Market Update – October 2023

Current State

For anyone trying to fathom the markets mood swings, it is like teaching a cat to waltz – "a dance neither party is quite prepared for!", but let's endeavour.

US GDP accelerated to a 4.9% annualised rate, more than double of the second-quarter pace. The economy's main growth engine - personal spending - jumped to 4%. One can't ignore the durability of economic momentum, but final months may see a slow down on account of higher borrowing costs and student-loan payments resumption. Just remember that inventories added 130 bps to this GDP number.

The Sahm's Rule identifies signals related to the start of a recession when the three-month moving average of the national unemployment rate (U3) rises by 0.50 percentage points or more relative to its low during the previous 12 months. Apparently 16 US states have triggered that rule. Keep a close watch on this, recession is not far off.

US consumers continued living beyond their means in September. Spending growth (0.7%) far exceeded income growth (0.3%) and real disposable incomes declined for the fourth month in a row. This does not bode well in a rising interest rate environment.

The UAW continues to use misdirection and maximised publicity to get auto firms to settle. The tentative deals will amount to pay hikes of more than 33%, when compounding and COLA increases, are factored in. This is clearly inflationary.

The US treasury cut its net borrowing estimate for Oct-Dec quarter to USD 776 billion, against the USD 852 billion predicted earlier. This is huge relief for longer tenor UST's.

China approved additional issuance of RMB 1tn central government bonds, effectively lifting the 2023 official deficit target from 3.0% to 3.8%. Though it is not enough to offset all the headwinds faced by the Chinese economy, it does send positive signals to the market (debt-to-GDP ratio is still around 20%). I am still unable to resolve the so called huge local governments debt (LGFV).

Bank of Japan said it will take a more flexible approach to controlling yields on 10-year government debt, saying the 1% level was now a reference point. Though inflation forecasts were raised, they emphasised the need to keep the policy easy. This is one policy that is not easy to understand for sure.

German headline inflation continues to tread lower, primarily attributed to energy costs. It eased to 3.0% from 4.3%. German GDP also is marking a move into probable recession from stagnation. The Europe engine is clearly stalling.

BoE Governor indicated that they are seeing evidence of inflation coming down, probably by the end of the year. BoE seems to follow a policy that walks the line of persistent inflationary pressures that need to be addressed, with persistent monetary pressures. I guess that's their way of breaking the back of the UK economy and push for a cliff effect in inflation.

Future State

Bank of Japan will continue to maintain an easy policy, and this clearly speaks to the pressure that policymaker's face, to withdraw stimulus. I believe that BoJ should step away from trialling stories to the media, as this creates a lot of confusion during the actual event. My take now is that we could see a shift in negative rate policy probably in Q1 2024, post BoJ seeing sustained wage pressures emanating in the economy. Till then, Yen would continue to remain under pressure (intervention is the only tool to manage it from here on). This trend may change if markets start to aggressively pencil in US rate cuts.

Like a broken record, I am insisting that recession is probably hitting the US in Q2 2024. The Atlanta FED estimate for Q4 2023 is treading towards 2.3%. This could probably be driven by the effects of Dollar appreciation and fall in net exports. It would be prudent to stick to Investment Grade credits, either in short dated or longer dated.

Though the last few US treasury auctions have seen tails (auctions not well received) and countries like China selling down (to defend their currencies), US total cross-border investment saw an inflow of USD 134.4 billion in August. I am of the opinion that duration and treasury, though out of favour now, will be back in fray. In a way, the narrative from BoJ has also changed the view on duration.

I feel that a curve mean reversion is a given; bearish or bullish does not matter in curve trades, as long as one gets the direction right and that it reads as moving into substantial positive territory on the differential front. In short, long UST 2's, short UST 10's and long duration. If you add it all up, staying long UST 2's seems to offer a good risk reward metrics.

Aditum Fixed Income Outlook

Yellow cake, a commodity that took a slide post Fukushima, is back in favour. This has been driven by expectations of higher power demand in Europe and a possible crunch in the UK. This is also driven by old facilities getting their lifespans extended, and China expanding its nuclear fleet. It feels like a long runway on this commodity.

The west African country that houses the Niger river is going through turmoil on currency front. The currency has been allowed to trade freely leading to a devaluation over 40%, to align with parallel market. I personally don't think this experiment will end well, though it is in the right direction. The Government has spent over 96% of revenues in 2022, on debt servicing. With a possible move lower in energy prices, negative impact on the economy could be pronounced. The NE corner of Africa, that houses the Suez Canal is also seeing a pressure on currency via NDF markets.

