Market Update – Q1 2023

2022 Highlights

"Low inflation is indeed the problem of this era." John Williams, president of the Federal Reserve Bank of New York, said in late 2019, adopting the dominant view at the time. Fast forward three years, and the problem is the exact opposite. Just about every country in the world grappled with soaring prices in 2022. What made 2022 so unusual was the breadth of price pressures pushing global inflation to over 9%. These pressures were further exacerbated by Russia/Ukraine war, disrupting energy and food prices. The draconian covid lockdown in China aggravated the supply chain causing massive demand supply gaps globally. US FED delivered aggressive rate hikes taking the FED funds rate from 0-0.25% to 4.25%-4.5% in less than a year. Most Central Banks across the world were worried about persistent inflation and the probable lack of monetary tools to address if such a situation were to arise. However, towards the end of 2022, most Central Bank's were able to tame a major portion of the inflationary pressures without massively compromising on growth aspects. The wake of the global inflationary pressure was not kind to Sri Lanka, Pakistan, and Ghana in the emerging market space. 2022 was also a year of a retreat in the Chinese Real Estate space with many big names defaulting. Among currencies the US Dollar, like the Boney M song "King of the Road", rose over 25%.

2023 Outlook

Hopping into the year of rabbit , the central themes from our perspective are as follows.

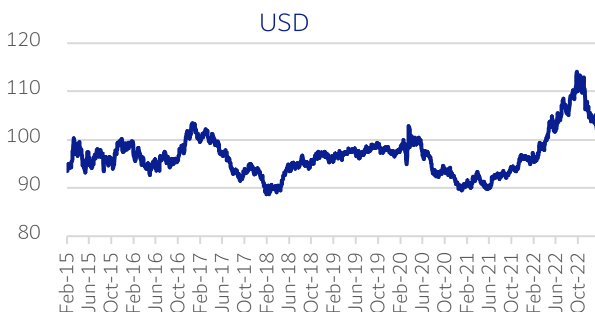
- China's reopening and their inclination to push the GDP towards 5.5%
- BoJ's potential exit from its unconventional easing
- FED's ability to soft land the economy with few quarters of sub optimal growth
- Probable cliff effect in inflationary pressures , driven by further easing in supply chains and flatlining of energy prices, though we may not see a negative demand shock.
- Commodity super cycle not over yet

Source: Bloomberg January 2003 – December 2022

CPI ex food and energy is still outside the comfort zone of FED, there exists a probability that the downtrend has started

China

The Rabbit is a symbol of longevity, peace and prosperity in the Chinese culture, and it's predicted to be a year of hope. Though hope was never a strategy in the markets, one can't dismiss it in life. The rapid move away from zero-covid policies led to a very large and compressed exit wave of cases that has now receded. Other than opening, there has been concerted efforts to stabilise the property sector, led to a very large and compressed exit wave of cases that has now receded. Other than opening, there has been concerted efforts to stabilise the property sector, which is a big contributor to GDP in China. A continued macro policy support across the private and property sector should see a pronounced pick up in economic activity and possible secondary derivative effects. We however believe that as demand surges, the supply side would be able to offset which will reduce concerns on inflation front. During the years of covid, a lot of countries explored the shift away from China, India being a major benefactor of this manufacturing shift but with China coming back, we might see this flow reversing. At the end of day , no country is able to replace China's position in the supply market yet and we are likely to see renewed interest in Chinese stock markets and PBOC may continue to stand pat or even use unconventional monetary tools to stoke demand. China may however refrain from using fiscal policies as they want to stabilise the leverage in the economy.



Source: Bloomberg 3 February 2015 – 2 February 2023

USD Index is on a clear decline , probably may revisit the lows it started from in Jan 2022

Bank of Japan ("BoJ")

BoJ will be in the limelight due to the upcoming change in leadership and its implications for global policy. Inflation has rebounded and may threaten to derail the Japanese economy if they continue to run the ultra-loose monetary policy. There exists a possibility that inflationary pressures may push the BoJ to step away from its "yield curve control" (YCC) and reduce the outsized role in government bond markets. It is important to take a decision when you are not pressured by markets, which means BoJ needs to act in the first quarter. This sets a nice trade in markets, long JPY, driven by a possible USD weakness from either FED standing pat or a pivot and BoJ exiting the YCC. It would be fair to assume that we could see a sub 100 exchange rate.

