Dear SGF Investors and Friends,

Source: Canva

SGF and Global Market Review

September was the weakest month for Global Equities since March 2020. We have been cautious of the market strength and have positioned defensively going into September. The global benchmark for equities, the MSCI All Country World Index (ACWI) was down -3.35% in MYR terms and the Dow Jones Islamic Market World (DJIM) Index was down -4.58% in MYR terms. The Strategic Growth Fund's (SGF) NAV for Class A, decreased by -3.43% and Class B decreased by -3.46%.

Equity Contribution -3.21%

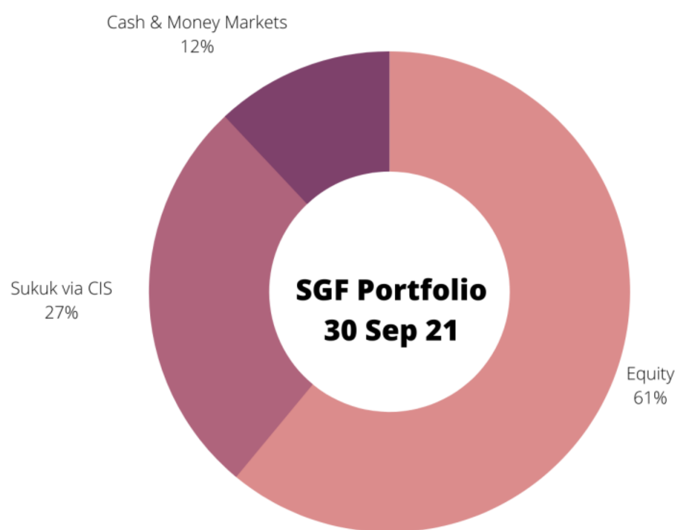
Equity allocation was lowered to 58% but performance was slightly below that of the DJIM index by c-0.5%. We started to buy the market dip after the following considerations. Quantitative: Sell off was driven by systematic funds and market internals remains strong. Expect markets to recover so long as there are no new exogenous shocks to the market. Qualitative: Investors face a wall of worry going into the 4th quarter. We think that the concerns can be overcome as we move closer to the year end.

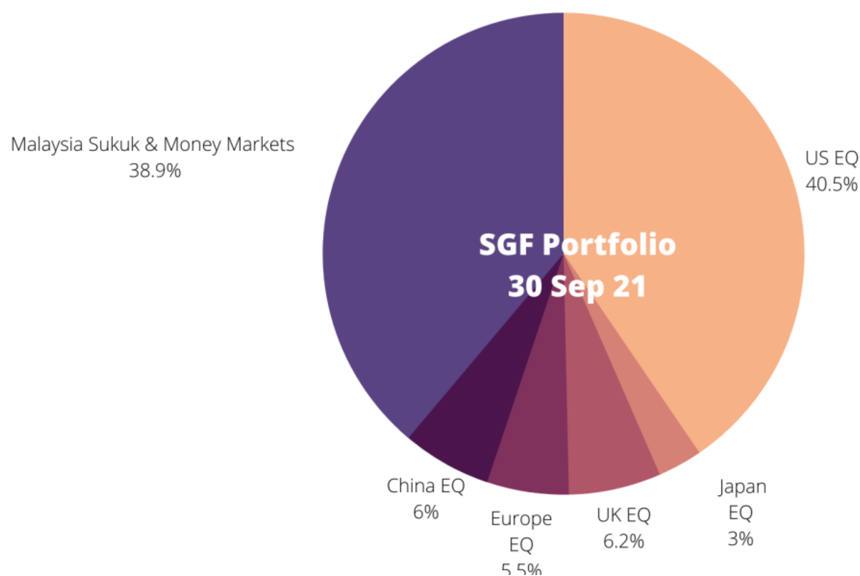
Fixed Income Contribution -0.23%

Our sukuk investments via the Nomura i-Income fund (Collective Investment Scheme CIS), returned -0.87%, but our lower allocation to sukuk given concerns on raising yields at 26.7% weight translated to a contribution of -0.23%.

FX Tailwinds +0.10%

Our cash and money market holding of c14% contributed a positive return of +0.10% showcasing the diversification benefits of our multi-asset model despite equity and fixed income moving in the same direction in September.





