

Sub-Manager's Commentary

Market Overview

Global equity prices rose in August, helped by the continuation of dovish monetary policy amidst sustained economic growth. The US and Japan led developed market gains, while peripheral Asian emerging markets (EMs) benefited from positive progress in the fight against COVID-19.

US equities were buoyed by upbeat comments made by US Federal Reserve (Fed) Chairman Jay Powell at the Jackson Hole Symposium. He indicated that the US economy had made substantial progress towards price stability and employment goals, suggesting that the Fed might start tapering its asset purchases later this year. Benchmark US Treasury yields rose during the month, reflecting the improved economic outlook, while high-yield corporate credit made gains. Despite positive economic data, the pace of growth in the US economy slowed to an eight-month low during August, according to the IHS Markit Flash US Composite PMI, as capacity pressures and material shortages weighed on the expansion.

Euro area inflation rose to 3% in August, amidst strong corporate earnings and a resurgence of economic activity linked to the lifting of lockdown restrictions. Despite this, economic sentiment in the euro area fell back from recent highs in August, while manufacturing growth slowed to a six-month low, exceeded by service sector growth for the first time since the pandemic, according to the IHS Markit Flash Eurozone Purchasing Managers' Index (PMI). Against this backdrop, European equities made modest gains during the month, led by peripheral markets, while benchmark German Bund yields rose on improving investor sentiment. The European Central Bank has maintained a dovish approach to monetary policy but may moderate that language at its September meeting, depending on whether rising inflation is viewed as transitory.

Elsewhere, Japanese equities were boosted by signs of a cyclical recovery, while EM equities also experienced strong growth. Equity markets in Thailand, India and the Philippines posted double-digit returns, in US dollar terms, helped by economic reopening. By contrast, Chinese equities remained subdued as industrial production and export growth continued to slow, affected by new restrictions related to the Delta variant and curbs on bank lending. Emerging European markets rose, helped by their proximity to the European Union and currency strength, while rising political tensions and fiscal indiscipline affected Brazilian markets, holding back the broader Latin American region. Oil prices fell slightly across the month, although they picked up in late August as demand worries eased. The Dow Jones Sukuk Index advanced 0.22%, amidst a tightening of spreads.

Performance and Positioning

The portfolio posted a net return of 0.85% (in US dollars), ahead of its custom benchmark which returned 0.72%.

Cross-asset allocation was positive in August, as an overweight to equities alongside an underweight to fixed income benefited results in an environment where global equity prices rose.

Equity fund selection contributed to relative performance, in aggregate, helped by European and US holdings, which outperformed the broad global benchmark. In contrast, a position in Templeton Shariah Global Equity Fund detracted from relative results, hurt by a subdued performance from several Asian markets including China, South Korea and Hong Kong.

Boubyan Multi Asset Holding Fund

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

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A larger allocation to Sukuk also contributed to relative results, in aggregate, as Emirates Global Sukuk Fund outperformed the benchmark Dow Jones Sukuk Index. In contrast, Franklin Global Sukuk Fund detracted slightly, while gold held back results on US dollar strength.

Outlook

We are adopting a cautiously optimistic approach to risk into September as global growth has begun to peak, in our view, while inflation remains elevated. We retain a preference for equities over bonds but recognise that full valuations could be adversely affected by monetary policy normalisation.

Tapering of asset purchases may increase volatility, but we believe equities remain the best source of returns. An uptick in geopolitical tensions or a setback in the global fight COVID-19 might cause us to scale back equity positions in the future, but we feel they are currently preferable to bonds given low yields.

Within equities, we remain more optimistic on the US and Canada than other developed markets given advanced vaccine programmes and solid economic data, while we also maintain a preference for Japan, which is well placed to benefit from a cyclical rebound. We have increased our allocation to Chinese equities slightly, recognising the prospect of stimulus measures from the People's Bank of China, although we remain bearish due to regulatory risks and trade tensions. We are also bearish on broader EMs, given localised inflation pressures and vulnerability to the Delta variant.

Higher oil prices since the first half of 2020, structural reform trends and a reduction in geopolitical risks broadly support our credit allocations, particularly to Gulf Cooperation Council (GCC) sovereigns. It is these healthier fundamentals, coupled with increasing demand for Sukuk markets, that support our positive outlook for the second half of the year, as we expect Sukuk to outperform the broader EM universe. We have not yet substantially reduced overall exposure to credit risk as we believe some sectors still offer value. We have, however, reduced the contribution of corporate idiosyncratic risks in recognition of increasingly stretched valuations.

Elsewhere, alternatives such as gold are useful diversifiers, offering different sources of return and a hedge against rising inflation.

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