Now coming back to the Cricket World Cup, the standings table is getting interesting, however the Indian juggernaut has moved to the next stage. This is probably the best Indian bowling attack that I have seen.

Normally I don't like to discuss geopolitics, as I don't have the depth nor the awareness of history to comment. However, I would like to highlight a quote by Bertrand Russel, "War does not determine who is right, only who is left".

Fund Positioning & Deployment Strategy

Data as of end October 2023

Aditum Global Sukuk Fund

The Global Sukuk Fund is currently holding 4% cash and may continue to push towards being nearly fully invested. The Fund does not expect any major changes on the current sector and country allocations and will continue to hold current levels of duration with a view to scale up, depending on the FED path.

	1M	3M	6M	1YR	S.I.*
Global Sukuk Fund	(1.81)	(4.22)	(3.82)	2.55	(4.20)
Sukuk Peer Group*	(1.36)	(3.16)	(3.35)	2.00	(6.36)

Past performance is not an indicator or guarantee of future performance. The value of shares in the fund and income received from it can go down as well as up, and investors may not get back the full amount invested. Performance may also be affected by currency fluctuations of the underlying holdings. Peer group data source: FE Analytics, equally weighted against each constituent (USD share class). The performance data shown is for the duration of the Global Sukuk Fund I(acc) USD share class which commenced its investment program on 16 November 2020. Source: Bloomberg and Aditum Investment Management Limited, USD terms, bid to bid, income reinvested.

KEY METRICS	
Fund Size (US$m)	73.6m
Number of Holdings	30
Weighted Ave. Yield to Maturity*	7.00%
Weighted Ave. Modified Duration*	5.90
Weighted Ave. Credit Rating*	BBB-
Weighted Ave. Credit Rating – Perps at Parent level*	BBB-
Weighted Ave. Credit Rating (Best of 3)	BBB-

*Metrics calculated excluding cash, Weighted Ave. Credit Ratings are based on the Best and Worst ratings from Fitch, Moody's and S&P

Aditum Global Alpha Fund

The Global Alpha Fund is nearly fully invested and is straddling a WARF of "BBB", to manage the downside risks in event of a recession. The Fund does not expect to see any sectoral or geographical changes from the current allocations.

	1M	3M	6M	1YR	S.I.
Global Alpha Fund	(2.90)	(7.89)	(7.26)	-	(6.30)

Past performance is not an indicator or guarantee of future performance. The value of shares in the fund and income received from it can go down as well as up, and investors may not get
*The performance data shown is for the duration of the Global Alpha Fund I(acc) USD share class which commenced its investment program on 8 March 2023. Source: Bloomberg and Aditum Investment Management Limited, USD terms, bid to bid, income reinvested.

KEY METRICS	
Fund Size (US$m)	21.1m
Number of Holdings	36
Weighted Ave. Yield to Maturity*	7.63%
Weighted Ave. Modified Duration*	9.1
Weighted Ave. Credit Rating (Worst of 3)	BBB
Weighted Ave. Credit Rating (Best of 3)	BBB+

*Metrics calculated excluding cash, Weighted Ave. Credit Ratings are based on the Best and Worst ratings from Fitch, Moody's and S&P

Aditum Target Maturity Fund 2025

The Fund is comfortable with the current exposures and no distressed obligors exist in the portfolio. The WARF on the portfolio continues to straddle "BB+" and we intend to stay at this level, if not move higher on rating scale.

	1M*	2M	3M	6M	1YR	S.I.	Dividends SI*
ATMF 25	(3.32)	(2.97)	(3.94)	(4.43)	11.73	(34.56)	18.00

The performance is calculated from B(inc) USD share class since inception 14 June 2021.
Past performance is not an indicator or guarantee of future performance. The value of shares in the fund and income received from it can go down as well as up, and investors may not get back the full amount invested. Performance may also be affected by currency fluctuations of the underlying holdings.

KEY METRICS	
Fund Size (US$m)*	71.7m
Number of Holdings	46
Weighted Ave. Yield to Maturity**	8.60%
Weighted Ave. Modified Duration	1.9
Weighted Ave. Credit Rating (Worst of 3)	BB
Weighted Ave. Credit Rating (Best of 3)	BB+

*Including leverage
**Unlevered

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