Where to from Here?

Concerns on China's credit and contagion fears from Evergrande was the catalyst for the first -5% correction in global markets this year. Whilst previous dips post the large correction of March 20 has been bought, investors are questioning on whether this dip should be similarly bought or sold. Ultimately, we think that the decision to buy the dip needs to be driven by:

Quantitative analysis of the selloff to understand the drivers behind the selloff and to measure the strength of market internals

Qualitative analysis. The market is currently faced with a 'Wall of Worry'. Ability for the market to recover from this selloff will be determined by its ability to overcome these concerns.

Summary + Looking Ahead

With the much awaited sell off finally arriving, the question now is whether it would be just a small dip or a much larger drawdown, for example, similar to that of 4Q18. The Quant view suggests this time is different – hence dips should be bought. That said, uncertainty and de-facto volatility will continue to remain high.

On the fundamental / Qualitative side, we think that the 'wall of worry' can be overcome and markets should be able to look past the concerns as we get closer to the year end. **The corollary is a market that grinds higher into the New Year** (See Qualitative section below for the list of concerns and how markets can potentially overcome them).

However, looking at FY22 and beyond, we think that the rise in inflation, which may remain high in the next 1-2 years, will lead to a structural change in fund duration and thus requires some re-thinking when it comes to asset allocation within the fund.

Bonds and Equities have both rallied together over the last decade whilst maintaining a negative correlation of daily returns. This has supressed fund volatility. However, with bond yields approaching the zero bound, this trend could be ending – especially if inflation (which has been missing) becomes structurally more visible. Whilst we believe long term deflationary factors are still in play, policy intent is for higher inflation.

We think this new investment landscape will be met with a higher allocation to real asset by investors, and hence a higher allocation to equities despite higher valuations and margin concerns. Adding stocks with a negative correlation to bond yields such as cyclicals will be one of the ways to manage the shortening of portfolio duration.

Portfolio Strategy

We will be thinking hard about the mid to long term portfolio construction of SGF over the coming weeks to reflect our thoughts above. Currently, we've started to buy the dip as the market corrected by -5% from the highs. Equity exposure currently stands at c61% at the end of September vs. 58% in August.

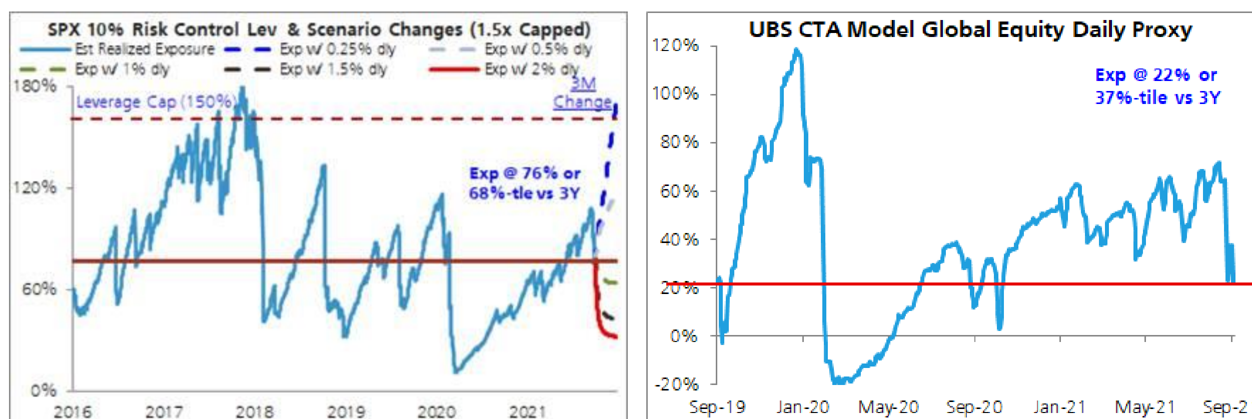
The Equity portfolio is currently positioned as a tilt between cyclicals (expressed via industrials, energy and consumer) and the more value part of tech (large cap mega tech rather than high growth software). We continue to believe that secular growth names will have a strong place in the portfolio given their ability to grow earnings in a slowing macro environment.

