Boubyan Multi Asset Holding Fund

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بـوبـيـان كـابـيـتـال
Boubyan Capital

Sub-Manager's Commentary

Market Overview

Global equities rose in December, adding to gains from the previous month, as falling inflation firmed investors' convictions that major central banks might soon pivot towards easier monetary policy. Emerging and developed markets both rose amidst the improved optimism.

The US Federal Reserve's (Fed's) monetary policy committee left rates unchanged in December and raised hopes of more dovish rhetoric from the Fed moving forwards, as Fed Chair Powell suggested that the lagged effect of previous policy tightening would be a factor in future decisions. The possibility of a soft landing for the US economy was further evidenced by the latest economic projections released by the Fed, which forecast higher growth and lower inflation for 2023 than third-quarter estimates. Projections for the federal funds rate were also revised down to an average of 4.6% in 2024 and 3.6% in 2025.

Broadly in keeping with the Fed's optimism, December's US purchasing managers' index (PMI) data from S&P Global noted a relatively healthy services sector, offset by some weakness in manufacturing activity. Elsewhere, the annual rate of US inflation fell slightly to 3.1% in November, whilst nonfarm payroll employment increased to 199,000, compared to 150,000 in October. Against this backdrop, US equities rose, whilst benchmark 10-year US Treasury yields fell by 45 basis points (bps) to reach 3.88%, as the yield curve remained inverted. Corporate bonds moved higher during the month, helped by falling yields and narrowing spreads.

The European Central Bank (ECB) held its main refinancing rate at 4.5% in December, revising down its projections for headline euro area inflation to an average of 5.4% in 2023, and 2.7% in 2024. Growth in the region is expected to benefit from rising real incomes, although it is projected to average just 0.6% in 2023.

The case for a pivot to easier monetary policy was bolstered by November's inflation data, as euro area annual inflation fell to 2.4%, down from 2.9% in October. Elsewhere, a PMI survey by Hamburg Commercial Bank noted that business activity fell in the euro area across both manufacturing and services sectors during December. Employment fell, as firms scaled back operating capacity in line with worsening order books. Despite signs of economic weakness, European equities responded positively to November's inflation data, as markets across the region recorded gains. Benchmark German Bund yields fell by 43 bps to reach 2.02%, whilst European corporate bonds rose.

Emerging market (EM) equities added value in December across all regions, although Chinese equities declined amidst economic and policy uncertainties. In Asia, South Korean equities rose sharply as inflation fell to a five-month low in December, whilst Indian markets also gained, responding to positive macroeconomic fundamentals. Latin America was the best-performing EM region, notably markets in Brazil and Mexico.

Performance and Positioning

The portfolio posted a net return of 3.36% (in US dollars) during December, slightly ahead of its custom benchmark, which returned 3.00% (also in US dollars).

An underweight to Sukuk proved positive for relative results during a period of "risk-on" sentiment in December, whilst a large allocation to cash detracted.

Our defensive holdings within fixed income proved positive for relative results, in aggregate, as exposure to Sukuk contributed. The two underlying Sukuk funds outperformed the benchmark Dow Jones Sukuk Index, as both funds benefited from a slight duration overweight, relative to the benchmark, during a period of falling rates. In contrast, exposure to a gold ETF (exchange-traded fund) detracted, despite posting positive absolute returns.

Equity fund selection was also positive, in aggregate. European and EM stocks posted robust gains in US-dollar terms, outperforming the global equity benchmark. This more than offset the negative relative performance of our US and global holdings.

Outlook

We have retained our positive view of equities into January, as we believe the recent market rally could extend further into 2024, helped by falling inflation and a stabilisation of growth in major developed market economies.

The probability of a recession in the United States (US) has become more remote amidst ongoing economic resilience, although we continue to be concerned about high interest rates, which could still create recessionary conditions in many developed markets. As a result, we remain wary of elevated equity valuations and retain a nimble approach to cross-asset positioning.

Core inflation remains relatively persistent in the US and Europe, although central banks in both regions should still pivot to easier monetary policy this year, in our view, particularly if economic conditions weaken and employment data cools sufficiently. Whilst some of the lagged effects of previous interest-rate rises are still to be felt, a more stable outlook for growth should support risk assets. However, we recognise that weaker consumer demand, alongside a lessening of employers' ability to pass on higher wages in the form of price increases, could impact profitability and earnings.

Against this background, we retain an optimistic outlook on US equities, despite concerns around a lack of breadth in the market, amidst relatively strong economic activity and robust earnings data. Elsewhere, our outlook on EMs (ex-China) remains positive moving into January, given more modest inflation pressures, whilst any stabilisation in developed market demand should also boost earnings for these highly cyclical markets. In contrast, we remain pessimistic on Europe, due to weak growth and the lagged effect of wage increases. We maintain a neutral view on China, where residual risks offset attractive valuations, despite the prospect of further stimulus measures from the Chinese government.

Our Sukuk positioning continues to show a preference for higher-quality credits that have financial buffers to manage slowing economic activity. Where we do take on higher-risk positions, they are increasingly selective, idiosyncratic and, in our view, compensate us for the elevated risks involved. On average, however, our portfolios do have higher credit quality than their historical average.

As the tragic war in Gaza continues into its fourth month, our expectation remains that the crisis will be contained. If the conflict escalates to draw in Lebanon, Israel's larger cities, or Iranian and US assets, fears of a wider geopolitical crisis may be realised. In that scenario, it is difficult to forecast outcomes, which provides another reason to remain defensive.

As a result, the outlook still supports an increase in allocations to higher-quality fixed income sectors, including global Sukuk, which look poised to better defend portfolios and provide attractive levels of income as we enter a rate-cutting cycle in 2024.

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