

SUB-MANAGER'S COMMENTARY



Market Overview

Global equities rose in August, in US dollar terms, as markets weighed persistent inflation and signs of labour market weakness against strong corporate fundamentals. Markets in Europe, Canada and Japan outperformed US stocks, as investors waited to see the full impact of recent trade deals on the US economy.

Federal Reserve (Fed) Chair Jerome Powell's speech at Jackson Hole paved the way for monetary policy easing in September, as he acknowledged recent labour market weakness, alongside the long-running theme of persistent inflation. Nonfarm payroll employment increased by a relatively modest 73,000 in July, while the unemployment rate remained unchanged at 4.2%. However, the market's expectations for further multiple interest-rate cuts could be confounded by growth and inflation data. The US economy grew at an annual rate of 3.3% in the second quarter of 2025, while core US Consumer Price Index inflation rose to 3.1% in July, from 2.9% in June, impacted by higher costs for airline fares and used cars. In addition, US business activity improved, with growth seen across both manufacturing and services sectors in August.

Against this background, US equities rose, led by the materials and health care sectors but held back by utilities. The US Treasury yield curve steepened as US two-year Treasury yields fell by 34 basis points (bps) on expectations for interest-rate cuts. Ten-year Treasury yields fell by 15 bps to end the period at 4.23%. High-yield corporate bonds benefitted from narrowing spreads linked to sustained risk appetite.

European equities rose across the month, fuelled by gains in Italy and Spain. The European Central Bank (ECB) didn't meet on monetary policy in August but kept rates unchanged in July following a period of policy easing that brought the deposit facility rate down to 2% from 3% at the start of 2025. The ECB's dovish stance has been made possible by inflation that has remained close to target during the second and third quarters. However, annual euro area inflation is expected to tick up to 2.1% in August, on higher food and services costs. The euro area economy grew at an annual rate of 1.4% in the second quarter, while unemployment remained stable. Manufacturing activity strengthened in the eurozone during August, offset somewhat by a softening in the services sector, although inflation pressures increased. Longer-term German Bund yields rose slightly, as 10-year yields rose by three bps to 2.72%.

Emerging market (EM) equities rose (in US dollar terms) as Latin American markets outperformed, notably Brazil, fuelled by falling inflation expectations and hopes for easier monetary policy that could boost corporate earnings. Chinese equities led Asian markets, as expectations for policy stimulus rose. However, Indian markets were impacted by punitive US tariffs, while South Korea and Taiwan suffered from semiconductor trade uncertainties.

The MSCI ACWI Islamic Index returned 1.53% in US dollar terms during August, while the Dow Jones Sukuk Index returned 1.00%. Gulf Cooperation Council (GCC) bonds rose in July, with the FTSE MENA Bond – GCC Index posting a 1.36% return in US dollar terms.



Performance and Positioning

The portfolio posted a net return of 1.30% (in US dollars) during August, ahead of its custom benchmark, which returned 1.16% (also in US dollars).

The equity element of the custom benchmark was changed to MSCI ACWI Islamic Index on 8 May, when the previous benchmark (MSCI ACWI Islamic ex-Japan Index) was decommissioned.

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The fund held an underweight to fixed income, relative to the benchmark, balanced by off-benchmark positions in cash and gold. Our equity allocation was broadly neutral, including the equity element of a position in Franklin Shariah Global Multi-Asset Income Fund.

Our EM equity and multi-asset holdings benefitted relative results, outperforming the global benchmark, while our US equity holdings detracted slightly.

Our defensive positioning contributed to relative returns, in aggregate, notably gold shares. Gold prices rose during August, responding to US dollar weakness, declining real yields, and “safe haven” flows that were partially linked to ongoing concerns about government debt and stagflation. Sukuk holdings had no significant effect, in aggregate. Franklin Global Sukuk Fund marginally outperformed the fixed income benchmark, helped by its longer duration profile during a period of falling US Treasury yields.



Outlook

Global macro conditions remain constructive for risk assets, with resilient growth, benign inflation and broadly supportive monetary and fiscal policy. Corporate fundamentals also appear healthy, amid improved earnings revisions. Despite this, we expect growth to weaken and inflation to rise, influenced by US tariffs, which have yet to flow through to consumers.

This dynamic, in isolation, would likely lead to a bullish view on risk assets, with the expectation that equity markets continue to rally as long as the fundamental backdrop remains supportive. However, we cannot ignore the fact that valuations seem increasingly stretched, while seasonal factors have also become less supportive for equities.

There is little evidence that equities have fully priced in a materially higher effective US tariff rate, while investor sentiment and positioning are becoming less supportive of continued equity market gains. Seasonal headwinds are also an important factor in our decision-making process this month, based on historical US equity market analysis that suggests September is the worst month of the year for excess returns and heightened volatility.

Against this background, our cross-asset allocation remains neutral towards equities, despite the positive macro setup, as we await a market pullback that would reset valuations and investor sentiment. We retain our underweight allocation to fixed income, as fiscal sustainability concerns, ambitious policy expectations and questions over Fed independence may sustain upward pressure on long-term yields. As a result, we are hesitant to add duration at current levels and hold a preference for the lower interest-rate sensitivity of cash.

Within our Sukuk portfolios, we still think valuations favour benchmark rates over credit spreads, and our outlook continues to support an increase in defensive allocations to higher-quality fixed income sectors.

Against this background, we have been actively managing duration amid rate volatility by trimming exposure during rallies and re-entering as yields rise. We have taken the opportunity to participate selectively in the primary market, focusing on high-quality issuers offering relative value.

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

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