

Sukuk to shine in 2023

Market update

December 2022



OUR KEY CALLS

Tactical Asset Allocation

- Overweight Cash
- Overweight Defensives over Cyclical
- Prefer USD

Sector Preferences

- Healthcare
- Energy

Key Short-term themes

- Economic growth will slow into 2023
- Yields expected to decline into slowdown

Key Long-term theme

- Inflation will trend lower in 2023 but will remain higher for longer, driven by:
 - Climate Change Policies
 - Build Back Better at Home Policies
 - Labour policies

OUTLOOK

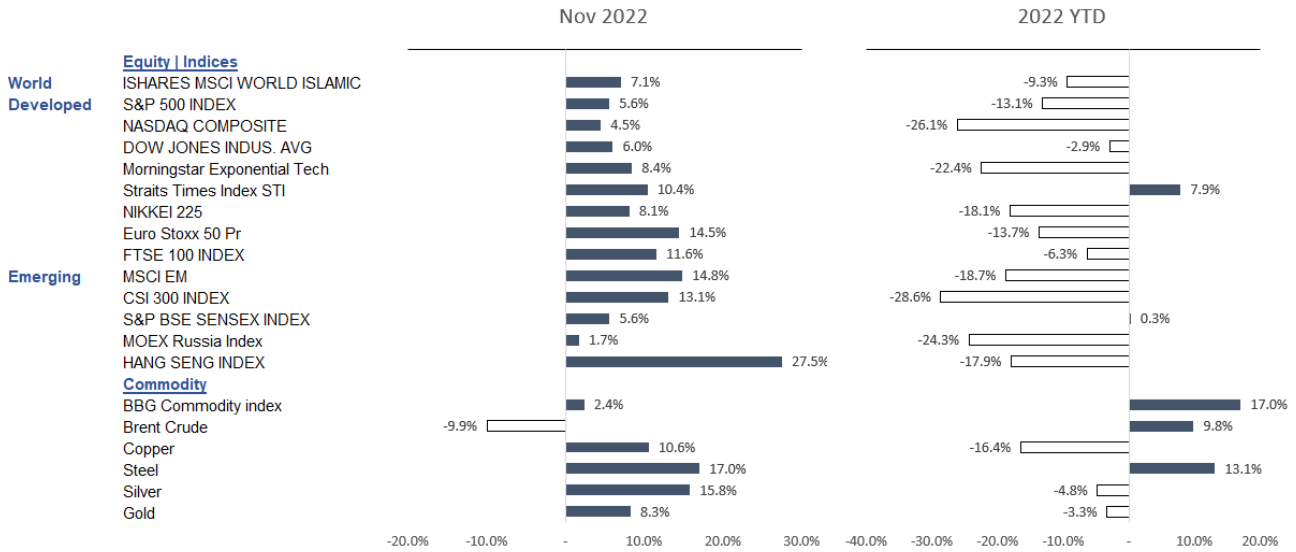
We continue to believe that we are in the midst of an economic slowdown and that it is prudent to manage risk exposure and to have an overweighting to cash and defensive areas of the market.

- We take the view that the rebound in Equities in October & November was a bear market rally. With this in mind, we expect Equities will likely make lower lows as the market prices in economic slowdown.
- We continue to favour a multi-asset class strategy in this environment, with exposure to high quality sukuk, precious metals and equities.
 - Sukuk yields are the highest they have been in years. Sukuk will likely provide strong performance as the market prices in the slowdown we expect in 2023. We recently added to our Sukuk position in early December.
 - Within equities, healthcare continues to perform well and offers protection in a slowdown.
 - Gold, we expect, will do very well as the delta of the Fed rate increases slows, relative to other central banks and the USD eventually weakens as we expect.

MARKET REVIEW

November was a great month for risk assets with the MSCI World Islamic index and the S&P 500 up 7% and 5.6% respectively. Softer than expected inflation data buoyed expectations that the US Fed might slow – or even end – its tightening cycle over the coming months. Better than expected macro-economic data, particularly in the US paired with a weakening US Dollar, further improved risk appetite. Chinese equities, after a difficult October, staged a stellar rebound with the Hang Seng up 27%. The rebound in Chinese equities was largely driven by renewed investor optimism around rumours of Zero-Covid policy easing and the reopening of the world's 2nd largest economy.

Gold and Copper rose 8% and 10% respectively, supported by a weakening US dollar, while cryptocurrencies suffered a brutal month driven by the FTX fiasco. Crude oil prices settled lower in November, with Brent closing the month around \$85 per barrel, down 9.9%. This was despite the pullback in USD and the rumours around a China reopening.



RASAMEEL'S PERFORMANCE

In terms of our performance, while all our Strategies and Funds were up in absolute terms, they underperformed their respective benchmarks. This comes as no surprise given our defensive sector positioning and overweight cash allocation. The Global Equity Strategy delivered a 6.6% (gross) return in November. Given the Strategy's defensive positioning and high cash position, the Strategy marginally underperformed its benchmark, the iShares MSCI World Islamic ETF, which rose 7%. The Multi-Asset Fund delivered a 5.2% return (net) vs the iShares Core Growth Allocation ETF's return of 6.9%. Year to date, the Fund is still outperforming its benchmark and peers. The Disruptive Technologies Strategy rose 5.2% (gross) vs its benchmark's (Morningstar Exponential Technologies index) rise of 8.4%.

ANOTHER BEAR MARKET RALLY IN EQUITIES?

Both bond and equity markets enjoyed a strong rebound from October lows. In the case of bonds, while there may be some further inflation surprises, such as inflation staying higher for longer, we see the trend as down from recent highs. Fed rates are, in our view, close to peaking and yields are expected to fall off as the market further prices in a slowdown in 2023.

In our view, this is a good time to add to sukuk, to benefit from falling yields.

The sweet spot for adding sukuk exposure is during the next 6-12 months as a trade as, while we expect inflation to drop off into the expected slowdown of 2023, we do see inflation trending at higher levels than we have seen over the past decade.

In the case of equities, however, we continue to believe that the rebound from October is a bear market rally and that the market is yet to price in the full impact of the Fed tightening.

Chart – S&P 500 1Yr daily chart with moving averages, MACD and RSI



The rally has been substantial enough for the S&P 500 to break through its 200dma, a critical technical indicator for us, but at this stage not enough for us to change our view. For example, we saw the same in March 2002, just as the market declined a further 30%.

