Global Strategic Thoughts #19

DEAR SGF INVESTORS AND FRIENDS,

GLOBAL EQUITIES MARKET REVIEW

July was a mixed month for the Global Equities, as Developed Markets significantly Outperformed Emerging Markets. The global benchmark for equities, the MSCI All Country World Index or ACWI was up +0.72% in USD terms but the Developed Markets measured by MSCI World Index was up +1.82% in USD terms as China Regulatory Pressure saw the Hong Kong Tech (HSTECH Index) fall by -16.8% in USD terms for the month of July. For Malaysian Ringgit investors, weakening of the ringgit against the US Dollar from 4.149 (30 June) to 4.2205 (31 July) meant that ringgit investors received a benefit of 1.72% from FX gains for the month of July. As such, the global benchmark for equities ACWI was up +2.43% in July.

After another strong performance by the developed markets in July, the US and European Equity Markets currently sit at all-time highs. Over the near term, we continue to be cautious of the possibility of market pullbacks and increased volatility. For starters, even though the Nasdaq index outperformed the US S&P500, the breadth or leadership of the index was very narrow. In other words, the rise in the general index level was driven by a few large cap Tech stocks rather than many companies participating in the move higher in the markets. Historically, this can be indicative that there is less demand from buyers and hence it might be difficult for the markets to continue higher without a small healthy correction, which allows positions to be reset and investors to come in to buy the dip.

DELTA VARIANT – THE WILD CARD

Earlier in the year, we talked about how rising yields was a concern for the markets, but more importantly, it's the rate of change or speed of the move that matters, vs. the actual increase itself. However, over the last few weeks, US yields have been declining at a rate that alarmed the market again, raising fresh concerns on the strength of the economic recovery, amidst the rise of the Covid delta variant globally. We think that the move lower is driven by partly fundamental reasons but exacerbated by technical reasons. Even though economic activity or rate of growth has likely peaked and the abundance of liquidity is behind us, the reality is that the US economy will likely continue to growth above trend, supported by a strong consumer (high savings) and strong capex recovery. The Delta Variant, whilst more transmissible, has shown to have a similar Case Fatality Rate as the annual flu, once a population is sufficiently vaccinated. As such, as we move towards the second half of the year, we think yields will likely start to move higher again, to reflect the true economic reality.

CYCLICAL VS. DEFENSIVES

If we are right in our thinking that US yields should rise from here, then the leadership in the market is likely to rotate back to the cyclical and re-opening trades, having underperformed over the past 2 months as yields declined. If we look at the S&P 500, whilst the market weighted 1 year forward P/E remains at 21x, the average P/E of the S&P 500 has fallen to <19x. What this means, is that similar to the Nasdaq example above, the performance of the broad index is being supported by a few large market cap companies (large cap tech). Subsequently, cyclical sectors (industrials, materials, energy, financials) have suffered through a rolling correction and de-rating, which positions them for a strong recovery and potential outperformance in the second half, should bond yields rise.

TAPER TANTRUM

As we get close to the Jackson Hole Symposium (annual event held by the US Federal Reserve) in late August, we should get further information on the outlook for taper and rate hikes. Whilst this is likely to trigger a move higher in yields, looking back at the previous taper tantrum of 2016, we saw the markets reacting negatively to the announcement of taper, with the S&P 500 declining by -5% to -7% before eventually making new highs. Another reason why, we remain cautious post the strong performance of markets Year to date.

ADDRESSING CHINA'S UNDERPERFORMANCE

Last but not least, regulatory concerns continue to drive a sharp de-rating and decline in the China equity markets with MSCI China down -13.8% and Hong Kong Tech (HSTECH) down -16.8% in Ringgit terms in the month of July. Whilst regulation risk is not new in China, there seems to be difference this time round that is worth analyzing. Taking a step back, our view is that if we look at developed markets, wealth inequality continues to rise. The impact can be felt in areas such as access to education, access to financial markets, living standards and social welfare. The driving factor here is capitalism and free markets. It seems to us that what the Chinese government is trying to do, is to manage the evolution of their socio-economy, hence the need to intervene and regulate the new growth sectors in China.