We continue to keep a lower allocation to Sukuk given rising yields. However, we have started to re-hedge c40% of our Global equity (foreign currency) exposure as the higher oil price, Malaysia reopening and US yields having moved up significantly to 1.6% (signals taper is starting to get priced in), could lead to the strengthening of the ringgit relative to developed market currencies (USD, Euro, Yen) over the coming months.

SGF readers who are interested in our detailed write up on the Quantitative and Qualitative factors considered in assessing this selloff, please read on. Those who are content with the summary above, please skip to page 10 for the final words.

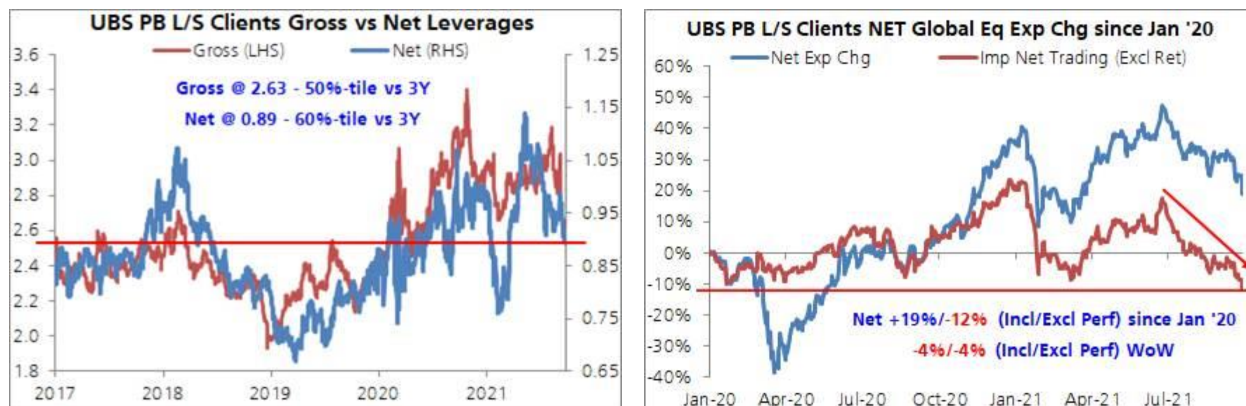
Quantitative Factors

Firstly, note that this correction was largely driven by fast money and systematic funds. Risk Control and Commodity Trading Advisors accounted for a large majority of the sell flow.



Source: UBS, Oct 21

Whilst hedge funds were initially buyers in early September, this turned into net selling as the month progressed.



Source: UBS, Oct 21

The selloff left the these market participants with a low to moderate exposure to equities hence positioning is much cleaner going into October, i.e. limited amount of selling remains (unless they turn net short). On the other hand, long only investors, corporate buybacks and retail investors have continued to be buyers in the market.

It is worth looking at the Market Internals here given the nature of the selloff thus far (systematic selling vs. investor buying). The UBS 4 month intraday recovery score which measures investor confidence or positioning bias through investor intraday behaviors on meaningful move days is currently tracking 28%, which is a bullish signal. The last 4 drawdowns were all preceded by a neutral to bearish recovery scores. With positioning at the systematic funds lighter going into October, it is unlikely that we get a drawdown

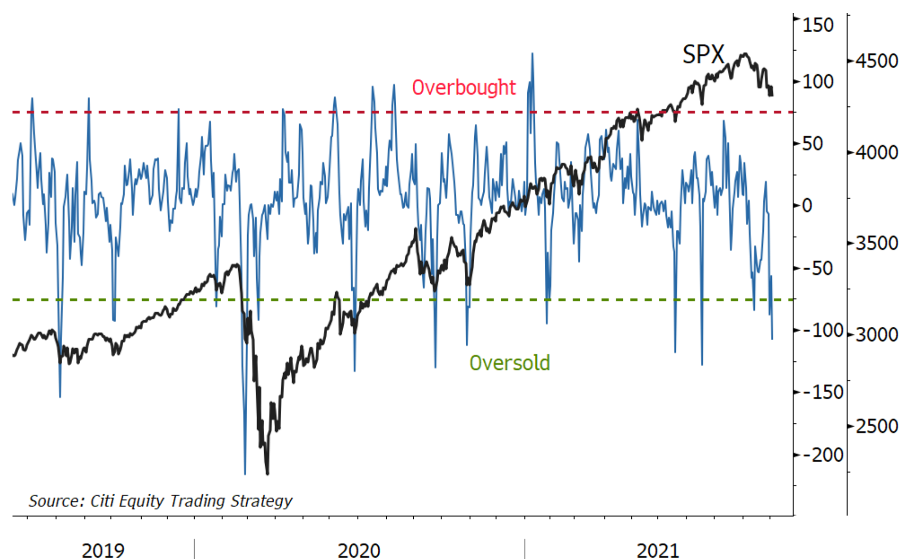
of similar magnitude, unless of course there is new Macro shocks which is not yet part of investors 'wall of worry' (see Qualitative Factors below).

