Boubyan Multi Asset Holding Fund

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30 June 2024

Boubyan Capital

SUB-MANAGER'S COMMENTARY

Market Overview

Global equities rose in June, as enthusiasm about artificial intelligence (AI) helped drive gains, particularly in the United States. Despite this, political uncertainty in Europe led equities in the region to lose ground, despite monetary policy easing from the European Central Bank (ECB). Emerging market (EM) stocks outperformed their developed market counterparts, led by Asia.

The US Federal Reserve's (Fed's) monetary policy committee held interest rates at 5.25%-5.5% at its meeting in June, referencing the need for further progress towards its 2% inflation target, amid solid economic activity and a robust labour market. US headline Consumer Price Index (CPI) inflation fell slightly to 3.3% (year-on-year) in May, while core inflation (less food and energy) also declined to 3.4%, down from 3.6% in April. Elsewhere, nonfarm payrolls rose by 272,000 in May, while the unemployment rate remained relatively unchanged at 4.0%.

Economic projections released by the Federal Open Market Committee during the month suggested that headline and core inflation would be higher in 2024 than previously forecast, while there was no change to projected average unemployment or growth figures. The number of interest cuts expected from the Fed this year was scaled back, with the Fed funds rate now expected to remain above 5%. Purchasing managers' index (PMI) data from S&P Global showed US business activity increased in June, led by the services sector, while manufacturing output also expanded, although the rate of growth of factory output slowed. Against this background, US Treasury yields fell across a yield curve that remained inverted. Corporate bonds gained ground, notably high-yield issues.

The ECB's Governing Council cut its main refinancing rate by 25 basis points (bps) to 4.25% at a meeting in early June, referencing declining inflation expectations as the trigger. Annual inflation in the euro area decreased slightly to 2.5% in June, with core inflation remaining at 2.9%. ECB projections show inflation averaging 2.5% in 2024, before falling to 2.2% in 2025, while it expects economic growth to average 0.9% in 2024 and 1.4% in 2025. Despite the relatively healthy projections, leading indicators showed that euro area economic growth is slowing. PMI data from S&P Global pointed to softer manufacturing demand and weaker sales, leading to factory production across the euro area falling at the fastest pace this year. Against this background, European equities fell in June, notably French and Italian stocks, while German Bund yields fell across a steepening curve.

EM equities rose in June, as measured by the MSCI EM Islamic Index, driven higher by Asian markets, although Chinese stocks lost some ground. Taiwanese and South Korean equities were bolstered by the semiconductor sector, while India's Sensex Index hit an all-time high during the month, driven by foreign institutional investors, amid a solid economy and prospects of policy continuity.

The MSCI ACWI Islamic Index returned 1.95% (in US dollar terms) during June, while the Dow Jones Sukuk Index returned 0.81%.

Performance and Positioning

The portfolio posted a net return of 1.77% (in US dollars) during June, outperforming its custom benchmark, which returned 1.25% (also in US dollars). An underweight to Sukuk proved positive for relative results during the month, as the asset class underperformed equities.

Equity fund selection contributed, in aggregate, helped by exposure to EM and US equities, which significantly outperformed the broad global equity benchmark. In contrast, our active equity funds proved a drag, notably Comgest Growth Europe Fund.

Our defensive holdings held back relative performance slightly, in aggregate. Our Sukuk holdings broadly matched the benchmark Dow Jones Sukuk Index and had no significant effect on relative performance, but a smaller allocation to gold shares detracted as gold prices stabilised in June.

Outlook

We retain our balanced approach to asset allocation into July, amid elevated valuations and an emphasis on artificial intelligence that has impacted market breadth. This is despite our constructive view of growth in developed market economies as recession risks fade.

US inflation continues to trend downwards, despite elevated services inflation linked to tight labour markets, although this should ease as wage pressures moderate. The US Federal Reserve has pushed back against the expectation of imminent cuts, seeking definitive signs of deflation, but leading indicators suggest the pace of growth is fading, supporting the initiation of policy easing measures.

A slight extension of the Fed's 'higher-for-longer' rhetoric should not be overly detrimental to risk assets, although we remain nimble in our cross-asset positioning, given stretched equity valuations and rich credit spreads. We expect moderating inflation to drive some divergence in monetary policy among developed market central banks, meaning multiple interest rate cuts are likely to come sooner in Canada, Europe, and the United Kingdom. China is unlikely to pursue further monetary easing, in our view, while the Bank of Japan may accelerate interest-rate hikes amid rising wage pressures.

Regionally, we have downgraded our outlook on US equities, despite resilient corporate earnings and a strong US dollar, reflecting our desire to take a more balanced approach to equity risk. As a result, we have upgraded our outlook on European equities, taking advantage of attractive valuations, as regional leading indicators suggest an improvement in eurozone economic conditions. Elsewhere, we remain constructive on EMs, despite a diminished conviction linked to the moderation of global growth. We remain neutral towards China, as property market risks balance stimulus measures, while we retain our pessimism towards the Pacific ex-Japan region given the importance of China to these economies.

Our Sukuk positioning continues to show a preference for higher-quality credits that have financial buffers to manage slowing economic activity, meaning our portfolios do now have higher credit quality than their historical average. 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.

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