Principal®

CIMB-Principal Islamic Asset Management (Ireland) (PLC)

Global Sukuk Fund

I Class June 2019

Market Review

US Treasuries (UST) continued its bullish run in June, with 10-year UST yields rallying 12basis points (bps) month-on-month (m-o-m) from 2.12% to 2.00%, the lowest level since November 2016, after the US Federal Reserve (Fed) opened the door to potential interest rate cuts in the future. Demand for safe haven assets were also buoyed by lingering concerns surrounding the US-China trade war, as well as escalating tensions between the US and Iran. The UST yield curve shifted lower and bull steepened during the month, with gains led by the short-end of the curve as softer US economic data bolstered expectations of potential rate cuts.

The US Fed kept interest rates steady at 2.25-2.50% at its meeting on 18 and 19 June, and dropped its earlier pledge to be "patient" in adjusting rates, as widely expected. The committee also downgraded its assessment of the pace of growth in domestic economic activity from "solid" in May to "moderate", while acknowledging that indicators of business fixed investment have been soft. Policymakers also revised their projections for personal consumption expenditure (PCE) inflation and core PCE lower from 1.80% in March to 1.50%, and from 2.00% to 1.80% respectively, citing muted inflationary pressures. US Fed chairman Jerome Powell adopted a notably more cautious stance in his press conference, signalling openness to cutting rates amid slowing global growth, ongoing trade war concerns, deteriorating business and risk sentiment in financial markets, as well as benign inflation.

US Treasuries remained relatively stable in early June, following the massive rally in May, with 10-year UST yields briefly rallying by 7bps from 2.12% at end-May to 2.05% on 7 June following weaker than expected US jobs data. The US economy created 75,000 new jobs in May, significantly missing consensus expectations of 175,000 jobs (April revised lower from 263,000 to 224,000), while wage growth declined from 3.20% year-on-year in April to 3.10% in May. However, 10-year UST pared gains as sentiment improved after President Trump called off his earlier threat of imposing 5.00% import tariffs on all Mexican goods, after Mexico agreed to rapidly expand a controversial asylum program and deploy security forces to stem the flow of illegal Central American migrations through its borders. Demand for UST during the month continued to be supported by soft US inflation data (1.80% in May vs. consensus 2.00%; April 1.90%). Meanwhile, Investors anxiously awaited the outcome of the meeting between Presidents Trump and Xi at the G20 summit in Osaka, Japan on 28 and 29 June. Although there is no official deal yet, the meeting eased tension between the world's two biggest countries for now, with Trump agreeing to hold off on any new tariffs while negotiations resume. Investors cheered the US Fed's dovish tilt, with the shorter 2-year UST rallying 17bps m-o-m to close the month at 1.75%, while 10-year yields marched to 2.00%, the lowest level since November 2016.

Brent crude oil prices rebounded by 3.10% in June from USD64.49 per barrel (bbl) at end-May to USD66.55/bbl at end-June, after posting a huge drop of 11.40% in May. Brent crude oil prices saw some volatility in early June, in line with the cautious sentiment in riskier assets amid looming trade war concerns. Prices were also pressured lower after the International Energy Agency lowered its 2019 oil demand growth forecast for a second straight month by 100,000 barrels to 1.2 million barrels per day, citing weakening economic sentiment. Brent crude oil prices got a shot in the arm following news that two tankers were damaged by explosions in the Gulf of Oman, a strategic waterway crucial to global energy supplies. Towards month-end, Brent oil prices continued to march higher to close the month at USD66.55/bbl after the Energy Information Administration reported that US crude inventories fell by 12.8 million barrels, the most since September 2016, and exceeding expectations of a 2.5 million barrels decline.

Fund Review

The Fund continued to produce strong positive returns of 1.63% in June, outperforming its benchmark return of 1.54%by 9bps. Outperformance was mainly driven by strong stock selection and yield curve positioning. Year to date, the Fund has generated outstanding returns of 6.14%. After a strong market rally, the Fund took profit in June and repositioned. During the month, the Fund participated in the new Sharjah Islamic Bank Tier 1 USD500 million new sukuk issuance.

Portfolio Outlook and Strategy

The global sukuk asset class continued to perform strongly, much in line with our earlier predictions. Persistent US-China trade tensions and worries over global economic slowdown continued to drive the US Treasury market, with the USD-denominated global sukuk market directly benefitting from the rally in US government bonds. Sukuk prices have also been pushed higher by exceptional demand for sukuk issuances out of the Middle East. The recent Saudi Aramco USD12 billion bond issuance, attracted overwhelming demand of more than USD100 billion, oversubscribed by more than 8 times. The success of Saudi Aramco has positioned Middle East issuers in the limelight, with upcoming issuances expected to garner similar interest.

With the market widely anticipating interest rate cuts in the US, we look to strategically lengthen the Fund's duration to capture further potential rally. Against a backdrop of slowing global economic growth, we will continue to mitigate credit risk by selectively investing in higher-rated sovereign Sukuk and issuers which display strong fundamentals and cashflow generating capabilities.

Disclosures

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All figures shown in this document are in US dollars unless otherwise noted. The information in this document has been derived from sources believed to be accurate as at 30 June 2019.