Current vs Sell-off Market Internal	9/27/21	1/26/18	9/20/18	2/19/20	9/2/20
Sell-off		-10.2%	-19.8%	-33.9%	-9.6%
Sell-off Duration		2 wks	14 wks	5 wks	3 wks
Market Internal	Bullish	High Short Gamma	Bearish Risk Appetite	Significant Retail Unwind	Retail Unwind + High Option Gamma
Risk Appetite					
4M Recovery Score	28% Bullish	13% Neutral	-8% Bearish	28% Bullish	29% Bullish
		as of 1/30	as of 10/10		
Long-Term Investor Flow					
UBS RMM Exp Time Wgt Flow	0.79	(1.11)	(0.79)	(2.83)	(0.85)
UBS RMM 5D Intraday Sell-off Flow	$864	($598)	($427)	($1,339)	($499)
	as of 9/20	as of 2/5	as of 10/11	As of 2/28	As of 9/4
Short Gamma Risk					
Risk Control Exp	87%	136%	122%	90%	48%
UBS CTA Eq Exp	37%	117%	47%	73%	37%
UBS Risk Parity Eq Exp	26%	57%	34%	39%	13%
UBS PB Net Leverage	90%	98%	80%	91%	85%
SPY Put/Call Ratio	1.96	1.79	2.03	1.68	1.72
SPX Top 10 Stock Option OI	7.5%	5.7%	9.1%	6.3%	8.5%
Stock Opt Gamma Risk 3Y Rank	63%	19%	100%	23%	98%

Source: UBS, Oct 21

Lastly, oversold conditions have been triggered on the 5th of Oct, which has historically led to an outsized bounce over the next 10-20 days.

Citi Overbought / Oversold Indicator (Oct, 21)

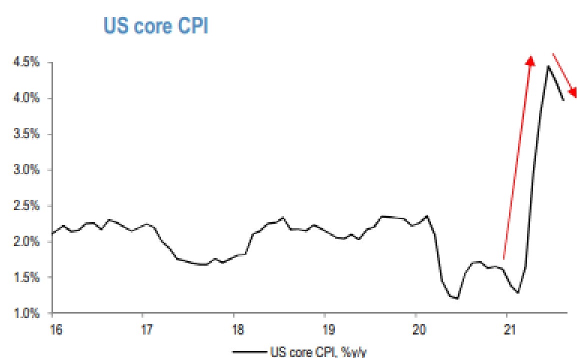


Qualitative Factors

Markets now have a ‘wall of worry’ to overcome before recovering from the September selloff. We go through some in turn and how investors could potentially get comfortable on the risks.

Rising inflation

Inflation pressures will likely start to ease whilst labour markets remain very strong. Core CPI looks to have peaked however concerns on supply chain dislocations increases uncertainty. We note that the 10 yr breakevens have been rising but still at a level below the peak seen earlier in the year. Strong labour markets should provide support for a strong consumer, further helped by a higher amount of savings and lower household debt.



Source: JP Morgan, Oct 21

More importantly, the surge in prices were not broad but in specific items that have been increasing since the pandemic began. Inflation is concentrated at core goods such as cars and imported items that suffer from bottleneck and supply chain issues. Whilst these bottlenecks would not be solved in the next few months, it is unlikely to be permanent. Supply chains will edge back to pre-pandemic conditions and moderation of inflation is likely.