Chart – S&P 500 daily chart with moving averages, MACD and RSI - 2002 to 2003



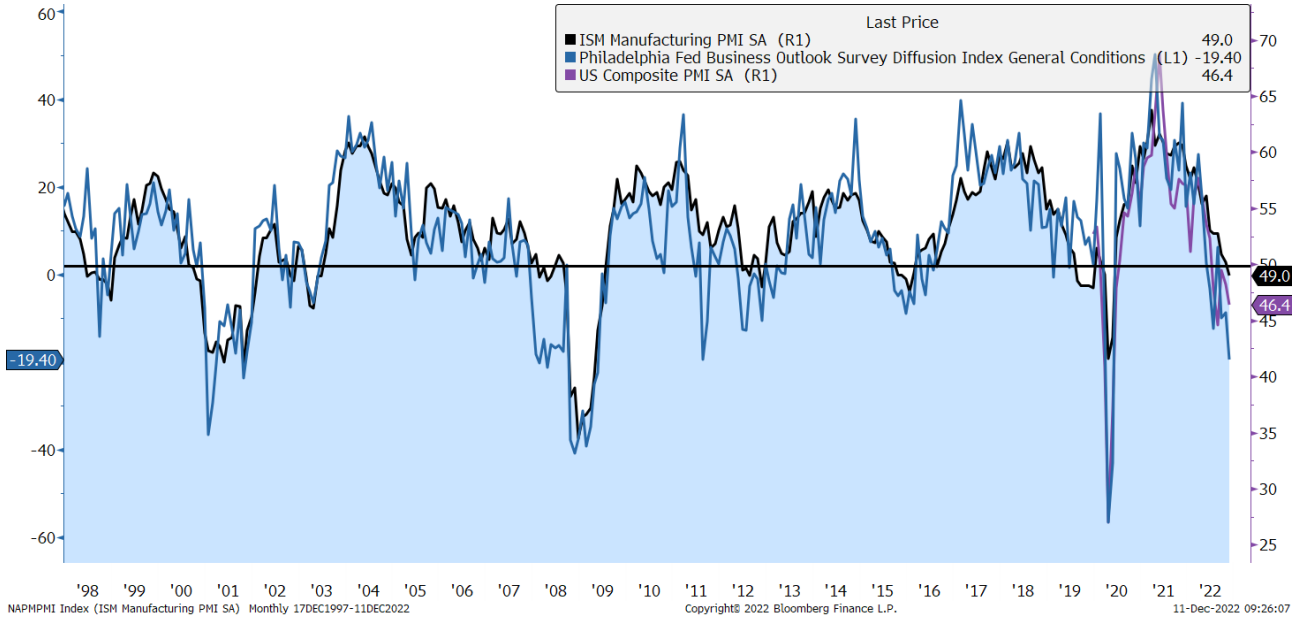
The key driver of our bearish view is the underlying macro-economic data and market valuations.

Economic data continues to come in relatively weak and below expectations.

See for example the S&P US Manufacturing and Services index, as well as those from ISM, and the Philly Fed Business Outlook, all came in weaker than expected. It can be noted that

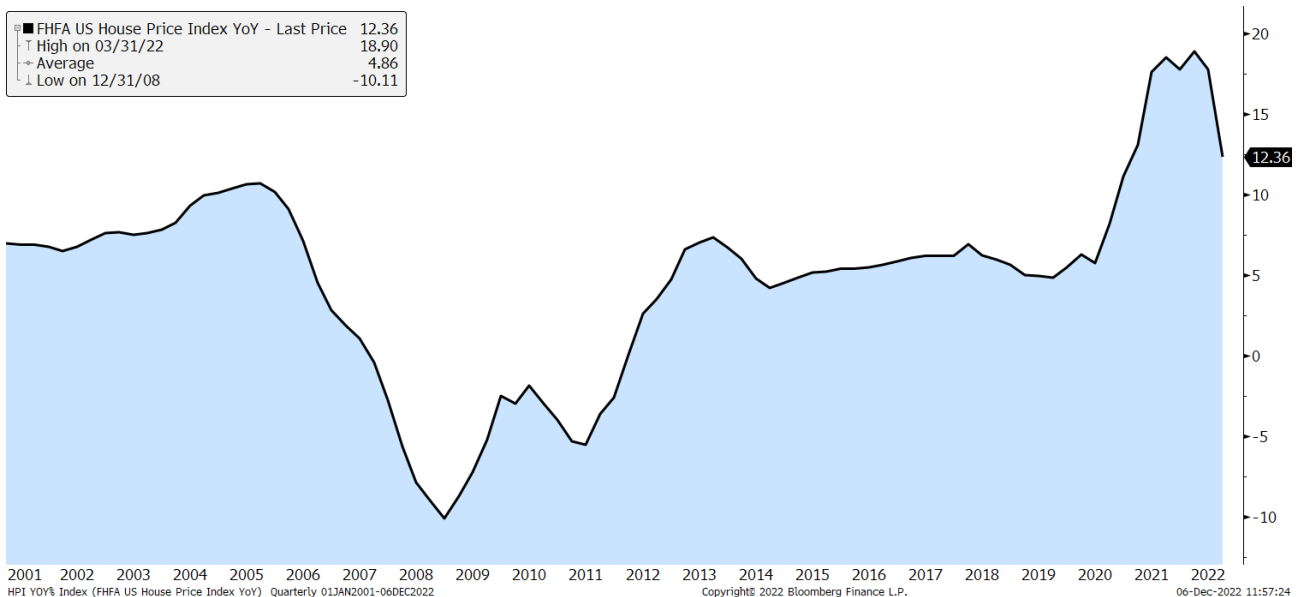
in each case, when these indicators reflected contraction, it corresponded to a much weaker economy and market – see for example 2000, 2008 and more recently in 2020.

Chart – ISM Manufacturing PMI, US composite PMI and Philadelphia Fed Business Outlook Index



Home prices, a key component of a healthy economy, also continue to decline, and pending home sales have fallen dramatically. Both a reflection of the impact of higher rates on the market.

Chart – US Home price Index



Given the lagged effect of higher rates, we are expecting home prices to fall off further. As noted in a prior report, homeowners will be reticent to sell as they may have locked in low-rate mortgages. So initially prices may not move by that much, but if we have a relatively long

period of slower growth and jobs come under pressure, then we may see dramatic selling pressure towards the end of the current down cycle.

Chart – US Pending Home Sales

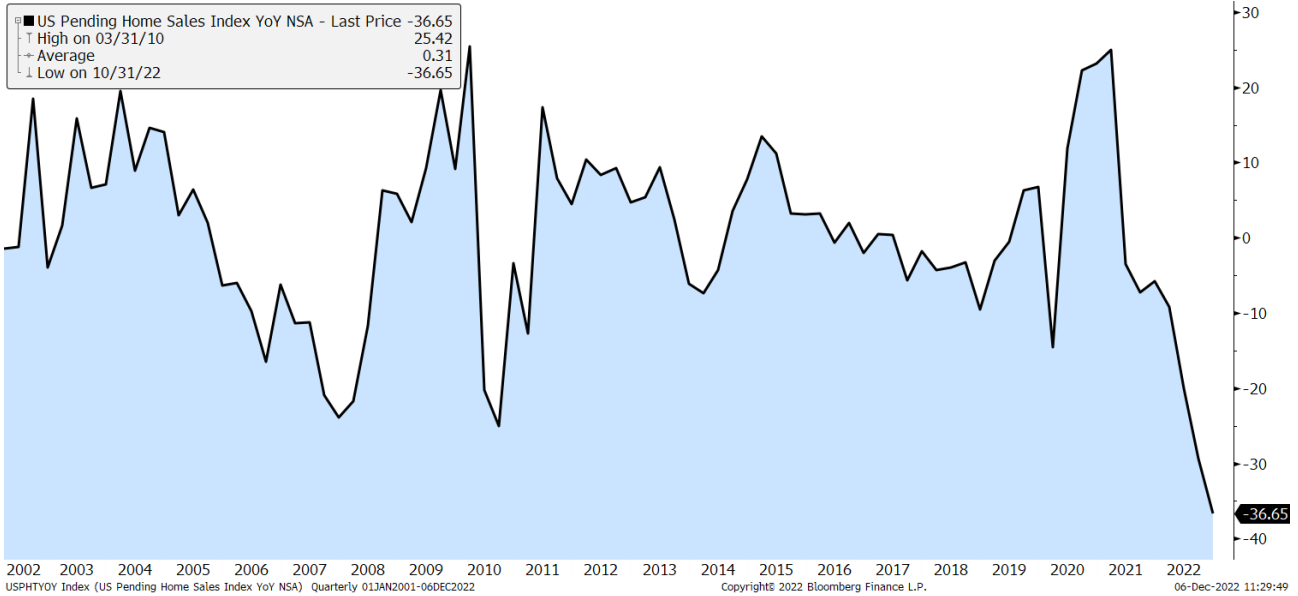
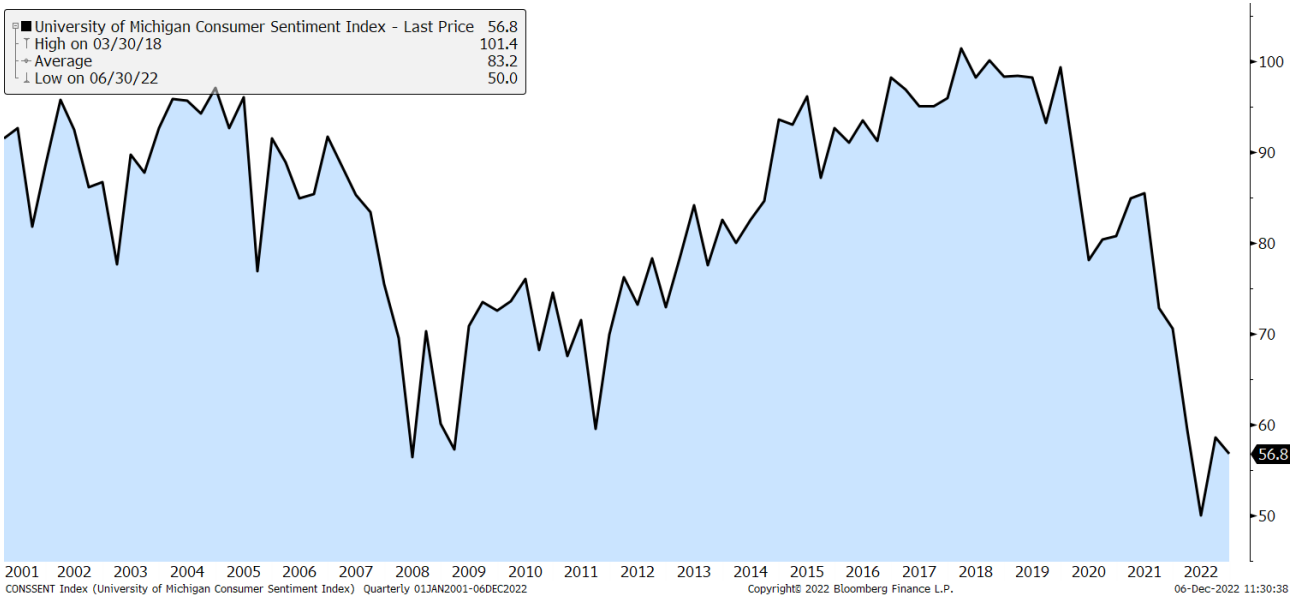