FED Policies

2023 is likely to be a year for Fixed Income. If 2022 was rock bottom for fixed income, 2023 could define the peak on prices. There exists a high probability of the FED pushing the terminal rate towards 5.00%, pausing for at least 6 months and possibly looking to pivot closer to Q3/Q4 2023. Considering the FED is winning the battle with inflation, the term premia paid for longer dated bonds has diminished further (inflation being contained by FED hikes), pushing Investors to capture duration and lock in yields. It would be well advised to stay in the IG space and not venture beyond crossover territory. It is not yet clear whether a global recession will become a reality, though it remains a possibility when looking at various market indicators. Whatever path the FED treads, we believe that longer duration IG bonds will continue to offer value. If there exists a possibility of a pivot this year or even early 2024, we could see the inverted curve mean revert, in short, the shorter end of the curve could rally faster than the longer end and we may see a bullish steepening from the current inversion. 2023 may also see a reasonable upside in equity markets driven by sustained demand and an economy that could embrace the "Goldilocks scenario". If one were to pick stock markets for growth, China, India and the US are likely to perform well, where Europe and the UK could see a stagflationary scenario.

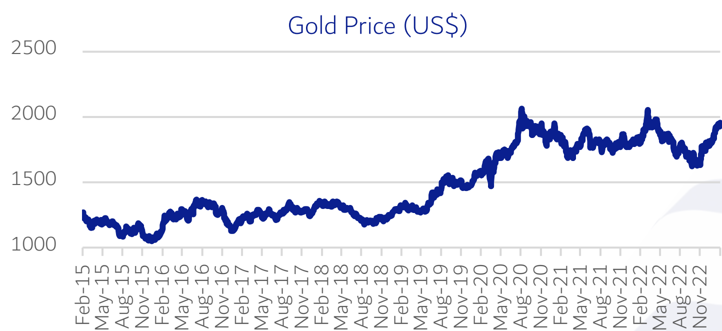
Inflation

We believe that the necessary evil, inflation, is likely to calm down in 2023. Price pressures have abated over the last quarter and is likely to see a drop in Q2 2023 driven by inventories build up, further easing in supply chain and flatlining of energy prices. This drop could also be driven by demand destruction (though the probability looks low and would driven more by recessionary forces). We expect global Central Banks to dial down on the hawkish rhetoric and even pivot in 2023, with the exception of the BoE , ECB and BoJ.

Commodities

Moving away from the above alphabetical soup of Central Bank acronyms, the space to watch in 2023 is commodities. From what we have ascertained, the super cycle is not over yet. The ongoing transition to green energy will continue to drive demand for Lithium and Copper along with all the second derivative demand for special alloys (which means the base metals would not see any demand destruction as yet). If Chinese real estate does get a policy boost, then the housing sector consumption would continue to support the ferrous metals, along with positive impacts on housing market necessities like cement etc. Energy prices are still tricky to put a finger on at this moment in time, though Russian oil is not directly hitting the market, it is still finding its way through other channels, ensuring that over 10 million barrels per day comes into the supply equation. The harsh winter that Europe forecast has so far been milder than anticipated and the reserves build up has helped them push through to the end of January. However, if there is no resolution to the Russia/Ukraine conflict, the Q4 2023 winter could feel longer and harsher as supplies from Russia have dwindled considerably across the continent. Black gold (aka coal) saw a revival to its fortunes primarily driven by diminishing Russian energy supplies to Europe and many economies shifting away from Nuclear power. Though many economies have invested in renewable power sources, the economies of scale are not enough to move away from fossil fuels. With this renewed interest in coal 2023 will be much the same as 2022 with demand outstripping supply.

Gold did not have a great 2022 , even demand from India could not save the downward trend but we believe that 2023 may be a year for gold to shine. We expect gold to scale $2,300 over the year, if not more, driven by USD weakness and rather than a jump in demand. On the similar note, our deficiency in understanding the crypto world continues and we do not believe that one can trade or forecast what one does not comprehend. We are happy to continue with this knowledge deficiency, as there are enough opportunities across other asset classes to dip one's toes in.



Source: Bloomberg 3 February 2015 – 2 February 2023

Gold needs to clear 2078-2080 levels to demonstrate a clear breakout ; the downtrend in USD index could accelerate this process.

So, what keeps us awake at night?

We are a bit apprehensive on the trajectory Pakistan is taking and to us it looks a very slippery slope. Pakistan would be ill advised to continue servicing their current debt and are better off calling for a debt structuring. We also have concerns over Egypt and the inflationary pressures that are being driven by a depreciating currency and the local interest rate spiralling to offset pressures. We are also hesitant about the Adani complex impact on Indian stock markets and the knock on effect on banks and corporates. But as with all things in life, this too shall pass.

