Boubyan Multi Asset Holding Fund

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30 November 2018

Sub-Manager's Commentary:

Market Overview

Global equities rose modestly during November, led by Asian emerging markets, which recovered somewhat from steep losses in October. Developed-market equities ended November with marginal gains, despite losses in Europe, due to a strong rally from US stocks towards the end of the month.

Within developed-market equities, value stocks outperformed the wider market, as US investors took a more defensive approach. Growth stocks outperformed in emerging markets, led by Asia, as investor confidence returned. The MSCI USA Index rose 1.95%, outperforming the MSCI World Index, which rose 1.19%, while the MSCI Europe Index fell 0.91%, all in US dollar terms. The euro weakened marginally against the US dollar.

Major European equity markets retreated in November, reflecting poor economic data and continued political uncertainty around the United Kingdom's exit from the European Union. The eurozone reported weaker-than-expected gross domestic product (GDP) growth for the third quarter, at 0.2% (sequentially) and 1.7% (annualized). Hopes for a rebound in the fourth quarter appear to be optimistic, as weak manufacturing purchasing managers' index (PMI) data released in November suggests the eurozone's export-driven economy is also being damaged by global trade tensions. Despite this data, the European Central Bank (ECB) seems determined to push ahead with plans to end its €2.6 trillion quantitative easing programme in December. ECB President Mario Draghi believes inflation is still set to rise gradually, pointing to low levels of unemployment and rising corporate profitability. Ten-year German Bund yields fell 8 basis points (bps) to 0.31% by month end, as investors sought safety.

US equities experienced a volatile month in November. A brief recovery from steep losses in October was halted by a statement from the Federal Open Market Committee (FOMC) that appeared to confirm its stance on further rate rises, to balance inflation risks. However, a renewed selloff in US stocks spurred Federal Reserve Chair Jerome Powell to strike a more dovish tone in a speech in late November. The speech boosted US stocks, such that they ended the month in positive territory. Nevertheless, the volatility in equity markets led to a rise in risk aversion, impacting high-yield corporate bonds and driving down 10-year US Treasury yields by 15 bps to 2.99%. Ten-year Japanese government bond yields also fell in November, losing 4 bps to end the month at 0.09%.

Emerging-market (EM) stocks made solid gains in local-currency terms, which translated into a gain of 4.13% in US dollar terms. The prospect of a thaw in global trade tensions boosted EM stocks and currencies, particularly in Asia. China-based equities gained 7.33% in US dollar terms over the month, recovering from recent losses, and equity markets in India and Indonesia both saw double-digit gains in US dollars, buoyed by strengthening currencies. European emerging markets were less impressive but still registered gains of 2.33% for the month, as Hungary and Poland shrugged off eurozone worries, and Turkish stocks rose 13.13% in US dollar terms, benefitting from a strong Turkish lira. Latin America was the only EM region to post losses in November in US dollar terms, affected by a weak Brazilian real. EM local-currency bonds rose, while hard-currency EM sovereign bonds lost ground, in US-dollar terms.

Broad commodity prices fell in November, driven by oil prices, which plunged on fears of oversupply during a period of uncertain global economic growth. The price of Brent crude oil fell below US$60 per barrel by month-end, wiping more than 20% off its value during November. Gold rose marginally, reaching US$1,220 per troy ounce.

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Boubyan Capital

Sub-Manager's Commentary:

Outlook

We believe the current market sell-off is not large enough to influence the longer-term economic outlook. At this stage, it may have some lasting impact on the level of risk that investors are willing to sustain, while causing some repositioning of portfolios. We are more interested to see, over the coming months, whether investors may shift their preferences from buying on the dips to reducing growth exposure on any recovery. Investor psychology may be informative.

The highlights of our analysis include the following:

• We remain confident about growth staying strong enough to support risk assets over a longer-term horizon. However, investors' concerns that a pause is close enough at hand to justify reducing risk tempers our enthusiasm for stocks in the short term.
• A return to long-run levels of market volatility, rather than the lower levels seen for much of the past ten years, indicates a new volatility regime. As we review our current conviction levels, we tilt toward a more cautious outlook.
• Despite elevated geopolitical headlines and trade tensions, growth fundamentals continue to be positive in the United States, with tax reforms still providing a tailwind for earnings and margins. This underlying story had not been changed much by recent market moves or by softening growth momentum in many economies.
• China's proactive steps to support its economy—lowering bank reserve ratios and promising tax cuts—appears to confirm that global growth divergence is real and worthy of attention.
• With short-term interest rates still subdued and global central banks on track to normalize policy, the headwinds for bonds are clear. However, with divergent economic growth and fears of a growing trade war impacting investors' behavior, we have a somewhat more positive view of European ex-UK bonds.
• We favor assets that have typically performed well during the latter stages of a business cycle, especially those that offer explicit inflation protection such as TIPS. These alternative assets could provide diversification against market weakness caused by an unexpected uptick in inflation.
• Although major EM central banks in India, Brazil and Indonesia have responded with tighter monetary policy, higher rates and protectionist trade policies from the United States present headwinds to EM investments. Selective positioning remains important, as some countries are better prepared to withstand sector headwinds and are less susceptible to fears of contagion.
• As the global liquidity environment evolves, we anticipate that the underlying attractions of EM investments will come to the fore. However, we maintain a modestly lower conviction in EM stocks for now.

We maintain a neutral view of equities and growth assets more generally. Within fixed income, we prefer shorter duration in sovereign bonds, even though long duration on perceived safe-haven investments like US Treasuries might be tactically appealing.

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