Boubyan Multi Asset Holding Fund

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

31 May 2024

SUB-MANAGER'S COMMENTARY

Market Overview

Global equities rose in May, recovering from a dip in April, as resilient corporate earnings in the United States and signs of economic recovery in Europe fuelled investor confidence. Moderating inflation increased the likelihood of imminent interest rate cuts from several major central banks, bolstering risk assets further. Developed market stocks outperformed their emerging market (EM) counterparts, led by Europe.

The US Federal Reserve's (Fed's) monetary policy committee held interest rates at 5.25%–5.5% at its meeting in early May, 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 3.4% (year-on-year) in April, against a 0.3% monthly increase. Core inflation (less food and energy) also declined to 3.6%, down from 3.8% in April. Elsewhere, nonfarm payrolls rose by 175,000 in April, while the unemployment rate remained unchanged at 3.9%. Purchasing managers' index (PMI) data from S&P Global showed US business activity increased across both the manufacturing and services sectors in May as new orders returned to growth. Despite the robust data, there were signs of weakness, as US economic growth was revised down to 1.3% on an annualised basis for the first quarter of 2024, from 3.4% in the fourth quarter of 2023. Against this background, US equities rose during the month, led by the information technology and utilities sectors, while US Treasury yields fell across a yield curve that remained inverted. Corporate bonds gained ground, notably longer duration issues.

The European Central Bank's (ECB) Governing Council cut its main refinancing rate by 25 basis points (bps) to 4.25% at a meeting shortly after the end of May. The bank referenced declining inflation expectations as the trigger for the move. Annual inflation in the euro area is expected to increase slightly to 2.6% in May, with core inflation rising to 2.9%, impacted by higher services prices. Despite the slight uptick, ECB projections show inflation averaging 2.5% in 2024, before falling to 2.2% in 2025. There were signs of an improving economy prior to the change in policy, as the euro area economy grew by 0.3% in the first quarter, following a slight detraction in the final quarter of 2023. The central bank expects economic growth to average 0.9% in 2024 and 1.4% in 2025. Elsewhere, a leading indicator of the German economy, the IFO Business Climate Index, rose for three consecutive months to April, driven by improvement in both the services and manufacturing sectors. Against this background, German and Italian stocks led gains for European equities, while German Bund yields rose across the curve.

EM equities, as measured by the MSCI EM Islamic Index, were marginally down in May, in US dollar terms, notably Latin American markets. Brazilian stocks detracted, impacted by a smaller-than-expected interest rate reduction. Elsewhere, markets in Poland and the Czech Republic added value, buoyed by optimism in the euro area. In Asia, Chinese stocks continued to benefit from stimulus measures and Taiwanese equities were bolstered by the semiconductor sector, but markets in South Korea and Indonesia lost ground.

The MSCI ACWI Islamic Index returned 2.36% (in US dollar terms) during May, while the Dow Jones Sukuk Index returned 1.08%.

Performance and Positioning

The portfolio posted a net return of 0.83% (in US dollars) during May, underperforming its custom benchmark, which returned 1.49% (also in US dollars). An underweight to Sukuk proved positive for relative results during the month, as the asset class fared worse than equities.

Equity fund selection detracted, in aggregate, hurt by exposure to EM equities via iShares MSCI EM Islamic ETF, which underperformed the broad global equity benchmark. In contrast, our active equity funds added relative value, notably Comgest Growth Europe Fund.

Our defensive holdings proved neutral for relative performance, in aggregate. Our Sukuk holdings broadly matched the benchmark Dow Jones Sukuk Index and had no significant effect on relative performance. The same was true for a smaller allocation to gold shares.

Outlook

We have moderated our view of risk assets into June, taking a balanced approach to asset allocation amid elevated valuations and waning investor sentiment. 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 rapidly 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 retain an optimistic outlook on US equities amid resilient corporate earnings and a low risk of recession. Our outlook on European equities has improved further, despite concerns about corporate profitability, as regional leading indicators suggest an improvement in eurozone economic conditions. Elsewhere, we have moderated our outlook for Japan but 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. We are maintaining our overweight duration positioning, which we look to increase further, particularly as credit spreads continue to perform and provide fewer opportunities for returns.

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

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