Principal Islamic Asset Management (Ireland) (PLC)

Global Sukuk Fund

I Class April 2020

Market Review

US Treasury (UST) yields were relatively stable in April, after a volatile month in March, with the 10-year notes trading within a narrow band of 0.53-0.77% amid lingering concerns over the Covid-19 crisis. The International Monetary Fund offered a somber assessment of global growth for 2020 in its latest World Economic Outlook report, as it projects the Great Lockdown to be the worst recession since the Great Depression in 1930s. UST yields were also buoyed by the US Federal Reserve (Fed)'s ongoing bond purchase program, which amounted to over $1 trillion purchases of USTs since the emergency plan began in March. The US Fed announced on 9 April, that it was further expanding its bond purchase program to include up to $2.3 trillion in loans to aid small and mid-sized businesses, state and local governments, as well as fund the purchases of eligible below-investment grade bonds. UST yields edged lower by 1-5 basis points (bps) month-on-month (m-o-m) across the board led by the shorter tenures, causing the curve to shift slightly lower and bull steepen.

10-year UST yields rallied in early April by 9bps from 0.66% at end-March to an intra-day low of 0.57% on 3 April as investors braced for weak US economic indicators, but pared gains after most data came out better than expected. The US Institute for Supply Management (ISM) manufacturing contracted in March, from 50.1 in February to 49.1, albeit better than consensus expectation of 44.5. Similarly, the US ISM non-manufacturing index slowed from 57.3 to 52.5, defying expectations of a sharper contraction to 43.0. However, US nonfarm payrolls plunged in March, shedding 701,000 jobs (consensus -100,000; February +273,000) and abruptly halting a historic run of 113 straight months of job growth, as the Covid-19 pandemic forced businesses to close and furlough employees. The unemployment rate jumped from 3.50% to 4.40% in March, and is expected to continue to climb in the coming months. 20.1 million Americans applied for unemployment benefits in April, bringing the total since mid-March to 30.3 million.

10-year UST yields continued to be pressured higher to 0.77% after minutes from the US Fed's meeting on 15 March lacked new information. 10-year UST yields resumed its downward trajectory in mid-April, rallying back to 0.54% after US retail sales for March collapsed by -8.70%, the biggest decline since the government started tracking the data in 1992. US Fed Chairman Jerome Powell voiced concerns during its meeting on 30 April, that the Covid-19 crisis may leave permanent scars on the US economy, and urged the government to set aside concerns about rising fiscal deficit and deliver more stimulus. Powell also emphasized that the committee is not in a hurry to raise interest rates from the current near zero levels, and pledged to maintain accommodative monetary policy until the committee is confident that the economy has weathered the Covid-19 crisis. 10-year US Treasury yields traded within a tight range of 0.54-0.66% towards month-end, before closing the month at 0.63% (m-o-m 3bps lower).

Brent oil prices rebounded by 60.30% from $22.71/barrel (bbl) at end-March, following a sharp decline in March, to touch $36.40/bbl on 9 April, amid reports that Saudi Arabia and Russia were ready to discuss a production cut agreement, with both countries saying they want the US to join the cuts. On 10 April, the Organization of the Petroleum Exporting Countries (OPEC)+ (which includes Russia) agreed on a historic deal to cut crude oil production by 9.7 million barrels per day (bpd), just below the initial proposal of 10 million bpd. The production cuts will take effect from 1 May, and are set to last for about two years – albeit at a tapered rate over time. In addition, the US, Brazil and Canada pledged to cut another 3.7 million bpd, while other G20 states will contribute 1.3 million. However following the agreement, Brent oil prices pared gains to around $28/bbl on 17 April, as investors remain unconvinced that the production cuts will counter the demand collapse caused by the Covid-19 pandemic. Brent oil prices continued to fall to touch an intra-day low of $15.98/bbl on 22 April, the lowest level in 18 years. Brent oil prices subsequently recovered after Saudi and Russia released a joint statement that they were prepared to cut production further if necessary. Sentiment was also buoyed by reports of progress in the development of a vaccine to treat Covid-19, as well as news that some countries have started to ease lockdown restrictions, e.g. parts of Europe, Canada, US, Australia, New Zealand as well as Gulf Cooperation Council (GCC) countries such as Saudi and UAE. Brent prices continued to recover towards month-end, by 58.90% from its intra-month low of $15.98/bbl to close the month at $25.39/bbl (m-o-m +11.80%).

Fund Review

The Fund rebounded in April, generating returns of 1.86% compared to the index return of 2.52%. The Global Sukuk market has been recovering, with prices driven higher following the recent OPEC+ meeting, with Saudi Arabia and Russia agreed on a historic deal to extend oil production cuts.

Portfolio Outlook and Strategy

The Global Sukuk market staged a turnaround following the historic agreement between OPEC+ and the G20 nations to collectively cut down oil production to stabilize the existing demand-supply imbalance arising from the Covid-19 pandemic. Fresh positive sentiment was also driven by recent rally in US Treasuries, reopening of several cities in China following a three-month lockdown, and successful fundraising exercises by Asian and GCC governments. Further news of gradual lockdown easing in GCC countries and other nations across the world: parts of Europe, Canada, US, Autralia, New Zealand and Malaysia may soon lead to revived demand for oil and should support further oil price recovery and has boosted demand for Sukuk.

The Fund has been repositioned following the successful OPEC+ agreement, adding exposure in the GCC region and selectively investing in sovereign Sukuk and issuers which display strong fundamentals and cashflow generating capabilities. This would allow the fund to ride the momentum along with the recovery in oil and Sukuk prices.

Moving forward, expectation of weaker global economic growth are expected to continue driving inflows into safe-haven fixed income assets. Given the ultra-low interest rate environment, demand for Global Sukuk may continue to be supported by investors' hunt for higher yields. In addition, GCC countries (Saudi, UAE, Qatar, Bahrain, Oman and Kuwait) constitute a significant weightage in the JP Morgan emerging market government bond (EMBI) indices, which may continue to sustain demand for GCC sukuk.

Disclosures