Chart - Michigan Consumer Confidence has also fallen dramatically



Another key indicator we track, is the yield curve inversion. Yield curve inversion refers to the fact that short dated rates are higher than long dated yields. A reflection of the fact that the fixed-income market is pricing in lower growth/inflation further out. As we have highlighted in the past, this indicator has been shown to be effective at predicting a recession ahead. We saw the initial inversion of the US yield curve in 2021 and it has a good record of predicting a recession some two years out.

Chart – Yield curve is deeply inverted

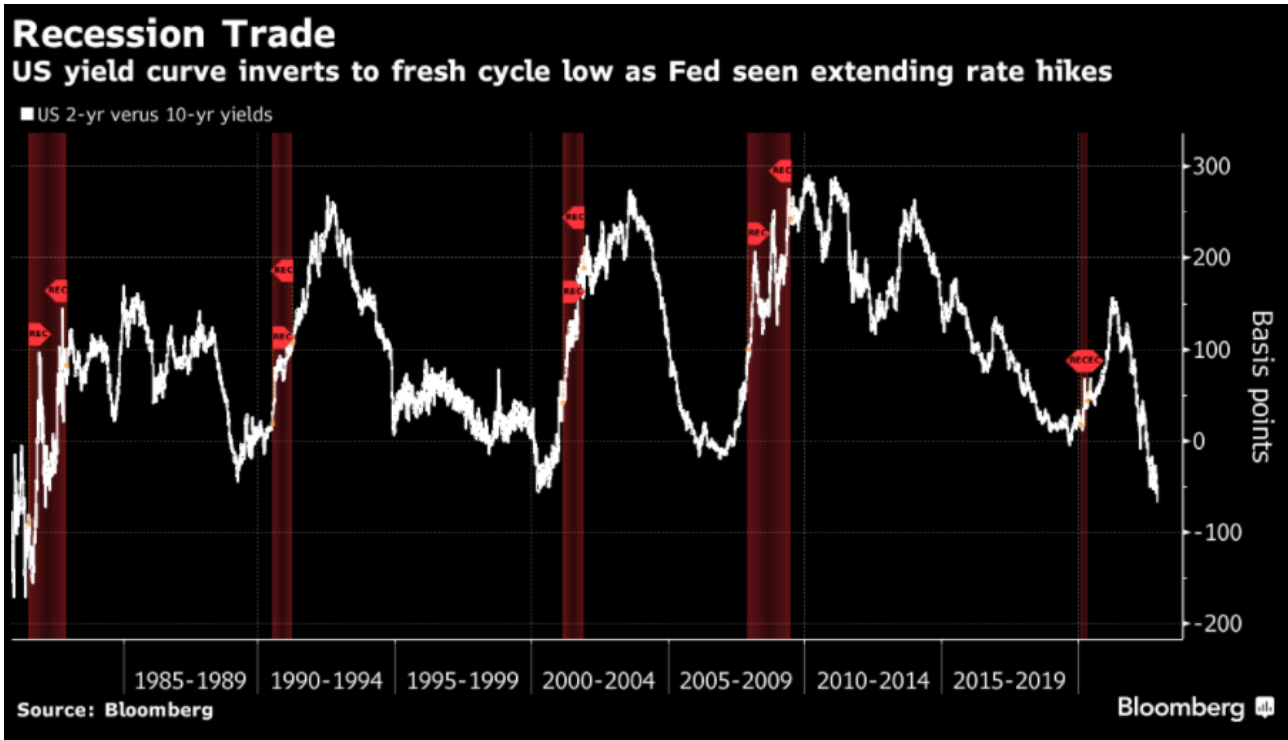
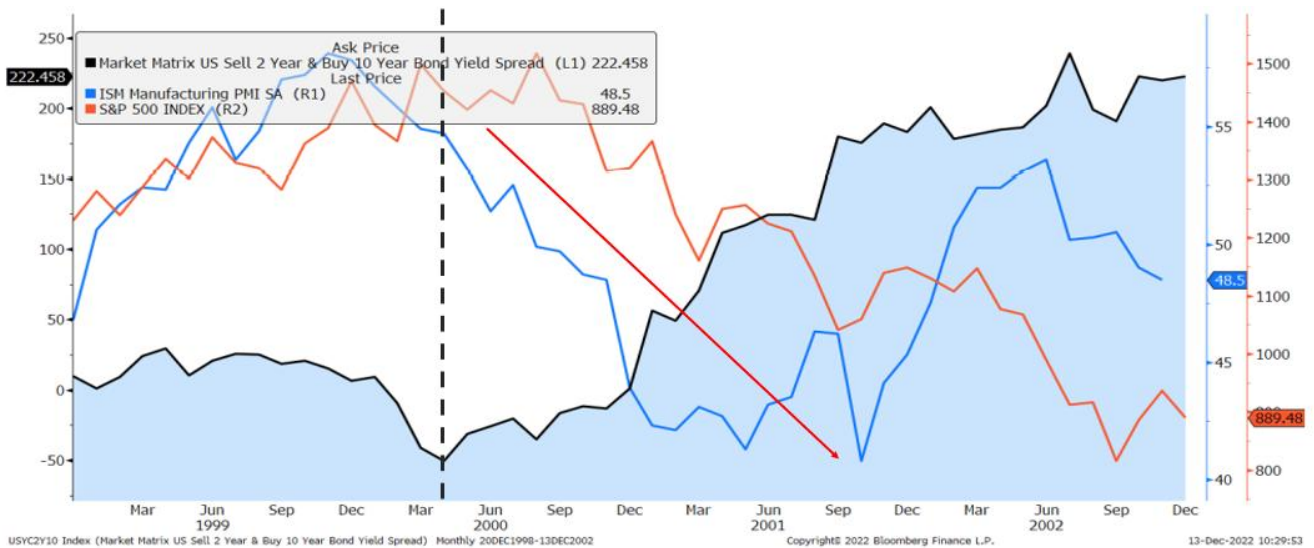