As Warren Buffet said, *"I make no efforts to forecast the market-my efforts are devoted to finding undervalued securities*", in short throw all the above forecasts out of the window and winnow the markets to find your gem.

Fund Positioning & Deployment Strategy

Data as of end January 2023

Aditum Global Sukuk Fund

We increased duration piecemeal throughout 2022 and those exposures have seen a material price rally. We have also been adding short end high coupon exposures to increase carry on the fund. Avoided idiosyncratic blow-ups in Serba and Garuda. The Fund continues to hold the view that bearish flattening/inversion has moved into the bullish flattening mode and with FED not releasing the pedal on rates , the long end would continue its dream run , driven by the fact that forward inflation expectations are contained and if sub optimal growth pans out , then far end would rally in sharper. So, the Fund continues to favour duration bonds though the choice is quite limited and UCITS restrictions prevent fund from running an overweight position. The Fund holds less than 1% in cash and may continue to run this over the next few months. The Fund continues to improve the WARF and is actually straddling BBB-, if the Perp exposures are rated at parent level, as opposed to the current fund policy of treating them at three notches lower than parent rating. The philosophy is that if recession hits the market, IG bonds would see a bigger rally , driven by rates beta. The Fund will continue to pay monthly dividends.

	1M	3M	6M	1YR	S.I.
Global Sukuk Fund	1.81	2.82	6.50	3.28	(1.74)
Sukuk Peer Group	1.69	5.17	0.93	(3.91)	(3.78)

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)	$47.7m
Number of Holdings	25
Weighted Ave. Yield to Maturity*	6.14%
Weighted Ave. Modified Duration*	5.40
Weighted Ave. Credit Rating*	BB+
Weighted Ave. Credit Rating – Perps at Parent level*	BBB

*Metrics calculated excluding cash

Aditum Fixed Maturity Fund

The Fund has strong credit quality with 71% IG and 29% sub IG. There is no individual issuer rating below BB- and we are very well diversified by geography and sector. 88% of exposure within the Fund are maturing on or before December 2025, reducing any extension risk. All bonds currently trading above $85 with a majority above $90. The Fund is still underleveraged and has enough capacity to capitalise on any market dislocations. The Fund will continue to pay quarterly dividends.

	1M*	2M	3M	6M	S.I.	Dividends SI
AFMF	1.92	1.62	6.74	(3.59)	(4.34)	3.50

The performance is calculated from Share Class B (Inc) USD share class since inception 31 May 2022.
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)*	$80.2m
Number of Holdings	56
Weighted Ave. Yield to Maturity**	5.85%
Weighted Ave. Modified Duration	1.94
Weighted Ave. Credit Rating	BBB

*Including leverage
**Unlevered

Aditum Target Maturity Fund 2025

78% of the Funds exposure is maturing within 2025 the remaining 22% was mostly bought at a significant discount and will experience a good price rally/pull to par. We have 7.5% exposure to single B names with 50% of the Fund IG. The strategy throughout 2022 was to move out of lower rated/riskier exposures to higher quality paper without loss of carry. This helped capture the rates led rally in November.. The Fund continues to straddle a BB+ WARF and slowly rotating the names to move up the WARF ladder. Though the Fund had exposure to Chinese RE, the exposure has been pared down to under 0.5% and the impact of sale of these exposures on the Fund’s NAV has been negligible. There have been no defaults within the Fund and no bonds are trading at distressed level (below 60 cents to a dollar). The Fund will continue to pay quarterly dividends.

	1M*	2M	3M	6M	1YR	S.I.	Dividends SI
ATMF 25	5.33	9.71	22.34	6.93	(19.25)	(28.34)	12.00

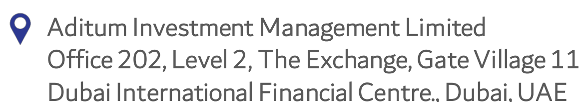
The performance is calculated from B(inc) USD share class since inception 14 June 2021.
Past performance is not an indicator or guarantee of future performance. The value of shares in the fund and income received from it can go down as well as up, and investors may not get back the full amount invested.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

KEY METRICS

Fund Size (US$m)*	$39.0m
Number of Holdings	39
Weighted Ave. Yield to Maturity**	7.14%
Weighted Ave. Modified Duration	2.39
Weighted Ave. Credit Rating	BB+

*Including leverage
**Unlevered

INVESTMENT MANAGER CONTACT DETAILS:



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