Risk of Higher yields

Similar to the move we saw earlier in March this year, it’s not the magnitude of the move that worries the market but the speed of the move. That said, whilst rates are likely to move higher from here, it is unlikely to materially move higher, given that the world looks very different compared to March. Growth, PMI and trade has peaked, investors are concerned about the outlook for FY22. We think that investors will get comfortable with the slowdown and focus on the growth which remains above trend. But for this same reason, the move in yields should be somewhat contained.

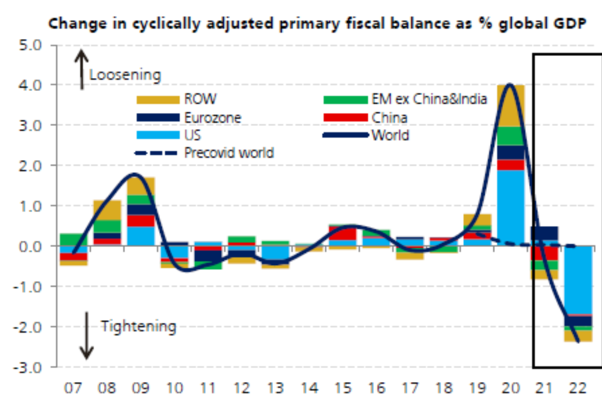
Tightening financial conditions – Taper + Rate Hikes / Hawkish Fed

Fed is expected to start tapering this December and the speed of taper slightly surprised markets. A mid taper completion could lead to rate hikes as early as H222, however we think that the Fed is unlikely to turn hawkish given their modus operandi in the last few years. Fed is also consistent with their views on inflation being transitory, as such there is no need to unnecessarily accelerate policy action that would de-rail markets. Perhaps the largest risk here is Jay Powell not being re-appointed as Fed chair (raises uncertainty in the short term).

Fiscal cliff

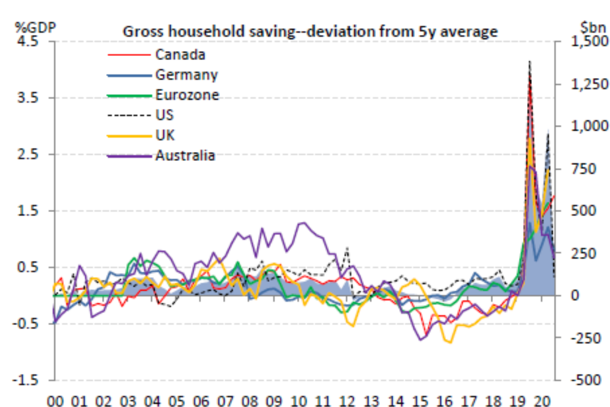
Next year's global fiscal cliff will be 5x larger than post Global Financial Crisis, but this does not necessarily derail the recovery. Budget adjustments can be pushed further out as the virus still lingers. Stimulus bills are not always aligned to calendar years. The US stimulus checks provided a boost to H121 growth but its expiry would be a detractor for H221 growth. i.e. adjustment does not start next year, it's already began. Also consider the fiscal multiplier effect. The lift in GDP growth was not equal to the amount of stimulus, as excess savings increased partly due to the inability to spend on services etc. As such, with the reopening, we may see a delayed multiplier effect as consumers utilize some excess savings which provides an offset to the fiscal cliff.

Next year's global 'fiscal cliff' is 5x larger than post GFC



Source : UBS, Haver

Spending out of (historically high) excess saving could offset next year's fiscal drag



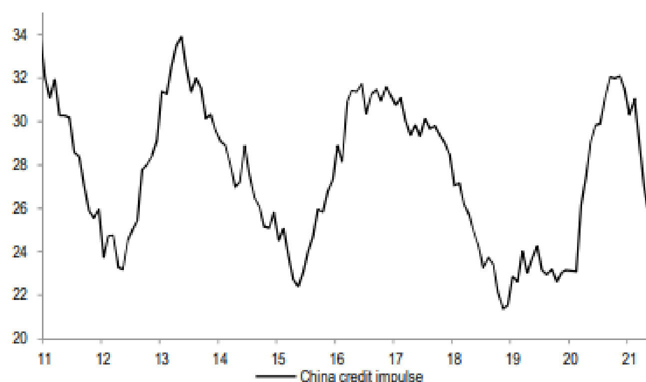
Source : UBS, Haver

Oct 21

China Credit contagion from Evergrande

China's closed economy is key. Whilst uncertainty remains elevated, level of state intervention in the Chinese Financial system is a big differentiating factor compared to the US. Property is an important sector to the overall economy, so whilst Evergrande may be used as a teaching tool for others, the Government is unlikely to allow buyer sentiment to be damaged. As such, property metrics should not decline materially.