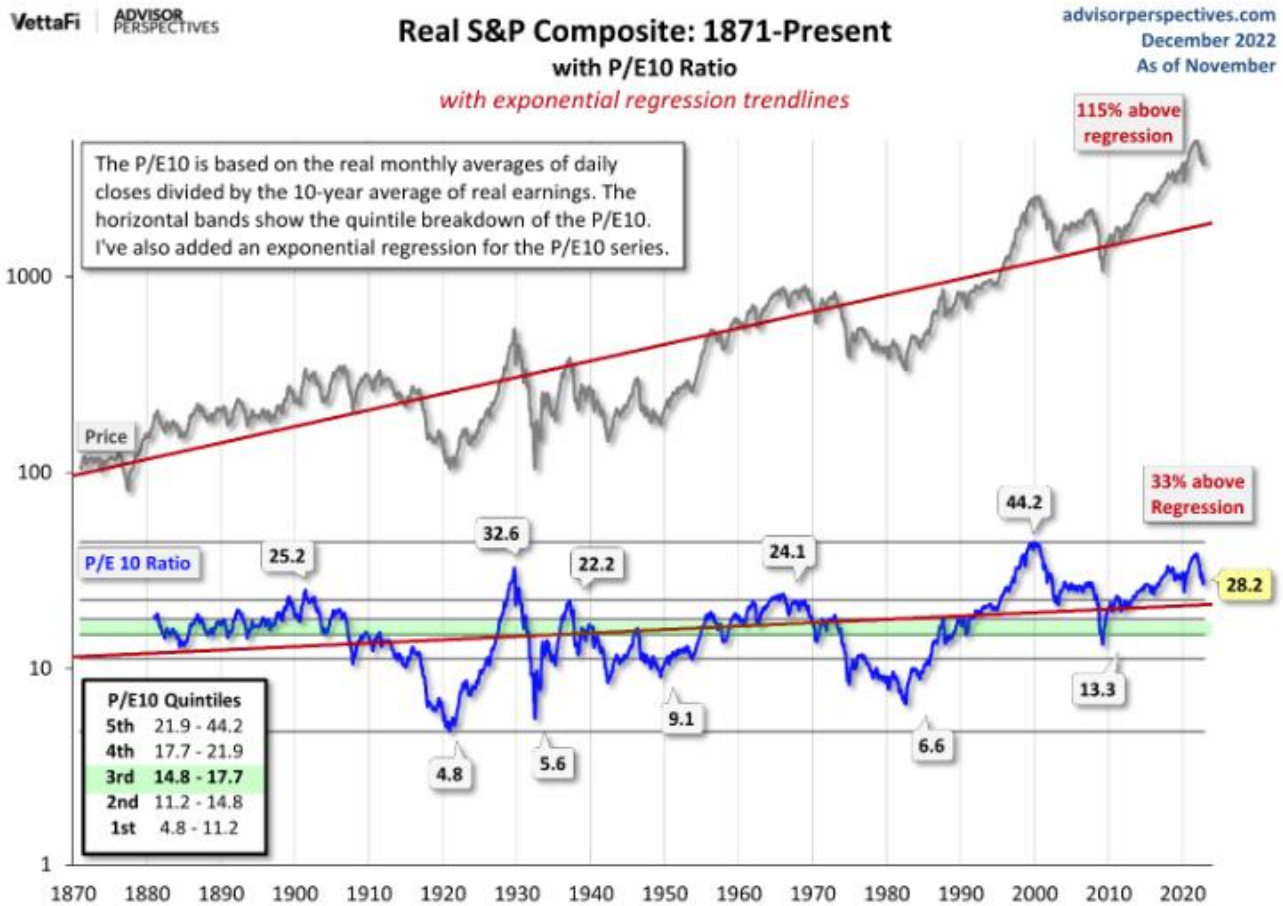
Chart – 2yr – 10Yr spread, ISM and S&P from 2000-2002



In our opinion, the market still has to price in a lot of negative economic data. The fact that the Fed will raise by likely only 50bps rather than the prior 75bps is, in our opinion, really neither here nor there. Rates are still moving higher, and the target rate has only come off marginally in the last month or so. The Fed itself is projecting rates to reach 5.1% in 2023. So, we think the market’s bullishness is a little overdone.

In terms of valuation, we have highlighted a number of times that the US market is still relatively expensive. So, there is little need at this stage to fight the fed because of attractive valuations.

Chart – PE 10



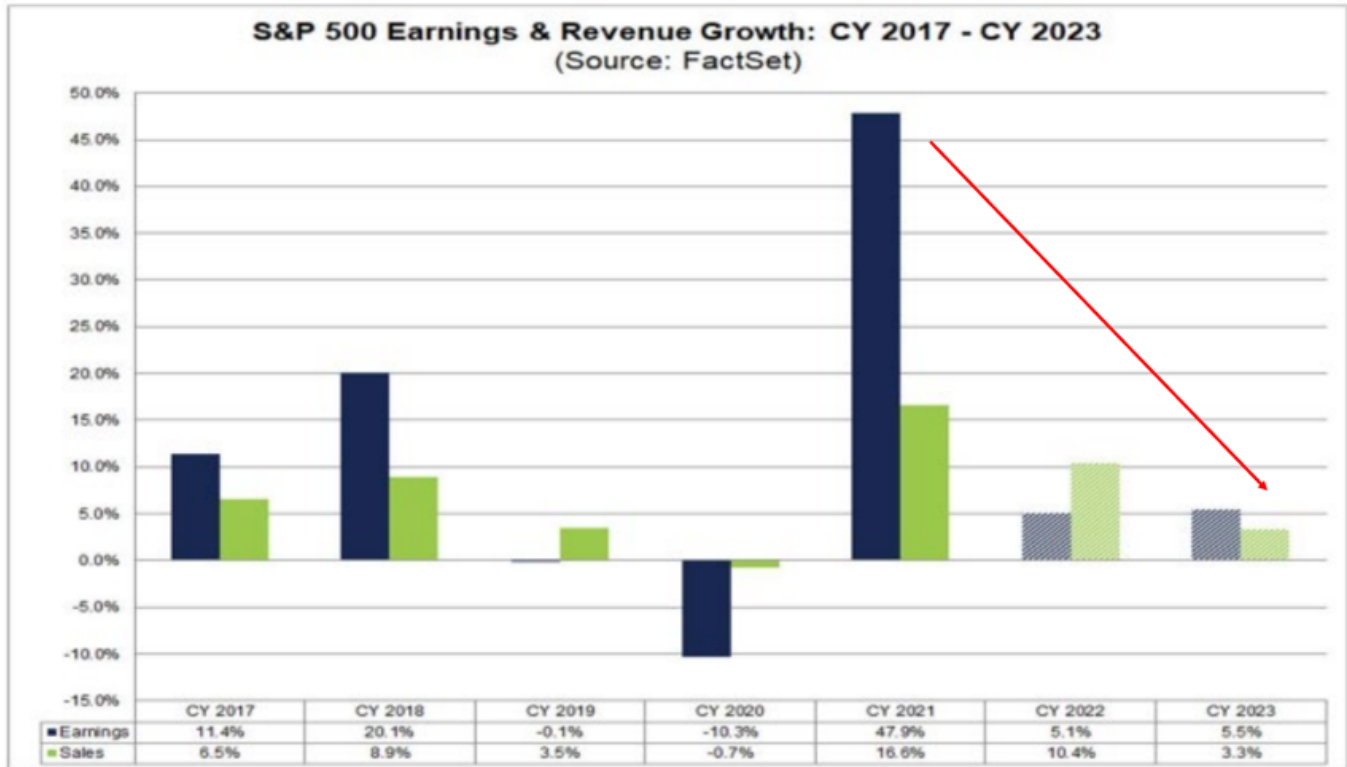
Similarly, earnings growth has been coming off. As we highlighted in our October report, the market was still pricing in 10% earnings growth in the S&P, which we felt was too high. Indeed, we postulated that if earnings growth was zero and the market traded at 14x, the S&P could trade down to 3100 levels.

