Boubyan Multi Asset Holding Fund

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

31 December 2018

بـوبـيـان كـابـيـتـال
Boubyan Capital

Sub-Manager's Commentary:

Market Overview

Global equities gave up significant ground in December. Developed markets fell, led by the US market, despite a late rally in the last week of the year. Emerging markets also fell, driven by poor performance from China.

Growth and value stocks both suffered, as a general sell-off, starting in the United States, gathered pace in early December. The MSCI USA Index fell 9.01% during the month, underperforming the MSCI World Index, which fell 7.57%, while the MSCI Europe Index fell 4.60%, all in US dollar terms. The euro strengthened somewhat against the US dollar.

Major European equity markets retreated in December, affected by contagion from the United States, plus fresh uncertainty surrounding the United Kingdom's exit from the European Union. Social unrest in France concerning fuel taxes and the cost of living added to investor anxiety. Despite downgrading its economic growth projections to 1.9% for 2018 and 1.7% for 2019, the European Central Bank (ECB) believes that the underlying strength of domestic demand continues to underpin euro area expansion and a gradual rise in inflationary pressures. The ECB kept its main rate unchanged in December and indicated that it will remain at 0% until the summer of 2019, or for as long as is necessary to ensure inflation remains close to 2% over the medium term. The central bank also confirmed the end of its €2.6 trillion asset purchase programme, but said it would continue to reinvest the proceeds from maturing securities to maintain favourable liquidity conditions within the eurozone economy. Ten-year German Bund yields fell 7 basis points (bps) to 0.24% by month end, as investors sought safety.

US equities suffered steep losses in December, on worries regarding a budget-related government shutdown alongside existing concerns about a fresh interest rate hike from the US Federal Reserve, slowing global growth, and trade tensions with China. The Federal Open Market Committee (FOMC) raised the federal funds rate for the fourth time in 12 months and confirmed that it would likely raise it twice more during 2019, despite lower growth and inflation forecasts. The FOMC said the continued strength of the US economy warranted ongoing policy normalisation, pointing to Consumer Price Index inflation of 2.2% for November and an increase in annualised real gross domestic product (GDP) of 3.4% for the third quarter of 2018. Ten-year US Treasury yields fell 31 bps to 2.68%, as investors sought a safe haven amidst the market turmoil, while 10-year Japanese government bond yields fell 9 bps to 0.00%.

Emerging-market (EM) stocks also lost ground in local-currency terms, although they proved more resilient than developed markets. The MSCI EM Index lost 2.60%, in US dollar terms, driven down by China, which suffered from renewed trade tensions with the United States and weaker manufacturing data. China-based equities lost 6.05% in US dollar terms during December, significantly underperforming the MSCI EM Asia Index, which lost 3.10%, in US dollars. India and Indonesia both made gains during December in local-currency terms. Latin America was the best performing EM region, losing just 0.75% during the month, as a strong peso saw Mexico add gains of 3.29% in US dollars. The MSCI EM Europe Index lost 2.79%, in US dollar terms, affected by currency weakness in Turkey and Russia. Both local-currency EM bonds and hard-currency EM sovereign bonds rose, in US-dollar terms.

Broad commodity prices fell in December, as global growth showed further signs of slowing. The price of Brent crude oil reached fresh lows for the year, ending the month at US$53 per barrel. Gold rose by 5% during December, benefitting from its perceived safe-haven status during periods of equity market volatility.

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Outlook

We believe the current market sell-off may have some lasting impact on the level of risk that investors are willing to sustain, while causing some repositioning of portfolios. The more interesting assessment over the coming months will be to see whether a change of mind-set may be required, as markets transition from a momentum-driven to a range-trading environment.

The highlights of our analysis include the following:

- 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. Our current conviction levels remain tilted toward a more cautious outlook.

- 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.

- The United States gave up its role as an oasis of relative calm and led global stock markets lower towards the end of 2018. Concerns extended to high-yield corporate sukuk and other less liquid parts of the credit market.

- With short-term interest rates still at subdued levels and global central banks set on a course to normalise policy, the headwinds for sukuk are clear. We have changed the balance of our convictions among fixed-income assets, modestly lowering duration overall, mainly by reversing a positive conviction on eurozone sukuk.

- Tight labour markets and an escalating trade war mean consensus inflation expectations are skewed to the upside. As a counterpoint to this, the sharp decline in the price of oil, with Brent Crude down more than 40% by year end from its recent peak in early October, has lessened energy-induced inflationary pressures.

- China's continued proactive steps to support its economy—lowering bank reserve ratios and promising tax cuts—appear to be affirmation that global growth divergence is real and worthy of attention.

- Although major EM central banks in India, Brazil and Indonesia have responded with tighter monetary policy, higher US 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.

- We maintain a modestly lower conviction in EM stocks for now, although, as the global liquidity environment evolves, the underlying attractions of EM investments may come to the fore.

We maintain a neutral view of equities and growth assets more generally. Ongoing global and capacity constraints lead us to prefer lower exposure to government sukuk and duration, but the economic environment still remains supportive of corporate sukuk. Long duration on perceived safe-haven investments like US Treasuries might be tactically appealing.