Contention between labour and capital is perpetual, in any economy. We think the government is trying to a certain extent, re-distribute the wealth from oligopolies that are extracting rent from the people. New sectors such as food delivery, ride sharing, e-commerce are disruptive and arguably better for the end consumers. However, it also comes at a cost, it lowers the cost of labour (shifting the benefit toward capital). Therefore, the regulatory steps taken in the new economy sectors, to reduce cost of education, raise min. wages, providing social security for food delivery riders, reduce anti-competitive behavior within e-commerce etc are all steps taken by the government to achieve 'Common Prosperity'. We think that the Chinese Government takes a long view (5 year plans) when making decisions, and they are not aimed to be anti-capitalist but to exert a greater influence by the Communist party. Over the long term, we think the outlook does not really change but expect more regulation to come in over the next quarter or two in these new growth sectors which does not have the same level of regulation as the traditional sectors. We continue to hold our positions in the China names within SGF (Nomura Strategic Growth Fund) and will look for opportunities to add over the next two quarters. Note that GHC and GSE currently do not hold any investments in China.

ASSET ALLOCATION – REGIONAL PREFERENCE

Given our cautious view of the markets as well as the looming risk of taper which has historically been more negative for emerging markets, we retain our preference for developed markets here. However, as we progress into the second half, the headwinds for EM should start to abate, with the China credit impulse bottoming out sometime in late 3Q or early 4Q, taper discussions underway and the re-opening of the countries within EM which are behind that of the developed markets due to speed of vaccine delivery. We will continue to monitor the developments and act accordingly.

PUTTING IT ALL TOGETHER

Given the global market outlook above, we continue to be cautious of the market in the near term and have reduce the equity exposure further to 58% (at the time of writing). The objective for now is to position the fund more defensively as we wait for any tactical dips in the market. More importantly, **we retain our positive view on risk assets over the mid to long term and view any corrections in the market as an opportunity to rebuild the equity exposure.**

We continue to favour developed markets over emerging markets (EM), given taper is coming and historically, rising rate expectations have been negative for EM and EM FX. Even though the equity book's performance was satisfactory, our exposure to China Tech was the largest source of drag. On our estimates, China Tech contributed -1.2%, so excluding this, SGF's performance in the month of July would have been 2.66% vs. the reported 1.46%.

Despite the pullback in the China Tech Sector, we continue to hold our positions with c5% of the fund exposed to this sector. Whilst we believe that the long term outlook of China Tech remains attractive, we do not feel that this is the right time to be adding to this space as further regulatory actions is likely to keep investors on the sidelined. We will continue to monitor the developments here to add risk in the coming months.

As for our FX hedges, recall that in June, we removed all hedges driven by our view that ringgit is likely to weaken due to rising covid cases and political uncertainty (this call has been favourable for July). We continue to be unhedged as risk of taper could see a stronger dollar and a weaker ringgit over the coming weeks.

Lastly, we continue to retain a cyclical tilt in our Equity portfolio, to favour re-opening / cyclical stocks as well as secular growth stocks (our "Future Investment Themes").

Sincerely,

Hisham Hamzah

Total Return %	1 Month Performance 30-June-21 to 31-Jul-21	3 Month Performance 30-Apr-21 to 31-Jul-21	6 Month Performance 31-Jan-21 to 31-Jul-21	1 year Performance 31-Jul-20 to 31-Jul-21	Since Inception (2nd June 20) 2-Jun-21 to 31-Jul-21
Nomura Global Shariah Strategic Growth A	1.46	4.29	9.15	17.81	23.11
Nomura Global Shariah Strategic Growth B	1.43	4.2	8.98	17.45	22.69
Source: Nomura Asset Management / Refinitive Lipper					

Disclaimer

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