		S&P 500 2022 Target (Spot – 3588 on 10/10/2022)					
2023 EPS Growth		-15%	-10%	-5%	0%	5%	10%
2023 EPS		189.6	200.7	211.85	223	234.15	245.3
Fwd PE Ratio	15.5	2938	3111	3284	3457	3629	3802
	15.0	2843	3011	3178	3345	3512	3680
	14.5	2748	2910	3072	3234	3395	3557
	14.0	2654	2810	2966	3122	3278	3434
	13.5	2559	2709	2860	3011	3161	3312
	13.0	2464	2609	2754	2899	3044	3189
	12.5	2369	2509	2648	2788	2927	3066

Note – The above analysis is based on the assumption of 2022 EPS meeting the current consensus of \$223

Earnings expectations have indeed been coming off and in the last few months consensus earnings growth has fallen from 8-10% to 5.5%.

Chart – Factset estimates



We remain cautious and underweight on equities and are adding to bonds. As active managers we continue to keep our cash allocations high, expecting the next leg down to be imminent. We are not alone in our outlook, which does reign in our enthusiasm to take our risk exposure down even further.

ACTIVE VS. PASSIVE MANAGEMENT

In our opinion, this is the time for active managers to shine. Unlike passive managers that invest pari passu in an index, active managers have the ability to add value through stock selection and tactical allocation, across sectors, countries and cash.

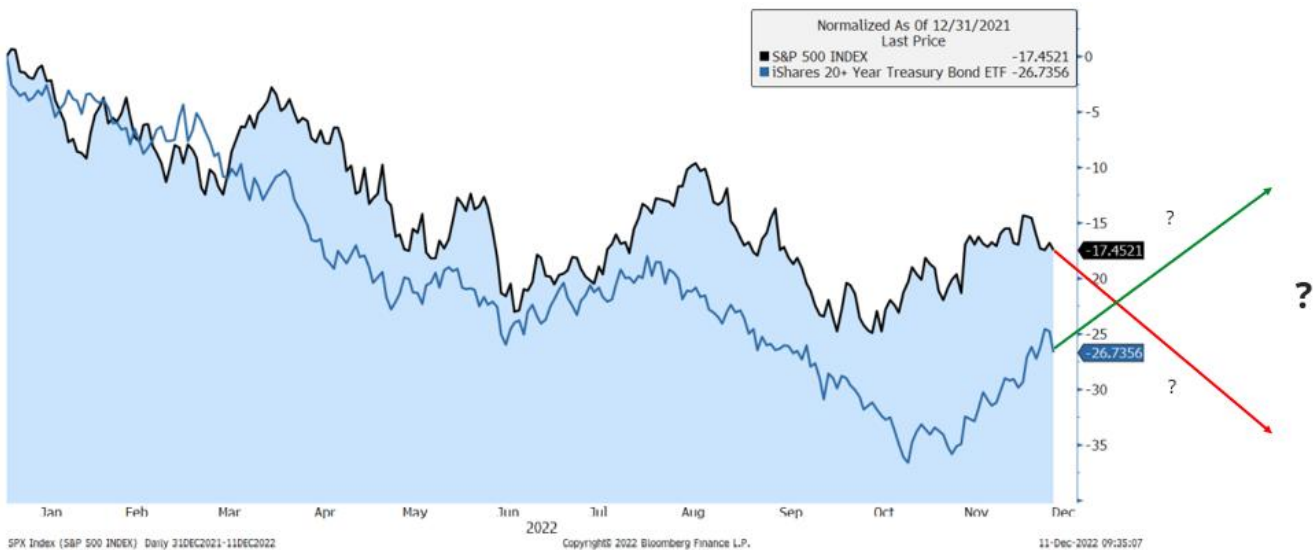
By way of example, our actively managed Multi-Asset Fund has outperformed passive balanced 60/40 (60% equities and 40% fixed income) funds. We came into the year underweight both sukuk and equities. Both asset classes were down, 30.6% and 14.1% respectively, through to November end, so the overweighting to cash has helped.

Table showing allocation & performance compared to benchmark 60/40 strategy

Asset Class	Allocation		Gross Performance		
	Benchmark 60/40 Strategy	1/1/2022 Multi-Asset Fund	30/11/2022 Multi-Asset Fund	Comparable ETF	Multi-Asset Fund
Equities	60%	57.8%	45.4%	-14.1%*	-8.55%
Fixed Income/Sukuk	40%	21%	32%	-30.65%**	-8.37%
Cash		7.5%	11%		-4.39%
Precious Metals		13.8%	11.5%		-6.23%
Net Performance YTD (30 th Nov 2022)					-9.33%

Notes – 1) *MSCI World Index ETF 2) **TLT US

Chart – S&P 500 and 20-year Bond performance YTD



While the passive index trackers simply kept their allocation to equities and bonds constant, we were able to avoid at least some of the sell-off across both the equity and bond space.

Similarly, active managers will be able to adjust their positioning as markets move from bear to bull.

As we detailed in our last update, our expectation is for bonds to outperform as the slowdown gets priced in. So, we are adding to sukuk. Similarly, once the equity market capitulates, we would look to shift aggressively back into risk exposure, such as equities. So, hopefully we can outperform through the bear market as well as the bull market a little further out.

So, we expect the recent correlation between bonds and equities to break and for high quality bonds to start to rally, while equities potentially go through another leg down. Something like we saw in 2008.

Chart – S&P 500, 20-year Treasury Bonds and Fed Funds rate – 2008



Actively managing bond and equity exposure during this volatile time should, in our opinion, add value.

We managed allocations successfully in 2020. We were early on pricing in the impact of covid and reduced risk exposure and protected capital in the selloff; and then added back once we saw the scale of the financial assistance coming in from the government. As a result, our Global and DT strategy ended 2020 up about 21% and 28%, relative to the MSCI World Islamic Index which was up only 7.8% for the year.

