounced 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 may not materialise, or at least compensate us for the risks involved. On average, however, our portfolios do have higher credit quality than in the recent past. Oil may be vulnerable to slowing demand, but restriction of supply should manage to keep oil prices above US$70 a barrel, a supportive level for Gulf Cooperation Council (GCC) sovereign credit profiles. A China reopening may also prove to be a tailwind as the year progresses.

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