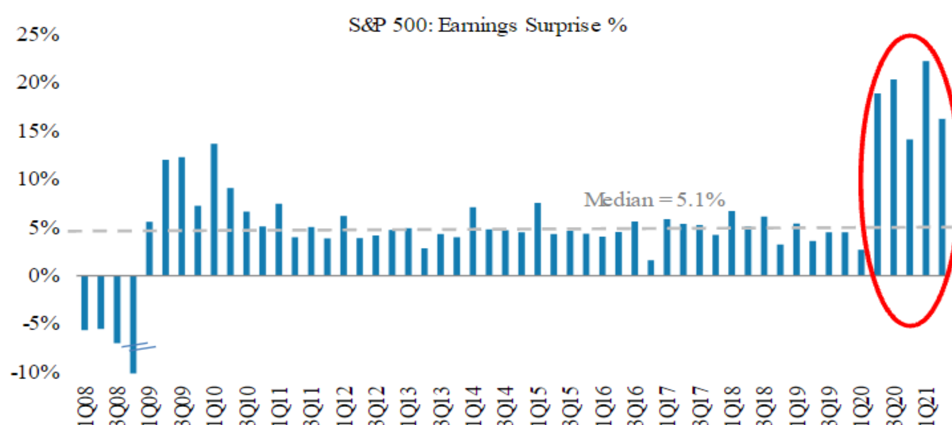
Furthermore, we are inching closer to a policy response from the People's Bank of China (PBoC) if 4Q GDP growth starts to trend lower, such that it starts to impact the Government's ability to deliver the FY22 growth targets. Policy easing in late H2 or H1 next year is highly likely.



Source: JP Morgan, Oct 21

Weak Q3 Earnings (margin pressure from Supply Chain issues)

Consensus expects S&P500 EPS growth to decelerate to +27% YoY in 3Q. Beats will moderate from H121 with the following risks being watched closely: 1) Energy Cost 2) Wage Inflation 3) Supply Chain impact on near term margins. However, this is now starting to be well flagged and expectations going into the results is now lower, unlike the previous two earning seasons where expectations were high and beat and raises not always rewarded with a move higher.



Oct 21

The risk here remains that Q3 earnings could end up being the catalyst for a further sell off, however given lowered expectations and COVID reopening improve outlook for certain sectors, we think investors will be looking in the rear view mirror in November with possible easing from China and the US bipartisanship solved.

Final Words

As the equity market completed a -5% correction from the highs, we started to add to our equity exposure which now stands at c61% at month end. Whilst we are still cautious into the earnings season, we retain our positive view on risk assets over the mid to long term. **Any corrections in the market is viewed as an opportunity to increase equity exposure and buy the dip.** We hope that this letter finds you in good health, as we commit to providing you a high level of transparency, on what transpires behind the fund, and insights to the fund manager's portfolio strategy.

Sincerely,

Hisham Hamzah

Fund Manager of the Nomura Global Shariah Strategic Growth Fund

Cumulative Fund Returns (%)	1 Month	3 Months	6 Months	1 Year	Since Inception
	31/8/2021 To 30/9/2021	30/6/2021 To 30/9/2021	31/3/2021 To 30/9/2021	30/9/2020 To 30/9/2021	22/5/2020 To 30/9/2021
Nomura Global Shariah Strategic Growth A	-3.43	-0.91	4.75	12.73	20.25
Nomura Global Shariah Strategic Growth B	-3.46	-0.98	4.58	12.39	19.77
Benchmark 6% Absolute Return MYR	0.49	1.47	2.96	6.00	8.24

Disclaimer

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