Chart - Rasameel Global Equities Strategy in 2020 vs MSCI World Islamic ETF (ISWD)

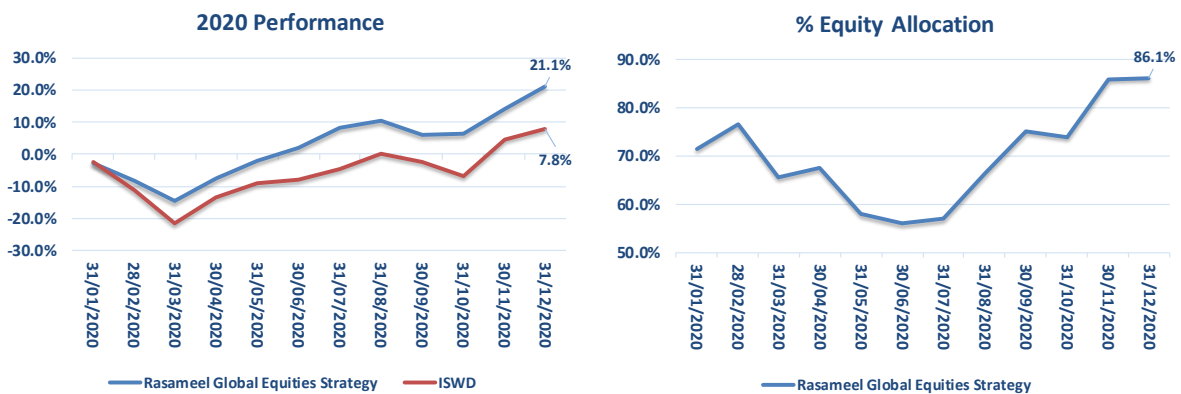
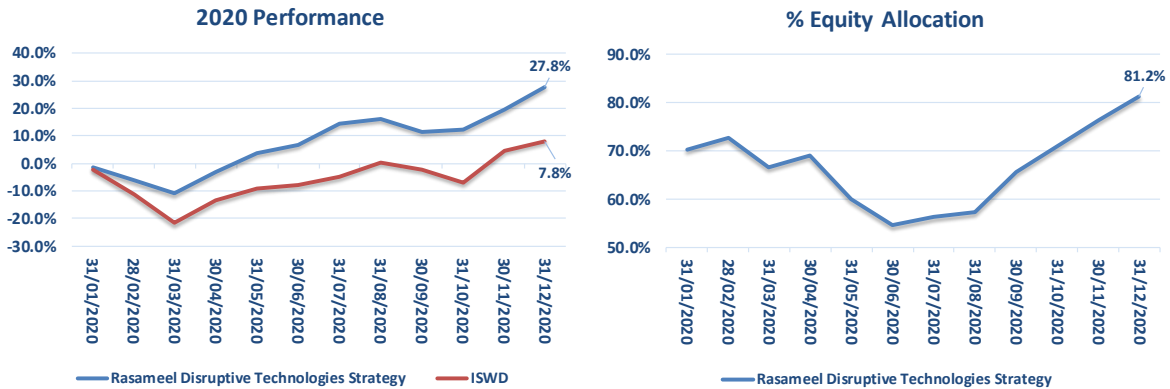


Chart - Rasameel Disruptive Technologies Strategy in 2020 vs MSCI World Islamic ETF (ISWD)



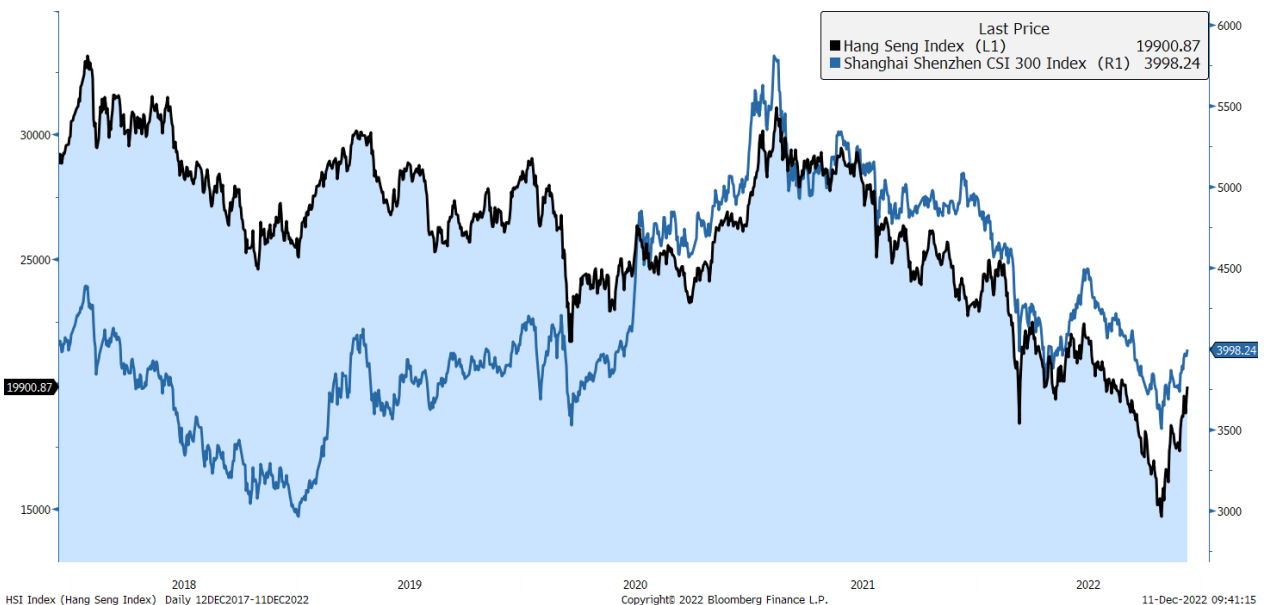
There will be periods though, such as now, during a bear market rally, that active managers lag their passive counterparts. Managers that are defensively positioned and overweight cash will inherently underperform their fully invested index tracking counterparts during bear market rallies.

Should our cautious allocation prove right, however, and the markets suffer another leg down, we will be well positioned to add value relative to passive index trackers. Not just in the short-term rebound but, if we have a substantial slowdown in economic activity and much lower lows, we should be able to capture above average returns for potentially a few years.

Covid Zero and China

Having exposure to Chinese equities, notably the e-commerce space, has been one of the toughest trades for us for the past two years. 2021 saw draconian regulatory oversight weighing on the sector. 2022 started off well but then Covid Zero policies and the CCP Congress hit the attention of the market and Chinese equities fell off with the HSI index down 15% in the month, reaching a multi-year low in October.

