CIMB Principal
ISLAMIC ASSET MANAGEMENT

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

Global Sukuk Fund

I Class March 2019

Market Review

US Treasuries (UST) rallied strongly in March, with yields plunging across the board as soft global economic data continued to drive inflows into safe haven assets. Demand for UST was further amplified after the US Federal Reserve (Fed) adopted a notably more dovish tone at its meeting on 19th - 20th March, pushing 10-year yields 31basis points (bps) lower month-on-month (m-o-m) from 2.71% at end-February to briefly touch 2.34%, the lowest since December 2017 before settling slightly higher at 2.40% at end-March.

The US Fed surprised markets at its meeting on 19th – 20th March, by abandoning their projections for further rate hikes this year, a dramatic U-turn from its projections of two rate hikes three months ago, reflecting a gloomier global growth outlook and weakening domestic momentum. The US Fed lowered its growth forecast for 2019 and 2020 from 2.3% in December to 2.1%, and from 2.0% to 1.9% respectively, while unemployment is expected to tick higher by 0.2% to 3.7% in 2019 and 3.8% in 2020. On inflation, the US Fed cut its projection for 2019 from 1.9% to 1.8%, citing lower overall inflation as it has persistently remained below its 2.0% target for the past few months.

10-year UST weakened briefly in early March, from 2.72% at end-February to 2.76% as investors switched to risk-on mode on growing hopes for a US-China trade deal, despite weaker economic data from China. However, UST yields reversed course beginning 4th March as optimism surrounding the trade deal faded, and global markets digested lower China manufacturing Purchasing Managers Index (49.2 vs. consensus 49.5), which continued to remain in contractionary territory for three consecutive months. China lowered its Gross Domestic Product (GDP) growth target on 5th March for 2019 to 6.0-6.5%, the lowest in almost three decades (2018 GDP 6.6% vs. 6.5% target) and revealed a major tax cut, as policymakers seek to steer the economy through a gradual deceleration while grappling with a debt legacy and the ongoing trade tensions with the US. 10-year UST yields continued to rally to around 2.60% ahead of the US Fed meeting, buoyed by similar weak trends in the US Institute for Supply Management Manufacturing data, which slowed from 56.6% in January to 54.2% in February. Nonetheless, other US economic indicators continued to point towards a slowing economy. 10-year UST yields plummeted further by 27bps from 2.61% on 19th March to briefly touch 2.34% on 28th March, before ending the month at 2.40%.

Brent crude oil price marched 3.6% higher in March from USD66.03/barrel (bbl) at end-February to USD68.39/bbl, lifted by healthy demand and the continuous output cuts led by the Organization of the Petroleum Exporting Countries (OPEC) which includes other members outside OPEC such as Russia, Kazakhstan and Mexico. Brent crude oil prices temporarily declined in early March after disappointing manufacturing data from the US and China stoked concerns over demand growth. However, Brent crude oil prices received a shot in the arm on 11th March after Saudi announced that it plans to cut its April crude oil exports to below 7 million barrels per day (bpd), while keeping its output well below the 10 million bpd mark despite higher demand, as it stays committed to draw down excess global inventories and boost oil prices. US energy firms reduced the total number of operating oil rigs to 816, the lowest in nearly a year, as independent exploration and production companies cut spending as they focus on earnings growth instead of increased output.

Fund Review

The Fund continued to produce strong positive returns of 0.94% in March, albeit lower than the Dow Jones index return of 1.50%, due to yield curve movements.

Portfolio Outlook and Strategy

The outlook for the Global Sukuk market remains bright, especially following the US Fed meeting in March, where policymakers unexpectedly signaled that it may not raise rates this year, a notable shift from its projections of two rate hikes three months ago. Moreover, after hinting at doing so in January, the Fed also confirmed it will begin tapering off its balance sheet reduction program in May and end it by September 2019. In addition, the US Fed lowered its growth forecast for 2019 and 2020 from 2.3% in December to 2.1%, and from 2.0% to 1.9% respectively, while unemployment is expected to tick higher by 0.2% to 3.7% in 2019 and 3.8% in 2020.

Meanwhile sentiment in the Gulf Cooperation Council (GCC) Sukuk market is also expected to continue to be buoyed by higher crude oil prices (which may translate into higher revenues for GCC governments), as well as the inclusion of sovereign and quasi-sovereign issuers from five GCC countries in the JP Morgan Emerging Market Bond Indices (EMBI) effective 31st Jan. The inclusion is expected to represent about 11.2% in JP Morgan's EMBI Global Diversified and EMBI Global, therefore boosting the indices' allocation to the Middle East to up to 17%. Following the announcement of the inclusion, we have been seeing strong buying of GCC sovereign Sukuk, which has also spilled over into the corporate Sukuk space, therefore driving prices higher. Going forward, buying interest in GCC Sukuk may remain strong as the index inclusion will be phased over nine months, supported by expectations that the US Fed will keep interest rates unchanged at least through the rest of the year.

Against a backdrop of slowing economic growth globally, we will continue to mitigate credit risk by increasing exposure in higher-rated sovereign Sukuk. Nonetheless, given that the Global Sukuk market has rallied strongly year to date, we will continue to closely monitor market movements to identify attractive re-entry levels, while continue to take profits on our Sukuk holdings to lock-in gains.

Disclosures

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 31 March 2019.