Boubyan Multi Asset Holding Fund

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

30 September 2018

Sub-Manager's Commentary:

Market Overview

Global equities continued to make gains in September, led by developed markets, despite a slower pace of equity gains in the United States. European markets bounced back from sharp losses in August, and Japanese equities made strong gains, as emerging markets lost ground.

Measures of developed-market equity volatility remained subdued in September, as major developed-market government bond yields moved higher, while gains in global equities were restricted, as developed-market growth stocks largely lagged the broader market. European stocks rose 0.37%, while US equities rose just 0.46%, underperforming the MSCI World Index, which gained 0.6%, all in US dollar-terms.

Within Europe, while the German market remained weak, Italy and the United Kingdom reversed losses to post healthy gains during September, although Italian stocks lost ground late in the month on concerns about the country's expanding budget deficit. Italian contagion spread to wider European markets, curbing Europe's gains, while the euro also fell sharply towards the end of the month against the US dollar, giving back advances made earlier in the period.

The European Central Bank (ECB) projects headline eurozone inflation to average just 1.7% through to 2020. Despite this, comments from ECB President Mario Draghi boosted investor sentiment during September as he said that a 'relatively vigorous' pickup in underlying inflation could pave the way for rate rises next year. The ECB kept its main rate unchanged and reaffirmed its commitment to slow the expansion of its quantitative easing programme, starting in October, helping 10-year German Bund yields to rise 14 basis points (bps) to 0.47% by month end. Japanese government bond yields remained more volatile—10-year yields rose 2 bps to 0.13%—as the yield curve continued to steepen following the Bank of Japan's decision to widen the yield-target band.

The US economy expanded at an annual rate of 4.2% during the second quarter of 2018, prompting the US Federal Reserve (Fed) to adjust its target range for interest rates to 2%-2.25% in September. It was the third rate rise this year, forming part of a strategy to keep medium-term inflation expectations close to 2%. A further rate rise is expected in December, consistent with the Fed's longer-term policy of monetary tightening. The US dollar finished the month flat against the euro, as 10-year US Treasury yields rose back above 3%, ending the month 20 bps higher at 3.06%. High-yield corporate bonds advanced over the month, while investment-grade corporate bonds outperformed US Treasuries, reflecting narrower yield spreads. The Dow Jones Sukuk Index depreciated 0.12% during September.

Emerging-market stocks saw moderate declines in local-currency terms, which translated into a loss of 0.5% in US dollars. The high dispersion of returns seen within the sector in August continued, with Europe and Latin America benefitting from a reversal of recent losses in Turkey and Brazil, respectively. Emerging-market stocks in Europe gained 6.79%, influenced by a currency-related gain of 20.63% in Turkey and strong gains in Russia. Latin America gained 4.71% on the back of strong Brazilian equities, in US dollar terms. Asian emerging markets were weak, reflecting the ongoing effect of global trade tensions. Chinese stocks lost further ground, falling 1.38% in US dollar terms. Emerging-market local-currency bonds made gains, reflecting lower yields in certain key markets. They outperformed developed-market peers, as did hard-currency emerging-market sovereign bonds, in US dollar-terms.

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بـوبـيـان كـابـيـتـال
Boubyan Capital

Sub-Manager's Commentary:

Broad commodity prices rose during September, driven by oil prices, which rose after the Organization of the Petroleum Exporting Countries (OPEC) decided not to increase output in response to fresh US economic sanctions on Iran. Brent crude oil moved above US$80 per barrel by month end. Gold fell below US$1,200 per troy ounce.

Outlook

The desynchronisation of global growth can be seen in a relative dispersion of performance between global markets, while fears of continued trade conflict and risks of contagion continue to fuel this phenomenon. Despite this, we believe market divergence can be sustained for now, and maintain a neutral view of equities, and growth assets more generally. With global central banks following divergent monetary policies, we expect to find multi-asset investment opportunities.

The highlights of our analysis include the following:

• Global recovery is still supported by rising corporate earnings and profit margins, although we are monitoring equity market growth momentum, due to increased desynchronisation.
• Despite recent corrections, equity valuations based on price-to-earnings ratios in developed markets appear demanding and remain elevated relative to their historical averages.
• Strength in the labour market has had a muted impact on wages, and globalisation has continued to prevent core traded goods prices from rising. Despite this, we continue to see inflation risks tilted clearly to the upside.
• Liquidity constraints are increasing, but are not of immediate concern, as plans implemented by the Fed and other central banks to tighten monetary policy have been well anticipated by markets.
• Central banks in developed markets appear constrained in their options however, as a desire to unwind unconventional policies and normalise interest rates is balanced by a continued need for stimulus measures.
• The prospect of interest rates remaining stimulative continues to see developed-market sovereign bond yields trading at low levels in many markets. Although certain major yields increased to more neutral levels in September, we generally prefer short duration exposure.
• Although emerging market central banks have responded with tighter monetary policy, higher US rates and protectionist trade policies from the United States present headwinds to emerging-market investments. Selective positioning remains important, as some countries are better prepared to withstand sector headwinds and are less susceptible to fears of contagion.
• A period of uncertainty about the pace of monetary policy tightening, the impact of fiscal developments and ongoing geopolitical risks suggest that market measures of volatility, having increased during 2018, may remain at these more normal levels.

For now, we may continue to see stronger returns from equities, especially where earnings are improving, despite demanding historic valuations. We remain bearish on those assets that we consider to be most overvalued, including developed-market sovereign-focused Sukuk, generally, and eurozone sovereign-focused Sukuk in particular.

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