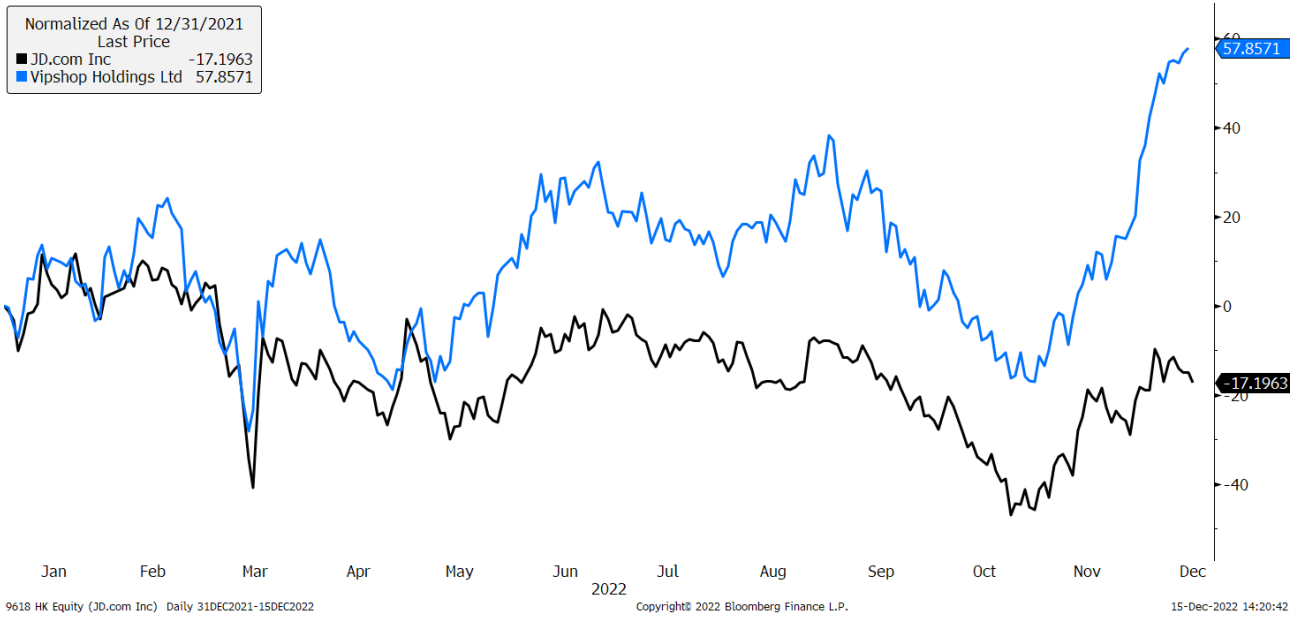
Chart - HSI and CSI daily price chart



Subsequently, the market rebounded on news flow that covid zero policies were going to be less stringent/gradually relaxed and we have seen testing and quarantine requirements fall on the margin.

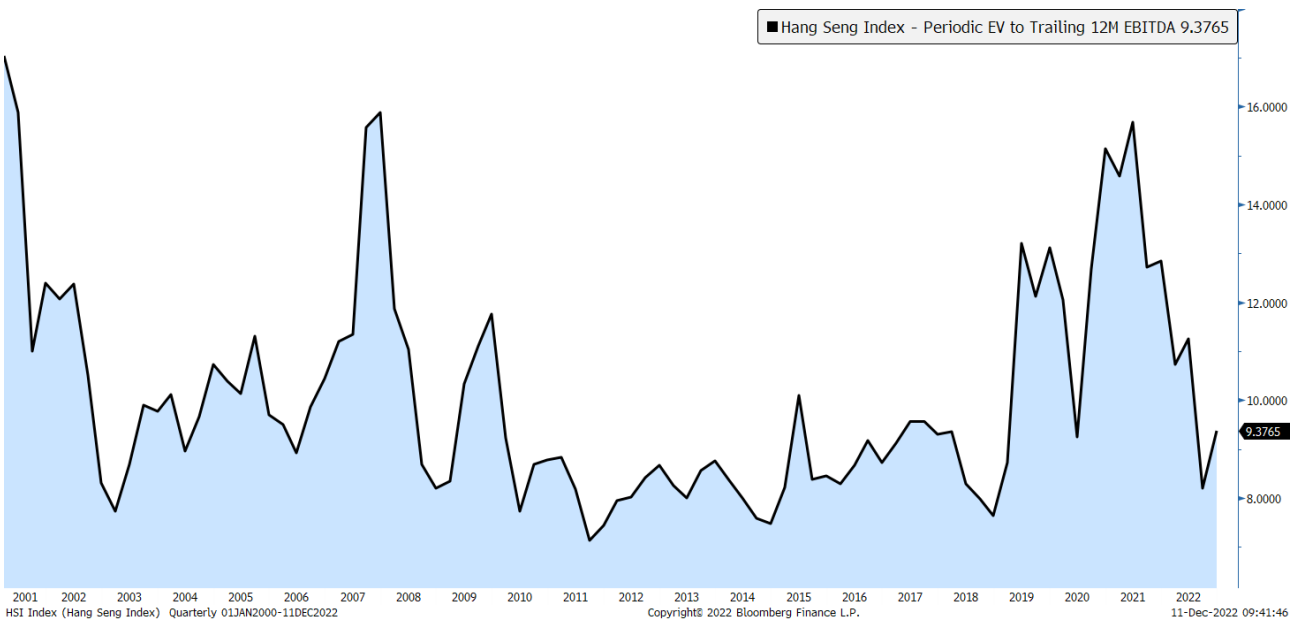
Our core China holdings, JD.Com and VIP Shop, which were down 47.6% and 16.6% respectively at the end of October, rallied 67% and 87% from their October low to their 9th December close.

Chart – JD.com and Vipshop stock chart YTD



Domestic buyers have stepped in on bargain hunting, with the HSI now trading at levels we haven't seen for some time.

Chart - HSI – EV/EBITDA chart for last 20 years



We have been holders of Chinese equities for some time, having gone overweight as far back as 2019. They worked for us in 2020, against us in 2021 and have once again started to work well in 2022. It's been a rough ride though, and we have had to regularly question our positioning.

We have been cautious to chase the rally, as the news flow from China has disappointed on a regular basis. We are though starting to feel that this may be the 'real thing', that China will eventually after 3 years of lockdown tyranny, step away from covid zero policies and deal with covid/Omicron no differently from the flu.

This would be a major step change. Yes, infections would, if the current testing regimes are maintained, increase exponentially, but this would allow the populous to gain natural herd immunity, no different from Sweden. Sweden did not lockdown or close schools. Kids did not need to wear masks. Schools did not close. So, their economy did not go through the same shock as others that did.

B Bloomberg.com

China to Set Economic Plans Amid Shift From Covid Zero to ...

China's abrupt ending of its Covid Zero policy injects more uncertainty into an already fragile economy, raising the prospect of looser...

6 hours ago



m Mint

Goldman says China may end covid zero earlier than expected | Mint

"In either case, China has arrived at the beginning of the end of Zero Covid," he said. Dan Wang, chief China economist at Hang Seng Bank Ltd.,...

2 weeks ago

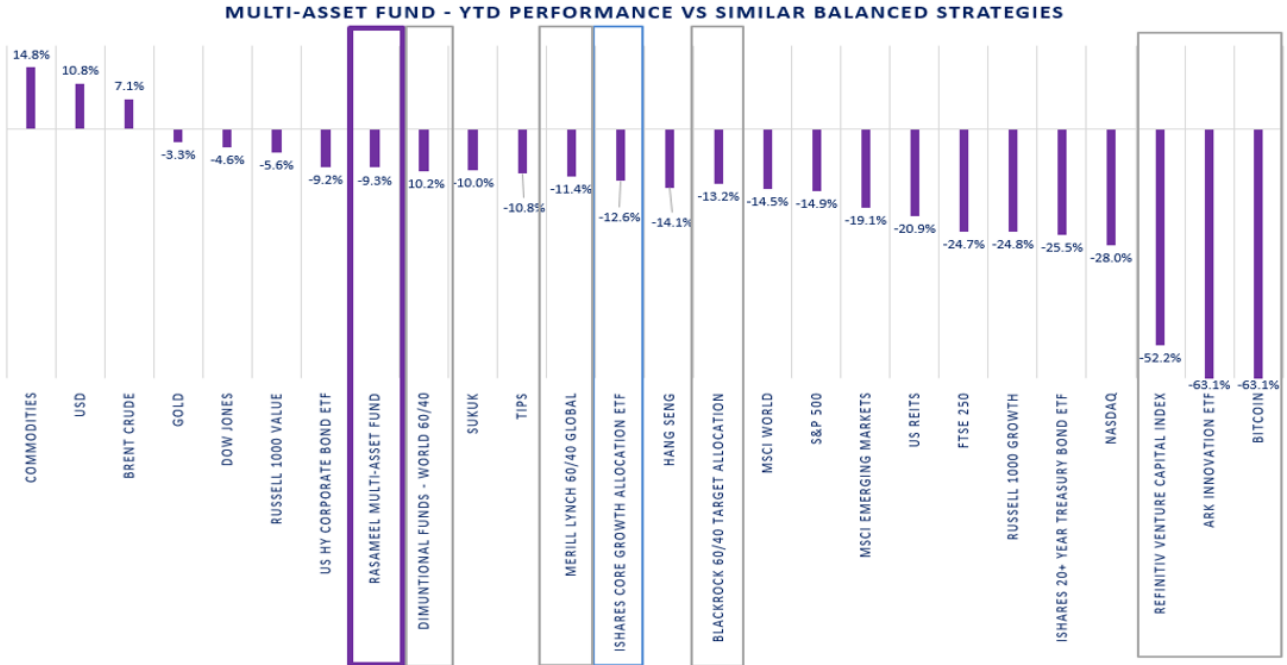


Outlook for Asset Classes

- **Sukuk:** Yields attractive.....good time to add as a trade for 2023
- Sukuk will do well as slowdown priced in by markets and inflation tapers off
- **Equities:** Remain defensive, too early to add.....still need to price in slowdown and declining earnings per share
- Healthcare sector preferred as defensive
- Cautious on sectors sensitive to underlying economy
- **Gold:** Rallied on recent USD weakness but expect USD has another leg up. Will perform well when USD strength wains.

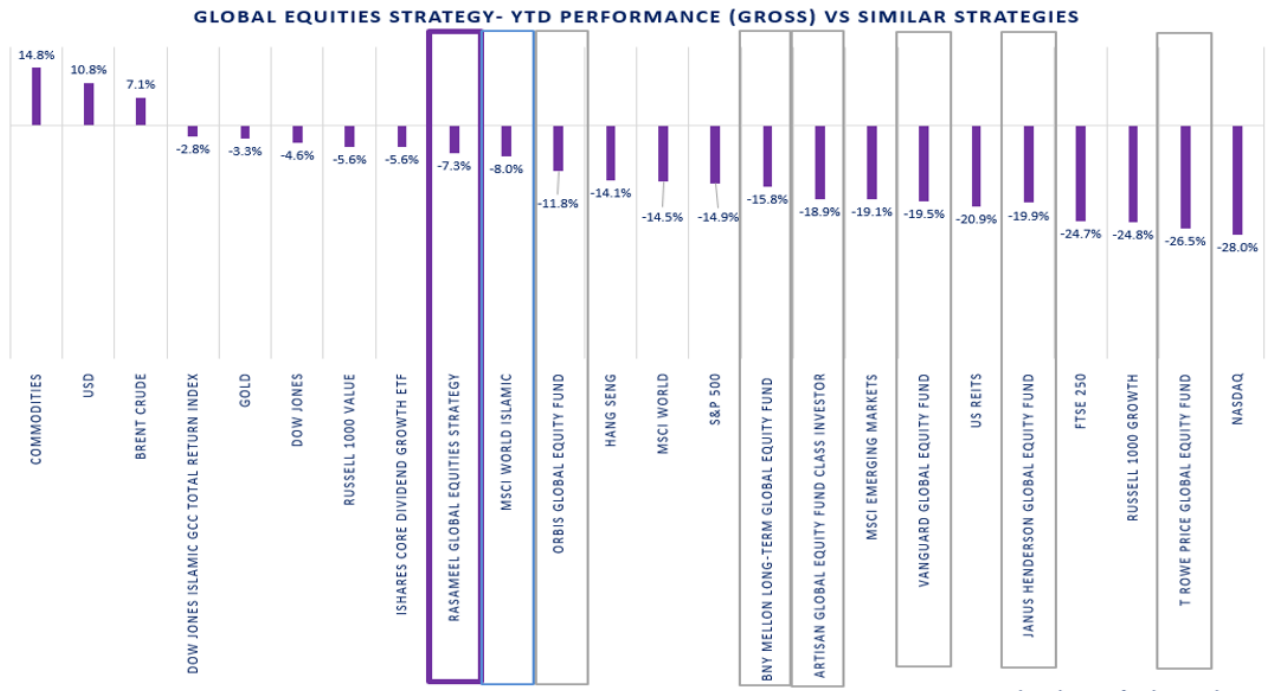
Rasameel's Performance

1. Multi-Asset Fund (Net Performance)



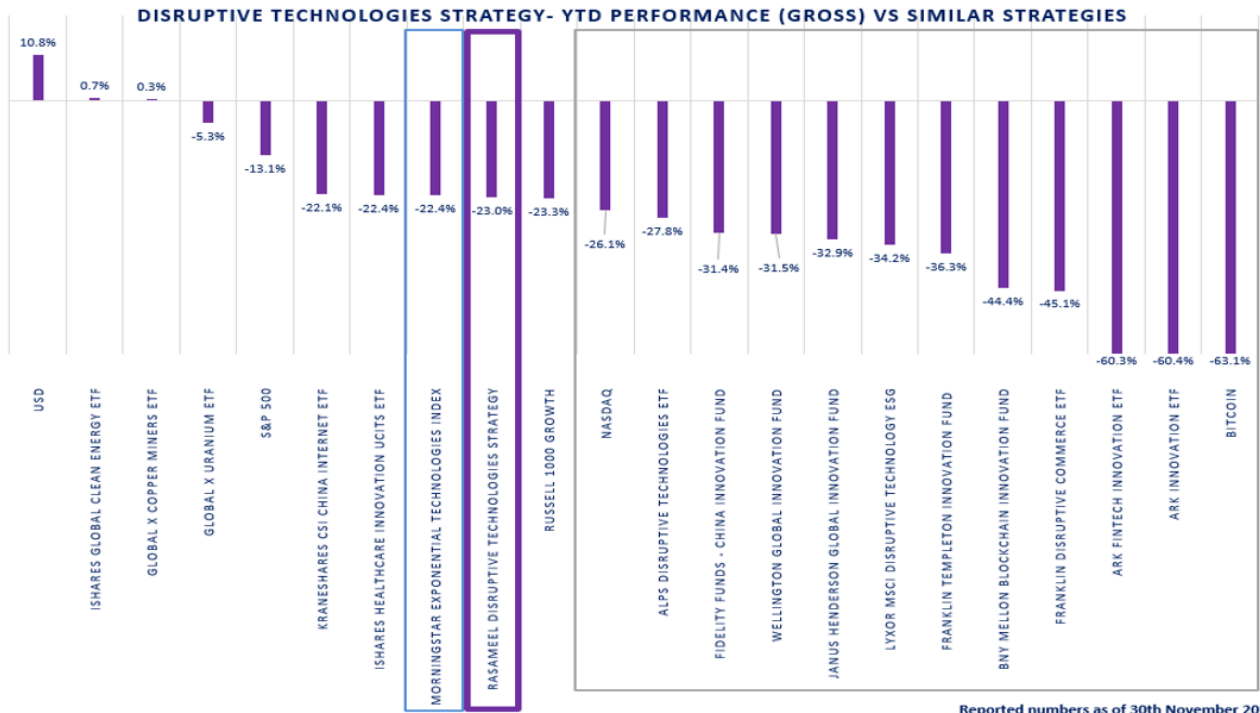
Reported numbers as of 30th November 2022

2. Global Equities Strategy (Gross Performance)



Reported numbers as of 30th November 2022

3. Disruptive Technologies Strategy (Gross Performance)



Asset Management Department

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Warning

The past performance of any investment or a product is not a reliable indicator of future results, and it cannot be relied upon for investment decision making. The performance stated above for the Global and Disruptive Technology Strategy is for a composite of client accounts and is gross of all fees and commissions. Actual client performance may vary from the composite. The performance of the Multi-Asset Fund is based on a model portfolio.



Rasameel Investment Company
Kuwait City, Souq Al Safat, 3rd Floor, Office 6 & 5
P.O. Box 4915 Safat 13050

T. +965 2247 8800
F. +965 2247 6600
E. info@rasameel.com

www.rasameel.com

   Rasameel